

April 1999

TAX ADMINISTRATION

Uses of and Problems With IRS' Non-Master File



General Government Division

B-279039

April 21, 1999

The Honorable Bill Archer
Chairman, Committee on Ways and Means
House of Representatives

Dear Mr. Chairman:

The Internal Revenue Service (IRS) maintains and processes most taxpayer accounts on the master file, which consists of separate files for various types of taxpayers, such as individuals, businesses, employee plans, and exempt organizations.¹ However, the master file has systemic limitations that render it incapable of handling some types of accounts. IRS established the non-master file (NMF) for those exceptions.

In September 1997, the Senate Finance Committee held hearings on IRS.² During those hearings, a taxpayer discussed numerous problems that she had encountered in trying to resolve her NMF account. Accordingly, you requested that we develop information to enhance your understanding of the NMF. In response to your request and subsequent conversations with your office, this report discusses (1) the basic differences between the master file and the NMF; (2) known problems that IRS and taxpayers have been experiencing with the NMF, including the sources of such problems; and (3) recent IRS proposals and actions intended to address these problems.

Results in Brief

IRS uses the NMF for accounts that either the master file is not configured to process or that must be processed more quickly than can be done through the master file. Compared to the master file, the NMF is newer (1991 vs. 1962) and smaller (about 122,000 NMF accounts scattered among 10 decentralized databases vs. millions of master file accounts in one large centralized system). The NMF is more flexible than the master file, and IRS' procedures for entering data into and processing accounts on the NMF are more streamlined and thus quicker than those for the master file.

Although the NMF enables IRS to process certain accounts that cannot be handled by the master file, the NMF also had limitations, at the time of our review, that caused problems for IRS staff and taxpayers. Our review and

¹In this report, we will refer to the various master files collectively as "the master file," except when it is necessary to specifically identify one of them.

²Hearings before the Committee on Finance, U.S. Senate, 105th Cong. 1st sess., Sept. 23-25, 1997.

IRS' studies revealed that the most significant limitations were (1) the lack of a central repository of all NMF accounts, (2) the absence of any meaningful link to the automated system that IRS staff use to obtain information about taxpayers' accounts, and (3) the fact that the NMF processing procedures were predominately manual. These limitations made it difficult for IRS staff to identify and access accounts and could cause delays in processing account information in some situations, such as when a taxpayer moves from one service center's jurisdiction to another. These access problems and processing delays, in turn, could cause taxpayers whose accounts were processed on the NMF to receive incorrect information and experience poor customer service.

After the September 1997 Senate Finance Committee hearings, IRS undertook several reviews of the NMF and developed a plan that included numerous proposed corrective actions. Implementation of some significant proposed actions, such as the movement of certain NMF accounts to the master file, has been deferred until at least 2001 because those actions involve extensive computer reprogramming that could interfere with IRS' efforts to make sure its computer systems are Year 2000 compliant. Recognizing the need to make improvements in the near term, however, IRS recently implemented other actions, such as adding a unique toll-free telephone number to NMF notices, that required fewer resources and little or no reprogramming.

If effectively implemented, IRS' near-term actions, in conjunction with the actions that have been deferred, should go a long way toward correcting identified NMF problems. However, IRS' action plan lacks a key component. There is nothing in the plan about IRS' (1) monitoring the NMF to identify any problems that arise in the future and (2) ensuring that timely action is taken to address any such problems. We are recommending that IRS institute procedures to achieve those ends.

Scope and Methodology

To develop information on the basic differences between the master file and the NMF, we reviewed relevant IRS documentation, including information on the number and types of accounts processed on the NMF; interviewed IRS officials at the National Office, at the Executive Office for Service Center Operations in Cincinnati, OH, and at 3 of IRS' 10 service centers—Atlanta, GA; Cincinnati; and Fresno, CA; and obtained information from NMF managers at all 10 service centers through a questionnaire. We also observed NMF transactions being processed at the Atlanta and Cincinnati Service Centers. We visited Atlanta and Fresno because they were the two centers with the most NMF accounts at the time we did our work; the Assistant Director of the Fresno Service Center

also headed a task force that reviewed the NMF. We visited Cincinnati because of its proximity to the Executive Office for Service Center Operations.

To identify problems that IRS and taxpayers have experienced with the NMF, we obtained data through the questionnaire and interviews described in the preceding paragraph as well as interviews at two of IRS' four regional offices—Western and Midstates—and at two IRS district offices—the Georgia District, headquartered in Atlanta, and the Ohio District, headquartered in Cincinnati. We visited the Western Region to interview the problem resolution analyst who had reviewed the NMF case that was discussed at the Senate Finance Committee hearings. We visited the Midstates Region to meet with Internal Audit staff who were doing related work. We visited the district offices in Atlanta and Cincinnati because of their proximity to other IRS locations at which we were doing work.

We also reviewed several IRS reports on the NMF, including a December 1997 report on the results of an internal IRS review of the NMF case that was discussed at the September hearings and a February 1998 report on the NMF by a task group from the Fresno and Ogden Service Centers. We discussed the NMF with problem resolution officers, who are responsible for resolving taxpayer complaints, at the Atlanta, Fresno, and Cincinnati Service Centers. Although we identified several limitations of the NMF, we were unable to determine the extent to which taxpayer problems could be traced back to those limitations because IRS had no data that would allow such an analysis.

To determine what IRS has done and plans to do to address the problems caused by the NMF, we identified corrective actions that were recommended as a result of the various IRS reviews and discussed the status of those actions with responsible IRS officials. IRS identified several actions that it said it implemented in early 1999, as we were completing our audit work. We did not verify that those actions were taken or assess their effectiveness in correcting past problems.

