



*Procedures Are Needed to Improve the  
Accounting and Monitoring of Restitution  
Payments to Prevent Erroneous Refunds*

**January 27, 2012**

**Reference Number: 2012-30-012**

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  
7 = Pre-Decision/Privileged Material

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## HIGHLIGHTS

### **PROCEDURES ARE NEEDED TO IMPROVE THE ACCOUNTING AND MONITORING OF RESTITUTION PAYMENTS TO PREVENT ERRONEOUS REFUNDS**

## Highlights

### **Final Report issued on January 27, 2012**

Highlights of Reference Number: 2012-30-012 to the Internal Revenue Service Chief, Criminal Investigation.

### **IMPACT ON TAXPAYERS**

When a defendant pleads guilty or is found guilty of a tax-related crime, the terms of a defendant's sentence can include various combinations of imprisonment, probation, and monetary penalties such as fines and restitution. Probation and restitution act to discourage similar criminal violations by others. However, the perception has grown that many defendants, despite being convicted of violating the tax laws, are escaping all responsibility for the payment of the taxes associated with the offenses they committed. This perception can erode taxpayers' confidence in the IRS's ability to collect taxes from defendants and weakens its administration of all tax laws.

### **WHY TIGTA DID THE AUDIT**

This audit was initiated as part of our Fiscal Year 2010 Annual Audit Plan and addresses the major management challenges of Tax Compliance Initiatives and Erroneous and Improper Payments and Credits. The overall objective of this review was to determine whether defendants convicted of tax-related crimes are held responsible for the payment of the taxes associated with the offenses they committed.

### **WHAT TIGTA FOUND**

The IRS does not have effective internal controls to ensure defendants convicted of tax-related crimes comply with conditions of probation and restitution. Specifically, the IRS's inability to properly account for restitution payments

resulted in the issuance of erroneous refunds to three defendants and 16 taxpayers totaling approximately \$543,000. In addition, the IRS's systems for monitoring defendants' compliance with the conditions of probation and restitution are neither effective nor reliable. TIGTA's analysis of data used to monitor defendants identified inaccurate tax account data totaling approximately \$330,000 for 25 defendants. TIGTA also determined that Criminal Investigation inconsistently used the refund offset procedure to collect restitution payments. Finally, the IRS was not always granted restitution by the courts in cases where it appeared to be warranted.

### **WHAT TIGTA RECOMMENDED**

TIGTA made several recommendations to the Chief, Criminal Investigation, to address internal control weaknesses regarding accurate accounting for restitution payments, including preventing the issuance of erroneous refunds. In addition, TIGTA made recommendations to establish a single database for monitoring defendants, revise guidelines for earlier notification to Criminal Investigation of the status of convicted individuals' adherence to conditions of probation and restitution, and obtain the IRS Office of Chief Counsel's opinion on the use of refund offsets. Finally, Criminal Investigation should document in its investigative files why restitution was not included in sentences to identify factors that hinder the IRS being granted restitution.

IRS management agreed with our recommendations and stated that corrective actions are planned or have already been taken to address them.



TREASURY INSPECTOR GENERAL  
FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY

WASHINGTON, D.C. 20220

January 27, 2012

**MEMORANDUM FOR** CHIEF, CRIMINAL INVESTIGATION

*Michael R. Phillips*

**FROM:**

Michael R. Phillips

Deputy Inspector General for Audit

**SUBJECT:**

Final Audit Report – Procedures Are Needed to Improve the Accounting and Monitoring of Restitution Payments to Prevent Erroneous Refunds (Audit #201030031)

This report presents the results of our review to determine whether defendants convicted of tax-related crimes are held responsible for the payment of the taxes associated with the offenses they committed. This audit was included in our Fiscal Year 2010 Annual Audit Plan and addresses the major management challenges of Tax Compliance Initiatives and Erroneous and Improper Payments and Credits.

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

Copies of this report are also being sent to the Internal Revenue Service managers affected by the report recommendations.

Please contact me at (202) 622-6510 if you have questions or Margaret E. Begg, Assistant Inspector General for Audit (Compliance and Enforcement Operations), at (202) 622-8510.



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## *Abbreviations*

CI	Criminal Investigation
CIMIS	Criminal Investigation Management Information System
DOJ	Department of Justice
FY	Fiscal Year
I.R.C.	Internal Revenue Code
IRM	Internal Revenue Manual
IRS	Internal Revenue Service
PII	Personally Identifiable Information
SB/SE	Small Business/Self-Employed
SSN	Social Security Number
TIGTA	Treasury Inspector General for Tax Administration
U.S.	United States
USAO	United States Attorney's Office
W&I	Wage and Investment



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## *Background*

To promote compliance with tax laws and confidence in the United States' (U.S.) tax administration system, the Internal Revenue Service's (IRS) Criminal Investigation (CI) conducts investigations of potential tax-related crimes that violate the Internal Revenue Code (I.R.C.).<sup>1</sup> When CI concludes that a tax-related crime has occurred and prosecution is warranted, it forwards the results of its investigation to the Department of Justice (DOJ) Tax Division.

The ultimate goal of every criminal prosecution is not merely to obtain a conviction, but also to obtain a sentence sufficient to discourage similar criminal violations by others. When a defendant<sup>2</sup> pleads guilty or is found guilty of a tax-related crime, the terms of the sentence can include various combinations of imprisonment, probation, supervised release, special tax-related provisions, and monetary penalties such as fines and restitution. Defendants can be ordered to pay restitution to compensate victims for their loss, and in tax-related crimes, the Federal Government can be a victim due to the unpaid taxes from the criminal activity. The DOJ has cited restitution as an important tool in reducing the Tax Gap in its Fiscal Years (FY) 2009 and 2010 Congressional Budget Justifications.

The IRS seeks restitution because it establishes some monetary obligation for the defendant at the time of sentencing. However, restitution does not represent the defendant's official tax liability. In accordance with the I.R.C., a supplemental tax liability is established only when the IRS completes an examination of an individual taxpayer's records and makes a tax assessment. Although restitution is not the official tax liability, it represents the defendant's legal obligation to pay a specified amount to the IRS and is an important tool in reducing the Tax Gap. Until the IRS makes an official tax assessment, only the United States Attorney's Office (USAO) may enforce the collection of restitution ordered by the court. Generally, when restitution is ordered as a condition of probation or supervised release, the obligation to pay restitution ceases when the period of probation or supervised release expires. However, once the tax assessment has been made, the IRS has a 10-year period to collect the assessed tax.

According to data provided by the IRS, during FYs 2007 through 2009, there were 3,234 tax-related investigations that resulted in sentences. Of these, 2,363 (73 percent) of the sentences included tax-related conditions of probation and the remaining 871 (27 percent) had no conditions of probation. In addition, 1,403 (43 percent) of the sentences included court-ordered restitution totaling \$673 million owed to the IRS. Figure 1 shows the amount of restitution

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<sup>1</sup> See Appendix VIII for a glossary of terms.

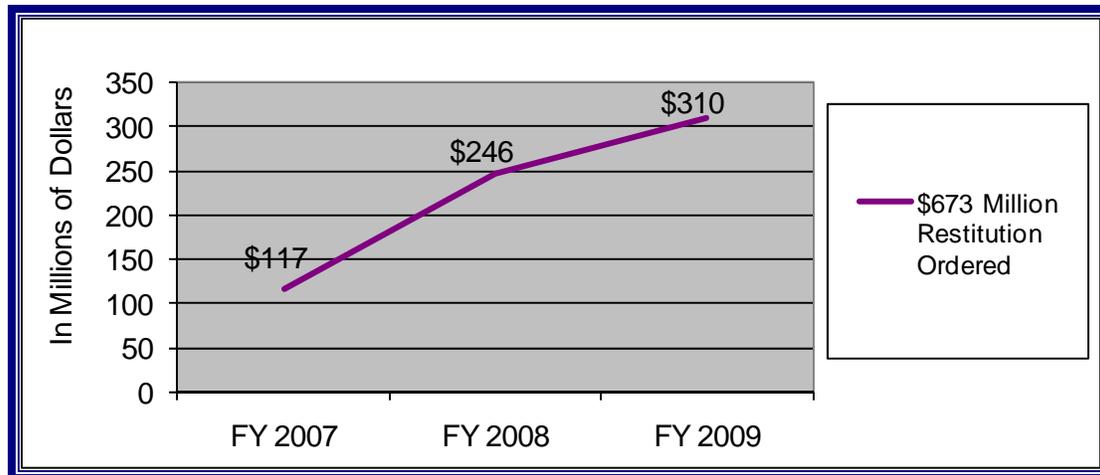
<sup>2</sup> For the purposes of this report, the term "defendant" includes both individuals and tax return preparers who pleaded guilty to or were convicted of a tax-related crime. The terms "convicted individual" and "convicted tax return preparer" used later in the report refer only to that specific group.



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ordered from FYs 2007 through 2009 has nearly tripled over the three-year period, which supports that CI is communicating the importance of restitution to the DOJ and that the DOJ is placing more emphasis on seeking restitution.

**Figure 1: Restitution Ordered in FYs 2007 Through 2009**



Source: Data from CI's Criminal Investigation Management Information System (CIMIS).

In a March 2004 review, the Treasury Inspector General for Tax Administration (TIGTA) reported that existing procedures within CI and the Small Business/Self-Employed (SB/SE) Division did not effectively ensure defendants who did not comply with the terms of their sentences were reported to the courts for appropriate legal action.<sup>3</sup> For example, if a defendant does not pay the restitution, the court may resentence the defendant to an extended period of imprisonment or supervised release. Such court rulings discourage defendants from disposing of assets rather than paying the IRS because they might face additional imprisonment.

In response to TIGTA's FY 2004 audit report, the Chief, CI, stated that as a result of the collective efforts of an IRS-DOJ Working Group (hereafter referred to as the Working Group), initiatives would be leveraged to substantially improve the conditional probation reporting and monitoring process. The Working Group consisted of representatives from the IRS's Office of Chief Counsel, the SB/SE Division, CI, and the DOJ. In an April 2004 paper,<sup>4</sup> the Working Group reported that the prohibition on directly assessing restitution as a tax was a significant issue facing the IRS because it barred the IRS from using existing enforcement techniques to collect restitution.

