

TREASURY INSPECTOR GENERAL FOR TAX ADMINISTRATION



The Internal Revenue Service Has Experienced Challenges in Transitioning to Electronic Records

September 6, 2023

Report Number: 2023-10-050

HIGHLIGHTS: The Internal Revenue Service Has Experienced Challenges in Transitioning to Electronic Records

Final Audit Report issued on September 6, 2023

Report Number 2023-10-050

Why TIGTA Did This Audit

This audit was initiated to assess the IRS's progress in transitioning to electronic records in accordance with Office of Management and Budget/National Archives and Records Administration Memorandum M-19-21, *Transition to Electronic Records*.

TIGTA has identified problems with paper document processing and emphasized the need for the IRS to transition to electronic records in previous audit reports. Additionally, other stakeholders have recommended process improvements in attempts to move the agency forward in its digitalization efforts.

Impact on Tax Administration

The IRS annually processes more than 240 million tax returns and other forms and currently stores over 5.7 million cubic feet of paper records (the bulk of which are tax returns) at Federal Records Centers distributed across 17 locations throughout the United States. On average, the IRS sends 526,000 cubic feet of records to the Federal Records Centers each year. In Fiscal Year 2022, the IRS spent approximately \$35 million in storage-related costs. Paper files are often difficult to access, and the Federal Government's interest is harmed when the IRS is unable to produce documents needed to support the IRS's position as part of an examination, appeal, tax court case, *etc.* Taxpayers are also burdened when IRS employees are unable to readily access paper files in response to requests for assistance.

What TIGTA Found

All Federal agencies are required to adopt electronic recordkeeping requirements by June 30, 2024. Due to delayed efforts to digitalize records, the IRS was not on track to meet the deadline, so it requested and was granted an extension until December 31, 2030.

The IRS scans millions of pages of documents every filing season, including tax returns, checks, correspondence, and other original documents. However, scanning systems and capabilities vary widely across the organization. Current technology, such as optical character recognition and two-dimensional document bar coding, would enable the IRS to machine read paper tax returns, yet the IRS does not currently possess the capability to perform these functions on a large scale.

Digitalization is key to addressing challenges associated with large volumes of paper and achieving compliance with electronic recordkeeping mandates. While the IRS has developed high-level strategies to help guide the transition to digitalized processes and electronic recordkeeping, these strategies have not been updated to reflect current priorities and the actions required to move forward.

IRS efforts to digitalize records could be significantly enhanced by increasing the rate of electronically filed returns; however, the IRS has not developed a single Service-wide strategy to incorporate all forms for electronic filing. Paper-filed tax returns are more costly to process and are also more likely to contain errors and be subject to delays in processing, as seen during the Coronavirus Disease 2019 pandemic. As a result, the IRS must pay interest on any delayed refunds. In Fiscal Year 2022, the IRS paid \$3.5 billion in total refund interest. This is a 70 percent increase from the \$2.06 billion paid in refund interest before the pandemic in Fiscal Year 2019.

Delayed efforts to digitalize records have resulted in continued reliance on outside storage facilities. Access to IRS records stored in the Federal Records Centers has been problematic in the past and was significantly hampered by the Coronavirus Disease 2019 pandemic-related closures.

What TIGTA Recommended

TIGTA recommended that the IRS 1) create a single Service-wide comprehensive digitalization strategy that identifies priorities, objectives, interim target dates, milestones, *etc.*, and identifies the IRS business units responsible for the applicable actions; and 2) develop processes to require management to track digitalization efforts and compare results against the plans, goals, objectives, milestone dates, *etc.*, and analyze any significant deviations to identify needed strategic changes. The IRS agreed with both recommendations. It plans to create a single Service-wide strategy that will identify the IRS business units responsible for the applicable actions and a process to track digitalization efforts against stated goals.



TREASURY INSPECTOR GENERAL
FOR TAX ADMINISTRATION

U.S. DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20024

September 6, 2023

MEMORANDUM FOR: COMMISSIONER OF INTERNAL REVENUE

Heather Hill

FROM: Heather M. Hill
Deputy Inspector General for Audit

SUBJECT: Final Audit Report – The Internal Revenue Service Has Experienced
Challenges in Transitioning to Electronic Records (Audit # 202210013)

This report presents the results of our review of the Internal Revenue Service's (IRS) progress in transitioning to electronic records in accordance with Office of Management and Budget/National Archives and Records Administration Memorandum M-19-21, *Transition to Electronic Records*. This review is part of our Fiscal Year 2023 Annual Audit Plan and addresses the major management and performance challenge of *Modernizing IRS Operations*.

Management's complete response to the draft report is included as Appendix IV. If you have any questions, please contact me or Bryce Kisler, Assistant Inspector General for Audit (Management Services and Exempt Organizations).

Table of Contents

<u>Background</u>	Page 1
<u>Results of Review</u>	Page 3
<u>The IRS Has Transitioned Its Permanent Records to an Electronic Format, but Has Struggled Transitioning Its Remaining Temporary Records</u>	Page 3
<u>Recommendations 1 and 2:</u>	Page 15
Appendices	
<u>Appendix I – Detailed Objective, Scope, and Methodology</u>	Page 16
<u>Appendix II – Ongoing Pilot Digitalization Projects</u>	Page 18
<u>Appendix III – Contracts Awarded in Efforts to Align With the National Archives and Records Administration Mandates</u>	Page 19
<u>Appendix IV – Management’s Response to the Draft Report</u>	Page 22
<u>Appendix V – Abbreviations</u>	Page.26

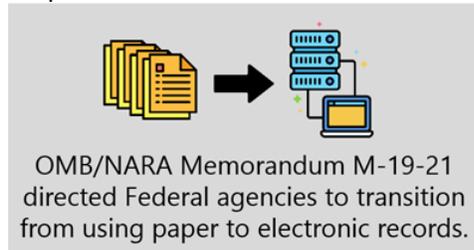
Background

Every year, the Internal Revenue Service (IRS) receives millions of paper-based documents, including tax returns, taxpayer correspondence (*e.g.*, audit responses), and internal records, which translate to tens of millions of sheets of paper. This large volume of paper presents an enormous cost and time burden to the IRS in both the resources required to process and transcribe these documents as well as the cost of physically transporting and storing them.

The IRS sends large volumes of paper to the Federal Records Centers (FRC), which are operated by the National Archives and Records Administration (NARA), for storage and future access. The IRS annually processes more than 240 million tax returns and other forms and currently stores over 5.7 million cubic feet of paper records (the bulk of which are tax returns) at FRCs distributed across 17 locations throughout the United States. On average, the IRS sends 526,000 cubic feet of records to the FRCs each year. Services provided by the FRCs include custodial management, security, retrieval, and disposal of records.

The IRS pays the NARA to store and access these records. Per IRS management, the cost to maintain records at the FRCs was approximately \$35 million in Fiscal Year (FY) 2022. Maintaining large volumes of paper documents requires dedicated resources, management attention, and security investments, which could be applied to more effectively manage electronic records.¹

As part of their continued efforts to compel Federal agencies to transform business processes and recordkeeping to a fully electronic environment, the Office of Management and Budget (OMB) and the NARA jointly issued OMB/NARA Memorandum M-19-21, *Transition to Electronic Records*.² The memorandum identified key targets and deadlines for Federal agencies to manage electronic records and for sending paper records to the FRCs.



Specifically, the memorandum stipulated that by December 31, 2022, Federal agencies should be:

- Managing all permanent records in an electronic format with the appropriate metadata.³

¹ An electronic record contains information recorded in a form that is machine-readable (*e.g.*, information that only a computer or similar system can process, and which, without a computer, would not be understandable to people). Recorded electronic information becomes a Federal record when it satisfies the statutory definition of a “record” and is the same definition applied to information recorded on paper.

² Memorandum for Heads of Executive Departments and Agencies - *Transition to Electronic Records* (June 28, 2019).

³ Permanent records are those that are appraised by the NARA as having sufficient historical or other value to warrant continued preservation by the Federal Government beyond the time it is needed for administrative, legal, or fiscal purposes. For example, organizational studies or realignments which document changes in the way the IRS does business or is structured (*e.g.*, organizational charts) have been identified and appraised by the NARA as permanent records. Metadata describes stored data and includes the structure, data elements, interrelationships, and other characteristics of electronic records.