We did our work from January 1998 to February 1999 in accordance with generally accepted government auditing standards.

Background

Before automated data processing, IRS maintained all tax accounts on ledger cards. In 1962, this system was replaced with the master file. Although the master file was an improvement over the manual system, it could not process certain accounts because of system limitations. These

accounts, referred to as NMF accounts, were kept on ledger cards until 1991, when the NMF was automated.

The automated NMF consists of 10 stand-alone databases—one in each of IRS' 10 service centers. Each service center has an NMF unit with 5 to 21 staff who enter account information into that center's database and otherwise manage the system. As of September 8, 1998, according to IRS, there were a total of about 122,000 accounts on the NMF. (See app. I for the number of staff in each service center's NMF unit and the number of accounts in each center's NMF database.)

The NMF Enables IRS to Process Taxpayer Accounts That Cannot Be Processed on the Master File

There are two general reasons why IRS puts accounts on the NMF. Some accounts have features that do not fit with the master file's configuration; other accounts have to be processed more quickly than the master file processing procedures allow. Because it is smaller and decentralized, the NMF can handle accounts that the master file cannot and can process transactions faster than the master file.

Most NMF Accounts Involve Either Split Assessments or Employee Plans

According to IRS, of the 122,000 accounts on the NMF as of September 8, 1998, about 82 percent involved either split assessments or employee plans. Split assessments are accounts that were originally on the master file for a joint entity (e.g., a husband and wife who filed a joint income tax return) but later had to be split into separate accounts. For example, application of the innocent spouse provisions of the tax law can relieve one spouse of all or some of the total tax liability assessed against a married couple who filed a joint return. That would require IRS to separately assess each of the spouses for the amounts that they legally owe.³ These accounts have to be set up on the NMF because the master file is not configured in a way that allows accounts to be linked to one another and does not allow IRS to separately assess and bill the filers of a joint return. According to IRS, of the 122,000 accounts on the NMF as of September 8, 1998, about 71,000 (58 percent) involved split assessments.

Employee plan accounts are on the NMF, according to IRS, so that IRS can assess excise taxes related to the plans. IRS officials told us that there is no place on the master file to enter the employee plan number, which is needed to assess the excise taxes. Thus, the accounts are put on the NMF, which is configured to accept employee plan numbers. IRS data indicate

³IRS would also split a joint account into separate accounts if only one of the parties (1) claimed bankruptcy, (2) petitioned the Tax Court, or (3) submitted an offer-in-compromise that was accepted by IRS. An offer-in-compromise is a taxpayer proposal to settle an outstanding tax debt at something less than the amount owed.

that about 29,000 (24 percent) of the 122,000 NMF accounts as of September 8, 1998, involved employee plans.

According to IRS, most of the remaining NMF accounts as of September 8, 1998, fell into one of the following five categories. IRS had no data on the number of accounts in each of these categories.

- **New legislation:** The NMF permits rapid implementation of new tax laws that may require extensive, and thus time-consuming, modifications to the master file. Because it is much smaller than the master file (as discussed later), the NMF can be quickly changed to handle these new laws.
- **Overflow accounts:** These are accounts that have more transactions than the master file is configured to handle. When the physical size of an account exceeds the master file configuration, IRS is to transfer the account to the NMF, which has no constraint on an account's size.
- **Large dollar amounts:** These are accounts with dollar balances that exceed the space allotted in the master file for an account's dollar amount. In that regard, the master file is not configured to handle accounts with balances of \$100 million or more. The NMF has no such limitation.
- **Immediate assessments:** These are accounts that must be assessed more quickly than the master file process allows. Generally, these assessments involve situations where IRS has determined that the assessment or collection of a deficiency will be jeopardized by delay. In such cases, IRS is authorized to immediately assess such deficiency. These accounts are processed on the NMF because, according to IRS, the NMF can process assessments in 24 to 36 hours, while the master file takes several weeks.
- **Reversal of erroneous abatements:** These are accounts in which an assessment is needed to correct some clerical action that had erroneously reduced (abated) a taxpayer's tax liability, and the statute of limitations for assessments had expired. As configured, the master file prevents the reversal of abatements after expiration of the statute of limitations.

Master File Configuration and Processing Procedures Make NMF Necessary

As indicated by the information in the previous section, most of the accounts on the NMF are there because of limitations in the master file's configuration (e.g., the master file's inability to handle split assessments, large accounts, and employee plan numbers).⁴ Other accounts (e.g., those involving new legislation and immediate assessments) are on the NMF because they have to be processed more quickly than is possible on the master file.

There are two basic reasons why accounts can be processed more quickly on the NMF than on the master file. First, the NMF is much smaller than the master file and, thus, easier to work with. The NMF had 122,000 accounts as of September 8, 1998, and those accounts were spread among stand-alone systems in each of IRS' 10 service centers. By comparison, the master file is one large system, housed in Martinsburg, WV, that has an account for every taxpayer that files a return—about 200 million in 1998.⁵

Second, the process IRS follows to enter account data into the master file and make the updated information available for researching taxpayer accounts is much more time-consuming than the NMF process. For master file purposes, account data flow from the service centers, where the data are initially received and validated, to IRS' computing center in Martinsburg, where the data are posted to the master file. Data coming into Martinsburg from the individual service centers are not posted to the master file upon receipt. Instead, data are accumulated during the week for posting on weekends. Martinsburg sends output from the posting process back to the service centers for their use in updating the Integrated Data Retrieval System (IDRS). IDRS is the primary system that IRS employees use to research and update accounts.⁶ For example, IRS' customer service representatives use IDRS to access accounts in responding to taxpayer inquiries. According to IRS, the process from the

⁴We do not know why the master file was not configured to accept these type of accounts when it was established in 1962 or why IRS did not reconfigure the master file once it became apparent that certain accounts could not be entered into the master file.

