



*Affordable Care Act: Assessment of
Efforts to Implement the Employer
Shared Responsibility Provision*

April 7, 2017

Reference Number: 2017-43-027

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

Redaction Legend:

1 = Tax Return/Return Information

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HIGHLIGHTS

AFFORDABLE CARE ACT: ASSESSMENT OF EFFORTS TO IMPLEMENT THE EMPLOYER SHARED RESPONSIBILITY PROVISION

Highlights

Final Report issued on April 7, 2017

Highlights of Reference Number: 2017-43-027 to the Internal Revenue Service Commissioner for the Small Business/Self-Employed Division.

IMPACT ON TAXPAYERS

The Affordable Care Act's Employer Shared Responsibility Provision requires employers with an average of 50 or more full-time employees (including full-time equivalent employees) to offer health insurance coverage to full-time employees and their dependents beginning in January 2015. Employers who did not offer health insurance coverage, or offered health insurance coverage that did not meet minimum requirements or was not affordable, may be subject to an Employer Shared Responsibility Payment.

WHY TIGTA DID THE AUDIT

This audit was initiated as part of our coverage of the IRS's implementation of key Affordable Care Act tax provisions. This audit assessed the status of the IRS's preparations for ensuring compliance with the Employer Shared Responsibility Provision and the related information reporting requirements.

WHAT TIGTA FOUND

The IRS implemented processes and procedures in an effort to ensure that employers subject to the Employer Shared Responsibility Provision could comply with information reporting requirements. As of October 28, 2016, the IRS had processed 439,201 Forms 1094-C, *Transmittal of Employer-Provided Health Insurance Offer and Coverage Information Returns*, and nearly 110 million Forms 1095-C, *Employer-Provided Health Insurance Offer and Coverage*. However, our review identified that some of the processes did not function as

intended, which resulted in the IRS not having accurate and complete data for use in its compliance strategy to identify noncompliant employers potentially subject to the Employer Shared Responsibility Payment.

In addition, due to system errors, the IRS was unable to process paper information returns timely and accurately. As of October 28, 2016, almost five months after the May 31 filing deadline, the IRS estimated that approximately 16,000 paper Forms 1094-C and 1.4 million paper Forms 1095-C had not been processed.

Further, the criteria used to identify validation errors in the submissions did not always work as intended. For example, some error codes erroneously generated when no error condition existed, and some error codes did not generate when an error condition existed. As of August 25, 2016, the IRS reported 16 of the 141 total error codes for Forms 1094-C and 1095-C on the known issues report. Several of the error codes did not function as intended because the IRS did not sufficiently test its error code programming.

Finally, the development and implementation of key systems needed to identify noncompliant employers subject to an Employer Shared Responsibility Payment have been delayed, not initiated, or cancelled. For example, the IRS's implementation of the post-filing compliance validation system was initially scheduled for January 2017 but has been delayed to May 2017.

WHAT TIGTA RECOMMENDED

TIGTA made seven recommendations to the Commissioner, Small Business/Self-Employed Division, to improve the processing of Forms 1094-C and 1095-C, including ensuring that paper Forms 1094-C and 1095-C are timely transferred to the ACA Information Returns system for Processing Year 2017. IRS management agreed with six of the seven recommendations. The IRS did not agree that it should establish a time frame for employers to correct errors identified on Forms 1094-C and 1095-C, but the IRS may reevaluate the need for additional written guidance in the future.



TREASURY INSPECTOR GENERAL
FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

April 7, 2017

MEMORANDUM FOR COMMISSIONER, SMALL BUSINESS/SELF-EMPLOYED
DIVISION

FROM: Michael E. McKenney
Deputy Inspector General for Audit

SUBJECT: Final Audit Report – Affordable Care Act: Assessment of Efforts
to Implement the Employer Shared Responsibility Provision
(Audit # 201540333)

This report presents the results of our review to assess the status of the Internal Revenue Service's preparations for ensuring compliance with the Employer Shared Responsibility Provision and the related information reporting requirements. This audit was included in our Fiscal Year 2016 Annual Audit Plan and addresses the major management challenge of Implementing the Affordable Care Act and Other Tax Law Changes.

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

Copies of this report are also being sent to the Internal Revenue Service managers affected by the report recommendations. If you have any questions, please contact me or Russell P. Martin, Assistant Inspector General for Audit (Returns Processing and Account Services).



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Abbreviations

ACA	Affordable Care Act
ACV	ACA Compliance Validation
E-Filed(d)	Electronically File(d)
EIN	Employer Identification Number
I.R.C.	Internal Revenue Code
IRS	Internal Revenue Service
MEC	Minimum Essential Coverage
PTC	Premium Tax Credit
PY	Processing Year
SCRIPS	Service Center Recognition Image Processing System
SSN	Social Security Number
TIN	Taxpayer Identification Number
TY	Tax Year



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Background

The Patient Protection and Affordable Care Act of 2010 and the Health Care and Education Reconciliation Act of 2010 (hereafter collectively referred to as the Affordable Care Act (ACA))¹ include the Employer Shared Responsibility Provision.² The Employer Shared Responsibility Provision applies to employers that had an average of 50 or more full-time employees,³ including full-time equivalent employees,⁴ during the prior calendar year. These employers are referred to as Applicable Large Employers. Under the provision, Applicable Large Employers must offer health insurance to full-time employees (and their dependents) during the current calendar year through an employer-sponsored plan beginning in January 2015 or a shared responsibility payment may apply. The health insurance coverage offered must:

- **Provide Minimum Essential Coverage (MEC)** – health coverage that contains essential health benefits including emergency services, hospitalization, doctor visits, prescription drugs, and preventive and wellness services.
- **Be affordable** – the employee’s share of the self-only premium does not exceed 9.5 percent of the employee’s annual household income.
- **Provide minimum value to full-time employees (and their dependents)** – the health plan covers at least 60 percent of the total allowed cost of benefits that are expected to be incurred under the plan.⁵

Employer reporting requirement provision

The ACA requires Applicable Large Employers to annually file information returns with the Internal Revenue Service (IRS) and provide statements to their full-time employees about the health care coverage they offered (or did not offer).⁶ Figure 1 summarizes the information return

¹ Pub. L. No. 111-148, 124 Stat. 119 (2010) (codified as amended in scattered sections of the U.S. Code), as amended by the Health Care and Education Reconciliation Act of 2010, Pub. L. No. 111-152, 124 Stat. 1029.

² Internal Revenue Code (I.R.C.) Section (§) 4980H.

³ An employee who works an average 30 or more hours per week or 130 hours during the calendar month.

⁴ An estimate of the number of full-time employees based on hours worked by employees working less than 130 hours per month. An employer calculates full-time equivalents by totaling the number of hours worked (limited to 120 hours per employee) for all part-time employees during the month and divides the total hours worked by 120.

⁵ The Department of Health and Human Services developed a minimum value calculator, which is available on its website (www.CMS.gov), for employers to use in determining if a health insurance plan provides minimum value.

⁶ I.R.C. § 6056.



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reporting requirements for Applicable Large Employers beginning in Processing Year (PY)⁷ 2016.