The Internal Revenue Service Has Experienced Challenges in Transitioning to Electronic Records

- Managing all temporary records in an electronic format to the fullest extent possible.⁴
- Using commercial storage facilities to store analog (paper) records produced after December 31, 2022.

Subsequently, the NARA extended the target implementation date due to delays encountered by agencies during the Coronavirus Disease 2019 (COVID-19) pandemic. In December 2022, the OMB and the NARA issued Memorandum M-23-07, *Update to Transition to Electronic Records*, which reinforces the requirements established in OMB/NARA Memorandum M-19-21, with an updated target implementation date.⁵ Under the updated guidance, all Federal agencies are required to complete the following actions by June 30, 2024:

- Manage all permanent records in an electronic format.
- Manage all temporary records in an electronic format or store them in commercial records storage facilities.

After June 30, 2024:

- Federal agencies must transfer all permanent records in an electronic format with appropriate metadata.
- The NARA will no longer accept transfers of permanent or temporary records in analog formats and will accept records only in an electronic format with appropriate metadata.

Within the IRS, the Commissioner has delegated overall records program management responsibility to the IRS Records Officer, who is organizationally located within the Privacy, Governmental Liaison, and Disclosure (PGLD) function. Within the PGLD function, the Identity and Records Protection function leads Service-wide efforts to implement NARA Federal electronic records management requirements within the IRS. The Identity and Records Protection function collaborates with the Enterprise Digitalization and Case Management Office (ED&CMO) to embed record requirements into its digitalization strategy.⁶ The IRS established the ED&CMO to improve the taxpayer experience by modernizing legacy systems through both Case Management and Digitalization Initiatives.

⁴ Temporary records are records approved by the NARA for disposal after a specified retention period. For example, Forms 1040, *U.S. Individual Income Tax Return*, are considered temporary records. These forms have been appraised and scheduled with a specific retention period of six years. At the end of that retention period, all routine Forms 1040 are eligible for destruction.

⁵ Memorandum for Heads of Executive Departments and Agencies - *Update to Transition to Electronic Records* (December 23, 2022).

⁶ "Digitalization" is the process of converting text, pictures, or sound into a digital form that can be processed by a computer, easily shared, and accessed, whereas "digitization" is the process of converting analog information (*i.e.*, physical documentation that requires physical storage) into a digital format that can be stored digitally through traditional scanning processes, transcription, or other technology.

Results of Review

The IRS Has Transitioned Its Permanent Records to an Electronic Format, but Has Struggled Transitioning Its Remaining Temporary Records

OMB/NARA Memorandum M-19-21 established the deadline for all agencies to adopt electronic recordkeeping requirements, to the fullest extent possible, by December 31, 2022. The OMB and the NARA subsequently extended the deadline for all agencies to June 30, 2024.

Agencies may request a limited exception to the requirements in circumstances where replacing specific analog records with electronic systems would be burdensome to the public, if the cost would exceed the benefit, or for other reasons including instances where statutory or regulatory barriers impede implementation or if there is exceptional intrinsic value in the original format. In September 2020, the IRS asked the NARA for an exception that would enable it to continue to produce paper records and store them at the FRCs until January 2028 (five years beyond the original Calendar Year (CY) 2022 deadline). The IRS request did not cite any specific NARA-identified criteria, but instead cited other reasons. These included:

- Complexity and continuity of IRS operations.
- Continuing assessment of an enterprise-wide strategy and long-term solution for electronic processing of paper records.
- Legislative/policy requirements to maintain specific record information in a paper format.
- Paper volumes – large paper volume (mostly tax records) will continue to be created and will need to be managed via a third-party service provider beyond December 31, 2022.
- Technological interdependencies – the IRS’s ability to successfully modernize includes necessary efforts to determine proper scanning operations and test upgraded environments to ensure the preservation of authoritative digital records prior to the destruction of source paper.

The IRS did not receive an official written response to its initial request and on November 30, 2022, submitted another request to the NARA asking for an exception to continue to produce paper records until December 31, 2030 (an additional three calendar years beyond its original request), stating that it was to “better align with technology modernization efforts and associated implementation requirements” as prescribed in the Taxpayer First Act and the Inflation Reduction Act of 2022.⁷

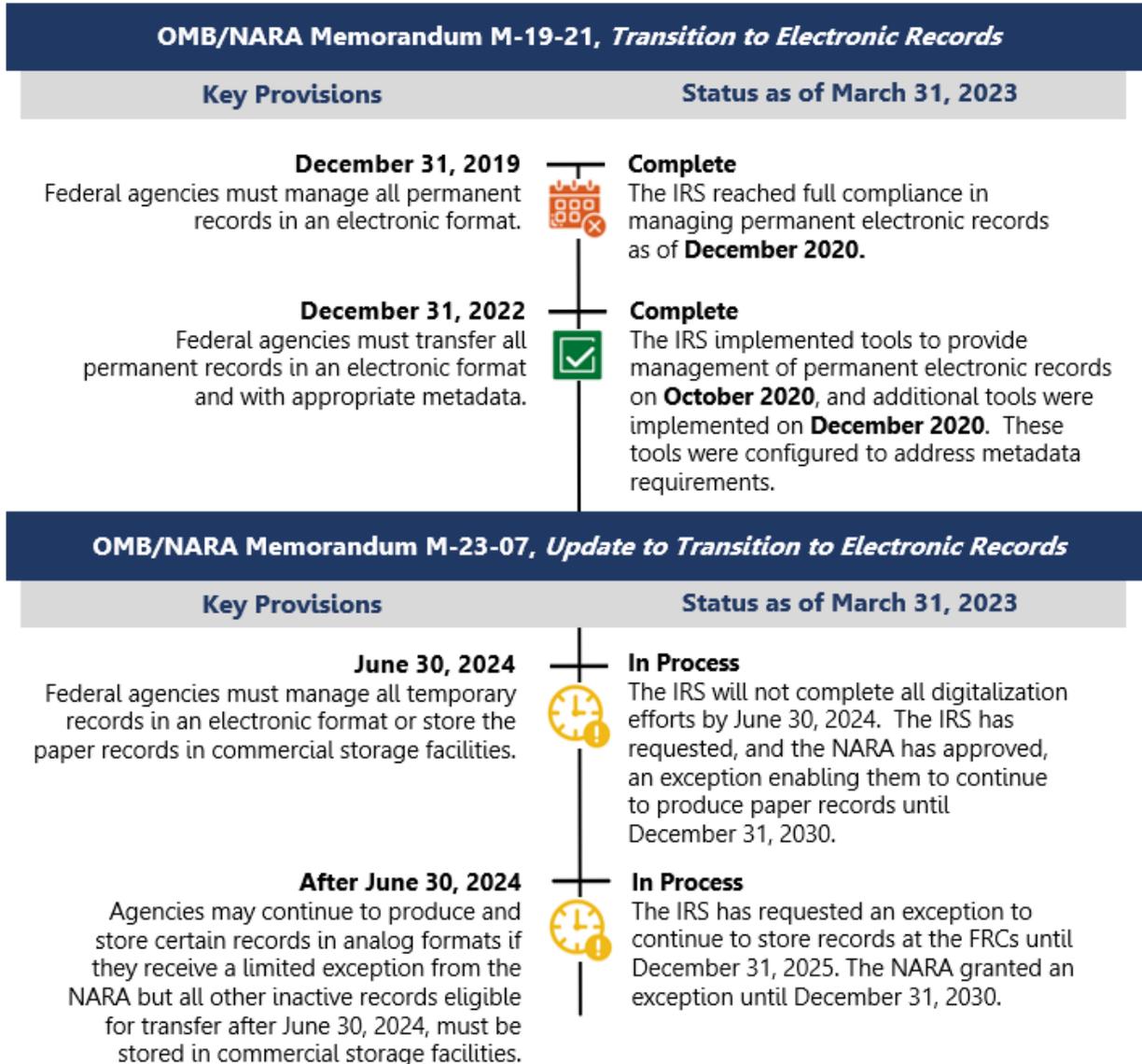
The IRS did not cite any specific provisions of these Acts to support why the additional time was warranted. IRS management had previously stated that they were on track to meet the terms of Memorandums M-19-21 and M-23-07 (hereafter referred to as the NARA mandates) by January 2028.