⁵The definition of an account on the NMF differs from the definition of an account on the master file. On the master file, each taxpayer has an account that includes everything related to that taxpayer over the years (returns filed, payments made, additional taxes assessed as a result of audit, etc.). On the NMF, a taxpayer may have more than one account. To illustrate, if a taxpayer files a return showing a \$1,000 tax liability and a subsequent audit shows that the taxpayer understated income and owes another \$500, there would be two accounts on the NMF for that taxpayer—one for the \$1,000 assessed on the basis of the filed return and a second for the \$500 assessed as a result of the audit. On the master file, both of these transactions would be part of one account.

⁶IDRS gives IRS employees instantaneous visual access to certain taxpayer accounts. According to IRS, the system's capabilities include (1) researching account information; (2) entering transactions, such as adjustments and name or address changes; (3) entering collection information for storage and processing in the system; and (4) automatically generating notices to taxpayers and other output.

time data are sent to Martinsburg until updated account information is available on IDRS can take from 4 to 6 weeks.

The NMF process is more streamlined and thus quicker. After receipt and validation by the service center, NMF account data are sent to the NMF unit in that same service center for immediate input to the NMF. According to IRS, that process generally takes about 1 day. There is no movement of data between the service center and Martinsburg, and NMF data are generally not input to IDRS (the one exception to this rule, delinquent accounts, will be discussed later).

Despite Some Advantages, NMF System Limitations Contributed to Processing Delays, Incorrect Assessments, and Customer Service Problems

Although the NMF enables IRS to process accounts that cannot be processed on the master file, the NMF also had limitations, at the time of our review, that caused problems for IRS employees and taxpayers. While the NMF's decentralization allowed employees to quickly enter account data and make more timely assessments than would be possible with the master file, it also limited the ability of employees to research NMF accounts. The ability to research NMF accounts was further limited by the absence of any meaningful link between the NMF and IDRS. The decentralized NMF system also involved many manual procedures and computations that increased the risk of error and delayed some processing. These problems could adversely affect the ability of IRS staff to do their jobs, including their ability to provide accurate service to taxpayers with accounts on the NMF.

It Has Been Difficult for IRS Staff to Research NMF Accounts

IRS staff need the ability to research account data. Customer service representatives, for example, need that capability so they can respond to taxpayer inquiries about their accounts and any related correspondence they may have received from IRS. Revenue agents and revenue officers need research capability in conjunction with their audit and collection case work.

At the time of our review, it was difficult for IRS staff to research NMF accounts because, as described by an IRS task force, IRS staff often had "difficulty identifying that the account is, in fact, in the NMF and then in determining which of the ten service centers has control of the account." A significant barrier to any research effort involving NMF accounts was the absence of a central repository of all such accounts. Each of the 10 service centers maintains its own NMF system on a stand-alone database. Even though these systems are basically the same, they are not linked in a way that facilitates easy access. A unique password is needed to process and research accounts on each of the 10 NMF databases. IRS staff in one service center cannot access other centers' NMF accounts without going

through the time-consuming process of obtaining a password from the system administrator at each center.

NMF account research was also hampered by the fact that only delinquent NMF accounts were on IDRS. As noted earlier, IDRS (1) facilitates research and, ultimately, the resolution of account questions by giving IRS staff instantaneous access to accounts that are on IDRS and (2) allows IRS staff to adjust accounts on-line. These advantages were not available to IRS staff dealing with the NMF, because NMF accounts were only put on IDRS after they were classified as delinquent and because, even with delinquent NMF accounts, IRS staff were limited in how they could use IDRS. According to IRS officials, delinquent NMF accounts, unlike delinquent master file accounts, were put on IDRS for reference purposes only. Any transactions involving delinquent NMF accounts still had to take place on the NMF.

The lack of a central repository of NMF accounts created a situation in which customer service representatives and other IRS staff were either not aware of an NMF account or had to contact the NMF units in as many as 10 service centers to see if such an account existed. As users of the system, NMF staff told us of their frustration in not having universal access to all NMF accounts. They contended that the absence of universal access made researching accounts difficult and that, as a result, some staff were likely to forgo this process and not learn of the existence of an NMF account. In its report on the NMF, an IRS task force said that this research limitation resulted in numerous instances in which NMF accounts were not identified and had even resulted in erroneous refunds to taxpayers.

Even if IRS staff had universal access to all NMF accounts, there still would have been no assurance that they could more effectively respond to inquiries from NMF taxpayers. That is because IRS staff, at the time of our review, often did not realize that the account in question was an NMF account. When a taxpayer with an NMF account receives a notice from IRS, the taxpayer's Social Security number on that notice is to end with an "N." However, according to IRS, taxpayers are typically unaware that their accounts are on the NMF and that the "N" after their Social Security number indicates an NMF account. As a result, when they call IRS about their account and are asked for their Social Security number, they typically do not include the "N." Thus, at the time of our review, customer service representatives who infrequently came into contact with NMF accounts may not have known to search the NMF databases and, as a result, may have given the taxpayer incorrect information.

The problems IRS staff encountered in trying to identify and access NMF accounts could have resulted in problems for taxpayers. The NMF-related case that was discussed in the 1997 Senate Finance Committee hearings involved a taxpayer who encountered several problems over several years in trying to get accurate information from IRS about the status of her account. Among other things, according to an IRS review of the case, a customer service representative had overlooked the “N” after the taxpayer’s Social Security number and did not search the NMF for the taxpayer’s account. Even if the account had been identified as an NMF account, the customer service representative would not have had access unless the account happened to be in that particular service center’s NMF. We were unable to determine the extent to which other taxpayers encountered problems in trying to get information about NMF accounts because IRS had no data that would allow such an analysis.