Figure 1: Filing Requirements for Applicable Large Employers

Information Return Required ⁸	Purpose of Information Return
Form 1094-C, <i>Transmittal of Employer-Provided Health Insurance Offer and Coverage Information Returns</i>	Used to report summary information of health insurance offered and coverage information by the Applicable Large Employer and to transmit Forms 1095-C.
Form 1095-C, <i>Employer-Provided Health Insurance Offer and Coverage</i>	Used to report health insurance offer and coverage information for each full-time employee. This includes the name and Employer Identification Number (EIN) ⁹ of the employer, the name and Social Security Number (SSN) of the employee, the type of health insurance offered by the employer by month, and the months of health insurance coverage for the employee and each of the employee's dependents if self-insured.

Source: Treasury Inspector General for Tax Administration analysis of information on IRS.gov.

The information from Forms 1094-C and 1095-C is needed by the IRS to verify the accuracy of reported health insurance offers of coverage and for calculating the Employer Shared Responsibility Payment.¹⁰ Employers that file 250 or more information returns during the calendar year must electronically file (e-file) Forms 1094-C and 1095-C with the IRS by March 31, whereas employers filing by paper are required to submit Forms 1094-C and 1095-C to the IRS by the last day of February. Applicable Large Employers are also required to furnish each full-time employee with a completed Form 1095-C or a substitute form that includes the same information by January 31 each year.

Beginning in PY 2016, the ACA Information Returns¹¹ system is used to process paper and e-filed Forms 1094-C and 1095-C along with other ACA information returns. E-filed Forms 1094-C and 1095-C are transmitted directly to the ACA Information Returns system, and

⁷ The calendar year in which the tax return or document is processed by the IRS.

⁸ See Appendices V and VI for examples of Forms 1094-C and 1095-C, respectively.

⁹ A unique nine-digit number used to identify a taxpayer's business account.

¹⁰ The Employer Shared Responsibility Payment is an assessable payment for Applicable Large Employers 1) that do not offer health coverage or 2) that offer coverage to employees, but an employee obtains coverage from a Health Insurance Exchange because the coverage offered was either unaffordable or did not provide minimum value. An Exchange is where individuals find information about health insurance options, purchase qualified health plans, and, if eligible, obtain help paying premiums.

¹¹ The ACA Information Returns system accepts ACA information return transmittals and documents, including Forms 1094-C and 1095-C. The ACA Information Returns system will process each submission and provide a status and detailed acknowledgement for the transmitter.



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paper Forms 1094-C and 1095-C are sent to the Kansas City, Missouri, or Austin, Texas, Submission Processing Sites to be scanned into the Service Center Recognition Image Processing System (SCRIPS).¹² Once scanned, the data are then transmitted from the SCRIPS to the ACA Information Returns system.

Once the forms are in the ACA Information Returns system, the IRS performs data validation checks to ensure the completeness and accuracy of key entries on the form. For example, the IRS's validation process checks for 155 conditions that can result in 141 error codes. Depending on the severity of the error, the form submission could be rejected and returned back to the submitter for correction. Errors resulting in the rejection of a form submission include an invalid or missing EIN of the Applicable Large Employer on Form 1094-C, a business name is missing on Form 1094-C, and a Form 1094-C tax year does not match the tax year supported by the ACA Information Returns system. When a reject condition occurs, the Applicable Large Employers are required to resubmit corrected forms within 60 calendar days.

When the errors identified are deemed to not require rejection of the forms, the IRS will process Forms 1094-C and 1095-C containing errors. Errors that do not result in the rejection of the submission include invalid or missing employee SSNs, a date of birth is provided in lieu of an SSN on Form 1095-C, and an employee's mailing address is missing on Form 1095-C. It should be noted that the IRS has established processes to reject submissions with less severe errors depending on whether or not the number of errors identified within a submission reach a predetermined threshold. However, management noted that these processes were not active for Tax Year (TY)¹³ 2015 Forms 1094-C and 1095-C. The error reporting process differs for employers that e-file versus employers that paper-file. For example:

- **The Applicable Large Employers that e-file information returns.** The IRS provides these employers electronic notification that the submission was rejected. For errors that do not result in the rejection of the submission, the IRS provides the employer an electronic file containing all errors identified. Errors may be corrected by the employer to avoid accuracy penalties.
- **The Applicable Large Employers that paper-file information returns.** The IRS provides these employers with Letter 1865C, *Information Return (Paper) Incomplete or Rejected for Processing/Instructions Enclosed: Form 1095, 1098, 1099, etc.*, to notify the employer that the submission was unable to be processed. For errors that do not result in the rejection of the submission, the employer is not notified of the errors, and the IRS accepts the submission with errors.

¹² The SCRIPS is a data capture, management, and storage system that uses high-speed scanning and digital imaging technology to process tax documents.

¹³ A 12-month accounting period for keeping records on income and expenses used as the basis for calculating the annual taxes due. For most individual taxpayers, the tax year is synonymous with the calendar year.



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The Employer Payment

The Employer Shared Responsibility Payment may be assessed against an Applicable Large Employer that does not offer health coverage or that offered coverage that was either unaffordable or did not provide minimum value and the employee obtains coverage from an Exchange. If at least one of the Applicable Large Employer’s full-time employees receives a Premium Tax Credit (PTC)¹⁴ or cost-sharing reduction¹⁵ to purchase coverage through an Exchange, the employer could be liable for the Employer Shared Responsibility Payment. Because only individuals who qualify for the PTC can also qualify for a cost-sharing reduction, the IRS identifies full-time employees certified as having received a PTC to determine which employers are potentially liable for the Employer Shared Responsibility Payment. The IRS is responsible for calculating the amount of the Employer Shared Responsibility Payment based on the extent to which the Applicable Large Employer offered coverage to its full time-employees. Figure 2 summarizes the calculation of the Employer Shared Responsibility Payment for PY 2016 and later.

Figure 2: Employer Shared Responsibility Payment Calculation

Shared Responsibility Payment Provisions	Payment Calculation
<p>Section 4980H(a)¹⁶ provides for an assessable payment for employers that do not offer health coverage. Under Treasury Regulations,¹⁷ the payment applies if:</p> <ol style="list-style-type: none"> 1. The Applicable Large Employer offered health insurance coverage to less than 95 percent of its full-time employees (and their dependents). 2. At least one of the Applicable Large Employer’s full-time employees receives the PTC. 	<p>The Employer Shared Responsibility Payment is \$2,000¹⁸ per employee for the number of full-time employees minus 30. The IRS calculates the payment on a month-by-month basis. Thus, an employer who owes the payment will pay \$166.67 (1/12 of \$2,000) per month per the number of full-time employees in excess of 30.</p>
<p>Hypothetical example:¹⁹ <i>Company K has 100 full-time employees for each month of the calendar year. Company K does not offer the MEC to its full-time employees (and their dependents) for any month of the calendar year. Fourteen full-time employees obtain health insurance through an Exchange and receive the PTC for each month. The Employer Shared Responsibility Payment is calculated as the number of full-time employees (100) less 30 x \$2,000. This results in an Employer Shared Responsibility Payment for Company K of \$140,000 for the calendar year.</i></p>	

¹⁴ A PTC is a refundable tax credit to assist eligible taxpayers with paying their health insurance premiums.

¹⁵ A cost-sharing reduction reduces out-of-pocket expenses for eligible taxpayers by reducing deductibles and copayments.

¹⁶ I.R.C. § 4980H(a).

¹⁷ Treasury Decision 9655.