On February 2, 2023, the NARA granted an exception to the IRS allowing it to continue to store records at the FRCs and additional time to transition to electronic records until December 31, 2030. This approval is contingent upon the IRS providing the OMB and the NARA

⁷ Pub. L. No. 116-25, 133 Stat. 981 (codified in scattered sections of 26 U.S.C.) and Pub. L. No. 117-169, 136 Stat. 1818.

with annual progress reports on specific benchmarks. Figure 1 shows the status of the IRS’s progress towards meeting the key provisions of the electronic recordkeeping requirements.

Figure 1: IRS Progress in Meeting the NARA Provisions



Source: OMB/NARA Memorandum M-19-21, OMB/NARA Memorandum M-23-07, IRS Request for Exception to NARA Mandates (November 30, 2022), and information provided by IRS management.

Fragmented scanning processes create prioritization and scanning challenges

The IRS scans millions of pages of taxpayer documents every filing season, including tax returns, checks, correspondence, and other original documents. However, scanning systems and capabilities vary widely across the organization. Fragmented scanning processes create prioritization and scanning challenges. Paper documents are received in a variety of formats and sizes with varying levels of complexity (e.g., handwritten/typed, quality of paper, length of document), resulting in large-scale electronic data capture challenges.

Current technology, such as optical character recognition (OCR) and document bar coding, would enable the IRS to machine read paper tax returns. However, the IRS does not possess the

capability to perform these functions on a large scale. Further, not all paper-based and electronic data received by the IRS are readily converted to digital data or are accessible electronically across the IRS.⁸

Delayed efforts to digitalize records result in continued reliance on outside storage facilities to manage IRS records and documents. Unlike electronic records, the process to retrieve paper documents is labor-intensive and time consuming. It often takes weeks or months to receive documents if they are received at all. IRS compliance functions are impacted when a previously submitted document cannot be secured. This can potentially result in lost revenue when a document is needed to determine or support a legal course of tax enforcement action.

Taxpayers are burdened when IRS employees are unable to readily access paper files in response to requests for assistance. Further, only one examiner can have the document at a time. This presents a unique challenge, as multiple examiners often need these original documents in cases that require various, simultaneous actions such as those resolving identity theft issues.

In addition, this limits a taxpayer's ability to efficiently interact with the IRS and hinders the IRS's ability to continue functioning during significant disruptions to operations, *e.g.*, Government shutdowns, the COVID-19 pandemic. For example, in response to the COVID-19 pandemic, the IRS took unprecedented and drastic actions to protect the health and safety of its employees and the taxpaying public by closing its tax processing centers nationwide.⁹ During this time, the IRS held large amounts of unopened mail, including paper tax returns and correspondence, in trailers until employees were able to return in person to work.

Digitalization is key to addressing challenges associated with large volumes of paper and achieving compliance with the NARA's electronic recordkeeping mandates. The IRS has long recognized the need to modernize methods for processing paper tax returns but has had limited success in effecting change. Efforts in this regard have primarily focused on improving the electronic filing rate, which has increased over time, although a significant volume of paper tax returns are still received.

Paper-filed tax returns are not only more costly to process than electronically filed (e-filed) tax returns, but they are also more likely to contain errors and be subject to delays in processing, as seen during the COVID-19 pandemic. As a result, interest may be due on refunds from returns that are subject to delays in processing. The IRS paid \$3.5 billion in total refund interest during FY 2022.¹⁰ This is a 70 percent increase from the \$2.06 billion paid in refund interest before the pandemic in FY 2019. While the IRS has developed high-level strategies to help guide its transition to digitalized processes and electronic recordkeeping, these strategies have not been updated to reflect current priorities and the actions required to move forward.

The IRS has struggled to meet electronic recordkeeping requirements

On November 28, 2011, a Presidential Memorandum – *Managing Government Records* – was issued that emphasized the need in Federal agencies for a records management framework that

⁸ Digital is defined as being of or relating to computers.

⁹ The location where the IRS processes paper and electronic submissions, corrects errors, and forwards data to its Computing Centers for analysis and posting to taxpayer accounts.

¹⁰ Total refund interest is related to delays in IRS processing of tax returns as well as amended returns, tax law changes, disaster declarations, and disputes.

would assist them to transition from a paper-based records management system to electronic records management where feasible.

E-mail records

Citing the 2011 Presidential Memorandum, the OMB and the NARA jointly issued Memorandum M-12-18, *Managing Government Records Directive*, on August 24, 2012. Under this directive, Federal agencies were instructed to eliminate paper and use electronic recordkeeping to the fullest extent possible, and to manage both permanent and temporary e-mail records in an electronically accessible format by December 31, 2016.

Further, on September 15, 2014, the OMB and the NARA jointly issued Memorandum M-14-16, *Guidance on Managing Email*, which reiterated that by December 31, 2016, Federal agencies will manage both permanent and temporary e-mail records in an electronically accessible format. Although the IRS had more than four years' notice to meet the electronic e-mail requirements, the IRS did not achieve this objective until October 2017. This delay was partially due to an acquisition protest filed with the Government Accountability Office (GAO).

Permanent records

OMB/NARA Memorandum M-12-18 also stipulated that all permanent electronic records in Federal agencies must be managed electronically, to the fullest extent possible, for eventual transfer of legal custody to the NARA in an electronic format by December 31, 2019. This requirement was reiterated in OMB/NARA Memorandums M-14-16 and M-19-21. However, the IRS did not achieve full compliance with this requirement until December 2020.

OMB/NARA Memorandum M-19-21 also stipulates that after December 31, 2022, all agencies will transfer their permanent records to the NARA in electronic formats with the appropriate metadata. The IRS timely achieved this objective in December 2020.

Temporary records

IRS management will not meet the original deadline to comply with the other provisions of the NARA mandates. Specifically, the IRS was not on track to manage all temporary records in an electronic format or store them in commercial records storage facilities by June 30, 2024. Management cites the large volumes of paper documents received, the paper-intensive nature of business operations and activities, along with the unanticipated demands on resources and attention the COVID-19 pandemic placed on the agency for its inability to meet the terms of the NARA mandates. The vast majority of documents the IRS is responsible for maintaining are temporary records, such as tax returns and supplemental documents. According to the IRS Data Book, the IRS processed more than 262.8 million Federal tax returns and supplemental documents in FY 2022.¹¹ Approximately 49.4 million of these tax returns and supplemental documents were filed on paper.¹²

¹¹ *Internal Revenue Service Data Book, 2022.*

¹² This number excludes information returns, tax-exempt bond returns, and employee retirement benefit plan returns because they do not have the requirement or option to be filed electronically. As a result, this number may be understated. For example, the IRS estimates that 27.2 million information returns were filed in FY 2022 on paper.

Limited actions were taken in response to prior recommendations

The Treasury Inspector General for Tax Administration (TIGTA) has previously identified problems with paper document processing and emphasized the need for the IRS to transition to electronic records in prior audit reports. Additionally, other stakeholders have recommended process improvements in attempts to move the agency forward in its digitalization efforts.

In FY 2009, we reported that the IRS uses a labor-intensive, costly, and error-prone system because it has been unable to implement a modernized submission processing system to convert paper tax returns into an electronic format. The IRS agreed to pursue implementing successful processes followed by States that use scanning technology, *e.g.*, OCR, two-dimensional (2-D) bar codes, to convert paper-filed tax returns prepared by individuals (using a tax preparation software package) into an electronic format.¹³

However, in CY 2015, the IRS determined that there was no longer a sound business case for it to convert paper returns to an electronic format using 2-D bar code scanning because paper return filing had decreased from 34 percent to 17 percent and the rate of e-filed tax returns had increased from 67 percent to 87 percent, significantly reducing the need for this technology.

