



March 18, 2004

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Dear Mr Kaizen

The Office of Government Ethics (OGE) has recently completed its review of the Internal Revenue Service's (IRS) ethics program. This review was conducted pursuant to section 402 of the Ethics in Government Act of 1978, as amended (Ethics Act). Our objective was to determine the ethics program's effectiveness, as measured by its compliance with applicable ethics laws and regulations. Our current review was conducted intermittently from June through November 2003 and focused on IRS' National Office, which consists of two separate and distinct entities: the Office of the Chief Counsel (Counsel) and the larger IRS organization (which is commonly referred to as the Service). The following is a summary of our findings, conclusions, and recommendations for improvement.

HIGHLIGHTS

We found the IRS ethics program to have many strong program elements that effectively ensure the public's confidence in an ethical Government, including a well-managed public system and a noteworthy counseling and advice program. We found vast improvements in the Service's confidential system (many of the deficiencies identified during our 1999 program review of IRS focused on this area), and noted the use of technology in the ethics program as an outstanding and effective resource.

The most significant change made to the ethics program since our last review was the establishment of the Service-wide Ethics Program Operations (SEPO) to manage the Service's ethics program. SEPO has made significant strides in managing the operational aspects of Service's ethics program, however, the program may suffer in the long-term unless it receives a high level of visibility within the Service and has sufficient staffing resources. Therefore, IRS leadership needs to commit a high level of support and attention to ensure that Service's ethics program receives the proper resources and assistance needed to be administered in a positive and effective manner, as required by 5 C F R § 2638 202(a).

Moreover some improvements are necessary to help further enhance the effectiveness of IRS' ethics program These improvements are

- developing procedures to ensure that all new employees entering and those transferring into covered positions within the Service file a new entrant confidential financial disclosure report in accordance with 5 C F R § 2634 903(b),
- developing procedures that outline the notification, completion, submission, review, and retention process for the Art Advisory Panel's financial disclosure system and that also clarify the responsibilities of both the Art Appraisal Services and SEPO,
- having financial disclosure reviewers use the prior approvals for outside employment when reviewing confidential disclosure reports to assure compliance with 5 C F R § 3101 104 and to enable the reviews to be conducted in accordance with §§ 2634 909(a) and 2634 605, and
- developing procedures to ensure that IRS' travel acceptances are no longer reported to OGE in error

When these issues are addressed, the IRS ethics program will be in full compliance

ADMINISTRATION OF ETHICS PROGRAM

IRS, a bureau of the Department of the Treasury (Treasury), consists of approximately 115,000 employees (including seasonal employees) IRS is divided into two components, Counsel and Service Counsel is comprised of approximately 2,400 employees and is headed by the Chief Counsel, a Presidentially-appointed and Senate confirmed employee (PAS), who serves as the chief law officer for the IRS ¹ IRS, including Service, is headed by the Commissioner, the only other PAS employee

You are the Designated Ethics Official (DEO) and are responsible for the overall administration of the ethics program agencywide However, day-to-day management of IRS' ethics program is divided between Counsel and SEPO

Ethics Staffing Within Counsel

Within the Ethics and General Government Law Branch, hereafter referred to as the Ethics Office, the Branch Chief is assisted by nine attorneys, one paralegal, and a secretary A senior attorney and an attorney technical advisor serve as primary ethics contacts The Ethics Office renders legal advice agencywide and manages IRS' public financial disclosure system It utilizes other offices including Counsel's Personnel, Policy and Operations Division (PPOD), the Labor and

¹ The Chief Counsel serves as an Assistant General Counsel for Treasury and reports directly to Treasury's General Counsel

Employee Relations Division (LERD), the Training and Communications Division (TCD), and the Executive Resource Board (ERB), as well as the Service's Office of Executive Leadership Services (OELS) to handle the other aspects of Counsel's ethics program

