



*Deficiencies Exist in the Control and Timely  
Resolution of Whistleblower Claims*

**August 20, 2009**

**Reference Number: 2009-30-114**

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

**Redaction Legend:**

1 = Tax Return/Return Information

3(d) = Identifying Information - Other Identifying Information of an Individual or Individuals

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TREASURY INSPECTOR GENERAL  
FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY  
WASHINGTON, D.C. 20220

August 20, 2009

**MEMORANDUM FOR DEPUTY COMMISSIONER FOR SERVICES AND  
ENFORCEMENT**

*Michael R. Phillips*

**FROM:**

Michael R. Phillips  
Deputy Inspector General for Audit

**SUBJECT:**

Final Audit Report – Deficiencies Exist in the Control and Timely  
Resolution of Whistleblower Claims (Audit # 200830034)

This report presents the results of our review to assess the Internal Revenue Service's (IRS) progress in establishing a Whistleblower Program. Our review included assessing the implementation of the Whistleblower Office and the controls monitoring the disposition of new claims. This audit was conducted as part of our Fiscal Year 2008 Annual Audit Plan under the major management challenge of Tax Compliance Initiatives.

*Impact on the Taxpayer*

The Whistleblower Program provides the IRS with an opportunity to recover potentially billions of dollars in taxes, penalties, and interest based on information provided by informants. The Tax Relief and Health Care Act of 2006<sup>1</sup> amended the Internal Revenue Code to provide increased awards to individuals for information that leads to the detection and punishment of persons guilty of violating, or conspiring to violate, internal revenue laws. The IRS has seen significant growth in claims since the passage of this law with claims in Calendar Year 2008 alleging more than \$65 billion in underreported income.<sup>2</sup> However, without effective control over and timely processing of these claims, the success of the IRS Whistleblower Program could be diminished.

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<sup>1</sup> Pub. L No. 109-432, 120 Stat. 2958 (2006).

<sup>2</sup> The underreported income amount is solely based on allegations by the whistleblowers submitting the claims. The completion of the process to validate an allegation through the performance of an audit can take years to complete. As such, it is too soon to tell what amount of taxes, interest, and penalties may ultimately be collected.



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### Synopsis

The intent of the Tax Relief and Health Care Act of 2006 was to provide focus on large-dollar cases with the potential of collecting billions of dollars for the Department of the Treasury. Under this law, whistleblowers can now receive a minimum award of 15 percent and a maximum of 30 percent of collected proceeds if their information leads to additional tax assessments. This Act created Section 7623(b) of the Internal Revenue Code<sup>3</sup> which generally requires the IRS to pay larger awards on amounts in dispute of more than \$2 million for business taxpayers and \$200,000 for individuals. The IRS refers to these types of cases as “7623(b) claims.” For those cases that do not meet the dollar threshold for 7623(b) claims, these claims are referred to as 7623(a)<sup>4</sup> claims which still qualify for lower award percentages if the information provided leads to the detection of an underpayment in taxes.

The Tax Relief and Health Care Act of 2006 required the IRS to establish a Whistleblower Office and develop processes to begin to distinguish whistleblower claims based on the potential amount of taxes to be recovered. The amendments in this Act to whistleblowers awards applied to information provided on or after the date of the enactment of this Act. However, many of the necessary administrative processes were not established, including the development of an effective claim control system.

Since standup, the Whistleblower Office has initiated a number of actions in an attempt to improve on the prior Informant Rewards Program which it replaced. However, the IRS did not have an effective inventory control system or adequate procedures and processes at the time of our review. To mitigate the limitations of its prior inventory control system, management relied on multiple systems to track and control claims. This resulted in inaccuracies and inconsistencies in the control and tracking of 7623(b) claims. Management has been in the process of developing and implementing a new inventory system for approximately 2 years and is in the process of transferring its 7623(b) claims inventory to this new system. Nonetheless, without effective procedures and processes to ensure timely, accurate input of case information into this system, the problems we noted with its inventory controls may continue to exist. In addition, timeliness standards and a process to monitor whether claims are worked timely had not been established.

The False Claims Act covers false claims by government contractors but specifically excludes tax fraud. The Whistleblower provisions in the Tax Relief and Health Care Act of 2006 cover actions in the area of tax compliance and provide a structure that is similar in certain respects to the False Claims Act. However, unlike the False Claims Act, Whistleblower law related to tax fraud does not include specific provisions for employee protection against retaliation by an

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<sup>3</sup> Section 406 of the Act amended 7623 of the Internal Revenue Code concerning payment of awards to certain persons who detect underpayment of tax (2006).

<sup>4</sup> This review focused on the control and processing of 7623(b) claims.



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employer. Our discussions with representatives within the operating divisions who work with whistleblowers identified that whistleblowers are concerned regarding possible retaliation from employers and that their confidentiality is their utmost concern.

### *Recommendations*

The Director, Whistleblower Office, should ensure that reporting capabilities are included in the newly implemented single inventory control system and perform a physical reconciliation of 7623(b) claim information to ensure that the information captured from existing systems and input into the new system is accurate. In addition, written procedures with timeliness standards should be established and processes to monitor the timely processing of claims should be developed.

### ***Legislative Recommendation***

Legislation is needed to ensure that informants are protected against retaliation by their employers and to provide specific relief to informants who are retaliated against.