Subsequently, in an FY 2018 report, the GAO reported that the IRS evaluated digitizing some paper returns using 2-D barcoding technology, but it had not updated that analysis or expanded it to consider other digitizing technologies.¹⁴ In December 2019, IRS officials reported that the agency planned to begin scanning and digitizing individual tax returns filed on paper in October 2021. However, in August 2021, the IRS requested an additional year to complete the recommended action.

In a December 2021 recommendation to Congress, the National Taxpayer Advocate requested dedicated multiyear funding for the IRS to purchase and implement scanning technology to improve the speed and accuracy of paper return and correspondence processing.¹⁵ Noting the COVID-19 pandemic and the significant backlog of unprocessed paper tax returns, the National Taxpayer Advocate subsequently issued a Taxpayer Advocate Directive to the IRS on March 29, 2022, directing it to:¹⁶

- Work with tax return software companies to develop a plan for the companies to voluntarily place 2-D barcodes on returns prepared with their software products during the 2023 Filing Season and beyond.

¹³ TIGTA, Report No. 2009-40-130, *Repeated Efforts to Modernize Paper Tax Return Processing Have Been Unsuccessful; However, Actions Can Be Taken to Increase Electronic Filing and Reduce Processing Costs* (Sept. 2009).

¹⁴ GAO, GAO-18-544, *Tax Fraud and Noncompliance: IRS Could Further Leverage the Return Review Program to Strengthen Tax Enforcement* (July 2018).

¹⁵ The National Taxpayer Advocate operates independently of any other IRS business unit and reports directly to Congress. National Taxpayer Advocate, 2022 Purple Book Legislative Recommendation #5, December 31, 2021: *Require the IRS to Work With Tax Software Companies to Incorporate Scanning Technology for Individual Income Tax Returns Filed on Paper*. The National Taxpayer Advocate Purple Book is a compilation of legislative recommendations made by the National Taxpayer Advocate.

¹⁶ The National Taxpayer Advocate has the delegated authority to issue a Taxpayer Advocate Directive to direct improvements to IRS operations or to grant relief to groups of taxpayers (or all taxpayers).

- Develop a plan to implement OCR or similar technology to automate the processing of handwritten returns and returns without readable barcodes by the start of the 2023 Filing Season or, if not feasible, by the start of the 2024 Filing Season.

In an October 2022 response to Congress, the IRS Commissioner stated that with the additional funding provided by the Inflation Reduction Act, the IRS would be “scanning some paper individual income tax returns as well as some employment tax returns early in 2023. If the scanning is successful, additional individual income tax returns and employment tax returns will be scanned later in 2023.” The response lacked specific details as to the methodologies that would enable these efforts and did not indicate the anticipated volume of documents to be scanned. Earlier in the same month, the IRS reported that OCR and adaptive scanning technologies had been enabled but only for returns received at IRS lockbox locations and only for processing Forms 940, *Employer’s Annual Federal Unemployment (FUTA) Tax Return*.

Currently, the IRS receives over 100 million pieces of mail annually, which are delivered to over 100 unique addresses at tax processing centers. These unique addresses are mainly at campuses to assist in identifying the functional area that generated the correspondence. The sorting of this incoming mail relies on manual processes that do not involve digitalization. IRS processing centers use the Service Center Automated Mail Processing System (SCAMPS) to process incoming mail. These systems automatically open, count, sort, and attempt to detect remittances. SCAMPS machines are over 20 years old and have not had any significant technical upgrades in more than 15 years. However, the IRS has recently initiated a pilot of a program to replace SCAMPS.¹⁷

As we noted in our February 2022 report, the IRS had not taken any significant actions to review and assess needed equipment upgrades, replacement options, *etc.*, even though SCAMPS has limited technological capabilities and there were frequent requests for maintenance.¹⁸ We had previously notified management of our concerns about their inaction to develop a strategy to update or replace SCAMPS equipment. We also noted that since the start of the 2021 Filing Season, SCAMPS machines have been serviced almost 300 times.

In their response, IRS management stated that they would take the actions necessary for the evaluation and purchase of a replacement for the equipment used for opening and sorting mail and ensure that those necessary actions are carried out timely. Because this procurement action is dependent on funding and is subject to competing priorities, IRS management will reevaluate continuing actions if implementation is not successful within three years.

High-level strategies were developed but have not been updated

The *Digital Recordkeeping Modernization Strategy* is an initiative commissioned by the PGLD function’s Chief Privacy Officer and the Director, Identity and Records Protection, to address and meet the targets outlined by the OMB, the NARA, and key legislation. The intent is to enable the IRS to transition recordkeeping to a fully electronic environment that complies with Records and Information Management laws and regulations. The strategy document was last revised in

¹⁷ TIGTA is reviewing SCAMPS replacement in TIGTA, Audit No. 202340610, *Continued Assessment of the IRS’s Efforts to Address the Backlogs During the 2023 Filing Season*.

¹⁸ TIGTA, Report No. 2022-40-015, *Plans to Close the Austin Tax Processing Center Should Be Halted Until Hiring Challenges and Substantial Backlogs at Remaining Centers Are Addressed* (Feb. 2022).

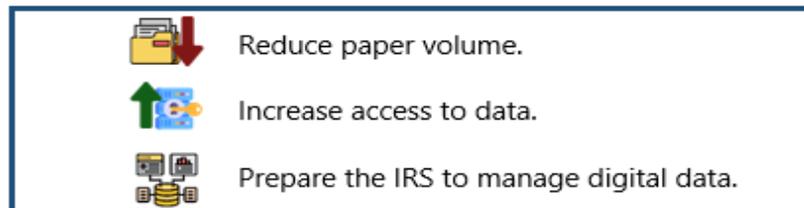
The Internal Revenue Service Has Experienced Challenges in Transitioning to Electronic Records

March 2022 and includes a roadmap that identifies target dates and objectives supporting four broad goals.

- Comply with the FRC mandate.
- Comply with the electronic records mandate.
- Support the modernization of paper intake.
- Support the reduction of paper created post-intake.

Additionally, the PGLD function drafted a digitalization status report that was submitted as support for the IRS's November 30, 2022, request for exception to the NARA mandates. However, seven of the current 13 objectives listed identify December 31, 2030, as the projected completion date and four do not have projected completion dates. Only two of the current objectives have near term completion dates of September 2023 and December 2025. Further, there are no interim target dates that could be used to measure whether progress is on track to meet the completion dates identified.

Per PGLD management, the ED&CMO is responsible for the overall IRS digitalization strategy efforts. The *IRS Digitalization Strategy* was developed in 2020 to address the challenges associated with ingesting large volumes of paper documents and unstructured data to better align the IRS with key Federal guidance, *e.g.*, the NARA mandates. The *IRS Digitalization Strategy* consists of three goals:



The stated vision of the strategy is to “enable a digitally driven IRS by 2025.” Subsequently, ED&CMO management acknowledged that the strategy needs to be “refreshed” and that the initial target date for a refresh of the existing strategy was June 30, 2022. However, per discussions with ED&CMO management in February and April 2023, the strategy had yet to be updated pending ongoing work with IRS executives and discussions relative to the implementation of the Inflation Reduction Act.

Although the IRS has been granted additional time to comply with the NARA mandates, an updated digitalization strategy is needed to help guide the transition to digitalized processes and electronic recordkeeping. The updated strategy should reflect current priorities and the actions required (with interim target dates) to ensure that the processes stay on track moving forward.

Per the GAO's *Standards for Internal Control in the Federal Government*, management should design control activities to achieve objectives and respond to risks.¹⁹ Control activities help management fulfill responsibilities and address identified risk responses in the internal control system. Key management functions include tracking major entity achievements and comparing these to the plans, goals, and objectives set by the entity and analyzing significant differences.

¹⁹ GAO, GAO-14-704G, *Standards for Internal Control in the Federal Government* (Sept. 2014).

Pilot digitalization projects are in progress but are limited in scope and several years out from full implementation

As part of its efforts to address the digitalization of millions of paper documents received annually, the IRS is using pilot projects as a method for testing and evaluating technologies and approaches that can be scaled across the agency. Pilot projects are intended to help the IRS quickly test concepts that could inform future large-scale digitalization solutions. Per IRS management, projects are recommended by employees in IRS business units and are selected based on their potential to help the IRS assess key digitalization capabilities, functions, and technologies.