¹⁸ The amount of the payment per employee is indexed to inflation beginning in PY 2015.

¹⁹ This hypothetical example was not drawn from any actual taxpayer’s information.



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Shared Responsibility Payment Provisions	Payment Calculation
<p>Section 4980H(b)²⁰ provides for a payment for those Applicable Large Employers that offer coverage to employees, but an employee obtains coverage from an Exchange because the coverage offered was either unaffordable or did not provide minimum value. Under Treasury Regulations, the payment applies if:</p> <ol style="list-style-type: none"> 1. The Applicable Large Employer offered health insurance coverage to 95 percent or more of full-time employees (and their dependents). 2. At least one of the Applicable Large Employer's full-time employees receives a PTC. 	<p>The Employer Shared Responsibility Payment is equal to the lesser of \$3,000²¹ for each full-time employee who receives the PTC or the payment calculated under § 4980H(a). The IRS calculates the payment on a month-by-month basis. Thus, an Applicable Large Employer that owes the payment will pay \$250 (1/12 of \$3,000) per month per the number of full-time employees receiving the PTC.</p>
<p>Hypothetical example:²² <i>Company M has 100 full-time employees for each month of the calendar year and offers the MEC to its full-time employees (and their dependents). However, the MEC is not affordable for all of the employees. Fourteen of its full-time employees obtain health insurance through an Exchange and receive the PTC for each month of the calendar year. The Employer Shared Responsibility Payment is calculated as the lesser of the:</i></p> <ul style="list-style-type: none"> - <i>Number of full-time employees who received the PTC for each month of the calendar year (14) x \$3,000 = \$42,000.</i> - <i>Number of full-time employees (100) less 30 x \$2,000 = \$140,000.</i> <p><i>For the calendar year, Company M is subject to an Employer Shared Responsibility Payment of \$42,000.</i></p>	

Source: Treasury Inspector General for Tax Administration analysis of information on IRS.gov.

It should be noted that the IRS's calculation of the annual Employer Shared Responsibility Payment may contain components of both § 4980H(a) and § 4980H(b) because of changes in the employer's level of coverage from month to month during the calendar year. Because of the complexity of the Employer Shared Responsibility Payment calculation, the IRS's compliance plans include the development of a process to contact the Applicable Large Employer about the potential assessment. The contact information will include identifying the employee(s) who have received the PTC and provide the employer an opportunity to respond to the notice of potential assessment. If the IRS determines that an employer is liable for an Employer Shared Responsibility Payment, the IRS will send the employer a notice and demand for payment. The Joint Committee on Taxation estimated revenues from the Employer Shared Responsibility Provision of \$167 billion for Fiscal Years 2016 through 2025.

Transition relief for TY 2015

Per the ACA, the employer reporting requirement provisions were to be effective on January 1, 2014. However, the Department of the Treasury provided transitional relief delaying the effective date until January 1, 2015. On December 28, 2015, the IRS further extended the

²⁰ I.R.C. § 4980H(b).

²¹ The amount of the payment per employee is indexed to inflation beginning in PY 2015.

²² This hypothetical example was not drawn from any actual taxpayer's information.



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Applicable Large Employer information returns filing due date for TY 2015 Forms 1094-C and 1095-C from February 29, 2016, to May 31, 2016, for those employers filing by paper and from March 31, 2016, to June 30, 2016, for those employers e-filing. The IRS indicated that the extension was provided because it had determined that some employers needed additional time to comply with the information reporting requirements. In addition to delays in the reporting time frame, Treasury Regulations included eight additional forms of transition relief for TY 2015. Figure 3 summarizes the eight transition relief provisions available for TY 2015.

Figure 3: Transition Relief for TY 2015

Transition Relief Provision	Description of Transition Relief
1. Employers With Fewer Than 100 Full-Time Employees.	For TY 2015, Applicable Large Employers with fewer than 100 full-time employees in Calendar Year 2014, including full-time equivalent employees, will not be subject to the Employer Shared Responsibility Provision provided certain conditions are met regarding the employer's maintenance of workforce and preexisting health coverage.
2. Offers of the MEC to at Least 70 Percent of its Full-Time Employees and Their Dependents.	For TY 2015, 70 percent is substituted for 95 percent in respect to offering health insurance coverage to full-time employees for the Employer Shared Responsibility Payment determination under § 4980H(a).
3. Calculation of the Employer Shared Responsibility Payment for Applicable Large Employers With at Least 100 Full-Time Employees, Including Full-Time Equivalent Employees.	For TY 2015, the number of full-time employees used to calculate the Employer Shared Responsibility Payment under § 4980H(a) will be reduced by 80 rather than 30.
4. Offers of the MEC to Dependents.	For the 2014 and 2015 plan years, relief is available for the requirement to offer coverage to the full-time employees' dependents as long as the employer meets certain conditions, including taking steps to offer the MEC to dependents and not dropping current dependent coverage.
5. Shorter Period Permitted for Determining Employer Status for 2015.	Rather than being required to measure its Applicable Large Employer status based on the number of full-time employees (including full-time equivalent employees) for all 12 months of Calendar Year 2014, employers may instead base their Applicable Large Employer status on any consecutive six-month period – as chosen by the employer.
6. Certain Non-Calendar Year Plans.	The Applicable Large Employer's sponsoring non-calendar year plans will not be subject to the Employer Shared Responsibility Payment for the months in Calendar Year 2015 prior to the beginning of the 2015 plan year with respect to certain employees if the employer and plan meet various conditions.



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Transition Relief Provision	Description of Transition Relief
7. Offers of the MEC for Payroll Periods in January 2015.	If an Applicable Large Employer offers the MEC to a full-time employee no later than the first day of the first payroll period that begins in January 2015, the employee will be treated as having been offered the MEC for January 2015 for purposes of the Employer Shared Responsibility Provision.
8. Shorter Measurement Periods Permitted for Identifying Full-Time Employees.	An Applicable Large Employer may adopt a transition measurement period for determining full-time employee status that is shorter than 12 consecutive months but that is no less than six consecutive months. This transition measurement period can begin no later than July 1, 2014, and end no earlier than 90 calendar days before the first day of the 2015 plan year.

Source: Treasury Inspector General for Tax Administration analysis of information on IRS.gov.

This review was performed at the National Headquarters of the Affordable Care Act Office in Washington, D.C., and the IRS Submission Processing Site in Austin, Texas, and with information obtained from the Information Technology and Small Business/Self-Employed Divisions in New Carrollton, Maryland, and the Wage and Investment Division Headquarters in Atlanta, Georgia, during the period September 2015 through December 2016. We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective. Detailed information on our audit objective, scope, and methodology is presented in Appendix I. Major contributors to the report are listed in Appendix II.