Ethics Staffing Within Service

To improve the ethics program and address deficiencies found in our 1999 program review, fundamental changes were made to the entire Service ethics program. Two Human Resource Specialists (or Program Managers) were assigned as the full-time ethics staff to carry out the day-to-day duties of Service's ethics program (currently SEPO is made up of only one Program Manager and two Human Resource Assistants). This staff coordinates the Service-wide ethics program with the Ethics Office, provides administrative program support for Service's 100,000 plus full- and part-time employees, administers the confidential financial disclosure system for Service's approximately 2,093 confidential filers, administers the Service ethics training program, and facilitates a Business Unit Coordinator network upon which it is highly dependent. There are approximately 11 Business Unit Coordinators (Coordinators) and 8 sub-Coordinators located throughout the Service to help in carrying out ethics program duties. The Coordinators serve as their Unit's central point-of-contact on the confidential disclosure system and distribute confidential financial disclosure forms and annual ethics training material to their respective employees. Coordinators work with their sub-Coordinators in gathering confidential disclosure and annual ethics training information for reporting to SEPO.

Although our current review found the management of Service's ethics program to have improved considerably since our last review, mainly due to the establishment of SEPO, there is concern that without a high level of visibility and sufficient staffing resources, the program will suffer in the long-term. IRS leadership needs to commit a high level of support and attention to ensure that Service's ethics program receives the resources and assistance needed to be administered in a positive and effective manner, as required by 5 C F R § 2638.202(a).

CONFIDENTIAL FINANCIAL DISCLOSURE SYSTEM

Counsel and Service have separate confidential financial disclosure systems. Counsel's system is operating well except for reviewers not using the outside employment prior approvals when reviewing confidential reports. (This is discussed in more detail in the "Prior Approval of Outside Employment" section below.)

For Service's system, we found vast improvements since our 1999 review. SEPO is doing a good job in meeting most of the confidential financial disclosure system requirements. It has done this through centralized confidential report filing, development of detailed confidential system instructional guidance to Coordinators, confidential report filers, and confidential report reviewing officials, and use of technology to administer the system. However, timely identification of new entrant filers and, as with Counsel, the non-use of outside employment prior approvals when reviewing confidential reports, are areas that need improvement.

Counsel's Confidential System

We reviewed the master lists of new entrant and annual confidential filers who were required to file in 2002 and examined a sample of 123 of the approximately 561 confidential financial disclosure reports required to be filed. The sample consisted of 23 new entrant and 88 annual OGE Form 450s and 12 OGE Optional Form 450-As (Form 450-As). Though we found few reports that included any review annotations by reviewing officials, the reports appeared to have been reviewed thoroughly, as evidenced by the lack of technical reporting omissions. Although we found the majority of these reports to have been timely submitted and reviewed, we did note that the majority of reports did not indicate the date of agency receipt, as required by 5 C F R 2635 605(a). Therefore, we based filing timeliness on the filers' signature dates. Using this method, no annual reports were filed more than 30 days late. Counsel's officials assured us that all reports would be date stamped during the current and future filing cycles.

Service's Confidential System

SEPO monitors the Service's confidential system and is the central repository for all Service reports. Coordinators provide notification and distribute forms and information to their Unit's confidential filers, ensure that all filed reports are properly completed prior to being forwarded to SEPO, work with the sub-Coordinators, if applicable, and compile statistical information concerning the filing for inclusion in OGE's annual Agency Ethics Program Questionnaire. As within Counsel, the confidential reports' initial review is done by the filer's immediate supervisor with final review and certification done by the second-level supervisor.

We examined all 31 of the new entrant reports required to be filed in 2002 and found 16 of the 31 were filed late, with the latest being filed 13 months late. The majority of these late reports were captured during the 2002 annual filing cycle. The reports were reviewed timely once filed. To ensure that new employees are identified and file in a timely manner, proper coordination needs to occur between SEPO, the servicing personnel office, and the new employee's supervisor. Procedures must be developed and implemented to ensure that, as required by § 2634 903(b), all employees file a new entrant confidential financial disclosure report not later than 30 days after entering or transferring into a covered position.