<sup>3</sup> TIGTA, Ref. No. 2004-10-060, *Courts Are Not Always Notified When Criminals Fail to Comply With Their Sentences to Settle Civil Tax Liabilities* (March 2004).

<sup>4</sup> *Restitution in Criminal Tax Cases – A Report and Recommendations Prepared by an IRS-DOJ Working Group* (April 1, 2004).



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On August 16, 2010, the President signed into public law an amendment to the I.R.C.<sup>5</sup> that allows orders of criminal restitution to be assessed in the same manner as if such amounts were a tax. The IRS established multiple design and implementation teams consisting of representatives from various internal stakeholder groups to develop guidance and procedures for this new authority. The IRS estimated the implementation process would be completed in FY 2012. Because the amendment is not retroactive, the design and implementation teams are not developing procedures to change the process to record restitution ordered or payments received for defendants sentenced before August 16, 2010.

The amendment to allow a tax assessment of restitution ordered is a significant opportunity for the IRS to develop a coordinated, cross-functional process to account for restitution owed and paid by defendants. Until the new guidance is put into effect, the IRS must continue to conduct an examination of a defendant's records to establish a tax assessment. However, even after these procedures are put in place, the IRS will still need additional procedures to account for restitution ordered and payments made by defendants before the enactment of the amendment.

This review was performed at the CI and SB/SE Division Headquarters Offices in Washington, D.C., the CI and SB/SE Division functions in Los Angeles, California; Plantation (Miami), Florida; and Philadelphia, Pennsylvania; the CI Scheme Development Center in Ogden, Utah; and the Wage and Investment (W&I) Division Campus in Kansas City, Missouri, during the period April 2010 through June 2011. We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective. Detailed information on our audit objective, scope, and methodology is presented in Appendix I. Major contributors to the report are listed in Appendix II.

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<sup>5</sup> Firearms Excise Tax Improvement Act of 2010, Pub. L. No. 111-237, August 16, 2010, 124 Stat. 2497 (Section 3. Assessment of Certain Criminal Restitution).



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## *Results of Review*

The laws and IRS regulations that apply to the accounting, payment, collection, and enforcement of restitution are complex and technical in nature. Over the past several years, the IRS has placed increased emphasis on using restitution to help ensure that defendants repay the IRS in criminal tax cases and to deter future criminal violations of the I.R.C. However, the perception has grown that many defendants, despite being convicted of violating the tax laws, are nevertheless escaping all responsibility for the payment of the taxes associated with the offenses for which they were convicted. This perception can erode taxpayers' confidence in the IRS's ability to collect taxes from defendants and weakens its administration of all tax laws.

Based on the results of this review, the IRS does not have effective internal controls to ensure defendants convicted of tax-related crimes are held responsible for paying taxes and adhering to conditions of probation and restitution associated with the offenses they commit. The absence of effective internal controls impaired the IRS's ability to ensure there were adequate accounting procedures and safeguards to prevent the issuance of erroneous refunds to defendants. In addition, weaknesses in internal controls hindered the IRS's efforts to monitor conditions of probation and restitution, and CI's use of the refund offset procedure to collect restitution payments is inconsistent. Finally, the IRS was not always granted restitution by the courts in cases where it appeared to be warranted.

### ***Weaknesses in the Procedures to Account for Restitution Payments Increased the Risk of Erroneous Refunds***

Our review of a sample of transactions determined that internal controls were not in place to prevent the IRS from issuing erroneous refunds due to systemic weaknesses in the accounting for restitution payments. The *Standards for Internal Control in the Federal Government* requires management to identify risks inherent in agency operations and enact internal controls to reduce the risk of error, waste, or wrongful acts or to reduce the risk of those going undetected.<sup>6</sup>

#### ***Restitution payments were not always applied to tax liabilities of convicted individuals***

Before the enactment of the Firearms Excise Tax Improvement Act of 2010, the IRS was legally prohibited from assessing the amount of restitution ordered on a convicted individual's tax account until a tax assessment was established through the examination process. However, the examination process is almost always suspended during the criminal investigation and court

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<sup>6</sup> Government Accountability Office, GAO/AIMD-00-21.3.1, (November 1999).



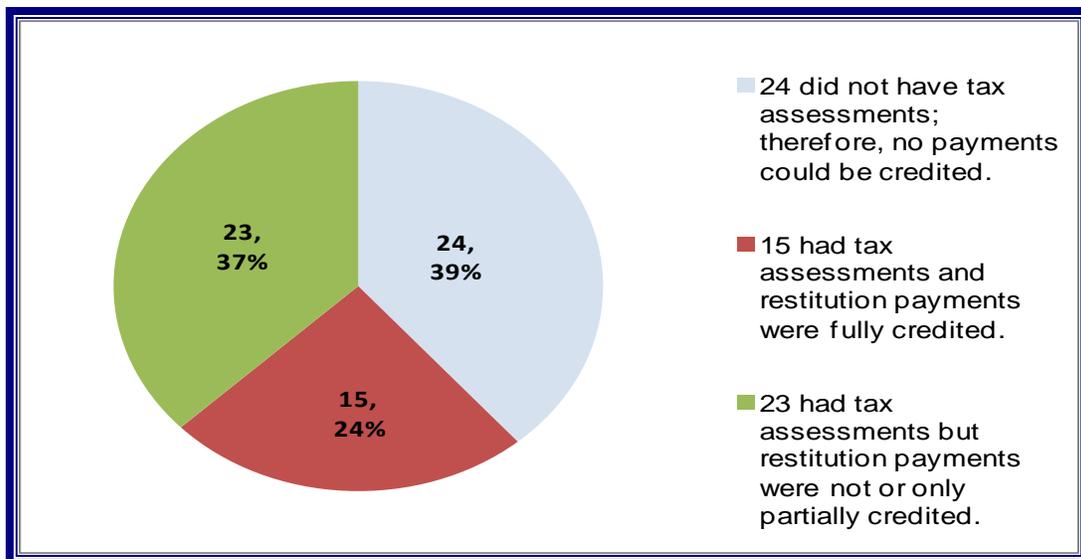
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proceedings. The suspension of the examination often resulted in a tax assessment not being made until well after a convicted individual was sentenced. However, after sentencing, some convicted individuals immediately begin to make restitution payments to the IRS. When this happens, the payments cannot be applied to the convicted individual's tax account until the examination is completed and the tax assessment is established. These payments are deposited to the Miscellaneous Revenue Account.

An analysis of restitution payments showed some restitution paid to the IRS over the years remains credited to the Miscellaneous Revenue Account. Reasons for this include the length of time it may take to complete an examination or, once the examination is completed, the W&I Division's Accounting Unit (hereafter referred to as the Accounting Unit), which processes all restitution payments, is not always notified that an assessment has been made and restitution payments should be moved to the convicted individual's tax account.

To determine if the IRS completed the examinations, made the tax assessments, and properly applied the payments to convicted individuals' tax accounts, we selected a judgmental sample of 90 restitution payments made by convicted individuals from a population of 11,775 payments received from defendants during FYs 2007 through 2009. Our research showed the 90 payments were made by 62 convicted individuals. We reviewed each of the 62 convicted individuals' tax accounts and, as shown in Figure 2, found that for 15 (24 percent) of them, the IRS made a tax assessment and the restitution payments had been fully credited.

**Figure 2: Results of Sample for Tax Assessment Made and Restitution Payment Credited**



Source: TIGTA's review of a sample of convicted individuals' tax account data.



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We also determined that CI did not always follow procedures to timely notify the Accounting Unit when a convicted individual was ordered to pay restitution to the IRS. Our results showed 53 (85 percent) of the 62 convicted individuals' sentencing information was not timely forwarded to the Accounting Unit.

In FY 2010, CI required the use of the Form 14104, *Notification of Criminal Restitution or Court Ordered Payments Payable to the IRS*,<sup>7</sup> to notify the Accounting Unit that a defendant had been sentenced and ordered to pay restitution. The instructions for Form 14104 state:

*It is crucial to notify all parties ... [of this information] so that a proper assessment can be timely made, if it has not ... already; collection can help monitor; and ... [the accounting unit] can properly post incoming payments. In order for restitution payments to be applied to ... tax liabilities, an assessment must be made. Otherwise the payments will be credited to a general account and could be refunded to the defendant if proper controls are not established.*

However, there are no procedures requiring Accounting Unit employees to:

- Follow up with CI when a restitution payment was received for a defendant for whom the Accounting Unit had not been notified that restitution was ordered.
- Complete subsequent research to identify if a tax assessment had been made to a convicted individual's tax account.

CI requires the use of Form 14104 and this is a good step toward improving the communication with the Accounting Unit and other necessary IRS functions. Equally important is the need for the Accounting Unit to follow up with CI and complete research to ensure restitution payments are correctly applied to tax accounts. When these steps are not completed, the IRS cannot effectively account for payments and monitor the defendant's compliance with sentencing ordered by the courts. This also prevents the IRS from being able to respond to defendants' inquiries regarding their restitution balances. In addition, the IRS is unable to routinely and accurately provide statements showing payments and outstanding restitution balances to defendants.

**Restitution payments were not always immediately associated with a defendant's tax account**

The Accounting Unit receives restitution payments from the courts in the form of U.S. Treasury checks. However, the IRS is not accurately accounting for defendant restitution payments because a longstanding issue had not been resolved regarding the absence of Personally Identifiable Information (PII), such as a full name and a Social Security Number (SSN). When a

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<sup>7</sup> Form 14104 includes the defendant's name, Social Security Number, total restitution ordered, the amount attributed to specific tax years, and any payment schedule.



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payment cannot be associated with a defendant, the Accounting Unit must deposit the funds into a Miscellaneous Revenue Account with a payee designation of “unknown,” partial name, or court docket number.<sup>8</sup>

The Working Group proposed restitution order language to help ensure the USAOs and the courts, as well as the defendants, provide the PII needed for the IRS to properly process and account for restitution payments. One provision in the language stipulates that with each payment to the court, the defendant provide his or her name, SSN, court docket number, and a request that the information be forwarded along with the payment to the IRS. In September 2009, the IRS issued a letter to the Administrative Office of the U.S. Courts (hereafter referred to as the Administrative Office) that included the following statement in an attempt to reiterate the importance of ensuring the PII be included on all checks: “In order to ensure that restitution payments are credited to the correct taxpayer account, it is important that the taxpayer’s full name and the court docket number be included on the check....”