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Results of Review

The IRS implemented processes and procedures in an effort to ensure that Applicable Large Employers subject to the Employer Shared Responsibility Provision could comply with information reporting requirements. As of October 28, 2016, the IRS had processed 439,201 Forms 1094-C and nearly 110 million Forms 1095-C.²³ To accomplish this, the IRS:

- Identified the information the Applicable Large Employers were required to provide to comply with the Employer Shared Responsibility Provision reporting requirements and developed information reporting tax forms, *i.e.*, Forms 1094-C and 1095-C, for use in reporting required information to the IRS. The forms and related instructions for preparing the forms are posted to the IRS website (www.irs.gov).
- Administered outreach and educational initiatives to provide information to employers, tax preparation firms, and other stakeholders. For example, the IRS established a website specifically for ACA information related to Applicable Large Employers and provided IRS webinars on the information reporting requirements and the Employer Shared Responsibility Payment. The IRS also developed publications and e-mailed “IRS Tax Tips” to assist the employers in meeting their ACA requirements.
- Developed and provided training for IRS employees responsible for answering taxpayer calls on the Employer Shared Responsibility Provision and information reporting requirements. The IRS also planned to complete training for those IRS employees handling taxpayer responses to IRS notices of potential assessments of the Employer Shared Responsibility Payment by January 2017.
- Developed processes, computer systems, and applications to receive and process both e-filed and paper Forms 1094-C and 1095-C. For example, the IRS updated the SCRIPS to scan and capture paper information returns and developed the ACA Information Returns system to process both e-filed and paper information returns. The IRS also developed validation processes to ensure the accuracy of information returns, which is important because the IRS plans to use these information returns as part of its strategy to ensure Applicable Large Employers’ compliance with ACA provisions.
- Developed TY 2015 compliance plans that detailed actions the IRS planned to take to identify the Applicable Large Employers potentially subject to the Employer Shared Responsibility Payment, including the Applicable Large Employers that do not file

²³ The processing figures provided are based on the total number of Forms 1094-C and 1095-C that were processed by the IRS and posted to the IRS’s Information Returns Database.



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Forms 1094-C as required (hereafter referred to as nonfilers) to assess the Employer Shared Responsibility Payment when applicable.

However, our review identified that some of the processes developed were not working as intended. For example, the IRS experienced significant delays in the timely and accurate processing of paper Forms 1094-C and 1095-C. The Department of the Treasury granted employers transition relief for TY 2014. This delayed the Employer Shared Responsibility Provision until January 1, 2015, allowing the IRS additional time to test and prepare its systems. Nonetheless, we found that the most basic processes were not functioning as intended, such as the ability to transfer scanned paper information returns from the SCRIPS to the ACA Information Returns system for processing. As a result, some of the information returns data was not accurate and complete for use in its compliance strategy to identify noncompliant Applicable Large Employers that are potentially subject to the Employer Shared Responsibility Payment.

Paper Information Returns Were Not Timely and Accurately Processed

Our review identified that due to SCRIPS and ACA Information Returns system processing errors, the IRS was not able to process paper information returns timely and accurately. As of July 22, 2016, the IRS reported that an estimated²⁴ 64,481 (98 percent) of the estimated 65,465 paper Forms 1094-C received and an estimated 4,519,759 (99 percent) of the estimated 4,575,517 paper Forms 1095-C received had not been processed by the ACA Information Returns system almost two months after the May 31 filing deadline. The following figure shows the inventory of paper Forms 1094-C and 1095-C as of July 22, 2016.

Figure 4: Paper Forms 1094-C and 1095-C Counts as of July 22, 2016

Stage of Paper Processing	Forms 1094-C	Forms 1095-C
Total Estimated Paper Forms Received	65,465	4,575,517
Estimated Forms Awaiting Scanning	46,156	3,271,387
Forms Held in the SCRIPS ²⁵	13,178	893,467

²⁴ Forms 1094-C and 1095-C are not counted until they are scanned into the SCRIPS. The IRS provided estimates of Forms 1094-C and 1095-C received and awaiting scanning based on the weight volume of the forms.

²⁵ Forms held in the SCRIPS represent those Forms 1094-C and 1095-C that have been scanned into the SCRIPS but have not been output to the ACA Information Returns system.



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Stage of Paper Processing	Forms 1094-C	Forms 1095-C
Forms Not Processed by the ACA Information Returns System Due to Processing Issues ²⁶	5,147	354,905
Forms Processed by the ACA Information Returns System	984	55,758

Source: The IRS's Information Return Intake function and Paper Processing Branch.

As of October 28, 2016, almost five months after the May 31 filing deadline, the IRS estimated that it still had not processed²⁷ into the ACA Information Returns system 16,020 (24 percent) of 66,183 paper Forms 1094-C and 1,413,802 (32 percent) of 4,481,900 paper Forms 1095-C received.²⁸ The IRS was unable to consistently transfer scanned paper Forms 1094-C and 1095-C data from the SCRIPS to the ACA Information Returns system. Figure 5 describes the paper forms processing issues identified during PY 2016.

Figure 5: Timeline of Paper Forms 1094-C and 1095-C Processing Issues

Date	Processing Delay/Resolution
January 21, 2016	The IRS began accepting paper Forms 1094-C and 1095-C for TY 2015.
February 1, 2016	The IRS began scanning paper Forms 1094-C and 1095-C at the Kansas City, Missouri, and Austin, Texas, Submission Processing Sites.
February 17, 2016	The IRS suspended ACA Information Returns system processing of paper forms because large volume paper transmissions from the SCRIPS could not be processed by the Taxpayer Identification Number (TIN) ²⁹ validation process. ³⁰
May 1, 2016	The IRS resolved the issue of the inability of the ACA Information Returns system to process a large volume of paper transmissions by restricting the file sizes coming from the SCRIPS to the ACA Information Returns system and limiting the number of TINs validated at one time from each transmission of Forms 1094-C and 1095-C.

²⁶ Minor discrepancies exist between the numbers of forms sent from the SCRIPS to the ACA Information Returns system and the total for the categories of these forms due to differences in the number of forms reported by the SCRIPS, duplicate transmissions, and reporting Forms 1094-C by submission and by EIN.

²⁷ The number of Forms 1094-C not processed as of October 28, 2016, is only an estimate because the IRS did not maintain an actual count of those Forms 1094-C and 1095-C that received Letter 1865C due to an EIN mismatch with IRS records.

²⁸ The number of Forms 1094-C and 1095-C received as of October 28, 2016, differs from the July 22, 2016, totals because the number of forms received but not yet scanned into the SCRIPS is an estimate.

²⁹ A nine-digit number assigned to taxpayers for identification purposes. Depending upon the nature of the taxpayer, it can be an EIN, an SSN, or an Individual TIN.

³⁰ The ACA Information Returns system TIN validation process validates the TIN and name combination against IRS records.



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Date	Processing Delay/Resolution
June 9, 2016	Following the IRS's May 1, 2016, resolution, the <i>SCRIPS 1094/1095C Transmission Search Results</i> showed that of 20 transmission files output from the SCRIPS to the ACA Information Returns system: <ul style="list-style-type: none"> - 11 transmission files were rejected from ACA Information Returns system processing. - 6 transmission files were in process status ranging from 12 to 21 calendar days. - 3 transmission files were processed by the ACA Information Returns system.
June 10, 2016	We alerted IRS management of our concern that a high percentage of paper transmissions from the SCRIPS continued to be rejected from ACA Information Returns system processing.
June 28, 2016	IRS management advised us that the rejected transmissions we identified on June 9 resulted because data for the paper Forms 1094-C and 1095-C coming from the SCRIPS were not correctly formatted for transmission to the ACA Information Returns system, <i>i.e.</i> , a schema validation error. These transmissions needed to be corrected and retransmitted.

Source: The IRS's Paper Processing Branch, Design System Integration Testing function, ACA Information Returns Information Technology function, and ACA Management Console.