According to IRS officials, they have recently taken some corrective actions to resolve the problems with identifying and accessing NMF accounts. These actions are discussed later in this report.

Certain NMF Processes Have Been Error-Prone and Time-Consuming

As discussed earlier, one of the benefits of the NMF is the ability to do things more quickly on it than on the master file. That benefit derives from the fact that each service center can directly enter data into its own NMF database instead of having to spend time sending data to a centralized location and waiting for the data to be processed and available for use.

Although a service center’s ability to enter data directly into its own database has advantages, having 10 such databases can cause significant problems when, for example, taxpayers move from one service center’s jurisdiction to another. In these circumstances, IRS would have to manually transfer the account from one center to the other. To accomplish this, staff at the former center would manually prepare an account transfer-in form, attach an account transcript, and mail both to the latter center, whose staff would have to manually key the account data into that center’s NMF. According to IRS, this manual transfer process could take from 4 to 6 weeks. In discussing this process, an IRS task force noted that “many cases are transferred from one service center to another, resulting in temporary loss of visibility, delayed actions, and lost paperwork.”

Not only are the NMF databases not linked, but they also do not interface with the master file. As with transfers between service centers, account transfers between the master file and the NMF require manual intervention, which can take several weeks. The need for manual intervention to transfer accounts from the master file to the NMF is

problematic because (1) most of the accounts on the NMF (such as those involving split assessments) were originally posted to the master file and (2) there may be many more such occurrences as a result of the innocent spouse provisions in the IRS Restructuring and Reform Act of 1998.⁷ In commenting on a draft of this report, IRS noted that a programming change has been scheduled that should reduce the time it takes to transfer accounts from the master file to the NMF. According to IRS, that change is scheduled for implementation in January 2000.

The time-consuming manual transfer processes increase the risk that information will not be readily available to respond to taxpayer inquiries or that taxpayers will be given incorrect information in response to their inquiries. For example, account activity may be taking place while the account is being moved from the master file to the NMF or from one service center's NMF to another. According to IRS, while the account is being manually transferred and not visible, IRS staff could mistakenly make refunds to the taxpayer when, in fact, an outstanding balance remains on the NMF account. Also, if payments are received or assessments are made in the former center after the account has been transferred, the related documents are to be mailed to the latter center for entering into the system, thereby resulting in additional delays.

Another significant part of the NMF process that staff have had to handle manually involves the computation of penalties and interest. Before automation of the NMF in 1991, penalties and interest for all NMF accounts were computed manually. Shortly after automation of the NMF, IRS discovered that the system was incorrectly calculating penalties and interest in some cases. NMF staff then had to manually compute penalties and interest and enter the results into the system.

According to NMF staff responsible for manually computing penalties and interest, the process is laborious, and it takes a long time to develop the full range of technical skills needed to make the computations. Staff at one of the service centers told us that the computation of penalties and interest was the biggest problem they had with the NMF.

⁷Before this act, to qualify for innocent spouse relief, a person had to meet certain criteria and establish that the understatement of tax liability met certain thresholds. The act eliminated those thresholds, which we estimated, based on prior work in the area, could add another 40,000 accounts to the NMF.

Corrective Actions Have Been Identified; Implementation of Some Has Been Deferred

After the September 1997 Senate Finance Committee hearings, IRS undertook the following reviews of the NMF:

- In November 1997, a problem resolution analyst in IRS' Western Region was tasked with identifying and reviewing all problems and mistakes that occurred in IRS' handling of the NMF case that was discussed at the hearings. She reported on the results of her review in a December 1997 report that was submitted to IRS' Deputy Commissioner.
- In December 1997, a group from the Fresno and Ogden Service Centers was tasked with studying the NMF process and recommending corrective actions that could be implemented in the short term. That group issued its report in February 1998.
- In December 1997, another group, chaired by IRS' National Director of Submission Processing, was formed to address longer term solutions.
- In November 1997, IRS' Office of Internal Audit began a review directed at determining whether NMF transactions were recorded accurately and timely. As of February 28, 1999, Internal Audit was finalizing a report on its results.

Those reviews identified the many systemic and procedural problems previously discussed and generated many recommendations for corrective action. (See app. II for a list of the recommended corrective actions and information on their status as of Feb. 17, 1999.) Included among those recommended actions were some that, if they were to be implemented immediately, would require a significant amount of computer reprogramming at a time when IRS has higher priority programming work associated with making its systems Year 2000 compliant. As a result, IRS deferred until at least 2001 the implementation of two recommendations that called for (1) moving many NMF accounts to the master file and (2) consolidating NMF accounts in one service center. IRS also adopted an alternative to two other recommendations that called for (1) loading all NMF accounts on IDRS and (2) changing the command code used by IRS staff to search the IDRS database.

There were several other recommendations, such as adding a unique toll-free telephone number on NMF notices and enhancing the technical expertise available to IRS staff working on NMF accounts, that required little or no reprogramming. According to IRS, those recommendations were generally implemented in January and February 1999.

Although IRS' corrective actions address the major problems identified with the NMF, they do not include any steps directed at (1) monitoring the

NMF to identify any problems that arise in the future and (2) ensuring that timely action is taken to address any such problems.

Moving NMF Accounts to the Master File

Probably the most significant corrective action proposed by IRS would move accounts involving split assessments and employee plans from the NMF to the master file. As noted earlier, about 82 percent of all the accounts on the NMF in September 1998 fell into one of those two categories.