Our analysis of the Accounting Unit’s database of restitution payments received during FYs 2007 through 2009 identified 3,379 (29 percent) of 11,775 payments still had “unknown” captured in the SSN field. We selected a judgmental sample of 83 payments from the 11,775 payments and determined that 63 (76 percent) of the payments did not have an SSN printed, and 32 (51 percent) of those 63 also did not have a full name printed.

***The IRS received 3,379 (29 percent) of 11,775 payments without sufficient PII to credit payments to defendants’ tax accounts.***

During a visit to the Accounting Unit, we determined the absence of the PII on U.S. Treasury checks continued to exist into FY 2010 because the IRS has been unable to convince the courts to change its process for submitting restitution payments. In addition, the IRS has not developed an effective alternative method for linking payments to defendants. The IRS stated that multiple attempts had been made to encourage the Administrative Office to direct the district courts to supply consistent and sufficient PII with payments. However, the Administrative Office advised the IRS that SSNs would no longer be included on checks. This action was pursuant to the recommendation of the Administrative Office’s General Counsel due to the growing emphasis in recent years on preventing the disclosure of PII. In addition, a new accounting system limited the printing space available on checks. While we understand the Administrative Office’s position on eliminating PII, including more than the defendant’s name on checks will help the IRS better associate the payment with the defendant to whom it should be credited.

The absence of sufficient defendant PII prevented the IRS from efficiently associating restitution payments with defendants’ tax accounts. As a result, the Accounting Unit must use additional employee resources to contact the applicable court to determine the defendant’s identity to

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<sup>8</sup> See Appendix V for the IRS Accounting Unit’s process for recording and depositing restitution payments received from the courts on behalf of defendants.



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ensure the payment is moved from the Miscellaneous Revenue Account and credited to the correct tax account.

**Restitution payments credited to the Miscellaneous Revenue Account were not adequately protected**

The IRS does not have effective internal controls to prevent issuing erroneous refunds when it receives restitution payments and a tax assessment has not yet been made to the convicted individual's tax account. For example, analysis of the 62 convicted individuals' tax accounts identified four who received erroneous refunds totaling \$282,470. In all four instances, the IRS received the payments but had not made a tax assessment to establish the tax liability. Shortly after the refunds were issued, \*\*\*\*\*1\*\*\*\*\*

***The IRS issued erroneous refunds totaling \$282,470 to four convicted individuals.***

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\*\*\*\*\*1\*\*\*\*\*  
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On May 27, 2010, we issued a memorandum to CI regarding \*\*\*\*\*1\*\*\*\*\*  
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**Management Actions:** \*\*\*\*\*1\*\*\*\*\*  
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The *Standards for Internal Control in the Federal Government* requires management to separate the key duties and responsibilities within a process of authorizing and reviewing transactions. However, there is no requirement in the Internal Revenue Manual (IRM) that a manager review and approve the transfer of payments from the Miscellaneous Revenue Account to a specific defendant's tax account. In addition, the IRS may systemically issue a refund if the restitution payment is transferred to a defendant's tax account that does not have a corresponding tax liability. As early as FY 2004, CI has been aware of the risks associated with defendants being issued erroneous refunds. For example, the Working Group acknowledged in its April 2004 paper that there had been instances of restitution payments being erroneously refunded to defendants. In addition, CI's June 30, 2010, Business Performance Review reflected the known



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risk of erroneous refunds: “...this amendment [the Legislative proposal to allow the IRS to assess restitution as a tax signed into law on August 16, 2010] would provide IRS with a better accounting of restitution payments and will help ensure that erroneous refunds are not disseminated to defendants.”

The passing of the legislation allowing the IRS to assess restitution as a tax will provide better accounting of restitution payments and should reduce the risk of erroneous refunds. However, passing the legislation does not eliminate the need for the IRS to ensure controls are in place to provide oversight of the millions of dollars in restitution payments that are susceptible to accounting and transfer errors and to prevent the issuance of erroneous refunds. Further, improving the communication among CI and IRS functions responsible for making tax assessments and processing restitution payments could reduce the use of staff resources required to research and monitor restitution payments deposited in the Miscellaneous Revenue Account. The absence of internal controls and guidelines requiring management approval makes these transactions vulnerable to misappropriation and the IRS at risk of issuing additional erroneous refunds.

### ***Recommendations***

The Chief, CI, should coordinate with the Commissioner, SB/SE Division, and the Commissioner, W&I Division, to:

**Recommendation 1:** Develop a process to routinely and accurately account for the amount of restitution ordered, restitution paid, and outstanding balances owed by defendants who had restitution ordered before the August 16, 2010, I.R.C. amendment.

**Management’s Response:** IRS management agreed with this recommendation. Policy and procedures will be developed to account for criminal restitution ordered, payments received, and outstanding balances owed by the defendants. The Accounting Unit will perform a review of the restitution General Ledger account every quarter to identify discrepancies in account activity. A report of the results will be provided to Submission Processing Headquarters for review and to resolve any discrepancies.

**Recommendation 2:** Ensure that, after the process is developed to accurately account for restitution paid by a defendant, an account statement is developed, including detail information on payments and outstanding balances, and mailed annually to defendants who had restitution ordered before the August 16, 2010, I.R.C. amendment.

**Management’s Response:** IRS management agreed with this recommendation. The Accounting Unit will work with CI to develop an annual notice reflecting the defendant’s outstanding balance due.



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**Recommendation 3:** Ensure that a process is negotiated with the Administrative Office that allows district courts nationwide to effectively provide necessary and consistent PII to the IRS, preferably the defendant's last name, first name, and court docket number, to associate restitution payments with specific defendants.

**Management's Response:** IRS management agreed with this recommendation. A process was negotiated with the Administrative Office to ensure that the district courts nationwide would provide identifiable information on the restitution check, including last name, first name, and court docket number. On October 17, 2011, a letter reiterating this process was sent to the Administrative Office. The Submission Processing Headquarters staff will request an updated quarterly listing from the Administrative Office and will provide the updated listing to the Accounting Unit for its use in contacting the U.S. Courts for obtaining additional PII.

**Recommendation 4:** Develop a process in the Accounting Unit to ensure employees take appropriate actions to obtain missing PII when the restitution payment cannot be associated with a specific defendant. This should also include the resolution of all previous restitution payments received with missing PII that were not applied to the defendant's tax account.

**Management's Response:** IRS management agreed with this recommendation. Policies and procedures will be updated for Submission Processing Headquarters to obtain a quarterly contact list from the Administrative Office. The list will be provided to the Accounting Unit and will be used to obtain missing PII associated with restitution checks that currently cannot be traced to a specific defendant. This additional information will allow the payments to be properly credited to the defendant's tax account.

**Recommendation 5:** Strengthen internal controls to ensure adequate separation of duties in the Accounting Unit regarding the preparation, review, and authorization of transactions that transfer funds from Miscellaneous Revenue Accounts to a defendant's tax account. This process should include requirements for the Accounting Unit to consult with CI in the resolution of inquiries regarding the accuracy of restitution payments and outstanding balances reported by defendants.

**Management's Response:** IRS management agreed with this recommendation. Current procedures require that the manager review and initial the credit transfer Form 2424, *Account Adjustment Voucher*. This is done to ensure that the individual who performs the journal entry on the Redesign Revenue Accounting Control System is not the same individual who initiated the adjustment request. The current process provides a clear separation of duties in initiating, reviewing, and journalizing the Form 2424. Existing procedures also require that the Accounting Unit consult CI in resolving questions of accuracy involving restitution payments and outstanding balances.



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**Recommendation 6:** Complete a comprehensive review of all tax accounts of defendants with restitution ordered before the August 16, 2010, I.R.C. amendment to determine whether the IRS has misapplied or erroneously refunded restitution payments.

**Management's Response:** IRS management agreed with this recommendation. The Accounting Unit will complete a comprehensive review of all accounts of defendants with restitution ordered prior to the August 16, 2010, I.R.C. amendment to determine if the payments were accurately applied to the appropriate taxpayer accounts.

### ***Steps Can Be Taken to Improve the Monitoring of Defendants' Adherence to Conditions of Probation and Restitution***

Despite an increased emphasis over the past several years, inconsistencies continue to exist in the IRS's efforts to monitor defendants' compliance with conditions of probation and restitution. The *Standards for Internal Control in the Federal Government* requires that monitoring should assess the quality of performance over time and include comparisons and reconciliations of records and data in management information systems. Transactions should be properly recorded to maintain their relevance and value to management in controlling operations and making decisions.

#### **Conditions of probation and restitution were not always included in the CIMIS**

The accuracy of restitution information entered in the CIMIS by CI field office employees is critical because it includes the defendants' conditions of probation and restitution that require monitoring. Guidance provided to CI employees states that coordinating and sharing this information among the CI's Scheme Development Center Refund Fraud Restitution Unit (hereafter referred to as the Restitution Unit) and the SB/SE Division's Examination and Collection functions is essential. These functions use electronic tools and monitoring logs to track defendants' adherence to conditions of probation and restitution and the status of any IRS enforcement actions taken.

We reviewed a judgmental sample of 40 defendants from a population of 1,831 defendants sentenced during FYs 2007 through 2009 to determine if restitution orders were correctly input in the CIMIS. Our results showed that six of the 40 defendants' restitution orders were not recorded in the CIMIS. We discussed these six defendants with CI and were provided information which showed five of the six appealed their sentences. CI procedures state that the amount of restitution ordered is not to be entered into the CIMIS until the court appeal process is completed or has expired. The remaining defendant did not file an appeal; however,

***A sample of restitution orders from FYs 2007 through 2009 showed one for \$173,267 was not included in the CIMIS.***



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restitution ordered totaling \$173,267 was not entered into the CIMIS until 17 months after sentencing.

When employees do not ensure conditions of probation and restitution are properly input into the CIMIS, CI and IRS functions cannot effectively monitor defendants' adherence to conditions of probation and restitution. If defendants are not meeting their conditions of probation, the period of supervised release could expire without the IRS having any recourse to collect the restitution. In addition, waiting until the adjudication of any appeal process to enter the conditions of probation or restitution to the CIMIS makes the system susceptible to the omission of information.