On November 16, 2016, IRS management advised us that the above identified schema validation errors were caused by SCRIPS programming errors. For example, SCRIPS programming errors caused the name and plan start month fields to be blank and added a dash to the EIN field within the SCRIPS data. Because the ACA Information Returns system requires the name and plan month fields to be populated, and it does not accept a dash in the EIN field, these transmissions were rejected by the ACA Information Returns system. IRS management stated that it implemented SCRIPS programming fixes on September 18, 2016, to resolve SCRIPS programming errors that were causing some SCRIPS transmissions to be rejected from the ACA Information Returns system.

IRS management also indicated that some Form 1094-C and Form 1095-C transmissions coming from the SCRIPS were rejected due to issues related to the transfer of ACA Information Returns system processing from the Memphis, Tennessee, to Martinsburg, West Virginia, Computing Centers on July 16, 2016, as part of its disaster recovery planning. IRS management indicated that they retransmitted the last of the SCRIPS transmissions on December 23, 2016.

Filing season priorities also contributed to delays in processing paper information returns

The IRS's filing season priorities further contributed to the delays in processing paper Forms 1094-C and 1095-C. For example, in April 2016, we learned that the IRS had suspended processing of paper information returns on March 17, 2016. Processing was not resumed until the beginning of May 2016 and was halted again in mid-May to divert resources to complete processing Forms 1040, *U.S. Individual Income Tax Return*, and other information returns. When we brought our concerns about the time frames for completing the processing of the paper ACA information returns to IRS management's attention, they indicated that they planned to have paper Forms 1094-C and 1095-C scanned into the SCRIPS by September 30, 2016. However, as we reported above, the IRS did not meet its planned September date.



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Errors in the scanning of paper Forms 1094-C and 1095-C result in missing and incorrect data

Our review of a judgmental sample³¹ of 20 Forms 1094-C and 100 Forms 1095-C received on or before April 28, 2016, found that four (20 percent) of the Forms 1094-C and 20 (20 percent) of the Forms 1095-C had entries that were missing or incorrectly captured when scanned into the SCRIPS. *****1*****
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*****1***** Because the IRS plans to use information from these forms for various compliance activities, it is important that it ensure that the information is correctly processed.

IRS management reviewed and agreed with the errors we identified, stating that the majority of the errors were caused by SCRIPS employees failing to correct scanning errors during data verification. However, in other instances, the errors occurred because of optical character recognition in which the scanner incorrectly read the form entry. IRS management stated that they will provide feedback to employees on the differences between validating ACA information returns compared to other information returns and revise the appropriate sections of its internal guidance. IRS management advised us that they did not correct the error conditions we identified because they have not developed a procedure to correct IRS input errors identified after a paper Form 1094-C or Form 1095-C has been processed.

Programming error incorrectly identified some employers as an applicable large employer

Our review of 5,737 business accounts containing an Applicable Large Employer Indicator as of April 28, 2016, identified 4,062 (71 percent) business accounts that were erroneous. For PY 2016, the IRS established an indicator on the Business Master File³² entity record that would identify whether or not an employer is an Applicable Large Employer. The IRS plans to use this indicator to identify Applicable Large Employers and evaluate compliance with Form 1094-C filing requirements in subsequent tax years. The Applicable Large Employer Indicator is required to generate on the business taxpayer's account when the IRS records the filing of a Form 1094-C by the employer. However, for the accounts we identified, a Form 1094-C had not been filed for TY 2015. The presence of an erroneous Applicable Large Employer Indicator affects the IRS's compliance activities by incorrectly generating inquiries for the filing of Form 1094-C when none is due.

³¹ A judgmental sample is a nonprobability sample, the results of which cannot be used to project to the population.

³² The IRS database that consists of Federal tax-related transactions and accounts for businesses. These include employment taxes, income taxes on businesses, and excise taxes.



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On March 22, 2016, we alerted IRS management that the Applicable Large Employer Indicator was being erroneously set on some business accounts. IRS management responded on April 1, 2016, stating that a programming error inadvertently caused the updating of the Applicable Large Employer Indicator. The IRS corrected the error on April 29, 2016, and took actions to reverse the erroneous indicators we identified. Our subsequent review of business taxpayer accounts on June 10, 2016, confirmed that the IRS had reversed the erroneous indicators.

Office of Audit Comment

In response to the draft report, IRS management stated they did not agree with our related outcome measure stating that while the error was corrected, it was unrelated to implementation of the ACA provisions and our recommendation would not have prevented and did not correct this systemic error. However, it should be noted that our review identified the erroneous Applicable Large Employer Indicators and we brought this issue to the IRS's attention for correction, which they did.

Recommendations

The Commissioner, Small Business/Self-Employed Division, should:

Recommendation 1: Ensure that SCRIPS data are timely transferred to the ACA Information Returns system for PY 2017. This should include ensuring that the system can adequately handle the capacity of paper Forms 1094-C and 1095-C transmissions for TIN validation.

Management's Response: The IRS agreed with this recommendation. In May 2016, the IRS implemented file size limits for SCRIPS transfers and adjusted the ACA Information Returns system to receive and process file sizes up to five gigabytes.

Recommendation 2: Develop processes to identify and resolve SCRIPS transmission errors that prevent processing by the ACA Information Returns system. This should include a process to identify incorrectly formatted data resulting from schema validation errors associated with paper Forms 1094-C and 1095-C transmissions coming from the SCRIPS.

Management's Response: The IRS agreed with this recommendation. The IRS responded that it made enhancements to the 2017 Filing Season ACA Information Returns Management Console to display schema errors.

Recommendation 3: Develop processes to ensure that the SCRIPS scanning process accurately captures Forms 1094-C and 1095-C data. This should include updating internal guidance as appropriate.

Management's Response: The IRS agreed with this recommendation. The IRS will review existing processes and determine where they can be enhanced or supplemented to



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ensure that Forms 1094-C and 1095-C are accurately scanned and transcribed by the SCRIPS.

Processes to Accurately Identify Information Returns Reporting Errors Were Not Always Working As Intended

While the IRS developed the ACA Information Returns system to process and validate both e-filed and paper ACA information returns, the criteria used to identify and communicate validation errors in the submissions were not always working as intended. Specifically, we found that:

- **Error codes erroneously generated when no error condition existed, and error codes did not generate when an error condition existed.** Our review of a judgmental sample of the top 10 most frequent Form 1094-C error codes as of April 15, 2016, identified six error codes that did not function correctly. In these instances, the error code generated when no error condition existed. *****1*****
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The IRS had also identified that the six error codes were not functioning correctly and subsequently corrected them.

In addition, our review of a judgmental sample of error codes with no reported occurrences as of April 15, 2016, identified two error codes for Form 1094-C and four error codes for Form 1095-C that did not generate when required. These errors are all associated with the field TIN Request Type code. We found that the field was blank when the field required an entry of either “BUSINESS_TIN” or “INDIVIDUAL_TIN” depending on whether the TIN entered on the form was for the employer or employee. This field is used to determine which IRS database should be checked first during the process of verifying the TINs on Forms 1094-C and 1095-C. The IRS corrected the programming to ensure that these error codes were setting correctly.