### *Response*

IRS management agreed with all of our recommendations. The IRS identified the need for reporting capabilities in the new E-TRAK inventory control system and those capabilities are now in place. In addition, the IRS identified the need to have a single inventory system and will ensure the accuracy of information in that system by completing the process in three phases with the final phase to be concluded in 2010. In addition, the IRS has established a quality control process based on a statistical sample of records to ensure accuracy of data. The IRS has developed written procedures to ensure effective processing, evaluation, tracking, and monitoring of whistleblower claims. However, pursuing new legislation to protect informants against retaliation by their employers is outside the jurisdiction of the IRS. Management's complete response to the draft report is included as Appendix IV.

Copies of this report are also being sent to the IRS managers affected by the report recommendations. Because this report contains a legislative recommendation, we will provide a copy to the Assistant Secretary of the Treasury for Tax Policy. Please contact me at (202) 622-6510 if you have questions or Michael E. McKenney, Assistant Inspector General for Audit (Returns Processing and Account Services), at (202) 622-5916.



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*Abbreviations*

I.R.C.	Internal Revenue Code
IRS	Internal Revenue Service



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## *Deficiencies Exist in the Control and Timely Resolution of Whistleblower Claims*

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### *Background*

The Internal Revenue Service (IRS) Informant Rewards Program was created to make award payments to private citizens who assist in detecting underpayment of tax. Section 7623 of the Internal Revenue Code (I.R.C.)<sup>1</sup> authorizes the IRS to pay awards to individuals for information that leads to the detection and punishment of persons guilty of violating, or conspiring to violate, internal revenue laws.

***The Informant Rewards Program provided rewards to individuals who gave the IRS information that led to the detection and punishment of individuals who violated tax laws.***

Prior to December 2006, awards paid were between 8 and 14 percent of the taxes, fines, and penalties collected during Fiscal Years 2001 to 2005. The percentage was based on the connection of the informant's information to the recovery. From Fiscal Years 2001 through 2005, more than \$340 million in taxes, fines, penalties, and interest were recovered based on information obtained through the Informant Rewards Program. Awards of more than \$27 million were paid to informants.

On December 20, 2006, Congress passed the Tax Relief and Health Care Act of 2006,<sup>2</sup> creating a centralized Whistleblower Office and amending the law to provide increased awards to informants (whistleblowers) who provide information resulting in the collection of taxes, penalties, interest, and other amounts. To comply with the law, the IRS created the Whistleblower Office which replaced its former Informant Rewards Program. The intent of the legislation was to provide focus on large-dollar cases with the potential of collecting billions of dollars for the Department of the Treasury. Under the new law, whistleblowers can now receive a minimum award of 15 percent and a maximum of 30 percent of collected proceeds. The Act created Section 7623(b) of the I.R.C.<sup>3</sup> which generally requires the IRS to pay larger awards on amounts in dispute of more than \$2 million for business taxpayers and \$200,000 for individuals. The IRS refers to these types of cases as "7623(b) claims." Those cases that do not meet this dollar threshold are referred to as 7623(a) claims.<sup>4</sup>

#### **Process to submit a claim for award**

- To report possible instances of tax fraud by a business or individual, a whistleblower submits an Information Report Referral (Form 3949A) and includes documentation in

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<sup>1</sup> 26 U.S.C. Section 7623 (2004).

<sup>2</sup> Pub. L No. 109-432, 120 Stat. 2958 (2006).

<sup>3</sup> I.R.C. Section 7623(b) (2006).

<sup>4</sup> This review focused on the control and processing of 7623(b) claims.



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support of the allegation. If the informant wants an award for the information provided, he or she must complete an Application for Award for Original Information (Form 211). The informant then sends the application and referral to the IRS Whistleblower Office located in Washington, D.C., for processing.

- The Whistleblower Office performs an initial review of the claim to identify whether it meets 7623(b) criteria and sends a letter acknowledging receipt of the claim and identifies the Whistleblower Office analyst assigned to process the claim.<sup>5</sup> Those that do not meet the 7623(b) dollar criteria are sent to the IRS Ogden Tax Processing Center for processing.
- A Whistleblower Office analyst researches IRS data files to determine whether the business or individual is already under examination, identifies assets and associated businesses, and performs a risk assessment to identify potential risk factors and/or fraud indicators. If the analyst concurs that the claim meets 7623(b) criteria and no fraud indicators are present, it is routed to the appropriate operating division for evaluation.<sup>6</sup> If fraud indicators are present, the claim is routed to the Criminal Investigation Division for evaluation.
- The operating division is responsible for evaluating the claim to determine if an examination is warranted. Based on the operating division's review:
  - A claim may be accepted for examination. The examination is conducted and when completed the operating division prepares a Confidential Evaluation Report on Claim for Reward (Form 11369). The Form 11369 is forwarded to the Whistleblower Office for review and the Director, Whistleblower Office, will determine the award percentage to be paid.
  - If a claim is not accepted for examination, a Form 11369 is prepared that includes an explanation as to why the claim does not warrant examination. The claim is then returned to the Whistleblower Office for review and issuance of a closing letter to the informant.

The completion of the above process can take years. Whistleblowers will receive awards only based on what is collected subsequent to the completion of the examination. Because taxpayers may exercise their judicial appeal rights or enter into alternative payment arrangements, payment of the award could take up to 10 years. For example, the Whistleblower Office recently paid an award on a 7623 claim 15 years after the claim was received. Because of the time periods to

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<sup>5</sup> The Whistleblower Office currently has six analysts located in Santa Rosa, California; Plantation, Florida; Brooklyn Center, Minnesota; Independence, Missouri; Buffalo, New York; and Houston, Texas.