For annual filers, we examined a sample of 73 of the 2,093 reports required to be filed in 2002. The majority of these reports were filed on time, with only two being submitted late. Although few reports included any review annotations made by reviewing officials, the reports appeared to have been reviewed thoroughly, as evidenced by the lack of technical reporting omissions. Several reports did not indicate the date of agency receipt, as required by 5 C F R § 2635 605(a). SEPO officials assured us that all reports would be date stamped during the current and future filing cycles.

ADVISORY COMMITTEE

Of IRS' seven advisory committees, the Art Advisory Panel of the Commissioner of Internal Revenue (Art Advisory Panel) is the only one whose members are designated as special Government employees (SGEs). Although we believe the ethics program for these SGEs is generally administered well, we found there was some confusion regarding the filing requirements. To eliminate this confusion, procedures need to be developed for the notification of filers, the completion, submission, review, and retention of financial disclosure reports, and to clarify responsibilities of both the Art Advisory Panel and SEPO.

According to the Ethics Office, Art Advisory Panel members had not been required to file new entrant reports annually because of a misunderstanding of a section of OGE's financial disclosure regulation found at 5 C F R § 2634 903(a) and (b). Since members were not redesignated/reappointed each year, a new entrant report was not filed annually. The Ethics Office received clarification of the requirements of § 2634 903(a) and (b) while at an OGE Government Ethics Conference and all members filed a new entrant confidential disclosure report in 2002 and were to file a new entrant report each year thereafter.

We examined all 20 of the confidential reports required to be filed in 2002 and found all reports were filed and reviewed timely. We found no substantive deficiencies, but noted that the majority of filers had not indicated their reporting status on the first page of the report as "New Entrant." Members should indicate their filing status as "New Entrant" each year on their report. This is important for technical compliance and because a new entrant filer, unlike an annual filer, does not have to report gifts and travel reimbursements.

We believe that an alternative disclosure system, in lieu of filing an OGE Form 450, may better serve the Art Appraisal Service because of the unique conflict concerns associated with members. An alternative disclosure system could provide the Art Appraisal Service with the ability to make more timely conflict of interest determinations rather than waiting to make the determination after an annual review of a new entrant OGE Form 450. It could also be tailored to provide more thorough conflict of interest information to help in determining whether Art Advisory Panel members, during their period of service, participated in private appraisals of works of art involved in Federal taxation, including any outside involvement with a work that has come before them as a member. Therefore, we encourage you to consider an alternative disclosure system and remind you that it must be approved in writing by OGE prior to it being implemented, in accordance with 5 C F R § 2634 905 (c).

PRIOR APPROVAL OF OUTSIDE EMPLOYMENT

Section 3101 104(a) of 5 C F R requires all Treasury employees to obtain prior written approval before engaging in any outside employment or business activities, with or without compensation, unless the employing bureau exempts categories of employment or activities pursuant

to § 3101 104 (b) Approval is granted based on a determination that the employment or activity is not expected to involve conduct prohibited by statute or regulation IRS employees are additionally subject to prohibited outside employment in § 3101 106 and Counsel attorneys are subject to prohibited outside employment in § 3101 107

Our review of the prior approval system focused on whether the approval requirement was being met, based on an examination of the outside employment/activities reported on the financial disclosure reports we examined for both Counsel and Service Although all of the reported outside employment/activities we examined were supported with the appropriate prior written approvals, neither the Ethics Office nor SEPO is provided copies of the approvals for use when reviewing the confidential reports We remind you that using these approvals when reviewing the reports assures compliance with the prior approval requirement at 5 C F R § 3101 104 and enables reviews to be conducted properly in accordance with §§ 2634 909(a) and 2634 605

ACCEPTANCE OF TRAVEL PAYMENTS FROM NON-FEDERAL SOURCES

As a matter of IRS policy, travel and related expenses are not accepted from non-Federal sources pursuant to 31 U S C § 1353 However, Counsel does permit employees to accept travel reimbursements for domestic travel under 5 U S C § 4111 from organizations exempt from taxation under § 501(c)(3) of title 26 of the U S C ("501 (c)(3)") During our 1999 review, we observed on Treasury's semiannual report to OGE (reflecting payments of \$250 or more for travel and related expenses accepted throughout Treasury under § 1353), three payments attributed to IRS employees from "501(c)(3)" organizations under § 4111 that were incorrectly reported as § 1353 payments To remedy the problem we were advised that the reporting requirements would be clarified with Treasury's travel officials