Implementation of this action, which would reduce the number of NMF accounts considerably, would require extensive reprogramming of the master file. According to a cost estimate prepared by IRS' Office of Information Services, which is responsible for any computer programming needed to implement the various recommendations, reprogramming the master file to accept split assessment accounts would require about 680 days of staff time at a cost of about \$185,000. (An estimate for reprogramming the master file to accept employee plan accounts was not available at the time we did our work.) This effort was put on hold because, according to IRS officials, the Commissioner of Internal Revenue requested that any efforts requiring extensive reprogramming be reconsidered given the need to give priority to Year 2000 compliance efforts. IRS' current schedule calls for implementing this recommendation in 2001.

Moving accounts involving split assessments and employee plans to the master file should improve customer service not only to the taxpayers whose accounts are moved to the master file but also to the remaining smaller number of NMF taxpayers. Movement of these accounts to the master file is a critical first step that, as discussed later, could have implications for other proposed corrective actions. However, based on our past work on the challenges facing IRS in trying to meet its Year 2000 requirements, we believe it was reasonable for IRS to delay this action until after Year 2000 changes are made.⁸

Consolidating NMF Accounts

Consolidation of all NMF accounts at one service center would improve service to NMF taxpayers, enable IRS to provide more consistent treatment of NMF taxpayers, and facilitate the correct resolution of taxpayer problems by IRS staff. Specifically, with all accounts located at one center, accessibility and identification of accounts would be less of an issue. NMF staff would not have to research databases in up to 10 centers

⁸IRS' Year 2000 Efforts: Business Continuity Planning Needed for Potential Year 2000 System Failures (GAO/GGD-98-138, June 15, 1998).

to locate an account. Accounts would less likely be overlooked, and consolidation would eliminate the need for different passwords. There would no longer be a need to transfer documents between NMF databases and to delay account updates during the time-consuming transfer process.

In discussing the possibility of consolidating all NMF accounts at one service center, an IRS task force said that IRS would need to secure software and a new computer to house the consolidated database at an estimated cost of about \$250,000. Also, according to the task force, there would be additional costs for salary, benefits, and training.

IRS officials told us that consolidation has been put on hold until after some of the other corrective actions are implemented. Specifically, officials said that they would like to consider consolidation after they are more certain which accounts are going to be moved to the master file. At that time, there will be a better sense of how many NMF accounts will be left. In that regard, even if IRS proceeds with its plans to move accounts from the NMF to the master file, it believes, as do we, that there will continue to be a need for a system, such as the NMF, for the remaining accounts—at least until future systems modernization efforts produce a different form of master file.

We agree that a decision about consolidation would best be made after deciding which, if any, accounts will be moved to the master file. At that time, IRS should have a better idea of the number of accounts that will have to be consolidated and a better basis for determining whether consolidation is necessary. For example, if accounts involving split assessments are moved to the master file, as is the current plan, the need for consolidation may be less persuasive because, according to IRS, those are the NMF accounts that are most likely to involve transfers between service centers. If IRS should decide to proceed with consolidation after moving certain accounts to the master file, the cost might be much less than estimated by the task force because existing equipment and staffing may be sufficient to handle the smaller number of NMF accounts.

Loading All NMF Accounts on IDRS and Modifying a Command Code

Two corrective actions proposed by an IRS task force called for loading all NMF accounts on IDRS and modifying a command code used by customer service representatives to search the IDRS database. These two actions, in concert, were intended to make it easier for IRS staff to identify and access an NMF account. The first action would eliminate the current NMF access problem by allowing anyone with access to IDRS to research information on all NMF accounts. The second action would cause all of a taxpayer's accounts on IDRS (including any NMF account) to be reflected

when a customer service representative enters the taxpayer's nine-digit Social Security number. At the time of our review, if an "N" was not entered after the Social Security number, the customer service representative did not receive any prompt identifying the existence of an NMF account.

Because of concerns about the amount of resources that would be required to implement these two recommendations, IRS' Office of Information Services developed an alternative that, according to IRS, was implemented in January 1999. Under that alternative,

- a specific transaction code (130) is to be generated automatically on the master file when an account is opened on the NMF,⁹
- certain identifying information from that account, such as the taxpayer's name and Social Security number, is to be entered into IDRS, and
- a flashing "N" is to be added to IDRS to denote the existence of an NMF account.

Information Services' alternative also included the establishment of an automated NMF National Account Index. As proposed by Information Services, a one-time extract of all open NMF accounts would be used to assemble the NMF National Account Index, and the file would be updated weekly to add new NMF accounts. Thus, the NMF National Account Index would be a central compilation of all NMF accounts.

Information Services told us that because of the extensive reprogramming that would be required to modify IDRS to handle all NMF accounts, the establishment of the NMF National Account Index and the use of a specific transaction code to identify an NMF account would provide an effective short-term option to modifying command codes and loading all cases on IDRS. According to Information Services, the two originally proposed corrective actions were intended to alert IRS staff to the existence of NMF accounts and to expedite the research of those accounts. Information Services' alternative would address both concerns. Specifically, automatic generation of transaction code 130 should better ensure that anyone accessing a master file account is alerted to the existence of a related NMF account. In the past, that transaction code was to be entered manually, which left open the possibility that it would mistakenly not get entered. Also, the flashing "N" should increase visibility of the existence of NMF accounts, and the NMF National Account Index should help expedite research by listing all NMF accounts and their service center location.

⁹A transaction code is a three-digit code used to identify actions being taken on a taxpayer's account.