<sup>6</sup> The operating divisions involved in the Whistleblower Program are the Large and Mid-Size Business, Small Business/Self-Employed, or Tax Exempt and Government Entities.



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process claims and collect taxes assessed, no awards have been paid out yet on 7623(b) claims received.

Figure 1 shows the status of 7623(b) claims processed in the Whistleblower Office as of March 30, 2009.

**Figure 1: Status of 7623(b) Claims as of March 30, 2009<sup>7</sup>**

Office	Open Inventory	Reclassified 7623(a)	Rejected	Total
Whistleblower Office	5	4	1	10
Whistleblower Analyst	30	149	137	316
Criminal Investigation Division Review	685		17	702
Operating Division for Initial Review	25	1	2	28
Operating Division Subject Matter Expert	700	5	133	838
Operating Division Counsel	2		1	3
Operating Division Examination	69	1	6	76
<b>Claims</b>	<b>1,516</b>	<b>160</b>	<b>297</b>	<b>1,973</b>

Source: Access database as of March 30, 2009.

**A prior Treasury Inspector General for Tax Administration review identified control weaknesses over the Informant Rewards Program**

***Our 2006 review identified a lack of detailed policies and procedures which limited management oversight in the Informant Rewards Program.***

In 2006, we completed a review of the Informant Rewards Program, which is the Program that existed prior to the enactment of legislation creating the Whistleblower Office. This review included an assessment of controls over all claims (since the categories of 7623(a) and 7623(b) claims were not yet codified in the law). The review<sup>8</sup> found that the Program significantly contributed to the IRS' efforts to enforce tax laws, but also that

additional management focus could enhance the effectiveness of the Program. A lack of standardized procedures and limited managerial oversight resulted in control weaknesses. It took more than 7½ years from the receipt of the initial claim to the payment of the award. There were

<sup>7</sup> Our report raises concerns regarding the accuracy of claim management information (see page 7). However, this is currently the best information the Whistleblower Office has regarding 7623(b) claims in inventory.

<sup>8</sup> *The Informants' Rewards Program Needs More Centralized Management Oversight* (Reference Number 2006-30-092, dated June 6, 2006).



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lapses in the monitoring of taxpayers' accounts for payment activity, which may have delayed the claims. The rejected claims took more than 6½ months between the date of the decision to reject the claim and issuance of the denial letter to the informant. In addition, for the 22 paid informant claims reviewed:

- 10 claims (45 percent) had problems with basic control issues (e.g., missing copies of key forms, no record of letters to informants).
- 7 claims (32 percent) did not have documentation to justify the award percentage.

Finally, for 52 (75 percent) of 69 rejected claims reviewed, we were unable to determine the rationale for the reviewer's decision to reject the claim. We recommended that the IRS develop and implement a detailed nationwide database to provide increased visibility of the processing and disposition of informant claims. IRS management agreed with our recommendations and stated that corrective actions would be taken which included implementing a nationwide web-based system to track, monitor, and control informant claims.

This review was performed in the Whistleblower Office at the IRS National Headquarters in Washington, D.C., and at the field office of an analyst in Buffalo, New York, during the period June 2008 through March 2009. The focus of this review was on 7623(b) claims, the category created by the Tax Relief and Health Care Act of 2006. We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective. However, we did note weaknesses in application controls<sup>9</sup> over information systems that led us to conclude that available data were not complete or accurate. Detailed information on our audit objective, scope, and methodology is presented in Appendix I. Major contributors to the report are listed in Appendix II.

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<sup>9</sup> Application controls include controls over input, processing, output, master data, application interfaces, and management system interfaces.



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## *Results of Review*

The Tax Relief and Health Care Act of 2006 required the IRS to establish a Whistleblower Office and develop processes to begin to distinguish whistleblower claims based on the potential amount of taxes to be recovered. The amendments in this Act to whistleblower awards applied to information provided on or after the date of the enactment of this Act. However, many of the necessary administrative processes were not established, including the development of an effective claim control system. Since standup, the Whistleblower Office has initiated a number of actions in an attempt to improve the Program. These actions include:

***The Tax Relief and Health Care Act of 2006 requires the IRS to issue an Annual Report to Congress on the use of Section 7623 including the results obtained.***

- Standing up a centralized Whistleblower Office to administer the IRS Whistleblower Program. Previously, all claims were processed at the IRS Ogden Tax Processing Center. Subsequent to enactment of the provisions in the Tax Relief and Health Care Act of 2006, the IRS needed to develop a new process for the receipt, review, and processing of whistleblower claims. This was necessary to distinguish between those claims meeting 7623(b) criteria from those that met 7623(a) criteria.
- Appointing a Director in February 2007 to oversee the Whistleblower Office.
- Requesting the development of a single inventory control system to track both the 7623(a) and 7623(b) claims. IRS management's goal is to have this system in place and fully operational in July 2009.
- Developing a communication plan to promote the new Program. Actions included the development of presentation material for internal and external audiences, development of training modules for the operating divisions, development of web sites for internal and external audiences, and the search for funds to develop a training video series.
- Establishing a procedure where the IRS and the whistleblower can enter into a contract to disclose specific return information pertaining to an allegation.
- Issuing an Annual Report to Congress on June 24, 2008, as required by the Tax Relief and Health Care Act of 2006. The Act requires the Secretary of the Treasury to conduct a study and report to Congress each year on the use of Section 7623, including an analysis of the use of that section and the results obtained, as well as any legislative or administrative recommendations regarding Section 7623 and its application. The Annual



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Report detailed actions taken in the first 12 months since the standup of the Whistleblower Office. Actions cited included:

- Staffing the Whistleblower Office.
- Designing the program flow for processing new whistleblower claims.
- Developing a communication plan to address outreach to the public and IRS personnel.
- Developing program guidance and revising claim forms.