As of August 25, 2016, the IRS reported 16 of the 141 total error codes for Forms 1094-C and 1095-C on the *Known Issues and Solutions for TY 2015 Production Forms 1094-B/1095-B, 1094-C/1095-C TY 2015* report,³³ i.e., identified them as not functioning correctly. It should be noted that the IRS did not sufficiently test all error code programming to ensure that all error conditions were functioning as intended. For

³³ The *Known Issues and Solutions for TY 2015 Production Forms 1094-B/1095-B, 1094-C/1095-C TY 2015* report identifies processing error conditions that are not functioning as intended. Once an error condition is corrected, it is moved to the resolved issues page. Both the known and resolved issues are available at (www.irs.gov) for electronic filers.



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example, 31 of 141 Form 1094-C and 1095-C error codes were not tested during Systems Acceptability Testing³⁴ prior to the start of the 2016 Filing Season. Furthermore, we noted that three of the 31 error codes are associated with error codes that did not generate when an error condition did exist. IRS management indicated that the 31 error codes were not tested because the mapping³⁵ of the Forms 1094-C and 1095-C error codes to their associated business rules was not done at the time of the testing, the associated error code was not present at the time of testing, or the error code was not included in the scope of testing.

The generation of erroneous error codes places an unnecessary burden on Applicable Large Employers filing electronic forms who must research the errors when no problem exists. The IRS must also expend resources to answer telephone calls by employers regarding the erroneous errors and to implement fixes during the filing season to correct the programming. Conversely, when the IRS does not properly identify error conditions, the Applicable Large Employers are not notified, and inaccurate Forms 1094-C and 1095-C data will not be corrected.

- **Established error rejection thresholds were not implemented to reject submissions back to the Applicable Large Employer when the number of errors exceeded established criteria.** The IRS planned to establish error rejection thresholds that would result in the rejection of an employer's submission when a certain number of the Forms 1095-C contained the same error condition. Although established, the rejection thresholds were not used during the 2016 Filing Season. As a result, the IRS accepted all Forms 1095-C regardless of whether the number of errors identified during validation exceeded established error rejection thresholds. It should be noted that employers that e-filed Forms 1094-C and 1095-C were provided error files. While the IRS encouraged these filers to correct all errors contained in the error file, it has yet to establish a time frame in which these errors must be corrected. For example, the employers were not required to correct errors, such as invalid or missing SSNs, prior to the IRS processing the Forms 1094-C and 1095-C.

IRS management explained that it did not implement rejection thresholds for the 2016 Filing Season due to concerns that the rejection of submissions may discourage the Applicable Large Employers from filing. In addition, the IRS wanted to obtain enough submissions to better understand the extent and type of Form 1095-C errors. The IRS explained that a decision will be made in January 2017 as to whether the rejection

³⁴ Systems Acceptability Tests are performed by the Test, Assurance, and Documentation group to independently assess the quality of the application software by testing with controlled data to determine conformance of the system to customer requirements and to aid the customer and developer in determining the system's tax return filing season readiness.

³⁵ Mapping of the form error codes to the business rules involves associating all form error code descriptions with corresponding business rule conditions.



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thresholds will be enforced for the 2017 Filing Season based on its analysis results of Form 1095-C data quality. As part of our ongoing ACA audit coverage, we plan to review the IRS's validation of information returns, including the establishment and use of rejection thresholds.³⁶

- **The error message description caused confusion for Applicable Large Employers attempting to identify and correct invalid or missing TINs on Forms 1094-C and 1095-C.** Each of the 141 error codes developed by the IRS include a description of the error. The error codes and descriptions are included in the error file sent back to employers. However, for the TIN validation error code, the error description only detailed which Form 1094-C or Form 1095-C contained the TIN that was invalid. The error file did not identify the specific TIN on the form that was invalid. Forms 1094-C may contain multiple EINs for the employers that are members of an aggregate group, and Forms 1095-C may contain multiple SSNs for covered individuals, *i.e.*, the employee, spouse and dependents. As such, employers had no way to know which TIN they needed to correct. This was also evident from calls made to the IRS E-Help Desk in which employers reported the inability to identify which TIN was invalid to make a correction. IRS management explained that for TY 2016 forms, it will improve the error messaging by adding additional detail to the error file that includes identifying which TIN(s) are invalid.
- **Management reports used to monitor volumes and types of errors associated with the processing of information returns were inaccurate.** We identified that the volume and types of errors were inaccurately reflected on management reports. For example, one management report dated April 12, 2016, showed that 6.2 million of the 7 million Forms 1095-C rejected because the offer of coverage code³⁷ was missing. However, our review showed that this error condition only occurred 828 times as of April 12, 2016, and that IRS criteria when identifying this error condition does not result in the rejection of a Form 1095-C. When we brought our concerns to IRS management's attention, they acknowledged the conditions we identified. IRS management stated that they had initiated reviews of both the accuracy of data reported on the management information reports and whether business rules were functioning as intended. The IRS determined that incorrect programming and labeling caused some of the inaccuracies in the management reports and initiated steps to correct these errors for the 2017 Filing Season.

³⁶ Audit # 201740317, ACA: *Accuracy of Processing Employer Information Returns and Compliance With Offering Coverage.*

³⁷ The Form 1095-C offer of coverage code specifies the type of coverage, if any, offered to the employee, the employee's spouse, and the employee's dependents. Form 1095-C business rules verify that the offer of coverage code is not missing. If the code is missing, an error code is set and reported to electronic filers for correction.



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Recommendations

The Commissioner, Small Business/Self-Employed Division, should:

Recommendation 4: Ensure that all error code business rules function as intended prior to the 2017 Filing Season.

Management's Response: The IRS agreed with this recommendation. The IRS responded that it conducted a test to ensure established requirements associated with error code business rules functioned as intended for the 2017 Filing Season. The IRS indicated that the test was completed on December 28, 2016, prior to the start of the 2017 Filing Season.

Recommendation 5: Ensure that the description included in the error files for e-filed Forms 1094-C and 1095-C contain sufficient information to allow employers to correct errors.

Management's Response: The IRS agreed with this recommendation. The IRS responded that it made enhancements on January 17, 2017, for the 2017 Filing Season to provide a greater level of detail in the error data file for transmitters.

Recommendation 6: Establish a time frame for employers to correct errors identified on Forms 1094-C and 1095-C.

Management's Response: The IRS disagreed with this recommendation. The IRS responded that TY 2015 was the first mandatory year for the filing of information returns, Treasury guidance extended good faith effort consideration for transmitters, and current IRS instructions include a statement that corrections should be filed as soon as possible after detection. The IRS also believes adopting this recommendation would go beyond the requirements of existing regulations and treat ACA information returns different from other information returns.

The IRS responded that it will reevaluate the need for additional written guidance in the future should data indicate both increasing penalty application and substantial increase of rejected returns not resubmitted within 60 calendar days and considering the applicability of "Good Faith Effort" in future years.

Office of Audit Comment: We continue to believe that the time frame of "as soon as possible after detection" in the IRS's instructions can have various meanings among employers, and a specific time frame is needed for the IRS to evaluate an employer's good faith effort to correct errors.



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Recommendation 7: Ensure that Forms 1094-C and 1095-C management reports correctly report error statistics.

Management's Response: The IRS agreed with this recommendation. The IRS responded that it revised all error reports to assure all error codes pertaining to the Forms 1094-C and 1095-C are accurately reported.