Despite these efforts, this travel continues to be included in error with Treasury's semiannual report to OGE In our most recent examination of Treasury's four semiannual reports submitted to OGE, for the period of October 1, 2001 to March 31, 2003, we found 61 payments attributed to IRS employees under 5 U S C § 4111 that were incorrectly reported as 31 U S C § 1353 payments IRS should cease reporting to Treasury payments under 5 U S C § 4111 for inclusion in the semiannual reports to OGE

PUBLIC FINANCIAL DISCLOSURE SYSTEM

The public financial disclosure system for both Counsel and Service is centrally administered and well-managed by the Ethics Office, with cooperative assistance provided by Counsel's ERB and Service's OELS Procedures are in place to ensure filers' receipt of notifications to file Reports receive a thorough compliance review with good documentation of the review

To evaluate the administration of the public system, we examined 116 (combined Counsel and Service) public reports of the approximately 438 public reports required to be filed in 2002 We

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examined 56 of the 57 Counsel public reports² and a sample of 60 of the Service's 381 public reports submitted by employees other than the IRS Commissioner and Chief Counsel³ We found these reports to have been filed and reviewed in a timely manner Moreover, they had been thoroughly reviewed as evidenced by the many annotations on the reports

We also examined for timeliness of filing, review, and forwarding to OGE, the termination report filed by the former Commissioner We note that the former Commissioner's termination report was filed and reviewed in a timely manner but was forwarded to our Office eight months from the date the Commissioner terminated

Late Filing of Public Reports

In 2002, of the approximately 438 public reports, there were 10 public filers who were granted waivers of the \$200 late filing fee Pursuant to 5 C F R § 2634 701(a), the Ethics Office referred one delinquent public filer to the Department of Justice (Justice) for willful failure to file both his 2001 annual and termination reports We were advised that this case is still pending

Transfer of the Public System to SEPO

Currently, OELS is responsible for managing the Service's public financial disclosure system, including serving as the central repository for all Counsel and Service public reports We were advised, however, that prior to the next public reporting filing cycle, SEPO would be responsible for maintaining the master list of Service public filers, notifying filers and distributing the reporting material, tracking report submission status, and serving as the central repository for all Counsel and Service public reports This would combine public and confidential financial disclosure reports in one location

We were assured that the administration of the public system would not suffer due to the new added responsibilities that will transfer to SEPO However, we are concerned whether current staffing levels will be able to absorb the additional workload

ADVICE AND COUNSELING SERVICES

Effective and useful ethics advice and counseling is provided to all Counsel and Service employees by the Ethics Office Our examination of the advice and counseling services found that IRS has complied with 5 C F R § 2638 203(b)(7) and (8) by developing and conducting a counseling program for employees concerning all ethics matters, including post employment, wherein records are kept, when appropriate, on the advice rendered We reviewed a large number of formal opinions

² We did not examine one report because at the time of our review, the public report was being used to review the filer's 2003 annual public report

³ On July 31, 2003, the Chief Counsel terminated his position Currently, the Chief Counsel position is vacant

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and electronic mail responses issued by the Ethics Office on a variety of issues (covering approximately a 12-month period) and found these ethics determinations to be comprehensive and consistent with all applicable regulations and statutes

EDUCATION AND TRAINING

The education and training program within IRS is highly decentralized. Within Counsel, the Ethics Office utilizes the PPOD, the LERD, and the TCD to help administer Counsel's ethics training program. SEPO is primarily responsible for administering the Service's training program.

In our 1999 review, we found lapses where the initial ethics orientation material was not being provided to all new employees. We are pleased to report in our current review that initial ethics orientation, as well as annual training, within both Counsel and Service satisfy the requirements found at 5 C F R part 2638.