The Whistleblower Program provides the IRS with an opportunity to potentially recover billions of dollars in alleged underpayment of taxes, penalties and interest. However, the IRS did not have an effective inventory control system or adequate procedures and processes at the time of our review. To mitigate the limitations of its prior inventory control system, management relied on multiple systems to track and control claims. This resulted in inaccuracies and inconsistencies in the control and tracking of 7623(b) claims. Management has been in the process of developing and implementing a new inventory system for approximately 2 years and is in the process of transferring its 7623(b) claims inventory to this new system. Nonetheless, without effective procedures and processes to ensure timely, accurate input of case information into this system, the problems we noted with its inventory controls may continue to exist. In addition, timeliness standards and a process to monitor the timely working of claims had not been established.

The IRS has seen significant growth in 7623(b) claims since the passage of the new law. Without effective control over and timely processing of these claims, the effectiveness of the IRS Whistleblower Program could be diminished. Figure 2 provides a comparison by calendar year for claims received with indications of alleged underreported income.

**Figure 2: 7623(b) Claim Receipts**

Calendar Year	Claims	Alleged Income Underreported
2007	83	\$8 billion
2008	1,890	\$65 billion

*Source: Whistleblower Office Access database as of March 30, 2009.*

It should be noted that the underreported income amounts in Figure 2 are solely based on allegations by the whistleblowers submitting the claims. The completion of the process to validate an allegation through the performance of an audit can take years to complete. As such, it is too soon to tell what amount of taxes, interest, and penalties may ultimately be collected.



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## ***Multiple Inventory Systems and Inadequate Procedures and Processes Resulted in Ineffective Control Over Whistleblower Claims***

Since the standup of the Whistleblower Office in February 2007, management has had to rely on multiple systems in an attempt to accurately control 7623(b) claims. As a result, the process to control and track 7623(b) claims was inefficient and ineffective. Each system lacks the basic functionality needed to accurately track claims and their processing. As such, management did not have the ability to generate management information reports to track the processing of claims and, ultimately, evaluate the success of the Program. In response to our prior review, IRS management agreed with our recommendation to develop a nationwide web-based inventory control system to track claims. Management anticipates its new nationwide tracking system will be fully operational in July 2009.

The Whistleblower Office maintains three inventory control systems for 7623(b) claims. The three systems are independent of each other and we identified inconsistencies among the claim information contained in these systems. Management noted that the additional systems have been necessary because the previous system did not allow management to distinguish between the types of claims (i.e., 7623(a) and 7623(b)) as required by the passage of legislation in December 2006. The systems in use are the:

- ***ICEWEB<sup>10</sup> Inventory Control System*** – This system was in place at the time the legislation was enacted. However, this web-based system did not provide management with the ability to generate reports by claim type and did not provide management with the ability to monitor the processing status of claims. If management needed to identify those claims that were classified as 7623(b), they were required to manually determine this count. However, management has been unable to cease using this system because the ICEWEB system generates a claim number that is used to track whistleblower claims.
- ***I-TRAK<sup>11</sup> Inventory Control System*** – In an effort to more effectively administer the program, the Whistleblower Office implemented the I-TRAK system in March 2007. It was implemented as the primary control system to track the 7623(b) cases. However, soon after implementation, the Whistleblower Office recognized deficiencies in this system. Specifically, the I-TRAK system also had no reporting capabilities and did not provide the level of detail needed regarding the status and processing of claims.

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<sup>10</sup> Informant Claims Examination web-based system (ICEWEB) stores 7623 cases indefinitely and tracks case dispositions including claim approval/denial and amounts.

<sup>11</sup> I-TRAK is a IRS-wide, web-based internal document tracking system that IRS leadership and business units can use to timely and effectively manage their responses to issues raised by taxpayers, IRS employees, Congress, the Department of the Treasury, the White House, the Government Accountability Office, and the Treasury Inspector General for Tax Administration.



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- ***Access Inventory Control System*** – Recognizing the deficiencies in the ICEWEB and I-TRAK systems, the Whistleblower Office implemented yet a third inventory control system using Microsoft Access. Management noted that this system was used to track the processing of 7623(b) claims as it enables the input of specific information as to the receipt, review, and routing of claims.

The initial release of the system that management has been developing since the standup of the Whistleblower Office was brought into use in January 2009. The E-TRAK Inventory Control System will eventually replace the multiple tracking systems currently being used. The Whistleblower Office is in the process of transferring applicable information from the existing three inventory systems to this new system. However, as of March 2009, the E-TRAK system still did not provide management information reports and, until the information is transferred, the Whistleblower Office will have to maintain four separate systems to control the claims.

### **Multiple inventory control systems resulted in inaccuracies and inconsistencies**

The inventory tracking systems did not accurately and/or consistently track 7623(b) claims and provide key information relative to these claims. Specifically, during the course of the audit, management provided us with extracts from the Access Inventory Control System and told us that this system would be the best source for us to identify 7623(b) claims. However, management noted that there was a lag between when the claims were received and when they were added to the Access database.