**Accurate information was not always reflected in the Restitution Unit's database used to monitor restitution payments**

The Accounting Unit and the Restitution Unit each use a separate stand-alone database to track defendant data for different purposes; nevertheless, the information in both databases must be accurate and consistent. The Accounting Unit is responsible for recording all restitution payments received from defendants. The Restitution Unit is responsible for monitoring only convicted tax return preparers' compliance with their conditions of probation and restitution because more complex monitoring is required than that for the convicted individuals who are monitored by the SB/SE Division.

To determine if convicted tax return preparers' payments were monitored by the Restitution Unit, we reviewed a judgmental sample of 33 payments from a population of 11,775 payments during FYs 2007 through 2009 that were recorded in the Accounting Unit's monitoring database. Our research showed the 33 payments were made by 28 convicted tax return preparers whose total payments were \$310,919. We determined that payments made by 24 of the convicted tax return preparers totaling \$156,805 (50 percent) were reflected in the Accounting Unit's database but were not reflected in the Restitution Unit's database. The IRS received some of these payments dating back to FY 2008.

***A sample of restitution payments from FYs 2007 through 2009 totaling \$156,805 were not monitored by the Restitution Unit.***

Once the Restitution Unit begins monitoring a convicted tax return preparer, guidelines require a letter be issued to provide a telephone number and IRS point of contact to answer any questions. In addition, the IRS should provide status of account letters when convicted taxpayers contact the IRS to inquire about submitted payments or outstanding balances. For the 28 convicted tax return preparers in our sample, the IRS issued 17 (61 percent) status letters. However, our analysis showed the outstanding balance in the status letter was incorrect for 10 (59 percent) of the 17 convicted tax return preparers because not all restitution payments were reflected in the Restitution Unit's database.



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There was not an effective process for the Accounting Unit to notify the Restitution Unit that convicted tax return preparers had made restitution payments to the IRS. For example, our results showed that when payments were received by the Accounting Unit, the Restitution Unit may not have become aware of the payments until months or, as in some instances in our sample, years after receipt.

In FY 2010, the Restitution Unit obtained access to the Accounting Unit’s database to research payment information. We agree this is a good step, but the absence of internal controls to ensure the Restitution Unit is aware of payments received by the Accounting Unit and the use of duplicative monitoring systems will continue to increase the chance of errors and prevent the IRS from providing accurate account balances to convicted tax return preparers. We are not making a recommendation regarding the accuracy of restitution payment and account balance information because Recommendations 1 and 2 address these issues.

**Restitution Unit monitoring efforts created complicated accounting procedures that increase the risk of issuing erroneous refunds**

The Restitution Unit does not have effective internal controls to monitor convicted tax return preparers who were ordered by the courts to pay restitution. Prior to and for part of FY 2009, the Restitution Unit used a complicated accounting procedure to monitor and account for restitution ordered for convicted tax return preparers involved in refund schemes. This procedure requires Restitution Unit employees to input a series of “dummy” transactions equaling the restitution amount to the tax account of the convicted tax return preparer. The use of this procedure increased the risk that erroneous refunds could be systematically generated.

Because a tax return preparer scheme can involve a large number of tax returns where the individual taxpayer may or may not be involved in the scheme, it is critical that the IRS have an effective process for monitoring restitution payments and outstanding balances to ensure the guilty parties are not issued any erroneous refunds. During our review of the judgmental sample of 28 convicted tax return preparers detailed in the previous section, we determined that this

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Based on these results, we expanded our judgmental sample to review an additional six convicted tax return preparers for which the Restitution Unit used the complicated accounting procedure. \*\*\*\*\*1\*\*\*\*\* \*

\*\*\*\*\*1\*\*\*\*\*. According to Restitution Unit guidelines, a “freeze” code should be entered on the tax account to prevent the computer system from systemically generating a refund. \*\*\*\*\*1\*\*\*\*\*  
\*\*\*\*\*1\*\*\*\*\*  
\*\*\*\*\*1\*\*\*\*\*.



*Procedures Are Needed to Improve the Accounting and Monitoring of Restitution Payments to Prevent Erroneous Refunds*

In October 2010, we brought the \*\*\*\*\* 1 \*\*\*\*\* ,  
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\*\*\*\*\* 1 \*\*\*\*\*  
\*\*\*\*\* 1 \*\*\*\*\* .

**Management Actions:** \*\*\*\*\* 1 \*\*\*\*\* ,  
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The complicated accounting procedure was not used for all convicted tax return preparers but, when asked, Restitution Unit officials could not explain the criteria used to make a determination of when or when not to use this procedure. During FY 2009, the Restitution Unit stopped using this accounting procedure, but a decision has not been made as to whether the procedure will be used in the future as a way to monitor and control the tax accounts of convicted tax return preparers. As of April 2010, the IRS’s financial accounting system showed this accounting procedure affected the tax accounts of 405 convicted tax return preparers representing \$16.4 million in restitution ordered. It is possible that erroneous refunds could still be generated from these accounts. We believe if this process is considered for reinstatement, strong internal controls must be established to safeguard against the issuance of erroneous refunds to convicted tax return preparers and taxpayers involved in the refund scheme.

**The SB/SE Division does not have an effective process for monitoring convicted individuals’ adherence to conditions of probation and restitution**

The SB/SE Division’s Examination and Collection functions are responsible for monitoring convicted individuals’ compliance with restitution orders. The SB/SE Division is required to provide a 180-calendar day memorandum to notify CI that convicted individuals’ probationary period will expire in six months and also outline whether the conditions of probation and restitution were met. We selected a judgmental sample of 53 convicted individuals from a population of 2,363 in the CIMIS who were sentenced with conditions of probation and restitution during FYs 2007 through 2009. We determined that the SB/SE Division was not consistently providing the 180-calendar day memorandum to CI. Results of our review showed that for 31 of the 53 convicted individuals, SB/SE Division employees were not required to notify CI because the probationary period expiration date was still greater than six months. For the remaining 22 convicted individuals, we found:



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- For 15 (68 percent), 180-calendar day memorandums were sent to CI.
- For seven (32 percent), 180-calendar day memorandums were not sent to CI. However, there was evidence in the files that the SB/SE Division was actively monitoring some of the convicted individuals' adherence to conditions of probation and restitution.

In August 2009, the SB/SE Division Collection function's IRM was revised to specifically state that Collection employees should not wait until the 180-calendar day memorandum was due to report defendant noncompliance, but instead should report it as soon as the noncompliance is discovered. The Collection function's IRM clarifies that the requirement to immediately report defendant noncompliance is in addition to the 180-calendar day memorandum requirement. However, the SB/SE Division Examination function's IRM was not revised to include the immediate notification procedure.

We also reviewed a judgmental sample of 41 convicted individuals from a population of 597 convicted individuals in the CIMIS in which the conditions of probation and restitution expired in FY 2009. We found that 21 of the 41 convicted individuals met the conditions of probation and restitution and that three actually had no conditions of probation and restitution ordered by the courts even though the CIMIS data indicated otherwise. For the remaining 17 convicted individuals who did not meet conditions of probation and restitution before the probationary period expired, we found:

- For 11 (65 percent), SB/SE Division personnel or the USAO determined the convicted individual would not be pursued based on inability to pay what was owed.
- For six (35 percent), SB/SE Division personnel were reviewing these convicted individuals to determine the appropriate enforcement action; however, the probationary period expired before action could be taken.

We believe the Examination function waiting to notify CI until 180 calendar days remain on the probationary period may not allow adequate time for CI to effectively follow up with the USAO to determine if further court action is warranted. Even though the IRS has 10 years to collect assessed tax debts, enforcement of the conditions of probation and restitution ordered is an important tool because if the restitution is not timely paid, the IRS can petition the court to re-sentence a defendant for nonpayment.

## ***Recommendations***

***Recommendation 7:*** The Chief, CI, should strengthen controls to ensure information is timely and correctly entered into the CIMIS as soon as the IRS is notified of the conditions of probation and restitution.



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**Management's Response:** IRS management partially agreed with this recommendation. CI believes that existing controls ensure that information is accurately and timely entered into the CIMIS. However, CI will reemphasize the importance of entering investigative updates by issuing a memorandum to all Special Agents in Charge.

The Chief, CI, should coordinate with the Commissioner, SB/SE Division, and the Commissioner, W&I Division, to:

**Recommendation 8:** Develop and implement a plan to assess the relative costs and benefits of creating a single, shared database that both the Restitution Unit and the Accounting Unit can use to ensure accurate data are available to both units. The results of the assessment should be used to determine whether the benefits would justify the costs to develop the database. If developing a single database is not beneficial, an automated process should be developed to routinely compare information in the two existing databases to ensure current and accurate data are shared between the units.

**Management's Response:** IRS management agreed with this recommendation that a single shared database will improve the accuracy and efficiency of work performed by the Restitution Unit and the Accounting Unit. Both Units have already obtained access to the shared database application.

**Recommendation 9:** Strengthen controls to ensure a freeze code is immediately entered by the Restitution Unit on the tax accounts of defendants ordered to pay restitution. In addition, the tax accounts of defendants ordered to pay restitution should be reviewed to ensure a freeze code is in place on the tax account.

**Management's Response:** IRS management agreed with this recommendation. CI has already strengthened controls by: 1) designating specific personnel within the Restitution Unit to place and monitor freeze controls on defendants' accounts, 2) requiring that freeze codes be placed on the respective defendants' accounts within 48 hours of receipt of the proper forms, and 3) reviewing monthly and quarterly reports to ensure that all defendants' accounts have been properly marked with the appropriate freeze codes.

**Recommendation 10:** Revise the SB/SE Division Examination function's IRM to ensure that CI is notified immediately of a defendant's noncompliance with conditions of probation and restitution. The revision should also clarify that the immediate notification is in addition to the current 180-calendar day memorandum requirement.

**Management's Response:** IRS management agreed with this recommendation. Current procedures will be revised to clarify that CI will be immediately notified of noncompliance in addition to the current 180-calendar day memorandum requirement.