Development and Implementation of Key Systems Needed to Identify Noncompliant Employers Have Been Delayed, Not Initiated, or Cancelled

The IRS is developing new systems that will use employer-reported information returns as well as other tax data to identify employers that are not compliant with the Employer Shared Responsibility Provision and may be subject to the Employer Shared Responsibility Payment. For example, the IRS is developing the ACA Compliance Validation (ACV) system, which will be used to identify potentially noncompliant Applicable Large Employers and calculate the proposed Employer Shared Responsibility Payments. The IRS began developing the ACV system in July 2015, with implementation scheduled for January 2017. The ACV system was to have the capability to identify noncompliant Applicable Large Employers subject to the payment for not offering health insurance coverage, *i.e.*, § 4980H(a) in TY 2015.

However, the implementation of the ACV system has been delayed to May 2017. IRS management indicated that the delay is due to incorporating new requirements into ACV system development to address data inconsistencies, *i.e.*, TY 2015 Forms 1094-C and 1095-C containing errors, missing entries, and contradictory form entries. As a result, the IRS is now having to develop an automation tool outside of the ACA system in an attempt to identify the Applicable Large Employers subject to the § 4980H(a) Employer Shared Responsibility Payment. IRS management advised us that as of January 18, 2017, the IRS was testing the automation tool that it developed and planned to deploy it by March 2017.

IRS management also explained that a lack of funding has resulted in the IRS not developing ACV capability to identify Applicable Large Employers not filing Forms 1094-C and 1095-C as required, *i.e.*, nonfilers, or to identify the Applicable Large Employers potentially subject to the Employer Shared Responsibility Payment for offering health insurance coverage in TY 2015 that did not provide minimum value or was not affordable, *i.e.*, § 4980H(b). Management further noted that the complexities associated with developing the programming requirements associated with the § 4980H(b) provision continue to be a challenge. As a result, IRS management indicated that they are also planning to develop an automation tool to identify nonfilers and Applicable Large Employers subject to the § 4980H(b) Employer Shared Responsibility Payment. IRS management advised us that as of January 18, 2017, the IRS is testing the automation tool that it developed and is planning to deploy it by March 2017. As part of our ongoing ACA audit coverage, we will evaluate the effectiveness of the new automation tools and eventual implementation of the ACV system.



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The case management system for working noncompliant Applicable Large Employer cases and assessing the Employer Shared Responsibility Payment was cancelled after expending millions of dollars in development costs

On December 8, 2014, the IRS approved development of the ACA Case Management system. This system was to provide the case management³⁸ capability for post-filing compliance activities associated with the Employer Shared Responsibility Provision. Beginning January 30, 2017, the new case management system was to have allowed IRS employees to create, manage, and track the status of the § 4980H(a) payment cases to ensure employer compliance. However, on June 7, 2016, the IRS cancelled the ACA Case Management system development effort. IRS management indicated that the ACA Case Management system was cancelled in an effort to save funds and free up resources for other information technology development efforts. It should be noted that the IRS had expended a total of \$7 million in development costs at the time the ACA Case Management system was cancelled.

In addition, IRS management indicated that an Enterprise Case Management system is under development that is intended to provide an IRS-wide solution for case management. The ACA Case Management system functional components are being transferred to the Enterprise Case Management system. On November 4, 2016, IRS management explained that it plans to use an existing document control system to provide the needed case management capabilities, including establishing manual processes for working the Employer Shared Responsibility Payment cases, as an interim alternative until the Enterprise Case Management system can provide case management for ACA-related compliance activities. As part of our ongoing ACA audit coverage, we plan to evaluate the IRS's efforts to implement processes to ensure Applicable Large Employer compliance with the Employer Shared Responsibility Provision and assessment of the Employer Shared Responsibility Payment.

³⁸ Case management is the process that addresses the resolution of tax administration issues through the management of case creation, execution, maintenance, and closure.



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Appendix I

Detailed Objective, Scope, and Methodology

Our overall objective was to assess the status of the IRS's preparations for ensuring compliance with the Employer Shared Responsibility Provision and the related information reporting requirements. To accomplish this objective, we:

- I. Assessed the adequacy of the IRS's tax forms, instructions, and publications developed to assist employers in meeting the shared responsibility provision and information return reporting requirements.
 - A. Compared the shared responsibility and reporting provisions required by the ACA legislation to the requirements established in the Department of the Treasury regulations and the I.R.C. to ensure that they were consistent.
 - B. Reviewed information posted by the IRS via social media outlets or on the IRS website to ensure that the information was accurate, clear, and consistent with the ACA legislation.
 - C. Reviewed Forms 1094-C, *Transmittal of Employer-Provided Health Insurance Offer and Coverage Information Returns*, and 1095-C, *Employer-Provided Health Insurance Offer and Coverage*, and the form instructions to determine whether the IRS will obtain sufficient information to verify the accuracy of reported health insurance offers and coverage.
- II. Determined whether the IRS was adequately prepared to accept and process Forms 1094-C and 1095-C for TY¹ 2015.
 - A. Reviewed documentation to support the testing of the SCRIPS² and ACA Information Returns system³ for receipt and processing of information returns.
 - B. Reviewed the Internal Revenue Manual and ACA Information Returns system business rules designed to ensure the completeness and accuracy of the information return data.

¹ A 12-month accounting period for keeping records on income and expenses used as the basis for calculating the annual taxes due. For most individual taxpayers, the tax year is synonymous with the calendar year.

² The SCRIPS is a data capture, management, and storage system that uses high-speed scanning and digital imaging technology to process tax documents.

³ The ACA Information Returns system accepts ACA information return transmittals and documents, including Forms 1094-C and 1095-C. The ACA Information Returns system will process each submission and provide a status and detailed acknowledgement for the transmitter.



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- C. Attended the IRS's filing season readiness meetings as needed to assess the initial processing of TY 2015 Forms 1094-C and 1095-C.
- D. Conducted a walkthrough at the Austin Submission Processing Site to assess the processing of paper information returns.
- E. Obtained reports identifying the number of information returns received, rejected, and processed along with error conditions for both paper and e-filed submissions.
- F. Assessed the IRS's capacity to accurately and timely process the returns.
 - 1. Evaluated the process for submitting Forms 1094-C and 1095-C to the IRS electronically and determined the capacity for processing electronically submitted returns and whether this capacity is sufficient based on the IRS's estimated volume.
 - 2. Evaluated the process for submitting Forms 1094-C and 1095-C to the IRS via paper.
 - a. Obtained a judgmental sample⁴ of 20 paper Forms 1094-C and 100 Forms 1095-C awaiting scanning as of April 28, 2016, from the Kansas City, Missouri, and Austin, Texas, Submission Processing Sites. The population of forms available for selection was unknown since the IRS does not maintain actual counts of Forms 1094-C and 1095-C awaiting scanning. We used judgmental sampling because we did not intend to project the results to the population.
 - b. Compared entries from the sampled Forms 1094-C and 1095-C to data contained in the SCRIPS to identify missing or incorrect entries in the SCRIPS.
- G. Evaluated IRS processes to ensure the consistency and accuracy of information reported by employers.
 - 1. Determined whether the error code statistics for Forms 1094-C and 1095-C are accurately reflected on the management information reports.
 - 2. Reviewed the results of testing conducted by the IRS to ensure that the error code programming would function as intended during the filing season.
 - 3. Determined if business rules errors functioned correctly.
 - a. Obtained TY 2015 Form 1094-C and Form 1095-C information return data from the Information Returns Database as of April 15, 2016.