Initially, we were not aware of the significance of this lag. The initial database received from management on October 30, 2008, did not accurately reflect claims in the possession of the Whistleblower Office. There were 1,086 claims included in the database received on October 30, 2008. However, an updated database received on February 24, 2009, included 1,973 claims. The additional 887 claims were added to the database between November 1, 2008, and February 24, 2009, even though the claims were received between August 7, 2007, and October 30, 2008.

The Access Inventory Control System is what management uses to provide statistical information on whistleblower claims to internal and external stakeholders. Management provides a similar caution regarding the delays in updating information so that stakeholders will be aware of the limitations of the statistical information being provided.

In addition, we identified inconsistencies in the claims information included in the inventory control systems. Our comparison of 7623(b) claim information on the ICEWEB, I-TRAK, and Access Inventory Control Systems identified:

- 144 claims that were assigned an ICEWEB system claim number but were not listed on either the I-TRAK system or the Access Inventory Control System.



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- 146 claims were listed on the I-TRAK system but were not included in the Access Inventory Control System.

Management informed us that the extracts from the Access Inventory Control System contained only 7623(b) claims. However, after we questioned management regarding the timeliness of closing actions, management noted that 62 of the 72 claims listed as closed were actually 7623(a) claims. Also, we identified that specific information regarding claims included in the whistleblower inventory tracking systems was not always accurate. Our review of a judgmental sample of the 32 oldest claims in inventory identified the following inaccuracies:

- *Incorrect receipt dates.* For 22 (69 percent) of the 32 claims in our sample, inventory records did not accurately reflect the date the IRS received the claim. The differences in claim receipt dates ranged from negative 13 calendar days to 165 calendar days. Procedural weaknesses during the Whistleblower Office standup period contributed to input errors. Figure 3 provides examples of the most significant discrepancies between the actual receipt date of the claim and the date of the receipt as shown in the inventory records.

**Figure 3: Comparison of Receipt Dates**

Sample Number	Received Dates		
	Case File	Access Database	Difference (in Days)
Sample Case #1	07/26/2007	08/21/2007	26
Sample Case #2	03/12/2007	05/08/2007	57
Sample Case #3	04/11/2007	05/11/2007	30
Sample Case #4	05/07/2007	06/18/2007	42
Sample Case #5	03/15/2007	08/27/2007	165

*Source: Whistleblower Office case files and Access database as of October 30, 2008.*

- *Incorrect transfer dates.* For 13 (41 percent) of the 32 claims in our sample, inventory records did not accurately reflect the date the claim was transferred to the operating division. The differences in claim transfer dates ranged from negative 69 calendar days to 196 calendar days. Figure 4 provides examples of the most significant discrepancies between the date the claim actually transferred and the date that it was entered in inventory records.



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**Figure 4: Comparison of Transfer Dates**

Sample Number	Dates Routed to Operating Division		
	Case File	Access Database	Difference (in Days)
Sample Case #1	10/10/2007	08/02/2007	(69)
Sample Case #2	09/18/2007	08/22/2007	(27)
Sample Case #3	07/11/2007	11/30/2007	142
Sample Case #4	03/09/2007	04/27/2007	49
Sample Case #5	08/16/2007	02/28/2008	196

*Source: Whistleblower Office case files and Access database as of October 30, 2008.*

*Standards for Internal Control in the Federal Government*<sup>12</sup> require that information be recorded and communicated to management and others within the entity who need it and in a form and within a time period that enables them to carry out their internal control and other responsibilities. We recognize the efforts management has taken in an attempt to implement a single inventory system to accurately control 7623(b) whistleblower claims. Management has begun the initial implementation of its new system but has yet to develop a process to ensure that the information input to this system is accurate. In addition, this new system may not solve the problems we identified. For example, the initial release of the new system did not include reporting capabilities even though they are critical in order for the system to be useful.

### **Recommendations**

The Director, Whistleblower Office, should:

**Recommendation 1:** Ensure reporting capabilities are included in the newly implemented E-TRAK inventory control system. These reporting capabilities should enable management to generate management information reports to track the processing of claims and evaluate the success of the program.

**Management's Response:** IRS management agreed with our recommendation. The IRS identified the need for reporting capabilities in E-TRAK inventory control system and those capabilities are now in place.

**Recommendation 2:** Perform a physical reconciliation of 7623(b) claim information to ensure that the information captured from existing systems and input into the newly implemented single inventory control system is accurate. In addition, a process should be developed to ensure that claims are accurately controlled in the new inventory control system.

<sup>12</sup> GAO/AIMD-00-21.3.1, dated November 1999.



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**Management's Response:** IRS management agreed with our recommendation. The IRS identified the need to have a single inventory system and ensure the accuracy of information in that system. This will be completed in three phases, and the final phase will be concluded in 2010. In addition, the IRS has established a quality control process based on a statistical sample of records to ensure accuracy of data.

### ***Whistleblower Claims Are Not Timely Processed***

The Whistleblower Office had not established timeliness standards to evaluate claims; therefore, with the concurrence of IRS management, we used a time standard for claims to be evaluated for acceptance within 60 days. Applying this criteria, we determined that 738 (85 percent) of the claims<sup>13</sup> received as of October 2008 were not processed and sent to an operating division for acceptance for an examination within 60 days of receipt. There are significant delays in the processing of whistleblower claims including:

- 30 days on average to route claims from the Whistleblower Office to an analyst for review (with a range from 1 day to 454 days).
- 107 days on average to route claims from the analyst to the operating division (with a range from 1 day to 507 days).