Although the Executive Officer for Service Center Operations, who is responsible for day-to-day NMF operations, agreed to the above alternative proposed by Information Services, he would eventually like to see all NMF accounts on IDRS. This is primarily because the National Account Index would contain only certain account information, such as the taxpayer's name and Social Security number, for identification purposes. Thus, the National Account Index would not give IRS staff the same research capabilities as would be available if all account information were available on IDRS—similar to what is now available on IDRS for delinquent NMF accounts.

We recognize that modifying IDRS to accept all NMF accounts would require extensive reprogramming, and we agree that the option proposed by Information Services would help to alleviate some problems with the NMF. We are concerned, however, that the proposed option would add to an already complex system another stand-alone database that would not have enough information on NMF accounts to help staff quickly resolve taxpayers' problems. The need for IRS to modify IDRS to accept all NMF accounts may be less critical, however, if IRS proceeds with its plan to significantly reduce the size of the NMF by moving split assessments and employee plans to the master file. The cost of loading the remaining accounts on IDRS after such a move might exceed any potential benefits.

Other Corrective Actions

In addition to the corrective actions discussed above, IRS developed a plan that called for implementing a number of other corrective actions in January 1999 that would require little or no reprogramming. Those actions included (1) adding a unique toll-free telephone number to NMF notices, (2) enhancing the technical expertise available to IRS staff who are working with NMF accounts, and (3) improving penalty and interest computations.

Include a Unique Toll-Free Telephone Number on NMF Notices

In its February 1998 report, a task force of Fresno and Ogden Service Center staff commented on the need for a unique toll-free telephone number on NMF notices. The task force said that if recipients of an NMF notice called one of the general toll-free numbers that taxpayers were told to call if they had a question, there was a great possibility that they would reach an IRS call site that did not have direct access to the service center where the NMF account was located, thus necessitating another telephone call for the taxpayer or a delay in making contact with the correct NMF site. Additionally, if the taxpayer failed to identify the "N" after the Social Security number, the customer service representative might not search for an NMF account. This could result in a search of only the master file,

which could lead to misinformation being given callers about the status of their accounts.

According to IRS officials, IRS started including a unique toll-free telephone number on NMF-related notices in February 1999. Each call to that number is to be routed to a particular service center based on the area code of the incoming call and is to be answered by specially trained customer service representatives. This change should help NMF taxpayers who have questions about their accounts reach someone at IRS with access to and knowledge about NMF accounts.

Enhance the Technical Expertise Available to IRS Staff Working With NMF Accounts

In response to recommendations in one of the internal NMF studies, IRS has taken steps to enhance the technical expertise available to IRS staff who are working with NMF accounts. That enhancement involves the (1) identification of district office staff who will function as NMF coordinators in addition to their normal responsibilities and (2) establishment of a new position (NMF account specialist) in the service centers.¹⁰ The district office NMF coordinators are to provide technical assistance to district staff, disseminate NMF listings and reports for coordination with district officials and service center staff, coordinate responses back to the service center NMF units, and provide continuing education for district staff. The service center account specialists are to provide technical assistance on NMF issues and individual accounts and coordinate with the district office coordinator.

On the basis of our work at the NMF unit in the Atlanta Service Center and at the Georgia District Office, IRS' actions, when implemented, should improve IRS employees' basic understanding of the NMF. The technical assistance to be provided by the service center account specialists is important because we found that while staff in the NMF units understood the NMF assessment process, they were limited in their overall understanding of the NMF. Similarly, the availability of help from district office coordinators should help district office staff who have to work with NMF accounts because, as noted by IRS officials, those staff are exposed to NMF accounts so infrequently that they have difficulty gaining expertise.

Improve Penalty and Interest Computations

As of January 1999, according to IRS, it had made programming changes to correct the automated NMF penalty and interest computations. Even with this new programming, however, NMF staff still have to manually compute

¹⁰As of February 17, 1999, according to IRS, these new service center positions had been established but were not yet filled.

penalties and interest when the data needed to correctly make the computations are not on the NMF. For example, according to IRS documentation, NMF staff manually compute penalties and interest when (1) the Tax Court or Bankruptcy Court has ordered interest charged at a different rate than normally charged by IRS or (2) an adjustment is made to a taxpayer's tax liability with no adjustment to penalties and interest. In those situations, according to IRS officials, the NMF has been modified to flag the account so that the system does not attempt to compute penalties and interest. NMF staff are to make the computations and enter the results into the NMF system.

In an attempt to alleviate the need for manual computation and reduce the risk of error, the National Office, in August 1998, circulated a commercial off-the-shelf software package for use in computing penalties and interest when the NMF system could not compute them. However, NMF staff told us, and the National Office confirmed, that the service centers stopped using the software because it did not compute penalties and interest accurately. As a result, there remain a number of situations in which penalties and interest must be manually computed and entered into the NMF system.

IRS' Corrective Action Plan Says Nothing About Monitoring Future Use and Growth of the NMF

The various corrective actions discussed earlier and listed in appendix II seem to address all of the major problems identified with the NMF and, if effectively implemented, should result in a dramatic drop in the number of NMF accounts. There is nothing in IRS' plan, however, that seeks to prevent the NMF from growing again and eventually causing other problems for other taxpayers. For example, there is nothing in the plan about IRS' (1) monitoring the NMF to identify any problems that arise in the future and (2) ensuring that timely action is taken to address any such problems.

Conclusions

After the Senate hearings, IRS made a concerted effort to identify NMF problems and potential solutions. IRS identified major deficiencies with the NMF and compiled a list of corrective actions that, if effectively implemented, should go a long way toward correcting those deficiencies. Understandably, those actions that are expected to require substantial computer programming (including perhaps the most significant action—moving numerous NMF accounts to the master file) have been deferred until after higher priority programming work is done. In the meantime, IRS has taken some significant actions, such as making NMF accounts more easily identifiable and researchable and putting a unique toll-free telephone number on NMF notices. Although it is too soon to assess their

effectiveness, those actions should help IRS provide better service to taxpayers with accounts on the NMF.