IRS Ethics Program Web Sites

In our 1999 program review report, many of the deficiencies noted were centered largely around making the IRS ethics program more accessible, particularly on the Service-side, and ensuring that all employees were made aware of all applicable ethical requirements. In our current review, we found both Counsel's and Service's Intranet ethics program Web sites serving as very useful and comprehensive ethics tools for all employees. Our examination of content on both Web sites found the ethics coverage to be very useful and informative.

Initial Ethics Orientations Within Counsel

Within Counsel, the PPOD and its Area/Office Managers in the field (through coordinating efforts with the Ethics Office) are responsible for identifying new Counsel employees and distributing the initial ethics orientation material to them. LERD is responsible for monitoring and tracking whether the orientation material was received by all new Counsel employees (both National Office and Field Office) and for providing the Ethics Office, on a quarterly basis, a status report. Based on LERD's records, there were 131 new Counsel employees hired in 2002. Of these, 112 employees signed and submitted a form acknowledging receipt of the orientation material timely. We were advised that LERD subsequently collected forms from the 19 remaining employees. All 61 new Counsel employees hired through July 2003 were found to have signed their acknowledgment forms timely.

Initial Ethics Orientations Within Service

Each of the Service's 23 personnel offices is responsible for identifying new Service employees and distributing the initial ethics orientation material to them while SEPO is responsible for monitoring and tracking the employees' receipt of the material. While new Service employees can access the orientation material via the Service's Web site, some personnel offices provide new employees with a hard copy of the material. Based on a review of SEPO's training records, we are

satisfied that all new Service employees hired in 2002 were provided with their initial ethics orientation material timely

Annual Ethics Training for Counsel and Service

In 2002, annual training consisted of a computer-based training (CBT) module on both Counsel and Service Web sites, addressing conflicts of interest and impartiality, and including a review of the pertinent ethics statues, regulations, and principles. We were advised that training for 2003 was to consist of a CBT module on outside employment and the Hatch Act. Additional training modules were to offer instruction on other ethics issues. Although SEPO is responsible for notifying Service public filers of their training requirement, the Ethics Office is responsible for monitoring, tracking, and documenting the completion of the training for Service public filers. We were advised that all Counsel and Service employees required to be trained completed their training.

The Commissioner and Chief Counsel completed a CBT module to satisfy the 2002 annual ethics training requirement. However, we encourage you to also consider providing them, on an annual basis, personalized in-person ethics training.

Additional Ethics Training Within Service

SEPO has done a good job of increasing overall awareness for the Service-wide ethics program. All Service employees, regardless of whether they are required to receive annual ethics training, are required to receive five mandatory agency employee briefings, of which ethics is one. The ethics briefing highlights things to remember about Government ethics and brings exposure to SEPO and the Ethics Office.

In March 2003, a new segment dedicated to ethics was established in the Service's "Employee Relations Compass" newsletter. This segment, entitled "News from the DEO," highlights a particular ethics regulation and/or updates to ethics rules and regulations. Moreover, the first installment reintroduced Service employees to the DEO and his role in the Service's ethics program. It also outlined the procedures for seeking ethics advice.

ENFORCEMENT

The Treasury Inspector General for Tax Administration (TIGTA)⁴ is responsible for making conflict of interest referrals to Justice and notifying OGE. TIGTA notified OGE of all of its 27

⁴ TIGTA was established in January 1999 in accordance with the IRS Restructuring and Reform Act of 1998 to provide independent oversight of IRS activities, the IRS Oversight Board, and the Counsel. TIGTA assumed most of the responsibilities of the IRS' former Inspection Service. It is organizationally placed within Treasury, but is independent of the Department and all other Treasury offices, including the Treasury Office of the Inspector General (OIG).

referrals made to Justice during 2001-2002 along with information regarding the final disposition of the 27 referrals

We found that both Counsel and Service have effective systems to ensure that prompt and effective administrative actions are considered to remedy violations of the ethics laws and Standards of Conduct. Service utilizes several components, including the Centralized Investigation Receipt and Control Unit, the Centralized Adjudication Unit, and the Commissioner's Compliant Processing and Analysis Group, to ensure that action is taken to remedy ethics violations. We examined 13 administrative actions taken during 2002, which appeared to have been prompt and effective.