Management stated that establishing timeliness standards for processing claims had not been a priority because the process was constantly changing. Management further explained that efforts were focused on maintaining three tracking systems, developing procedures, training the staff, and setting up a program design for processing claims and coordinating with the operating divisions.

We recognize that there were competing priorities in establishing a new office. However, the office has been in existence well over 2 years and, in our opinion, establishing standards to work the claims should have been one of its immediate priorities. The Director, Whistleblower Office, stated that he has made establishing baselines for processing claims one of his priorities in Fiscal Year 2009. Subsequent to our fieldwork, the Director advised us that the office is using a time standard of 60 days to evaluate the claims for acceptance.

### **Closing letters notifying whistleblowers of nonacceptance of claims were not timely issued**

We identified significant delays in the issuance of closing letters to whistleblowers. Our review of the 32 oldest 7623(b) claims identified that 13 were returned to the Whistleblower Office from the operating division as rejected (no examination potential). The main reasons these claims were rejected is that the business or individual was already under examination. For 12 claims, no closing letters were sent to the informants despite the completed claim evaluations being returned to the Whistleblower Office on average 290 days prior to our review. The receipt of the

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<sup>13</sup> This analysis was based our initial database of 866 records that contained 1,086 claims.



## ***Deficiencies Exist in the Control and Timely Resolution of Whistleblower Claims***

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completed claim evaluations ranged from 155 to 625 days. For the remaining claim, [REDACTED]

***For claims rejected as having no examination potential, no closing letter was sent to the whistleblower. On average, 290 days had passed after the operating division recommended not initiating an examination.***

We questioned management as to the specific actions needed once the operating division notifies the analyst that an examination was not warranted. We were informed that the analyst reviews the operating division's evaluation of the claim and generates the closing letter. Management stated that some of the delays resulted from their waiting to receive an opinion from IRS Counsel as to what information could be included in the closing letters sent to individuals explaining the reason the claims were rejected. The Counsel opinion was received August 2008, but closing letters still were not issued. For one claim, [REDACTED]

### ***Recommendations***

The Director, Whistleblower Office, should:

**Recommendation 3:** Establish written procedures that include timeliness standards for processing whistleblower claims. These standards should include time periods to forward a claim to an analyst for review subsequent to receipt, forward a claim to the appropriate operating division for review, and generate closing letters.

**Management's Response:** IRS management agreed with our recommendation. The IRS identified the need for standardized, written procedures for the Whistleblower Office. In October 2008, the Director communicated case processing standards to the staff. These standards have now been published in the Internal Revenue Manual, desk guides for use of the E-TRAK Whistleblower information system, and case processing instructions for Whistleblower Office analysts and administrative staff. The standards cover each of the areas our review identified.

**Recommendation 4:** Develop a process to monitor the timely processing of claims.

**Management's Response:** IRS management agreed with our recommendation. The IRS identified the need for monitoring cases, including processing time. Monitoring has been established and is in place.



## **Deficiencies Exist in the Control and Timely Resolution of Whistleblower Claims**

### **Whistleblower Law Does Not Include Employee Protection Against Retaliation**

The False Claims Act covers false claims by government contractors but specifically excludes tax fraud. The Whistleblower provisions in the Tax Relief and Health Care Act of 2006 cover actions in the area of tax compliance and provide a structure that is similar in certain respects to the False Claims Act. However, unlike the False Claims Act, Whistleblower legislation related to tax fraud does not include specific provisions for employee protection against retaliation by an employer. This can be a significant issue in some whistleblower claims of tax fraud. Of the 1,973 whistleblower claims received, 93 (5 percent) were submitted by an employee of either the individual or the business.

The False Claims Act contains provisions stating that any employee who is discharged, demoted, suspended, threatened, harassed, or in any other manner discriminated against in terms and conditions of employment shall be entitled to all relief necessary to make the employee whole. Such relief shall include reinstatement with the same seniority status, twice the amount of back pay, interest on the back pay, and compensation for any special damages sustained.

In our discussions with representatives from the IRS operating divisions who work with whistleblowers, they told us that whistleblowers are concerned about possible retaliation from employers and that their confidentiality is their utmost concern. For example:

- 3(d) • An IRS analyst in the Large and Mid-Size Business Division told us that several whistleblowers were concerned about retaliation and [REDACTED] 3(d)
- 3(d) • Another IRS analyst in Large and Mid-Size Business Division told us that [REDACTED] 3(d)
- 3(d) • An IRS lawyer told us that, of six whistleblowers recently debriefed, [REDACTED] 3(d)
- A Whistleblower Office analyst told us that all whistleblowers who are employees and work with the IRS fear reprisals and there are instances when they ask how the IRS could protect them.

In addition, we spoke with a lawyer in private practice who is experienced in this area of tax administration, as well as litigation brought under the Federal False Claims Act. This lawyer's clients, both current and former employees, have concerns about their confidentiality because of possible retaliation from their employers.