### Use of Tax Refund Offsets to Collect Restitution Is Inconsistently Applied to Defendants

The Restitution Unit uses the refund offset procedure to keep refunds of convicted tax return preparers who owe restitution to the IRS; however, the refund offset procedure is not used for convicted individuals. The refund offset is a statutory or common law tool the IRS is allowed to use to retain tax refunds as payments toward, among other things, outstanding tax liabilities. Our research of the Restitution Unit database for a 20-year period (April 1990 through April 2010) showed the IRS offset 925 tax refunds of convicted tax return preparers totaling approximately \$1.5 million.

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However, since the use of the Treasury Offset Program was not mandated, CI chose to continue using the common law right of offset for convicted tax return preparers only. By not offsetting refunds for all defendants who owe restitution, the IRS may be missing opportunities to use its authority to offset refunds as a tool to collect restitution payments.

### Recommendation

**Recommendation 11:** The Chief, CI, should obtain a comprehensive Office of Chief Counsel opinion to determine whether the IRS should use the Treasury Offset Program before the common law right of offset to retain refunds as restitution payments. The opinion should also determine if the use of either refund offset can be applied to convicted individuals as well as convicted tax return preparers. If so, procedures should be established to ensure that the appropriate refund offset procedures are consistently used.

**Management's Response:** IRS management agreed with this recommendation.

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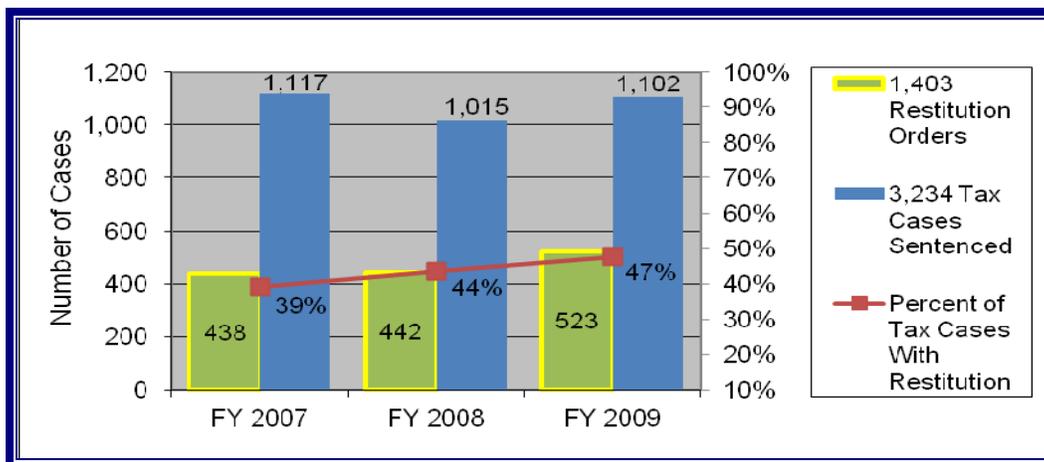
## Procedures Are Needed to Improve the Accounting and Monitoring of Restitution Payments to Prevent Erroneous Refunds

### Restitution for Unpaid Taxes Was Not Always Granted in Sentences Where It Appeared to Be Warranted

CI considers including restitution as part of a plea agreement to be an effective method to facilitate the defendant's cooperation in the settlement of the court case. CI guidance requires that special agents emphasize the importance of restitution to the USAO and report the amount of any restitution on the Form 13308, *Criminal Investigation Closing Document*, after a defendant is sentenced. To determine if restitution might have been appropriate in the sentencing, we reviewed court documents, public information, and CIMIS data for a judgmental sample of 23 defendants from a population of 1,831 defendants sentenced without restitution during FYs 2007 through 2009.

Our results showed nine (39 percent) of the 23 defendants had underreported income totaling \$23 million that we believe are good examples in which restitution could have been imposed as part of the sentence. In addition, as presented in Figure 3, our analysis of the CIMIS data showed that less than 50 percent of all tax-related court cases resulted in sentences with restitution.

**Figure 3: FYs 2007 Through 2009  
Frequency of Restitution in Tax-Related Sentences**



Source: Data from CI's CIMIS.

CI officials advised us that their influence in obtaining restitution in court sentences is limited because the USAO has the final decision whether to recommend to the courts that a defendant should be ordered to pay restitution. However, there are no requirements for special agents to explain in closing documents the reasons why the USAO chose not to pursue restitution in a tax-related prosecution. Providing the reasons for the absence of restitution on Form 13308 could provide CI an opportunity to ensure that special agents are encouraging restitution as part of the prosecution. Further, CI could trend court cases where restitution was sought, but not



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imposed, to identify practices favored by specific district courts which could be beneficial and increase the IRS's ability to encourage the DOJ to use restitution as a tool to reduce the Tax Gap.

### ***Recommendations***

The Chief, CI, should:

**Recommendation 12:** Modify procedures requiring special agents to explain, in CI closing documents, why restitution to the IRS was not obtained by the USAO or ordered by the courts.

**Management's Response:** IRS management agreed with this recommendation. CI is currently updating the Form 13308 as a result of the amendment to I.R.C. 6201(a)(4). This revised form will require an explanation as to why restitution was not ordered in cases where it is apparently appropriate.

**Recommendation 13:** Complete a comprehensive review of future tax-related sentences without restitution to identify trends and factors that hinder the IRS being granted restitution in sentences.

**Management's Response:** IRS management agreed with this recommendation. Once the revised Form 13308 is in use, CI will conduct a review of Forms 13308 for a period of six months and summarize the results.



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## **Appendix I**

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

The overall objective of this review was to determine whether defendants<sup>1</sup> convicted of tax-related crimes are held responsible for the payment of the taxes associated with the offenses they committed. We used judgmental sampling throughout this review because we did not plan to project our results. We relied on data from the CIMIS; however, we did not verify the reliability and accuracy of all data in the CIMIS due to resource constraints. In prior audits, our overall assessment has been that the CIMIS data are of undetermined reliability. In our opinion, using the data from the CIMIS did not weaken our analyses. We validated data pertaining to conditions of probation and restitution information in the CIMIS through the specific test included in this audit. To accomplish our objective, we:

- I. Evaluated and discussed national and local procedures with CI Headquarters and field office personnel to determine if CI has established internal controls, procedures, and processes to accomplish its FY 2010 Annual Business Plan. This includes setting operational priorities to work with other IRS operating divisions and DOJ prosecution, probation, and district court partners to effectively monitor and track compliance with conditions of probation and restitution.
- II. Determined if CI coordinates with the USAO and Probation Offices to ensure that conditions of probation and restitution were included in sentences for tax-related crimes when appropriate.
  - A. Analyzed CIMIS data for 1,831 defendants sentenced during FYs 2007 through 2009 who had no restitution amounts entered in the CIMIS. We reviewed a judgmental sample of 40 defendants, *i.e.*, 10 defendants each from the Los Angeles, California; Miami, Florida; and Philadelphia, Pennsylvania, field offices and an additional 10 defendants from among the highest estimated criminal tax deficiency amounts without restitution from the entire population (outside the selected field offices). We visited the three field offices to review files and to determine if there was an explanation why the sentencing did not include restitution.
  - B. Researched various sources and court documents to verify the sentence given the defendant.
  - C. Reviewed available information for a judgmental sample of 23 out of 1,831 defendants sentenced during FYs 2007 through 2009 who had no restitution

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<sup>1</sup> See Appendix VIII for a glossary of terms.



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- amounts entered in the CIMIS to determine if restitution appeared to have been appropriate and the potential effect of its omission.
- D. For any defendants in the samples who had conditions of probation and restitution that were not recorded in the CIMIS, determined if the sentence was monitored for compliance by verifying if restitution was documented in the Accounting Unit's and Restitution Unit's monitoring records and databases.
- III. Determined if CI coordinated with the SB/SE and W&I Divisions to effectively monitor defendants' compliance with conditions of probation and restitution contained in sentences for tax-related crimes.
- A. Analyzed CIMIS data for 2,363 convicted individuals sentenced during FYs 2007 through 2009 for whom there was a probationary period expiration date entered in the database.
1. Reviewed a judgmental sample of 53 convicted individuals' files selected from the three field offices we visited to evaluate court documents and other pertinent documentation to verify that the convicted individual was included in the monitoring process.
  2. Determined if the 180-calendar day memorandum was prepared before the expected probationary period expiration dates as appropriate.
  3. Determined if noncompliance with conditions of probation and restitution was promptly reported between CI and the SB/SE Division Examination and Collection functions.
- B. Analyzed CIMIS data for 597 convicted individuals for whom conditions of probation expired during FY 2009. We reviewed a judgmental sample of 41 convicted individuals from the three field offices we visited to determine if there was evidence to verify whether the conditions of probation and restitution payments were met.
- C. Interviewed all CI and SB/SE Division Condition of Probation Coordinators in the three field offices visited to identify the procedures used to monitor conditions of probation and restitution.
- D. Interviewed two CI managers in each of the three field offices visited to determine what emphasis is placed on monitoring sentences with conditions of probation and restitution.



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- IV. Determined whether payments of restitution forwarded to the IRS were properly accounted for and protected from inadvertent refund, misapplication, or misappropriation.
- A. Analyzed Accounting Unit data for 11,775 payments received by the IRS during FYs 2007 through 2009.
  - B. Evaluated the effectiveness of internal controls in place to monitor restitution payments made by defendants.
    - 1. Conducted a walk-through of the Kansas City Campus Accounting Unit and Ogden Campus Restitution Unit monitoring systems.
    - 2. Reviewed documentation maintained in remittance/account folders for a judgmental sample of 33 payments (made by 28 convicted tax return preparers) to ensure payments were monitored and recorded. Based on our results, we expanded our judgmental sample to review an additional six convicted tax return preparers for whom the Restitution Unit used the complicated accounting procedure.
    - 3. Reviewed a judgmental sample of 90 payments (made by 62 convicted individuals) to determine if CI notified IRS functions that a convicted individual had been sentenced and ordered to pay restitution. For each convicted individuals' tax accounts, we determined if the IRS completed the examination, made tax assessments to establish a tax liability, and applied payments to the tax accounts.
    - 4. Evaluated the process for using the refund offset to make restitution payments.
  - C. Evaluated the characteristics of incoming restitution remittances in each location.
    - 1. Observed and reviewed all sources of restitution payments, *i.e.*, Clerk of Court, Probation Office, and IRS offices.
    - 2. Reviewed a judgmental sample of 83 out of 11,775 payments to determine if the payments contained the PII needed to process restitution payments received from the courts.
    - 3. Evaluated the process used by the Accounting Unit to identify defendants when restitution checks received from the courts do not have sufficient PII.
  - D. Evaluated existing internal controls and determined if the identified weaknesses increased the risk of fraud, *i.e.*, misapplication or misappropriation of funds.