In December 2021, the IRS established the Digital Integration Board, which is comprised of high-level management officials from various IRS functions and is intended to serve as a catalyst for the *IRS Digitalization Strategy*. Per IRS management, the Digital Integration Board will observe the progress of pilot digitalization projects to assess their potential for scalability across the IRS. However, the pilot projects are limited in scope, and it will be several more years before testing is complete. As such, it is not yet evident if any of the projects will provide the solutions needed for the IRS to meet current electronic recordkeeping requirements. In addition, successful pilots will have to be scaled up to extensive projects, which will take several more years to complete before significant benefits are realized.

Most of the projects are worked collaboratively with the ED&CMO and one or more of the other IRS business units. The list of currently ongoing pilot digitalization projects is provided in Appendix II.

The ED&CMO is using outside vendors on some of the projects. Contracts were awarded under four Requests for Proposal using the Pilot IRS Procurement process. Under this process, projects are awarded with built-in phases that allow officials to determine whether to continue funding or terminate the pilot at the end of each phase. As such, the IRS can select the most qualified vendor for subsequent phases of a project based upon their performance in a prior phase. Cumulatively, the IRS has spent more than \$24 million on contracts for these four pilot projects (Submission Processing Modernization, Augmented Reality (AR), OCR, and Scanning as a Service (SCaaS)) that are intended to further IRS efforts in achieving compliance with the NARA mandates. A more detailed description of the contract terms and the associated costs are provided in Appendix III.

The IRS has spent more than **\$24 million** on contracts intended to further IRS efforts in achieving compliance with the NARA mandates.



TIGTA has initiated an audit to evaluate the IRS's efforts to scan paper-filed individual tax returns into an electronic format for the 2023 Filing Season.²⁰ This will include the three pilot projects that ED&MCO management considers to be the most critical to the success of the digitalization process:

SCaaS – This project involves converting paper records into digital files that will be stored in an IRS repository and serve as the official record and converting incoming paper returns into digital files and filing them electronically. The initial phase of the

²⁰ TIGTA, Audit No. 202340829, *IRS Efforts to Scan Paper-Filed Individual Tax Returns for the 2023 Filing Season*.

project focused on scanning Forms 709, *United States Gift (and Generation-Skipping Transfer) Tax Return*, while the second phase is focused on expanding the scope to include other forms and a more significant volume of paper documents.

Although they comprise far less than 1 percent of all forms received annually, Forms 709 were selected for the SCaaS pilot because of their long retention period. They are held in storage (sometimes for decades) until they can be associated with the applicable Form 706, *United States Estate (and Generation-Skipping Transfer) Tax Return*, which is filed after the death of the gift giver.

Contracts were awarded to vendors in August 2021 and the project is currently in the second of two phases that is expected to take up to four and a half years. In addition to Forms 709, contractors have begun scanning Forms 941, *Employer's Quarterly Federal Tax Return*, for Tax Year 2022.

Lockbox – This project relies on an existing relationship with the Department of the Treasury's Bureau of the Fiscal Service to scan Forms 940 and submit them electronically. Per IRS management, 3,705 Forms 940 were accepted into the electronic filing system through the lockbox project in CY 2022 and this continued into CY 2023. As of March 6, 2023, over 120,000 scanned paper Forms 940 were accepted through the lockbox project. IRS management anticipates that the volume of Forms 940 will reach approximately 400,000 through this project in CY 2023 and intends to expand the process with additional industry partners and forms. The stated intent is to expand the process to include Forms 941 and Forms 1040, *U.S. Individual Income Tax Return*, later in CY 2023.

Submission Processing Modernization – This project seeks to identify solutions to improve the IRS's ability to receive, count, sort, mark, and process high volumes of mail of varying shapes, sizes, and dimensions with additional capability to identify, extract, and digitize/digitalize data from envelopes and their contents. Contracts were awarded to vendors in August 2022, and the project is currently in the second of three phases with completion of Phase 2 expected in FY 2023. During Phase 2, the contractors transitioned to scanning and e-filing Forms 1040 and 10 attachments. Phase 3 of the project will expand to scanning and e-filing Forms 1040 and 25 attachments. Phase 3 of the project is expected to take up to four years to complete.

Other efforts have been completed with limited results:

OCR – This project involved extracting machine-readable data from low-resolution and poor-quality images (both digital and paper) with the capability to integrate them with the IRS's information technology systems and intake different types of forms and data. The pilot project was discontinued in October 2022 after failing to identify acceptable solutions using the vendor and resources provided. The ED&CMO has no plans to resume this effort at this time.

2-D Barcoding – This project requires tax return preparation software to generate and imprint a barcode that captures the information from the return. Upon receipt of the paper return, the IRS then scans the barcode to capture the data and process the return as if it had been transmitted electronically. The technology has been employed for data intake for Forms 8918, *Material Advisor Disclosure Statement*, and 8886, *Reportable Transaction Disclosure Statement*. However, the IRS cannot expand 2-D barcoding to

Forms 1040 without engaging the software industry to revise industry standards for data intake and processing. The National Taxpayer Advocate has submitted a legislative request asking Congress to require the IRS to work with tax software companies to incorporate scanning technology for individual income tax returns filed on paper. Per IRS management, there are currently no additional efforts to expand 2-D barcoding to other forms.

V-Code Initiative – The ED&CMO was not directly involved in this initiative to address the backlog of Tax Years 2020 and 2021 paper returns. It was an effort led by the Wage and Investment (W&I) Division using scanning technology to convert paper-filed tax returns (that were prepared using tax preparation software) into an electronic format. Once converted, the tax return was processed as an e-filed tax return. However, the results were inconsistent, and per IRS management, the project has since been discontinued.

Continued expansion of e-filing is critical to the *IRS Digitalization Strategy*

IRS efforts to digitalize records could be significantly enhanced by increasing the rate of e-filed tax returns. As noted in a May 2022 TIGTA report, e-filing provides significant benefits to taxpayers and the IRS.²¹ One of the primary benefits to the IRS is the substantially reduced processing costs. On average, compared to paper-filed tax returns, the IRS saves \$4.29 per return in processing costs for e-filed business tax returns and \$7.06 per return for e-filed individual tax returns.²² Further, e-filed tax returns allow for immediate retrieval and reduce the need for storage.

Paper-filed tax returns are not only more costly to process than e-filed tax returns, they are also more likely to contain errors and be subject to delays in processing.

Paper-filed tax returns are not only more costly to process than e-filed tax returns, but they are also more likely to contain errors and be subject to delays in processing. For example, as we previously reported, the IRS closed its tax processing centers in March and April 2020 in response to the COVID-19 pandemic. Although the IRS re-opened its tax processing centers in June 2020, delays in processing backlogged paper tax returns continue to burden taxpayers and the IRS continued to have a backlog into the 2023 Filing Season.²³

Additionally, return processing backlogs and delays in issuing refunds were contributing factors in the IRS paying significantly more refund interest to taxpayers. This is because the IRS is generally required to pay interest on refunds issued more than 45 days after the filing deadline.²⁴ The IRS paid \$3.5 billion in total refund interest during FY 2022, an increase from the \$3.03 billion and \$3.27 billion paid in both FYs 2020 and 2021, respectively, and the \$2.06 billion paid in FY 2019.

²¹ TIGTA, Report No. 2022-40-036, *A Service-Wide Strategy Is Needed to Address Challenges Limiting Growth in Business Tax Return Electronic Filing* (May 2022).

²² Document 6746, *Cost Estimate Reference* (Rev. 5-2022).

²³ TIGTA, Report No. 2023-46-007, *Backlogs of Tax Returns and Other Account Work Will Continue Into the 2023 Filing Season* (Dec. 2022).

²⁴ 26 U.S.C. § 6611.

For FY 2022, nearly 213.4 million returns and other forms were filed electronically. These represented approximately 81 percent of all filings. For individual tax returns, 93.8 percent were filed electronically. However, the number of paper-filed tax returns is still significant with over 13 million individual tax returns (Forms 1040 and 1040-SR, *U.S. Tax Return for Seniors*) and over 20 million business tax returns filed on paper in CY 2022.