**Whistleblowers are concerned about retaliation from employers. Confidentiality is of the utmost importance.**



*Deficiencies Exist in the Control and Timely Resolution of Whistleblower Claims*

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The underlying premise of the Whistleblower provision in the Tax Relief and Health Care Act of 2006 is that individuals with knowledge of significant tax noncompliance issues would come forward if there was a significant financial incentive for them to provide information to the IRS. Protection against retaliation would increase the likelihood that employees would come forward with information when their employers are significantly misreporting their tax liabilities. Without such protection for employees, the risk of retaliation might outweigh the incentive of the reward.

***Legislative Recommendation***

***Recommendation 5:*** Legislation is needed to ensure that informants are protected against retaliation by their employers and to provide specific relief to informants who are retaliated against.

***Management's Response:*** This recommendation is outside the jurisdiction of the IRS.



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*Deficiencies Exist in the Control and Timely Resolution of Whistleblower Claims*

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## Appendix I

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

The overall objective of this review was to evaluate the implementation of the Whistleblower Office. Our review included assessing the implementation of the Whistleblower Office and the controls monitoring the disposition of new claims.

To identify time lapses between activities, we analyzed the initial Access database received from management on October 30, 2008, that showed 866 records without identifying the number of related claims. During a briefing on February 4, 2009, the Director and Senior Advisor of the Whistleblower Office informed us that the initial Access database was incomplete and provided a subsequent Access database on February 24, 2009, that showed 1,154 records with 1,973 claims received as of October 30, 2008. The Whistleblower Office staff subsequently advised us that the original 866 records had 1,086 claims associated with the records provided. Based on these observations and attempts to verify data accuracy, we concluded that the Access data were not reliable because the data may not be complete and were not always accurate. This limitation adversely impacted our ability to identify workload and to evaluate processing actions without reviewing the hard-copy documents on file. We did conduct analyses on the records associated with 1,973 claims received by October 30, 2008, but we still had concerns with the completeness and accuracy of the data. Therefore, we qualified our observations because of those concerns. To accomplish our objective, we:

- I. Evaluated whether agreed-upon recommendations from our 2006 audit report<sup>1</sup> were implemented.
  - A. Determined whether the IRS centralized the campuses'<sup>2</sup> Informant Claims – Examination Units and evaluated whether it resulted in increased oversight of the Program and standardization of the processing of informant's claims.
  - B. Ascertained whether a nationwide database of informant claims had been developed and implemented, and provided increased visibility of the processing and disposition of informant claims.
- II. Interviewed the Director, Whistleblower Office, and other personnel involved in the program to obtain an overview of the Whistleblower Program processes and procedures for the coordination among the Whistleblower Office, the Criminal Investigation

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<sup>1</sup> *The Informants' Rewards Program Needs More Centralized Management Oversight* (Reference Number 2006-30-092, dated June 6, 2006).

<sup>2</sup> The data processing arm of the IRS. The campuses process paper and electronic submissions, correct errors, and forward data to the Computing Centers for analysis and posting to taxpayer accounts.



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*Deficiencies Exist in the Control and Timely Resolution of Whistleblower Claims*

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- Division Confidential Informant Program, and the Large and Mid-Size Business Division.
- A. Evaluated whether the Whistleblower Office developed guidelines for screening informant claims and routing them to the appropriate function, and whether they revised forms, letters, and procedures for the processing of Section 7623(b) cases.
  - B. Evaluated whether the Whistleblower Office had established strategic direction for the program and developed goals and measures to track the Program's progress toward its mission.
  - C. Ascertained whether the Whistleblower Office had a communication plan and informed the general public about the new Whistleblower Program.
  - D. Evaluated whether the Whistleblower Office defined and communicated the performance goals of the Whistleblower Program.
  - E. Determined whether the Whistleblower Office prepared the Annual Report on the Informant Rewards Program to Congress.
- III. Interviewed the Whistleblower Office program analysts and discussed the processing of Section 7623(b) informants' claims.
- A. Interviewed the Whistleblower Office analysts and determined the procedures for processing claims.
  - B. Determined the methodology used by the Whistleblower Office to account for and track actions on Section 7623(b) informants' claims, the criteria used for an acceptance or rejection decision of Section 7623(b) cases, and whether timeliness standards have been established for rendering an accept or reject decision.
- IV. Determined whether I.R.C. Section 6103 (disclosure provisions) affected the Tax Relief and Health Care Act of 2006<sup>3</sup> and evaluated the actions taken by the Whistleblower Office to share information with informants.
- A. Determined whether IRS Counsel had given an opinion on entering into contracts with informants to allow sharing examination activities under I.R.C. Section 6103.
  - B. Requested Treasury Inspector General for Tax Administration Counsel's opinion on the legality of the IRS using an I.R.C. Section 6103 exception to permit interaction between informants and the IRS.
- V. Reviewed a judgmental sample of the 32 oldest 7623(b) claims from a population of 1,973 claims and determined whether they were properly processed and routed to the appropriate operating division. The judgmental sample was used to identify possible

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<sup>3</sup> Pub. L No. 109-432, 120 Stat. 2958 (2006).



*Deficiencies Exist in the Control and Timely Resolution of Whistleblower Claims*

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delays in the processing and routing of claims.

- VI. Assessed how closely the process followed in redesigning and implementing the IRS informant reward program changes compares with best practices advocated by the Government Accountability Office.
- VII. Developed a matrix and compared and contrasted the IRS Whistleblower legislation to the False Claims Act and identified areas where the legislation may need strengthening.
  - A. Interviewed appropriate operating division personnel who examined 7623(b) claims and discussed the Whistleblower legislation.
  - B. Interviewed an attorney who represented several informants that submitted IRS Whistleblower claims and discussed the Whistleblower legislation.