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**Internal controls methodology**

Internal controls relate to management's plans, methods, and procedures used to meet their mission, goals, and objectives. Internal controls include the processes and procedures for planning, organizing, directing, and controlling program operations. They include the systems for measuring, reporting, and monitoring program performance. We determined the following internal controls were relevant to our audit objective: CI's policies, procedures, and practices relating to conditions of probation and restitution. We evaluated these controls by interviewing CI, SB/SE Division, and W&I Division employees; analyzing data related to investigations with conditions of probation and restitution; and reviewing the IRS's monitoring procedures.



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## **Appendix II**

### *Major Contributors to This Report*

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Janis Zuika, Senior Auditor



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**Appendix III**

*Report Distribution List*

Commissioner C  
Office of the Commissioner – Attn: Chief of Staff C  
Deputy Commissioner for Services and Enforcement SE  
Commissioner, Small Business/Self-Employed Division SE:S  
Commissioner, Wage and Investment Division SE:W  
Deputy Chief, Criminal Investigation SE:CI  
Deputy Commissioner, Small Business/Self-Employed Division SE:S  
Deputy Commissioner of Operations, Wage and Investment Division SE:W  
Director, Collection-Field, Small Business/Self-Employed Division SE:S:C  
Director, Examination, Small Business/Self-Employed Division SE:S:E  
Director, Fraud/Bank Secrecy Act, Small Business/Self-Employed Division SE:S:F/BSA  
Director, Refund Crimes, Criminal Investigation SE:CI:RC  
Director, Strategy, Criminal Investigation SE:CI:S  
Director, Submission Processing, Wage and Investment Division SE:W:CAS:SP  
Field Director, Submission Processing (Kansas City), Wage and Investment Division  
SE:W:CAS:SP:KC  
Chief Counsel CC  
National Taxpayer Advocate TA  
Director, Office of Legislative Affairs CL:LA  
Director, Office of Program Evaluation and Risk analysis RAS:O  
Office of Internal Control OS:CFO:CPIC:IC  
Audit Liaisons:  
Deputy Commissioner for Services and Enforcement SE  
Director, Planning and Strategy, Criminal Investigation SE:CI:S:PS  
Chief, GAO/TIGTA/Legislative Implementation, Small Business/Self-Employed  
Division SE:S:CLD:PSP:GTL  
Chief, Program Evaluation and Improvement, Wage and Investment Division  
SE:W:S:PRA:PEI



*Procedures Are Needed to Improve the Accounting and Monitoring of Restitution Payments to Prevent Erroneous Refunds*

**Appendix IV**

*Outcome Measures*

This appendix presents detailed information on the measurable impact that our recommended corrective actions will have on tax administration. These benefits will be incorporated into our Semiannual Report to Congress.

**Type and Value of Outcome Measure:**

- Revenue Protection – Actual; \*\*\*\*\*1\*\*\*\*\*  
\*\*\*\*\*1\*\*\*\*\* (see page 4).

**Methodology Used to Measure the Reported Benefit:**

We selected a judgmental sample of 90 payments (made by 62 convicted individuals) from a population of 11,775 payments made during FYs 2007 through 2009 that were recorded in the Accounting Unit’s monitoring database. For each convicted individuals’ tax account, we determined if the IRS completed the examination, made tax assessments to establish a tax liability, and applied payments to the tax accounts. We identified four convicted individuals who received erroneous refunds totaling \$282,470 which represented restitution payments that were previously paid to the IRS. The erroneous refunds occurred because the IRS had not made a tax assessment to the convicted individuals’ tax account. Analysis of the tax accounts showed \*\*1\*  
\*\*\*\*\*1\*\*\*\*\*  
\*\*\*\*\*1\*\*\*\*\*.

**Type and Value of Outcome Measure:**

- Revenue Protection – Actual; 16 taxpayers and \*\*\*\*\*1\*\*\*\*\*  
\*\*\*\*\*1\*\*\*\*\* (see page 11).

**Methodology Used to Measure the Reported Benefit:**

We selected a judgmental sample of 33 payments (made by 28 convicted tax return preparers) from a population of 11,775 payments made during FYs 2007 through 2009 that were recorded in the Accounting Unit’s monitoring database to ensure restitution payments were recorded and being monitored. \*\*\*\*\*1\*\*\*\*\*  
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\*\*\*\*\*1\*\*\*\*\*  
\*\*\*\*1\*\*\*\*\*, we expanded our judgmental sample to review an additional six convicted tax return preparers where the complicated accounting procedure was also used. We



*Procedures Are Needed to Improve the Accounting and Monitoring of Restitution Payments to Prevent Erroneous Refunds*

identified \*\*\*\*\*1\*\*\*\*\*  
\*\*\*\*\*1\*\*\*\*\*  
\*\*\*\*\*1\*\*\*\*\*  
\*\*\*\*\*1\*\*\*\*\*  
\*\*\*\*\*1\*\*\*\*\*  
\*\*\*\*\*1\*\*\*\*\*.

**Type and Value of Outcome Measure:**

- Reliability of Information – Actual; the IRS had \*\*\*\*\*1\*\*\*\*\* \$330,072 \*\*\*\*\*1\*\*\*\*\* and 24 convicted tax return preparers sentenced to pay restitution in its monitoring systems (see page 11).

**Methodology Used to Measure the Reported Benefit:**

We reviewed a judgmental sample of 40 defendants from a population of 1,831 who were sentenced during FYs 2007 through 2009 to determine if the defendants’ conditions of probation and restitution were correctly input to the CIMIS. We identified \*\*\*\*\*1\*\*\*\*\* \*\*\*\*\*1\*\*\*\*\*.

We also reviewed a judgmental sample of 33 payments, made by 28 convicted tax return preparers, from a population of 11,775 payments made during FYs 2007 through 2009 that were recorded in the Accounting Unit’s monitoring database to determine if payments were also recorded and monitored in the Restitution Unit’s database. We then identified all the restitution payments made by the 24 convicted tax return preparers, which totaled \$310,919. Analysis of these payments showed that \$156,805 (50 percent) of the \$310,919 restitution payments made by 24 of the 28 convicted tax return preparers were reflected in the Accounting Unit’s database, but were not reflected in the Restitution Unit’s database.

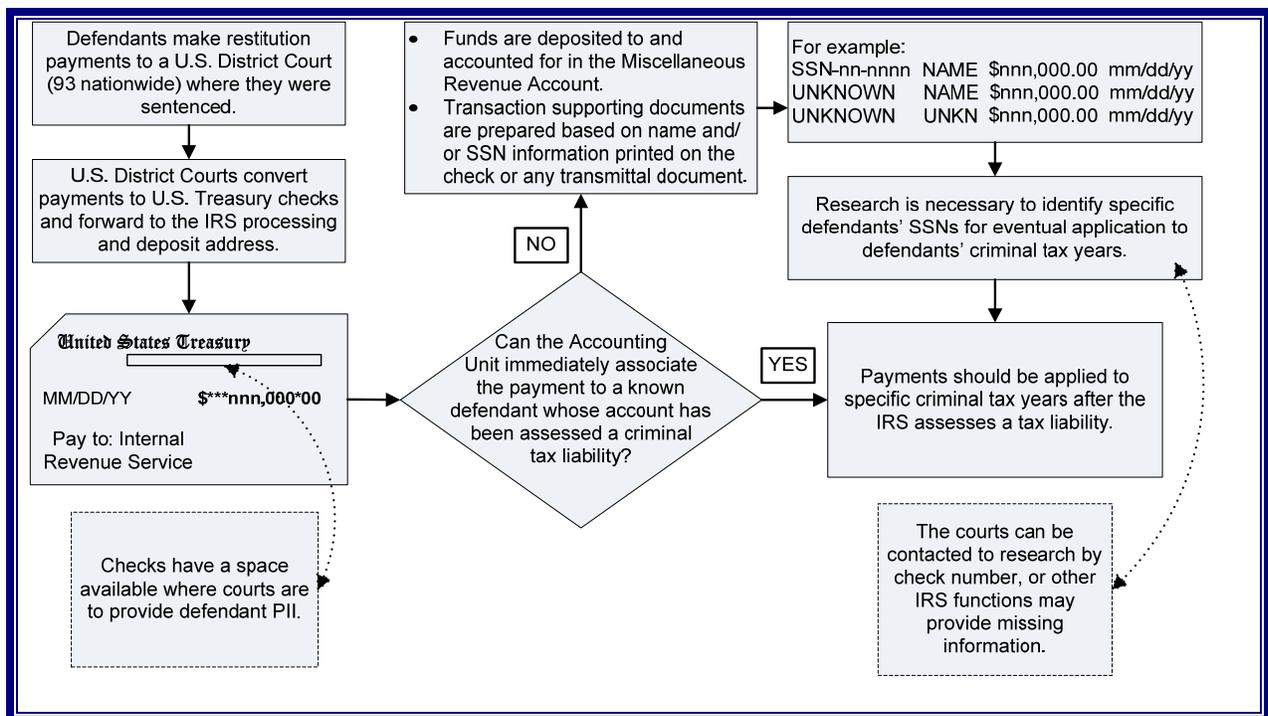


Appendix V

Accounting Unit's Process to Account for Restitution Payments

All restitution paid to the IRS is processed by one designated IRS W&I Division Accounting Unit that receives payments from the courts in the form of U.S. Treasury checks. Figure 1 shows the IRS's Accounting Unit process for recording and depositing restitution payments received from the courts on behalf of defendants.

Figure 1: Accounting Unit Steps for Processing Restitution Payments



Source: TIGTA's assessment of the IRS's Accounting Unit process for restitution payments.



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Monitoring of Restitution Payments to Prevent Erroneous Refunds*

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**Appendix VI**

*Audit Alert Memorandum –*

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**Appendix VII**

*Audit Alert Memorandum –*

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## Appendix VIII

### *Glossary of Terms*

**Accounting Unit** – IRS function responsible for recording and monitoring restitution payments received from defendants and convicted tax return preparers.