IRS has populated the NMF with accounts, such as those involving split assessments, that could have been kept off the NMF or moved from the NMF if IRS had made the necessary programming changes to the master file. While we recognize that the number of NMF accounts is small in relation to the total number of accounts IRS has to process and maintain, that is little comfort to taxpayers whose accounts happen to be among that small number. With that in mind, we believe that IRS' action plan lacks a key component. We saw nothing in the plan about (1) monitoring the NMF to identify any problems that arise in the future and (2) ensuring that timely action is taken to address any such problems.

Recommendation

We recommend that the Commissioner of Internal Revenue direct appropriate officials to institute procedures to (1) monitor future activity in the NMF to identify any problems that arise in the future and (2) ensure that timely action is taken to address any such problems.

Agency Comments and Our Evaluation

We obtained written comments on a draft of this report in a March 25, 1999, letter from the Commissioner of Internal Revenue (see app. III). IRS said that it agreed with the findings and recommendation in the draft report. IRS also emphasized that it had taken immediate action to address the problems encountered by taxpayers with accounts on the NMF and the resulting issues that surfaced during the Senate Finance Committee hearings in September 1997. IRS noted, however, that "the ultimate solution is the fundamental replacement of the entire master file system and until such time as this occurs, we will continue to be at risk for additional deficiencies to be identified." IRS pointed out that this ultimate solution is scheduled to be implemented over the next several years and that, until then, it "will continue to monitor the NMF process to identify any problems and take immediate steps to mitigate them."

With respect to our recommendation, IRS said that it had included provisions to monitor future activity on the NMF in its January 1999 revision of that part of the Internal Revenue Manual dealing with the NMF. According to IRS, these procedures, in addition to increased monitoring by National Office staff, will ensure that timely action is taken once a problem is identified. However, the procedures referred to by IRS are directed at improving controls over individual accounts on the NMF. The intent of our recommendation was more global. We believe that IRS needs to institute some mechanism that will enable it to proactively identify and correct situations, such as the existence of a large number of accounts on the NMF

that could and should be moved to the master file. The presence of such a mechanism, for example, might have triggered action by IRS to do something about the large number of split assessment accounts in the NMF before being prodded in that direction by congressional hearings.

IRS also provided updated information on certain issues discussed in the report as well as updates on the status of its various corrective actions. We revised the body of this report and appendix II to reflect those updates.

We are sending copies of this report to Representative Charles B. Rangel, the Committee's Ranking Minority Member; Representative Amo Houghton, Chairman, and Representative William J. Coyne, Ranking Minority Member, of the Committee's Subcommittee on Oversight; and Senator William V. Roth, Jr., Chairman, and Senator Daniel P. Moynihan, Ranking Minority Member, Senate Committee on Finance. We are also sending copies to The Honorable Robert E. Rubin, Secretary of the Treasury; The Honorable Charles O. Rossotti, Commissioner of Internal Revenue; and The Honorable Jacob Lew, Director, Office of Management and Budget. Copies will be made available to others on request.

Major contributors to this report are listed in appendix IV. Please contact me on (202) 512-9110 if you have any questions.

Sincerely yours,



Cornelia M. Ashby
Associate Director, Tax Policy and
Administration Issues

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Abbreviations

IDRS	Integrated Data Retrieval System
IRS	Internal Revenue Service
NMF	Non-master file

NMF Staff and Account Inventory as of September 8, 1998, by Service Center

Service Center	Staff	Inventory
Andover	5	6,950
Cincinnati	13	7,341
Kansas City	21	9,091
Brookhaven	17	11,312
Austin	17	11,349
Ogden	17	12,734
Philadelphia	18	14,245
Memphis	17	14,940
Fresno	17	16,718
Atlanta	17	17,344
Total	159	122,024

Source: IRS.

Status of Recommended NMF Corrective Actions as of February 17, 1999

Recommended corrective action	Purpose of action	Status
1. Move split assessments and employee plan accounts to master file	To reduce the number of accounts on the NMF	Deferred until 2001.
2. Consolidate NMF accounts at one service center	To provide better service to taxpayers and ensure consistent procedures on NMF accounts	To be considered after IRS is certain which accounts will be moved to the master file.
3. Modify command codes to reflect all open accounts	To simplify research by quickly identifying existence of NMF accounts	Actions 3 and 4 have been combined and an alternative was developed that was implemented in January 1999.
4. Load all NMF accounts onto IDRS	To allow anyone with IDRS access to research NMF account information, thus eliminating the NMF access problems	The alternative to this action is the development of the NMF National Account Index, which was developed and implemented in January 1999.
5. Add a toll-free telephone number on NMF notices	To better ensure that NMF taxpayers will reach someone in IRS with access to and knowledge about NMF accounts	Implemented February 8, 1999.
6. Establish an NMF account specialist position at each service center	To provide technical assistance to IRS field offices	Positions created but not filled as of February 17, 1999.
7. Improve penalty and interest computations	To correct problems with computations of penalty and interest	Programming to correct penalty and interest computations implemented in January 1999. Manual computations still required in some cases.
8. Create an NMF account transcript similar to the master file transcript	To create a more understandable transcript that is taxpayer-friendly	Completed in January 1999.
9. Reinstate publication and distribution of a pocket guide to include NMF reference information	To use as a ready reference source for district and service center personnel	Completed in January 1999.
10. Establish an NMF coordinator position in each district	To serve as the NMF expert and liaison for contacts between the district and the service centers	Rather than establish a separate district coordinator position, the intended duties of that position are to be assigned as collateral duties to existing staff.
11. Establish a process for review of NMF notices	To establish a system or process (including criteria) for reviewing NMF notices for accuracy	Implemented January 1999.
12. Establish an oversight group to monitor implementation of the National Strategy	To monitor implementation of the long-term solutions to NMF problems	Oversight group established.
13. Generate notice to match master file addresses against NMF addresses	To identify all address updates	Completed in January 1999.
14. Create a computer program to match NMF taxpayer identification numbers to master file taxpayer identification numbers	To provide information to ensure that NMF accounts reflect current information and identify all possible opportunities for collection of past due amounts	Completed in January 1999.