*Deficiencies Exist in the Control and Timely Resolution of  
Whistleblower Claims*

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**Appendix II**

*Major Contributors to This Report*

Michael E. McKenney, Assistant Inspector General for Audit (Returns Processing and Account Services)

Russell P. Martin, Director

Edward Gorman, Audit Manager

Kathleen A. Hughes, Senior Auditor

Lawrence R. Smith, Senior Auditor

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*Deficiencies Exist in the Control and Timely Resolution of  
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**Appendix III**

*Report Distribution List*

Commissioner C  
Office of the Commissioner – Attn: Chief of Staff C  
Director, Whistleblower Office SE:WO  
Chief Counsel CC  
National Taxpayer Advocate TA  
Director, Office of Legislative Affairs CL:LA  
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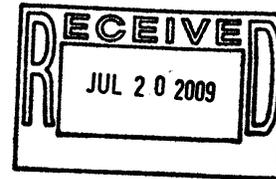
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**Appendix IV**

*Management's Response to the Draft Report*



DEPARTMENT OF THE TREASURY  
INTERNAL REVENUE SERVICE  
WASHINGTON, D.C. 20224  
July 20, 2009



**MEMORANDUM FOR DEPUTY INSPECTOR GENERAL FOR AUDIT**

**FROM:**

Stephen A. Whitlock  
Director, Whistleblower Office

**SUBJECT:**

Draft Audit Report 200830034 – Deficiencies Exist in the Control and Timely Resolution of Whistleblower Claims

Thank you for the opportunity to comment on the draft report on the IRS Whistleblower Program. The December 2006 amendments to 26 USC 7623 made fundamental changes in the legal authority for paying whistleblower awards, most notably changing from "may pay" to "shall pay" for information resulting in IRS action, where the amount in dispute exceeds \$2 million. The law also set statutory ranges for awards, generally between 15% and 30% of collected proceeds, and effectively removed an upper limit on award amounts that had been established in IRS policy under the prior law.

The Service began to receive whistleblower submissions alleging more than \$2 million in underpayment of tax almost immediately after enactment of the amendments to section 7623. Since programs to support the claims received under the new statute did not exist, the submissions were initially evaluated using processes and systems designed for the pre-amendment informant awards program. As a result, as noted in your report, there were challenges at the start as the Service was receiving claims at the same time it was standing up the new office and program. The IRS clearly recognized that those processes and systems would not be adequate to manage the claim receipts under the new law and used them only as a stop-gap until the new program could be designed and implemented. The IRS has successfully taken steps to develop guidance, procedures, processes, and information systems to ensure effective processing, evaluation, and tracking of whistleblower claims. Significant progress has been made on all fronts. We will continue to identify improvements as we gain experience with this new work.



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*Deficiencies Exist in the Control and Timely Resolution of Whistleblower Claims*

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Our response to your specific recommendations is below:

**Recommendation 1:** The Director, Whistleblower Office, should ensure reporting capabilities are included in the newly implemented E-Trak inventory control system. These reporting capabilities should enable management to generate management information reports to track the processing of claims and evaluate the success of the program.

**Response:** The IRS identified the need for reporting capabilities in E-Trak and those capabilities are now in place.

**Completion Date:** Completed - June 30, 2009

**Recommendation 2:** The Director, Whistleblower Office, should perform a physical reconciliation of 7623(b) claim information to ensure the information captured from existing systems and input into the newly implemented single inventory control system is accurate. In addition, a process should be developed to ensure claims are accurately controlled in the new inventory control system.

**Response:** The IRS identified the need to have a single inventory system and ensure the accuracy of information in that system. We are completing this work in three phases. The final phase will be concluded in 2010. Additionally, we have established a quality control process based on a statistical sample of records to ensure accuracy of data.

**Completion Date:** Phase I - Migration of Open B Claims completed June 30, 2009  
Phase II - Migration of Closed B Claims – September 30, 2009  
Phase III - Migration of ICE WEB cases – June 30, 2010

**Recommendation 3:** The Director, Whistleblower Office, should establish written procedures that include timeliness standards for processing whistleblower claims. These standards should include time periods to forward a claim to an analyst for review subsequent to receipt, forward a claim to the appropriate operating division for review, and generate closing letters.

**Response:** The IRS identified the need for standardized, written procedures for the Whistleblower Office. In October 2008, the Director communicated case processing standards to the staff. These standards have now been published in the Internal Revenue Manual, desk guides for use of the E-Trak Whistleblower information system, and case processing instructions for Whistleblower Office analysts and administrative staff. The standards cover each of the areas you have identified.

**Completion Date:** Completed - October 2008 procedures published in the IRMs and communicated to the staff. E-Trak desk guide updated – July, 2009.

**Recommendation 4:** The Director, Whistleblower Office, should develop a process to monitor the timely processing of claims.



*Deficiencies Exist in the Control and Timely Resolution of Whistleblower Claims*

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**Response:** The IRS identified the need for monitoring cases, including processing time. Monitoring has been established and is in place.

**Completion Date:** Completed - June 30, 2009

**Recommendation 5:** Legislative recommendation: Legislation is needed to ensure informants are protected against retaliation by their employers and to provide specific relief to informants who are retaliated against.

**Response:** This recommendation is outside the jurisdiction of the IRS.

If you need additional information, please contact me at (202) 622-0351.