**Assess/Assessment** – The statutorily required recording of a tax liability. This generally happens when the IRS determines the taxpayer owed more taxes than reported on the tax return.

**Campus** – 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.

**Common Law Right of Offset** – Right of offset is the common-law right of every creditor to recover a debt owed through a deduction from an amount the creditor is due to pay the debtor.

**Convicted Individual** – In the context of this report, an individual (or business owner) sentenced for an individual tax-related crime where only his or her own tax return or tax account is affected.

**Convicted Tax Return Preparer** – In the context of this report, a tax return preparer found guilty of a tax-related refund scheme. These refund schemes can involve a large number of tax returns where the individual taxpayer(s) whose return(s) was used in the scheme may or may not be involved in the scheme.

**Criminal Investigative Management Information System (CIMIS)** – A database that is used by CI to track the status and progress of investigations and the time expended by special agents.

**Defendant** – In the context of this report, defendant is defined to include both individual taxpayers who were convicted of a tax-related crime (referred to as “convicted individuals”) and tax return preparers who were convicted of a tax-related refund scheme (referred to as “convicted tax return preparers”).

**Docket Number** – Unique identifying number assigned by a court to a specific court case. The docket is a log containing the complete history of each court case in the form of brief chronological entries summarizing the court proceedings.

**Erroneous Refund** – Incorrect refunds issued to taxpayers due to processing errors, misapplied payments, incorrect tax adjustments, taxpayers filing fraudulent tax returns, or using an incorrect Taxpayer Identification Number.



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**Fiscal Year** – A 12-consecutive-month period ending on the last day of any month, except December. The Federal Government’s fiscal year begins on October 1 and ends on September 30.

**Internal Revenue Code** – Federal tax law enacted by Congress in Title 26 of the United States Code (26 U.S.C.). It is the codified collection of U.S. laws on income, estate and gift, employment and excise tax, plus administrative and procedural provisions.

**Levy** – A levy generically refers to seizure of property to collect a debt. For tax debts, it is the legal process by which the IRS orders a third party to turn over property in its possession, *e.g.*, the Federal Government payment, that belongs to the tax debtor.

**Lien** – Under 26 U.S.C. Section 6321 (Supp IV. 2010), the IRS has the authority to attach a claim to the taxpayer’s assets for the amount of unpaid tax when the taxpayer neglects or refuses to pay.

**Personally Identifiable Information** – A combination of taxpayer information used to uniquely identify a person, *i.e.*, name, SSN, and address.

**Probation** – Sentencing option in the Federal courts. With probation, instead of sending an individual to prison, the court releases the person to the community and orders him or her to abide by certain conditions and complete a period of supervision monitored by a probation officer.

**Probation Officer** – Officers of the Probation Office of a court. Probation officer duties include conducting pre-sentence investigations, preparing pre-sentence reports on defendants, and supervising released defendants.

**Prosecution** – The act of initiating civil or criminal court action against someone charged with a crime. A prosecutor tries a criminal court case on behalf of the Federal Government.

**Refund Offset** – A taxpayer’s overpayment applied to any outstanding Federal tax or various nontax obligations instead of crediting the overpayment to the taxpayer’s future tax or making a refund to the taxpayer.

**Restitution** – A legal remedy that can be ordered in a criminal court case. A restitution order requires the defendant to pay money to the victim(s) in order to compensate for the loss inflicted. It is generally imposed during sentencing as a condition of probation or supervised release in tax-related crimes.

**Restitution Unit** – IRS function responsible for monitoring only convicted tax return preparers’ compliance with their conditions of probation and restitution

**Sentence** – The punishment ordered by a court for a defendant convicted of a crime.

**Special Agents** – A law enforcement employee who investigates potential criminal violations of the Internal Revenue laws and related financial crimes.



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*Procedures Are Needed to Improve the Accounting and Monitoring of Restitution Payments to Prevent Erroneous Refunds*

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**Special Tax-Related Provisions** – Requirements included in criminal sentences, such as filing past due and current tax returns and paying or making arrangements to pay past due taxes.

**Supervised Release** – Term of supervision served after a person is released from prison. The court imposes supervised release during sentencing in addition to the sentence of imprisonment. Supervised release does not replace a portion of the sentence of imprisonment but is in addition to the time spent in prison. Probation officers supervise people on supervised release.

**Tax Case** – A criminal tax case involves tax offenses and tax-related offenses. A tax offense refers to criminal offenses under the I.R.C. Tax offenses include, but are not limited to, willful attempt to evade or defeat tax, willful failure to collect or pay over taxes, willful failure to file or failure to pay, and willfully making a false declaration under penalties of perjury or willfully assisting in the preparation of a false document.

**Tax Gap** – The difference between the amount taxpayers owe and the amount they voluntarily and timely paid for a tax year.

**Tax-Related** – A tax-related offense may fall under either Title 18 or Title 31 of the United States Code when the offense is associated with a tax crime or the offense impedes the administration of the Internal Revenue laws. Examples of tax-related offenses include, but are not limited to, false statements on a tax return; presenting a false, fictitious, or fraudulent claim for a refund; conspiracy to defraud the IRS; and willful violations of reporting requirements.

**Treasury Offset Program** – The Treasury Offset Program is a centralized offset program, administered by the Financial Management Service's Debt Management Services, to collect delinquent debts owed to Federal agencies and States (including past-due child support).

**United States Attorney** – A lawyer appointed in each judicial district to prosecute and defend court cases for the Federal Government. The U.S. Attorney employs a staff of Assistant U.S. Attorneys who appear as the Federal Government's attorneys in individual court cases.



*Procedures Are Needed to Improve the Accounting and Monitoring of Restitution Payments to Prevent Erroneous Refunds*

**Appendix IX**

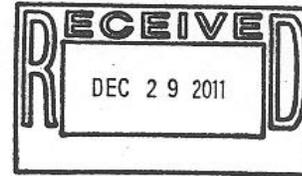
*Management's Response to the Draft Report*



Criminal Investigation

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

December 29, 2011



MEMORANDUM FOR DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM:

Victor S.O. Song *V.S.O.* *E. J. For*  
Chief, Criminal Investigation (SE:CI)

SUBJECT:

Response to Draft Audit Report— Procedures Are Needed to Improve the Accounting and Monitoring of Restitution Payments to Prevent Erroneous Refunds (Audit #201030031)

In order to ensure that criminal defendants do not escape responsibility for paying the taxes associated with the offenses for which they were convicted, Congress enacted the Firearms Excise Tax Improvement Act of 2010 (Internal Revenue Code section 6201(a)(4)). This law enabled the Internal Revenue Service to assess, as a tax, a restitution order that arises from a criminal conviction involving a defendant's failure to pay federal taxes.

The responsibility for implementation of this new law was designated to Examination, Technical Services. Four sub-teams were established to work on issues specific to their functional expertise. These teams consist of Criminal Investigation (IRS-CI) - Investigations and Enforcement Operations, Wage and Investment (W&I) – Kansas City Restitution Unit, Small Business and Self Employed (SBSE) – Examination (Field and Policy), and SBSE – Collection Advisory.

These teams, comprised of members from the impacted functional areas, have been addressing the needs of all stakeholders to establish and/or refine procedures and policies for:

- Processing a case containing criminal restitution, including establishing and defining the roles of IRS-CI, W&I and SBSE;
- Assessing tax in the amount of the restitution ordered, including transaction codes, reference codes, computation of interest and penalties, and additional civil-examination, if necessary;
- Collection actions permitted as a result of an assessment pursuant to an order of restitution; and,
- Issues unique to Questionable Refund Program (QRP) and Return Preparer Program (RPP) cases.

In the 14 months since the implementation of IRC 6201(a)(4), there have been approximately 800 cases closed by IRS-CI in which restitution was ordered payable to the IRS by the court.



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*Procedures Are Needed to Improve the Accounting and Monitoring of Restitution Payments to Prevent Erroneous Refunds*

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The following is the IRS' response to the above named report:

**IDENTITY OF RECOMMENDATION #1**

Develop a process to routinely and accurately account for the amount of restitution ordered, restitution paid, and the outstanding balances owed by defendants who had restitution ordered prior to the August 16, 2010, I.R.C. amendment.

**CORRECTIVE ACTION**

We agree with this recommendation. Policies and procedures will be developed to maintain and accurately account for criminal restitution ordered, payments received, and outstanding balances owed by the defendants who had restitution ordered. The Kansas City Submission Processing Center (KCSPC) Accounting Operation will perform a review of the restitution General Ledger account every quarter to identify discrepancies in account activity. A report of the results will be provided to Submission Processing (SP) Headquarters (HQ) for review and to resolve any discrepancies identified as a result of the quarterly review.

**IMPLEMENTATION DATE**

July 15, 2012

**RESPONSIBLE OFFICIAL**

Director, Submission Processing, Wage and Investment Division

**CORRECTIVE ACTION MONITORING PLAN**

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

**IDENTITY OF RECOMMENDATION #2**

Ensure that, after the process is developed to accurately account for restitution paid by a defendant, an account statement is developed, including detail information on payments and outstanding balances, and mailed annually to defendants who had restitution ordered prior to the August 16, 2010, I.R.C. amendment.

**CORRECTIVE ACTION**

We agree with this recommendation. The KCSPC Accounting Operation will work with IRS-CI to develop an annual notice reflecting the defendant's outstanding balance due.

**IMPLEMENTATION DATE**

July 15, 2012

**RESPONSIBLE OFFICIAL**

Director, Submission Processing, Wage and Investment Division



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*Procedures Are Needed to Improve the Accounting and Monitoring of Restitution Payments to Prevent Erroneous Refunds*

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**CORRECTIVE ACTION MONITORING PLAN**

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

**IDENTITY OF RECOMMENDATION #3**

Ensure that a process is negotiated with the Administrative Office of the U.S. Courts that allows district courts nationwide to effectively provide necessary and consistent Personally Identifiable Information (PII) to the IRS, preferably the defendant's last name, first name, and court docket number, to associate restitution checks with specific defendants.