Source: GAO compilation of IRS data.

Comments From the Internal Revenue Service



COMMISSIONER

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

March 25, 1999

Ms. Cornelia Ashby
Associate Director
Tax Policy and Administration Issues
General Accounting Office
General Government Division
441 G Street, N.W.
Washington, D.C. 20548

Dear Ms. Ashby:

Thank you for the opportunity to comment on your General Accounting Office draft report entitled "Tax Administration: Uses of and Problems with Internal Revenue Service (IRS) Non-Master File (NMF)," dated March 1999. The IRS agrees with the findings and the recommendations in the draft report and has taken this opportunity to provide status updates to the 14 corrective actions presented in the appendix to the draft report.

We would like to emphasize that the IRS took immediate action to address the problems encountered by taxpayers with accounts on the NMF and the resulting issues that surfaced during the Senate Finance Committee hearings in September 1997. We conducted several reviews of the NMF and developed a comprehensive action plan detailing numerous actions we needed to take to improve our NMF system and related procedures, the majority of which have been implemented. However, due to the extensive programming requirements needed to support the remaining actions and the demands on our information systems staff to address the Century Date Change, additional changes will not be implemented until 2001.

Although we have taken immediate steps to implement what we consider to be short term fixes within the current NMF system, we face serious systems limitations due to outdated technology. The ultimate solution is the fundamental replacement of the entire master file system and until such time as this occurs, we will continue to be at risk for additional deficiencies to be identified. As you are aware, the current version of the Modernization Blueprint includes the scheduled migration of the mainline processing to a corporate database over the course of the next several years. Until such time as this is implemented, we will continue to monitor the NMF process to identify any problems and take immediate steps to mitigate them.

Recommendation #1:

Institute procedures to monitor future activity in the NMF to identify any problems that arise in the future.

Appendix III
Comments From the Internal Revenue Service

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Action:

The implementation plan did not provide for monitoring of the NMF to identify problems that arise in the future. To rectify this omission, we included procedures to monitor future activity on the NMF in the January 1999 revision of Internal Revenue Manual (IRM) 3.17.46, Automated Non-Master File (ANMF) Accounting. IRM Sections 1.6 and 1.7 outline the mechanisms in place to monitor NMF.

IRM Section 1.6 - Strengthen Managerial Control Review, establishes internal control for work processed to the NMF database through operational or management reviews to identify weaknesses and mitigate known risks. We created a NMF checklist to assist management in establishing the required internal controls needed to determine completeness of both case receipts and closed cases. This will also help in identifying processing trends and/or deficiencies before an account is processed on NMF.

IRM Section 1.7 - Program Analysis System Review, establishes the review of work processed on the NMF system and will identify problems with accounts after processing is completed.

Responsible Official(s):

Chief Operations Officer
Assistant Commissioner (Forms and Submission Processing)
Assistant Commissioner (Customer Service)

Recommendation #2:

Institute procedures to ensure that timely action is taken to address any such problems.

Action:

We included additional procedures in the January 1999 revision of IRM 3.17.46, ANMF Accounting, for monitoring account data prior to and after processing. These procedures, in addition to increased monitoring by the National Office staff, will ensure that we take timely action once a problem is identified.

Responsible Official(s):

Chief Operations Officer
Assistant Commissioner (Forms and Submission Processing)
National Director, Submission Processing

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General Comments:

We would like to provide you with current information about the following observations commented upon in the draft report:

NMF Data Transfers are Error Prone and Time Consuming (pages 15 - 18)

NMF databases are not linked and require manual intervention – We scheduled a January 2000 implementation for a programming change to eliminate the time-consuming process by which a Transaction Code posts to the master file. The programming will allow the originator of the account transfer to input the code to the Integrated Data Retrieval System (IDRS), thereby reducing the posting time to the master file by 2 to 3 weeks. This will also reduce the time that it takes to generate the transcript to process the accounts to the NMF.

Improve Penalty and Interest Computations (page 29)

Manual computation of penalty and interest increases the chance of error. We established a NMF Task Force in June 1998, to identify conditions where the ANMF system incorrectly calculates interest and penalty. The task force requested that field offices identify and submit NMF penalty and interest problems for review. Several actions resulted from this review:

We submitted a programming change request on June 30, 1998, to correct the penalty and interest computation on the NMF database. This change was effective January 1, 1999. However, a limited number of circumstances still remain where manual computation is needed.

A new Exception Code [M] marks accounts that require manual computation of interest and penalty.

We provided TAXINTEREST Software and IDRS Command Code "COMPA" to field offices to be used when manual computation of interest and penalty is required.

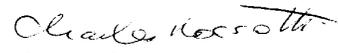
To ensure increased accuracy in the manual computation of penalty and interest, we held a Restricted Penalty and Interest Training Workshop during the week of September 14, 1998. The class instructors were penalty and interest specialists from two service centers.

Appendix III
Comments From the Internal Revenue Service

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We thank you for your continued support, and again extend our appreciation for the opportunity to comment on this report.

Sincerely,



Charles O. Rossotti

Enclosure

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