Although the use of e-file has increased, business tax returns are less likely to be e-filed. Responding to a FY 2014 TIGTA report, the IRS agreed to:²⁵

- Develop a Service-wide strategy that outlines specific efforts the IRS will initiate to advance the e-filing rate of business tax returns.
- Continue to expand the type of business tax returns that can be e-filed through the Modernized Electronic Filing system.

The IRS's stakeholders continue to share concerns about its e-filing rate for business income and employment tax returns. For example, in a March 2021 report, the GAO noted that although the IRS established several projects to modernize some of its paper-based processes, none of the ongoing projects involve making additional business-related tax forms available for e-filing.²⁶

Additionally, in Publication 3415, *IRS Electronic Tax Administration Advisory Committee Annual Report to Congress* (June 2021), the Electronic Tax Administration Advisory Committee recommended that the IRS prioritize work that will make e-filing available or easier for forms with significant filing volumes.²⁷ Emphasis was placed on employment tax returns given that the e-file rate was approximately 53 percent. The Electronic Tax Administration Advisory Committee asserts that more progress must be made in removing the barriers to e-filing and that the IRS needs to place greater emphasis on e-filed employment tax returns.

However, as we reported in May 2022, IRS management did not take sufficient actions to address the recommendations included in our prior review and more effort was needed to increase growth in e-filing of employment tax returns. Further, we reported that the Modernized Electronic Filing Sequencing Plan to prioritize the continued expansion of forms available for e-filing was replaced by an ineffective decentralized process. The *IRS Digitalization Strategy* does not include continued expansion of forms for e-filing.

In response, IRS management stated they plan to "reevaluate e-filing options and coordinate across the organization to understand stakeholders' digital needs and the challenges in meeting these needs and to develop a clearer and more comprehensive view of ongoing digitalization efforts." IRS management also stated that they planned to develop a strategy to incorporate individual and business tax forms that may be filed through the existing e-filing platform. The IRS agreed to implement these actions by March 15, 2023; however, IRS management has since

²⁵ TIGTA, Report No. 2014-40-084, *A Service-Wide Strategy Is Needed to Increase Business Tax Return Electronic Filing* (Sept. 2014).

²⁶ GAO, GAO-21-251, *Tax Filing: Actions Needed to Address Processing Delays and Risks to the 2021 Filing Season* (Mar. 2021).

²⁷ Section 2001(b)(2) of the IRS Restructuring and Reform Act of 1998 (Pub. L. No. 105-206, 112 Stat. 685 (codified as amended in scattered sections of 2 U.S.C., 5 U.S.C. app., 16 U.S.C., 19 U.S.C., 22 U.S.C., 23 U.S.C., 26 U.S.C., 31 U.S.C., 38 U.S.C., and 49 U.S.C.)) authorized the creation of the Electronic Tax Administration Advisory Committee to ensure input from the private sector in the development and implementation of a plan to eliminate barriers, provide incentives, and use competitive market forces to increase e-filing.

stated that they require additional time to perform these actions and requested an extension to March 15, 2024.

The IRS cannot mandate that returns be submitted electronically although certain types of entities and filers are statutorily required to e-file, including certain large corporations and tax return preparers. Additionally, with the passage of the Taxpayer First Act, tax return preparers who file 10 or more returns in CY 2022 are now required to file returns electronically.

Congress intended for the IRS to actively pursue e-filing per the IRS Restructuring and Reform Act of 1998. The IRS was directed to “establish a plan to eliminate barriers, provide incentives, and use competitive market forces to increase electronic filing....” Further, the IRS was advised that the plan should, “to the extent practicable, provide that all returns prepared electronically for taxable years beginning after 2001 shall be filed electronically.” Given that the IRS has not developed a Service-wide strategy to incorporate all forms for e-filing, additional legislation may be necessary to spur expansion of e-file to certain types of forms or filers.

Delayed efforts to digitalize records have resulted in continued reliance on outside storage facilities

The volume of paper documents created as well as delayed digitalization necessitates the use of outside storage facilities to maintain IRS records until they are scheduled for destruction. The IRS does not maintain any agency-operated storage facilities for paper records and currently uses the FRCs to store them. As part of its interagency agreement with the IRS, the NARA is responsible for the storage, management, and retrieval of IRS records and documents at its FRCs. However, the FRCs were closed or operating at limited capacity due to COVID-19 pandemic restrictions starting in March 2020, which affected the servicing of IRS document requests.

As stated in our May 2022 report, the IRS reported having more than 8.9 million tax returns waiting to be shipped to an FRC and more than 2,000 outstanding requests for paper-filed tax return-related documents (needed by IRS business units to address taxpayer compliance and customer service cases) as of December 31, 2021. The Chief Operating Officer of the NARA estimated that it would take several years to fulfill the IRS’s outstanding document requests.

Problems securing records from the FRCs are not entirely attributable to COVID-19 pandemic-related access issues. As we reported in 2020, the IRS could not always locate or timely retrieve paper tax records.²⁸ Specifically, the IRS could not locate 12 (6 percent) of 185 examination case files and five (3 percent) of 185 related individual tax returns that we requested. An additional 43 (23 percent) of the 185 examination case files and 19 (10 percent) of the 185 individual tax returns were eventually located but were not provided timely.

Further, previous interviews with IRS management confirmed that there is no tracking method in place to determine when document requests are received and completed. As a result, some requestors may never receive the documents requested. Without a tracking method, a reconciliation of document requests cannot be performed, and the IRS could be paying for services that may not be provided.

²⁸ TIGTA, Report No. 2020-10-050, *Sensitive Tax Records Could Not Always Be Located or Timely Provided* (Aug. 2020).

The Federal Government's interest is harmed when the IRS is unable to produce the documents needed to support the IRS's position as part of an examination, appeal, tax court case, *etc.* This issue is being addressed in a separate TIGTA audit that is included in our FY 2023 Annual Audit Plan.²⁹

The IRS does not anticipate completing digitalization efforts until December 31, 2030; however, it is not currently seeking commercial storage space for paper records created after June 30, 2024, as stipulated in the 2022 NARA mandate. Because the IRS is not seeking commercial storage space, it will continue to incur costs to store its records at the FRCs until more documents are digitalized. Fees paid include not only the cost to store documents, but also costs to transfer records, service reference requests, and refile documents. PGLD management indicated that they anticipate these costs will increase to over \$38 million in FY 2023 and will be approximately \$36 million in both FYs 2024 and 2025.

The Chief Information Officer should:

Recommendation 1: Create a single Service-wide comprehensive digitalization strategy that identifies priorities, objectives, interim target dates, milestones, *etc.* The strategy should identify the IRS business units responsible for the applicable actions and should be updated annually.

Management's Response: The IRS agreed with this recommendation and will create a single Service-wide comprehensive digitalization strategy. The Chief Information Officer will collaborate with the Transformation and Strategy Office on corrective actions for this recommendation. The Transformation and Strategy Office will create a single Service-wide comprehensive digitalization strategy that identifies priorities, objectives, interim target dates, milestones, *etc.* The strategy will identify the IRS business units responsible for the applicable actions and will be updated annually.

Recommendation 2: Develop processes to require management to track digitalization efforts and compare results against the plans, goals, objectives, milestone dates, *etc.*, and analyze any significant deviations to identify needed strategic changes.

Management's Response: The IRS agreed with this recommendation and will develop a process requiring management to track digitalization efforts against stated goals.

²⁹ TIGTA, Audit No. 202330016, *IRS Management of Taxpayer Paper Files*.

Appendix I

Detailed Objective, Scope, and Methodology

The overall objective of this audit was to assess the IRS's progress in transitioning to electronic records in accordance with OMB/NARA Memorandum M-19-21, *Transition to Electronic Records*. To accomplish our objective, we:

- Identified the key provisions of the NARA mandates and other relevant guidance to determine the actions necessary for the IRS to achieve compliance with the mandates.
- Identified the roles and responsibilities of the PGLD function, the ED&CMO, and other IRS business units responsible for implementing provisions of the NARA mandates.
- Determined the actions taken by the IRS in response to the NARA mandates by:
 - Interviewing IRS management officials in the PGLD function and the ED&CMO.
 - Obtaining and reviewing supporting documentation from the IRS including the *IRS Digitalization Strategy*, the *Digital Record Keeping Modernization Strategy*, etc.
- Identified and reviewed TIGTA and GAO audit reports that address the IRS's efforts to digitalize records to identify potential causes and effects of the IRS's failure to timely digitalize records.