**CORRECTIVE ACTION**

Communication by email and conference calls with two representatives from the Administrative Office of the U.S. Courts was conducted. A process was negotiated to ensure the district courts nationwide would provide necessary identifiable information on the restitution check, including last name, first name, and court docket number. A letter reiterating this was sent to the Administrative Office of U.S. Courts on October 17, 2011. The SP HQ staff will request an updated quarterly listing from the Administrative Office of the U.S. Courts, and will provide the updated listing to the Kansas City Submission Processing Center Accounting Operation for their use in contacting the U.S. Courts for obtaining additional Personally Identifiable Information (PII).

**IMPLEMENTATION DATE**

Implemented

**RESPONSIBLE OFFICIAL**

Director, Submission Processing, Wage and Investment Division

**CORRECTIVE ACTION MONITORING PLAN**

N/A

**IDENTITY OF RECOMMENDATION #4**

Develop a process in the Accounting Unit to ensure employees take appropriate actions to obtain missing PII when the restitution check cannot be associated with a specific defendant. This should also include the resolution of all previous restitution payments received with missing PII that were not applied to the defendant's tax account.

**CORRECTIVE ACTION**

We agree with this recommendation. Policies and procedures will be updated for SP HQ to obtain a quarterly contact list from the Administrative Office of the U.S. Courts. The list will be provided to the KCSPC Accounting Operation, and will be used to obtain any missing PII associated with restitution checks that cannot be traced to a specific defendant so that the payments can be credited to the defendant's tax account.

**IMPLEMENTATION DATE**

February 15, 2012



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*Procedures Are Needed to Improve the Accounting and Monitoring of Restitution Payments to Prevent Erroneous Refunds*

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**RESPONSIBLE OFFICIAL**

Director, Submission Processing, Wage and Investment Division

**CORRECTIVE ACTION MONITORING PLAN**

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

**IDENTITY OF RECOMMENDATION #5**

Strengthen internal controls to ensure there is adequate separation of duties in the Accounting Unit regarding the preparation, review, and authorization of transactions that transfer funds from Miscellaneous Revenue Accounts to a defendant's tax account. This process should include requirements for the Accounting Unit to consult with IRS-CI in the resolution of inquiries regarding the accuracy of restitution payments and outstanding balances reported by defendants.

**CORRECTIVE ACTION**

We agree with this recommendation. Current procedures require the credit transfer Form 2424, *Account Adjustment Voucher*, be reviewed and initialed by the manager to ensure that the individual who performs the journal entry on the Redesign Revenue Accounting Control System (RRACS) is not the same individual who initiates the adjustment request on Form 2424. The current process provides a clear separation of duties in initiating, reviewing and journalizing Form 2424. Existing procedures also require that the KCSPC Accounting Operation consult IRS-CI in resolving questions of accuracy involving restitution payments and outstanding balances. This corrective action was completed on October 29, 2010.

**IMPLEMENTATION DATE**

Implemented

**RESPONSIBLE OFFICIAL**

Director, Submission Processing, Wage and Investment Division

**CORRECTIVE ACTION (S) MONITORING PLAN**

N/A

**IDENTITY OF RECOMMENDATION #6**

Complete a comprehensive review of all tax accounts of defendants with restitution ordered prior to the August 16, 2010 I.R.C. amendment to determine whether the IRS has misapplied or erroneously refunded restitution payments

**CORRECTIVE ACTION**

We agree with this recommendation. The KCSPC Accounting Operation will complete a comprehensive review of all accounts of defendants with restitution ordered prior to the August 16, 2010 I.R.C. amendment to determine if the payments were accurately applied to the appropriate taxpayer accounts.

**IMPLEMENTATION DATE**

July 15, 2012



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*Procedures Are Needed to Improve the Accounting and Monitoring of Restitution Payments to Prevent Erroneous Refunds*

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5

**RESPONSIBLE OFFICIAL**

Director, Submission Processing, Wage and Investment Division

**CORRECTIVE ACTION MONITORING PLAN**

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

**IDENTITY OF RECOMMENDATION #7**

The Chief, IRS-CI, should strengthen controls to ensure information is timely and correctly entered into the CIMIS as soon as the IRS is notified of the conditions of probation and restitution.

**CORRECTIVE ACTION**

Criminal Investigation partially agrees with this recommendation. Criminal Investigation believes controls are in place to ensure that information in CIMIS is accurately and timely entered. Current IRS procedures, as specified in IRM 9.9.1.4 (1), dictate that all IRS-CI special agents input investigative updates on the same day the investigative action occurs, but no later than five calendar days following the action. However, IRS-CI will reemphasize the importance of entering investigative updates by issuing a memorandum to all Special Agents in Charge from the Director of Operations, Policy and Support (OPS), reminding all personnel of such updates, even when restitution orders have been or may be appealed.

**IMPLEMENTATION DATE**

March 15, 2012

**RESPONSIBLE OFFICIAL**

Director, Operations, Policy and Support, Criminal Investigation

**CORRECTIVE ACTION MONITORING PLAN**

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

**IDENTITY OF RECOMMENDATION #8**

Develop and implement a plan to assess the relative costs and benefits of creating a single, shared database that both the Restitution Unit and Accounting Unit can use to ensure accurate data is available to both units. The results of the assessment should be used to determine whether the benefits would justify the costs to develop the database. If developing a single database is not beneficial, an automated process should be developed to routinely compare information in the two existing databases to ensure current and accurate data is shared between the units.

**CORRECTIVE ACTION**

We agree that a single shared database will improve the accuracy and efficiency of work performed by the Restitution Unit and the Accounting Operation. The corrective action was completed on October 6, 2010, when the Restitution Unit and the Accounting Operation obtained access to the shared database application.



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*Procedures Are Needed to Improve the Accounting and Monitoring of Restitution Payments to Prevent Erroneous Refunds*

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**IMPLEMENTATION DATE**

Implemented

**RESPONSIBLE OFFICIAL**

Director, Submission Processing, Wage and Investment Division

**CORRECTIVE ACTION MONITORING PLAN**

N/A

**IDENTITY OF RECOMMENDATION #9**

Strengthen controls to ensure a freeze code is immediately entered by the Restitution Unit on the tax accounts of defendants ordered to pay restitution. In addition, the tax accounts of defendants ordered to pay restitution should be reviewed to ensure a freeze code is in place on the tax account.

**CORRECTIVE ACTION**

Criminal Investigation agrees with the recommendation and has already strengthened controls by instituting the following: designating specific personnel within the Ogden Scheme Development Center to place and monitor freeze controls on QRP/RPP defendants' accounts, requiring that freeze codes be placed on the respective defendants' accounts within 48 hours of receipt of the proper forms, and reviewing monthly and quarterly reports to ensure that all defendants' accounts have been properly marked as QRP/RPP with the appropriate freeze codes.

**IMPLEMENTATION DATE**

Implemented

**RESPONSIBLE OFFICIAL**

Director, Refund Crimes, Criminal Investigation

**CORRECTIVE ACTION MONITORING PLAN**

N/A

**IDENTITY OF RECOMMENDATION #10**

Revise the SB/SE Division Examination function's IRM to ensure that IRS-CI is notified immediately of a defendant's noncompliance with conditions of probation and restitution. The revision should also clarify that the immediate notification is in addition to the current 180 calendar day memorandum requirement.

**CORRECTIVE ACTION**

We concur with this recommendation. IRM 4.8.2 will be revised to clarify that IRS-CI will be immediately notified of noncompliance in addition to the current 180 calendar day memorandum requirement.

**IMPLEMENTATION DATE**

May 15, 2013



*Procedures Are Needed to Improve the Accounting and Monitoring of Restitution Payments to Prevent Erroneous Refunds*

**RESPONSIBLE OFFICIAL**

Director, Technical Services, Small Business/Self-Employed Division (SB/SE)

**CORRECTIVE ACTION MONITORING PLAN**

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

**IDENTITY OF RECOMMENDATION #11**

The Chief, IRS-CI should obtain a comprehensive Office of Chief Counsel opinion to determine whether the IRS should use the Treasury Offset Program before the common law right of offset to retain refunds as restitution payments. The opinion should also determine if the use of either refund offset can be applied to convicted individuals as well as convicted tax return preparers. If so, procedures should be established to ensure that the appropriate refund offset procedures are consistently used.

**CORRECTIVE ACTION**

Criminal Investigation agrees with the recommendation and has already received the Office of Chief Counsel opinion. \*\*\*\*\*7\*\*\*\*\*

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**IMPLEMENTATION DATE**

Implemented

**RESPONSIBLE OFFICIAL**

Director, Refund Crimes, Criminal Investigation

**CORRECTIVE ACTION MONITORING PLAN**

N/A

**IDENTITY OF RECOMMENDATION #12**

Modify procedures requiring special agents to include, in IRS-CI closing documents, explanations as to why restitution to the IRS was not obtained by the USAO or ordered by the courts.

**CORRECTIVE ACTION**

Criminal Investigation agrees with this recommendation. Criminal Investigation is currently updating the IRS-CI closing Form 13308 as a result of the amendment to I.R.C. 6201 (a)(4). This updated form will require an explanation as to why restitution was not ordered in cases where it is apparently appropriate.

**IMPLEMENTATION DATE**

June 15, 2012



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*Procedures Are Needed to Improve the Accounting and Monitoring of Restitution Payments to Prevent Erroneous Refunds*

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**RESPONSIBLE OFFICIAL**

Director, Operations, Policy and Support, Criminal Investigation

**CORRECTIVE ACTION MONITORING PLAN**

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

**IDENTITY OF RECOMMENDATION #13**

Complete a comprehensive review of tax-related sentences without restitution to identify trends and factors that hinder the IRS being granted restitution in sentences.

**CORRECTIVE ACTION**

Criminal Investigation agrees with this recommendation. The most relevant and comprehensive data that can be gathered will be derived from the revised Form 13308 as outlined in recommendation #12. The revised form will include an explanation of why restitution was not ordered by the courts which will enhance the ability to complete a reliable review. Once the revised Form 13308 is in use, Criminal Investigation will conduct a review of Forms 13308 for a period of six months and summarize the results.

**IMPLEMENTATION DATE**

June 15, 2013

**RESPONSIBLE OFFICIAL**

Director, Operations, Policy and Support, Criminal Investigation

**CORRECTIVE ACTION MONITORING PLAN**

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