Within Counsel, to ensure that all allegations of misconduct are promptly and thoroughly investigated, and that in all instances employees are treated in a fair and uniform manner, Counsel established a Professionalism Program to handle allegations or evidence of serious misconduct or unprofessional behavior that did not present issues that must initially be referred to TIGTA.⁵ According to Counsel's most recent report on professionalism, it received 29 allegations that Counsel employees had committed misconduct or violated professional standards in 2002. Six of these allegations were transmitted to the Deputy Chief Counsel (Operations) from offices within Counsel or other sources. All six were subsequently transmitted to TIGTA for investigation or other action. The remaining 23 allegations were forwarded to the Deputy Chief Counsel (Operations) by TIGTA, with a request that the Deputy Chief Counsel (Operations) investigate the matter and report back to TIGTA upon final disposition. Of the 29 cases under active consideration in 2002 by either TIGTA or Counsel, 16 were closed. Of the 16 that were closed, 6 were substantiated and disciplinary actions were taken, 9 were not substantiated, and in 1 case an employee separated before the review was completed. Additionally, Counsel took disciplinary actions in 51 other cases which were not transmitted directly to the Deputy Chief Counsel (Operations) or referred back to the Deputy Chief Counsel by TIGTA. These actions included admonishment, removal, reprimand, and suspension. All disciplinary actions taken by Counsel appeared to have been prompt and effective.

Finally, based on discussions with ethics and TIGTA officials, and especially as evidenced by IRS' compliance with the notification requirements of 5 C F R § 2638.603, we believe that an effective working relationship has been established between the Ethics Office and TIGTA.

CONCLUSIONS AND RECOMMENDATIONS

IRS has many effective elements in its ethics program. We found the public financial disclosure system to be well-functioning, with timely filing, review, and certification of public reports. The ethics advice and counseling system is effective and responsive to the needs of IRS employees, as evidenced by the timely responses to employee inquiries. We also acknowledge the

⁵Under these procedures, all allegations or evidence of an employee's serious or significant failure to comply with the accepted standards of legal practice, to include non-frivolous allegations of professional misconduct, any ethical violation, failure to protect the statute of limitations, failure to coordinate a legal position with responsible offices, and repeated failures to meet pleading deadlines, must be referred to Counsel's Deputy Chief Counsel (Operations).

outstanding use of technology to help administer the ethics program within Counsel and Service and encourage you to continue these efforts. However, improvements are needed, especially to the ethics program within Service.

To further enhance the IRS ethics program, we recommend that you take actions to assure that

- 1 Procedures are developed and implemented to ensure that, as required by 5 C F R § 2634 903(b), all new employees entering and transferring into covered positions within the Service file a new entrant confidential financial disclosure report
- 2 Art Advisory Panel procedures are developed and implemented for the notification of filers, for the completion, submission, review, and retention of financial disclosure reports, and to clarify responsibilities of both the Art Advisory Panel and SEPO
- 3 Confidential financial disclosure reviewers use the prior approvals for outside employment when reviewing the confidential reports to assure compliance with 5 C F R § 3101 104 and to enable the reviews to be conducted in accordance with §§ 2634 909(a) and 2634 605
- 4 IRS ceases reporting to Treasury payments under 5 U S C § 4111 for inclusion in Treasury's semiannual reports to OGE of travel payments of more than \$250 from non-Federal sources under 31 U S C § 1353

In closing, I wish to thank you and your staff for all of your efforts on behalf of the ethics program. Please advise me within 60 days of the specific actions IRS has taken or plans to take on our recommendations. A brief follow-up review will be scheduled within six months from the date of this report. In view of the corrective action authority vested with the Director of the Office of Government Ethics under subsection 402(b)(9) of the Ethics Act, as implemented in subpart D of 5 C F R part 2638, it is important that IRS take timely actions to implement our recommendations. Copies of this report are being sent via transmittal letter to the Treasury Designated Agency Ethics Official and the Treasury Inspector General for Tax Administration. Please contact David A. Meyers at 202-482-9263 if we can be of further assistance.

Sincerely,



Jack Covaleski
Deputy Director
Office of Agency Programs