Performance of This Review

This review was performed with information obtained from the PGLD function and the ED&CMO in Washington, D.C., during the period November 2021 through June 2023. 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.

Major contributors to the report were Bryce Kisler, Assistant Inspector General for Audit (Management Services and Exempt Organizations), Glen Rhoades, Director; Lindsay Steward, Audit Manager; Meaghan Tocco, Acting Audit Manager; and Mary Herberger, Lead Auditor.

Internal Controls Methodology

Internal controls relate to management's plans, methods, and procedures used to meet their mission, goals, and objectives. Internal controls include the processes and procedures for planning, organizing, directing, and controlling program operations. They include the systems for measuring, reporting, and monitoring program performance. We determined that the following internal controls were relevant to our audit objective: the NARA mandates (OMB/NARA Memorandums M-19-21 and M-23-07); the *IRS Digitalization Strategy* (July 2020); the *Digital Recordkeeping Modernization Strategy* (multiple revisions) as well as the results of

other related TIGTA and GAO audits and the Joint Audit Management Enterprise System.¹ We evaluated these controls by requesting and reviewing IRS guidance and documentation on transitioning to electronic records as well as interviewing IRS personnel responsible for implementing provisions of the NARA mandates.

¹ The Department of the Treasury system for use by all bureaus to track, monitor, and report the status of internal control audit results. The system tracks specific information on issues, findings, recommendations, and planned corrective actions from audit reports issued by oversight agencies, such as the GAO and TIGTA.

Appendix II

Ongoing Pilot Digitalization Projects

Pilot	Description	Primary Business/ Organizational Unit
AR	Collaborate with the Information Technology organization to generate information when any mobile device is directed at IRS images, forms, etc., based on the IRS's publicly available information. The application explains the benefits of e-filing and encourages taxpayers to file in this way.	The ED&CMO is operating as the primary, with project support from the Online Services function and the W&I Division.
Digital and Mobile Adaptive Forms	With the Services and Enforcement Program Management Office and the W&I Division, the IRS is working to support business unit migration of paper-based forms to mobile-responsive and 508 compliant adaptive forms.	W&I Division
Lockbox	In collaboration with the W&I Division, the ED&CMO is working on a document intake solution that will increase data collection up front, optimize electronic file storage, and achieve full data capture for paper submissions received at IRS lockbox processing sites.	W&I Division
Scaled Digital Initiative Model	Develop a standardized project life cycle to support the evolution and maturity of project management efforts.	ED&CMO
SCaaS	Collaborate with the Small Business/Self-Employed Division to manage services to convert paper files to digital records and data. SCaaS contractors will scan paper files and transfer the digital files and related metadata to the IRS. The IRS will then store these digital files in a NARA-compliant storage repository and destroy the paper records.	Small Business/ Self-Employed and W&I Divisions
Submission Processing Modernization	Seek information on technologies capable of high-capacity (100 million+ pieces of mail) digital intake.	W&I Division
Taxpayer Digital Communications Form 8288 Installation	Allow the taxpayer or taxpayer's Power of Attorney to communicate with the IRS via secure two-way messaging, electronically file Form 8288, <i>U.S. Withholding Tax Return for Certain Dispositions by Foreign Persons</i> , and obtain an opportunity zone eligibility certificate, eliminating a new requirement for a paper form.	Large Business and International Division

Source: Enterprise Digitalization and Program Management Office (February 10, 2023).

Appendix III

Contracts Awarded in Efforts to Align With the National Archives and Records Administration Mandates

OCR

	Phase 1	Phase 2	Phase 3
Description of Phase	Proof of Concept and Prototype: Extracting machine-readable data from publicly available Form 990, <i>Return of Organization Exempt from Income Tax</i> (not to exceed \$50,000/60 days).	Additional Testing and Pilot/Initial Deployment - will expand the scope of the results of Phase1 by increasing the number and type of Forms 990 and possibly additional forms (not to exceed \$150,000/120 days).	Deployment - additional deployment efforts within IRS systems, additional IRS forms/images, or shifting to poor-quality documents (not to exceed \$7.3 million/4.5 years).
Number of Vendors Awarded Contracts	Five	Three	One
Current Phase	Discontinued as of October 18, 2022		
Cumulative Cost Total (no FY 2023 contractual expenditures).	\$1,400,000		

Source: IRS Request for Proposal dated June 23, 2021; Notice of Award on July 26, 2021; and IRS management cost totals as of March 14, 2023.

The Internal Revenue Service Has Experienced Challenges in Transitioning to Electronic Records

SCaaS

	Phase 1	Phase 2
Description of Phase	Testing and Pilot/Initial Deployment - will consist of a demonstration of the ability of the solution to provide high-resolution scans and to transfer them to the IRS through secure digital channels. The project will focus on scanning Form 709 (not to exceed \$200,000/180 days).	Deployment - will focus on scaling the scanning solution and transmission of documents to encompass a significant volume of paper documents. A key component of Phase 2 will be leveraging efficiencies to timely handle the significant scanning workload (not to exceed \$7.3 million/4.5 years).
Number of Vendors Awarded Contracts	Five	Three
Current Phase	Ongoing – Phase 2	
Cumulative Cost Total (including FY 2023 commitments)	\$15,550,000	

Source: IRS Request for Proposal dated July 19, 2021; Notice of Award on August 18, 2021; and IRS management cost totals as of March 14, 2023.

AR

	Phase 1	Phase 2	Phase 3
Description of Phase	Proof of Concept and Prototype: Provide operational prototypes which utilize the IRS's publicly available sets of information to improve the taxpayer experience (not to exceed \$50,000/60 days).	Additional Testing and Pilot/Initial Deployment - will consist of efforts to gain additional empirical information on how the solutions generate improvements to the taxpayer experience (not to exceed \$150,000/120 days).	Deployment - will focus on additional deployment of solutions involving other IRS publicly available sets of information and improvements to the taxpayer experience (not to exceed \$7.3 million/4.5 years).
Number of Vendors Awarded Contracts	Four	Three	One
Status	Ongoing – Phase 3		
Cumulative Cost Total (no FY 2023 contractual expenditures).	\$3,000,000		

Source: IRS Request for Proposal dated August 31, 2021; Notice of Award on September 22, 2021; and IRS management cost totals as of March 14, 2023.

The Internal Revenue Service Has Experienced Challenges in Transitioning to Electronic Records

Submission Processing Modernization

	Phase 1	Phase 2	Phase 3
Description of Phase	Proof of Concept and Prototype: Demonstrate sorting, opening, processing, and reporting on various types of mail. Primarily a demonstration of the solution to perform intake of mail of various shapes and dimensions in large quantities (not to exceed \$75,000/180 days).	Additional Testing and Pilot/Initial Deployment - will demonstrate the ability to further process mail beyond intake, to include sorting accuracy, reporting functions, remittance identification and management, opening and extracting contents, <i>etc.</i> (not to exceed \$150,000/180 days).	Deployment: - will demonstrate the ability to digitalize data extracted from the mailings, to include how data recording and downstream access will occur; remittance processing; ease of IRS access to extracted data and the ability to interface and be compliant with IRS systems, cybersecurity requirements, hardware, and software, <i>etc.</i> (not to exceed \$7.275 million/4 years).
Number of Vendors Awarded Contracts	Five	Four	To Be Determined
Status	Modified, ongoing – Phase 2 ¹		
Cumulative Cost Total (including FY 2023 commitments)	\$4,375,000		

Source: IRS Request for Proposal dated July 12, 2022; Notice of Award on August 8, 2022; and IRS management cost totals as of March 14, 2023.

¹ Contracts with Phase 2 vendors were subsequently modified to include: compression of Phase 2 and the first half of Phase 3 to combine the proof of concept, solution deployment, and production. Funding was reallocated and \$1,000,000 was distributed to each Phase 2 vendor. The Phase 2 time frame was revised to 90 days with expected completion in May 2023.

Appendix IV

Management's Response to the Draft Report



DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, DC 20224

August 25, 2023

MEMORANDUM FOR DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: Kathleen E. Walters *Kathleen E. Walters*
Chief Privacy Officer

SUBJECT: Draft Audit Report – The Internal Revenue Service Has Experienced Challenges in Transitioning to Electronic Records (Audit #202210013)

Thank you for the opportunity to review the above referenced draft audit report. We agree with your recommendations and appreciate your acknowledgement of the steps we have already taken to transition to electronic records. The IRS is firmly committed to meeting the Office of Management and Budget (OMB) and the National Archive and Records Administration (NARA) Memoranda M-19-21 and M-23-07 goals and criteria and will continue efforts to digitize and transition from analog to digital records management in the manner prescribed by NARA.

As noted in your report, given the paper-intensive nature of IRS business operations, along with the unanticipated demands on resources and attention that the COVID-19 pandemic placed on the agency, full compliance with M-19-21 and M-23-07 by June 2024 was not feasible for the IRS; therefore, we requested an exception until December 2030, which NARA granted.

We disagree with the assertion in your report that the IRS did not cite any specific NARA-identified criteria for requesting this exception but instead cited other reasons. In accordance with NARA Bulletin 2020-01, exception requests submitted by agencies had to be based on a combination of criteria, broadly outlined in M-19-21 and M-23-07, as part of an overall business case. The business case could contain variables such as the cost for digitization services, the cost for reference services, legal analysis of ownership and access issues, and time estimates with supporting documentation for how long an exception would be needed. The exception request submitted by IRS aligned with the criteria established by NARA for all federal agencies and was approved accordingly.

Building on recent progress enabled by the Inflation Reduction Act (IRA), the IRS recently announced the Paperless Processing Initiative that will allow taxpayers to go paperless for all IRS correspondence by the 2024 filing season and enable paperless processing for all tax returns by the 2025 filing season. The IRS Commissioner has identified four key digitalization priorities to enable this and achieve a “Digital First IRS”. These priorities include:

- **Digital & Mobile Adaptive Forms:** Modernize forms that enhance the taxpayer experience while bringing electronic data through web portals and system integrations.
- **Historical Digitalization:** Clear out historical documents stored at physical C-site and campuses by leveraging current scan and store methodology to expand digital accessibility for taxpayers and employees, while eliminating millions of dollars of storage costs.
- **Document Upload Tool (DUT) & Deliver Digital Inventory Management:** Scale DUT enabling taxpayers to submit all documents (e.g., correspondence, non-tax forms, responses to notices) to IRS electronically and deliver a solution to sort and assign incoming digitized documents for improved employee experience.
- **Paper Tax Return Digitalization:** Scanning and digitalizing paper submissions at the point of entry, enabling the IRS to provide faster tax refunds, while also delivering real-time data to employees; driving faster case closure times and the ability to effectively solve taxpayer issues.

Collectively, these initiatives support IRS's goals of reducing paper, increasing access to digital data, and preparing employees to effectively manage that data. Privacy, Governmental Liaison and Disclosure is collaborating with the Transformation and Strategy Office, Information Technology, and the impacted business unit leaders on developing the IRS digital roadmap/strategy.

With respect to the pilot digitalization projects referenced in the report (pages 10-11), we provide the following clarification:

- **Pilot IRS – Pilot IRS** is an agile acquisition methodology in accordance with Federal Acquisition Regulation, Part 13, and is used for Scanning as a Service (SCaaS) and Submission Processing Modernization. It is an iterative procurement technique focused on outcomes to enable the IRS to rapidly identify, test, and deploy solutions through a phased structure and incremental funding decisions. If a solution fails to meet expectations, then it will not proceed to the next phase of funding. Multiple vendors can be selected to advance phases, and Pilot IRS projects are not limited to one vendor.
- **The Augment Reality Project – IRS Information Technology** is included in the working group. The industry partner has developed the technical solution, not IT.

- SCaaS – In addition to Forms 709, industry partners have begun scanning and e-filing Forms 941, Employer's Quarterly Federal Tax Return, for Tax Years 2022 and 2023. SCaaS industry partners have already scanned and e-filed these forms for TY23 Q1 and are beginning to scan and e-file these forms for TY23 Q2. As of July 25, 2023, 98,000 scanned Forms 941 were accepted into Modernized e-File (MeF).
- Submission Processing Modernization – In March 2023, industry partners scanned, and e-filed F1040 and 10 attachments. In June 2023, the project expanded to include Form 1040 and 25 attachments. As of July 25, 2023, 47,368 scanned Forms 1040 were accepted into MeF.
- Lockbox – Per IRS management 3,705 Forms 940 were scanned and e-filed by the Lockbox project in CY 2022, and scanning Forms 940 has continued into CY 2023. As of July 25, 2023, over 480,000 paper Forms 940 were scanned and e-filed by the Lockbox project. As of July 25, 2023, over 137,000 paper Forms 941 (Q1 & Q2) TY23 were scanned and e-filed by the Lockbox project.

Attached is a detailed response outlining our corrective actions.

If you have any questions, please contact me at 202-317-6449, or a member of your staff may contact Michael Oser, Acting Director, Identity and Records Protection, at (408) 513-3568.

Attachment

Attachment

RECOMMENDATION 1:

The Chief Information Officer should create a single Service-wide comprehensive digitalization strategy that identifies priorities, objectives, interim target dates, milestones, etc. The strategy should identify the IRS business units responsible for the applicable actions and should be updated annually.

CORRECTIVE ACTION:

The IRS agrees with this recommendation and will create a single Servicewide comprehensive digitalization strategy. The Chief Information Officer will collaborate with the Transformation and Strategy Office on corrective actions for this recommendation. The Transformation and Strategy Office will create a single Service-wide comprehensive digitalization strategy that identifies priorities, objectives, interim target dates, milestones, etc. The strategy will identify the IRS business units responsible for the applicable actions and will be updated annually.

IMPLEMENTATION DATE:

June 28, 2024

RESPONSIBLE OFFICIAL(S):

Transformation and Strategy Office, Information Technology (IT), Associate Chief Information Officer (ACIO), Enterprise Program Management Office (EPMO)

CORRECTIVE ACTION MONITORING PLAN:

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

RECOMMENDATION 2:

The Chief Information Officer should develop processes to require management to track digitalization efforts and compare results against the plans, goals, objectives, milestone dates, etc., and analyze any significant deviations to identify needed strategic changes.

CORRECTIVE ACTION:

The IRS agrees with this recommendation and will develop a process requiring management to track digitalization efforts against stated goals.

IMPLEMENTATION DATE:

June 28, 2024

RESPONSIBLE OFFICIAL(S):

Information Technology (IT), Associate Chief Information Officer (ACIO), Enterprise Program Management Office (EPMO)

CORRECTIVE ACTION MONITORING PLAN:

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

Appendix V

Abbreviations

2-D	Two-Dimensional
AR	Augmented Reality
COVID-19	Coronavirus Disease 2019
CY	Calendar Year
ED&CMO	Enterprise Digitalization and Case Management Office
E-file(d); E-filing	Electronically File(d); Electronic Filing
FRC	Federal Records Center
FY	Fiscal Year
GAO	Government Accountability Office
IRS	Internal Revenue Service
NARA	National Archives and Records Administration
OCR	Optical Character Recognition
OMB	Office of Management and Budget
PGLD	Privacy, Governmental Liaison and Disclosure
SCaaS	Scanning as a Service
SCAMPS	Service Center Automated Mail Processing System
TIGTA	Treasury Inspector General for Tax Administration
W&I	Wage and Investment



**To report fraud, waste, or abuse,
contact our hotline on the web at www.tigta.gov or via e-mail at
oi.govreports@tigta.treas.gov.**

**To make suggestions to improve IRS policies, processes, or systems
affecting taxpayers, contact us at www.tigta.gov/form/suggestions.**

Information you provide is confidential, and you may remain anonymous.