⁴ A judgmental sample is a nonprobability sample, the results of which cannot be used to project to the population.



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- b. Reviewed a judgmental sample of one error code for each of the top 10 most frequent Form 1094-C and Form 1095-C error codes and determined whether error codes erroneously generated when no error condition existed. We used judgmental sampling because we did not intend to project the results to the population.
 - c. Reviewed a judgmental sample of one error code for five of the 12 error codes with no reported error occurrences for Form 1094-C and one error code for five of the seven error codes with no reported error occurrences for Form 1095-C to determine whether the error codes generated when required. We used judgmental sampling because we did not intend to project the results to the population.
- H. Evaluated IRS processes for updating employer status on business taxpayer accounts.
1. Obtained extract of which accounts had the Applicable Large Employer Indicator on the Business Master File⁵ as of April 28, 2016.
 2. Obtained a Business Objects Enterprise report⁶ to identify all the Applicable Large Employers that had filed a Form 1094-C as of May 5, 2016.
 3. Compared the employers that had filed a Form 1094-C with the business taxpayers with an Applicable Large Employer Indicator to identify business taxpayers that were identified as an Applicable Large Employer on the Business Master File that had not filed a Form 1094-C.
- III. Determined if the IRS had adequate plans to ensure the determination of the Employer Shared Responsibility Payment and compliance with reporting requirements.
- A. Reviewed ACA legislation and corresponding I.R.C. and Treasury Regulations to identify how the Employer Shared Responsibility Payments are to be calculated.
 - B. Determined whether the IRS's plans for Employer Shared Responsibility Payment calculations accurately reflect the requirements in the regulations.
 - C. Evaluated IRS plans for the reconciliation of approved PTC claims with Forms 1095-C to identify the Applicable Large Employers potentially subject to the Employer Shared Responsibility Payment.
 - D. Evaluated IRS plans for determining whether the health insurance coverage reported by the Applicable Large Employer meets the MEC and is both affordable and

⁵ The IRS database that consists of Federal tax-related transactions and accounts for businesses. These include employment taxes, income taxes on businesses, and excise taxes.

⁶ Business Objects Enterprise is a tool used by the IRS for performance management activities, *i.e.*, reporting, querying, and analyzing data.



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provides minimum value, whether an employee is a full-time employee, and whether the Applicable Large Employer filed Forms 1094-C and Form 1095-C when required.

- E. Reviewed the IRS's compliance plans and procedures to notify employers of the potential liability (including the number of full-time employees that claimed the PTC), evaluate employer responses, and assess the Employer Shared Responsibility Payment if required.

Data validation methodology

For this review, we relied on IRS-provided TY 2015 Forms 1094-C and 1095-C data extracted from the Information Returns Database. We also relied on employer entity record data extracted from the Business Master File and Form 1094-C filing information contained on the IRS's Business Objects Enterprise report. To assess the reliability of the computer-processed data, programmers within Strategic Data Services validated the data extract files, while we ensured that the data extract contained the specific data elements we requested and that the data elements were accurate. In addition, we selected judgmental samples and verified that the data in the extracts and on the Business Objects Enterprise report were the same as the data contained in the IRS's Integrated Data Retrieval System⁷ and ACA Information Returns system. We determined that the data were sufficiently reliable for our intended purpose.

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 IRS's policies and procedures for the receipt and processing of Forms 1094-C and 1095-C and processes for ensuring employer compliance with the shared responsibility provision and information reporting requirements. We also evaluated the controls incorporated into the systems to help ensure the accuracy and completeness of Forms 1094-C and 1095-C processed during the 2016 Filing Season. We accomplished this by interviewing IRS management and reviewing the Internal Revenue Manual, management information reports, and key system documentation related to the receipt and processing of Forms 1094-C and 1095-C.

⁷ IRS computer system capable of retrieving or updating stored information. It works in conjunction with a taxpayer's account records.



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Appendix II

Major Contributors to This Report

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Appendix III

Report Distribution List

Commissioner
Office of the Commissioner – Attn: Chief of Staff
Deputy Commissioner for Operations Support
Deputy Commissioner for Services and Enforcement
Chief Technology Officer
Associate Chief Information Officer, Affordable Care Act (PMO)
Director, Affordable Care Act Office
Director, Affordable Care Act, Small Business/Self-Employed Division
Director, Customer Account Services, Wage and Investment Division
Director, Program Management Office, Affordable Care Act Office
Director, Submission Processing, Wage and Investment Division
Director, Office of Audit Coordination



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Appendix IV

Outcome Measure

This appendix presents detailed information on the measurable impact that our audit had on tax administration. This benefit will be incorporated into our Semiannual Report to Congress.

Type and Value of Outcome Measure:

- Reliability of Information – Actual; 4,062 business taxpayer accounts erroneously identified as Applicable Large Employers (see page 9).

Methodology Used to Measure the Reported Benefit:

We identified 5,737 business taxpayer accounts containing an Applicable Large Employer Indicator as of April 28, 2016. We also identified all the Applicable Large Employers that filed a Form 1094-C, *Transmittal of Employer-Provided Health Insurance Offer and Coverage Information Returns*, as of May 5, 2016. We compared the two lists and determined that 1,675 business taxpayers with an Applicable Large Employer Indicator had filed a Form 1094-C. The remaining 4,062 business taxpayers had not filed a Form 1094-C, but the business taxpayers accounts were erroneously identified as Applicable Large Employers on the Business Master File.¹

¹ The IRS database that consists of Federal tax-related transactions and accounts for businesses. These include employment taxes, income taxes on businesses, and excise taxes.



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Appendix V

Form 1094-C, Transmittal of Employer-Provided Health Insurance Offer and Coverage Information Returns

Form 1094-C Transmittal of Employer-Provided Health Insurance Offer and Coverage Information Returns. Includes OMB No. 1545-2251 and year 2015.

Part I Applicable Large Employer Member (ALE Member). Fields 1-16 for employer and designated entity information.



18 Total number of Forms 1095-C submitted with this transmittal. 19 Is this the authoritative transmittal for this ALE Member?

Part II ALE Member Information

20 Total number of Forms 1095-C filed by and/or on behalf of ALE Member. 21 Is ALE Member a member of an Aggregated ALE Group?

22 Certifications of Eligibility (select all that apply): A. Qualifying Offer Method, B. Qualifying Offer Method Transition Relief, C. Section 4980H Transition Relief, D. 98% Offer Method

Under penalties of perjury, I declare that I have examined this return and accompanying documents, and to the best of my knowledge and belief, they are true, correct, and complete.

Signature, Title, Date fields.



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Form 1094-C (2015)

120216
Page 2

Part III ALE Member Information – Monthly

		(a) Minimum Essential Coverage Offer Indicator		(b) Full-Time Employee Count for ALE Member	(c) Total Employee Count for ALE Member	(d) Aggregated Group Indicator	(e) Section 4980H Transition Relief Indicator
		Yes	No				
23	All 12 Months	<input type="checkbox"/>	<input type="checkbox"/>			<input type="checkbox"/>	
24	Jan	<input type="checkbox"/>	<input type="checkbox"/>			<input type="checkbox"/>	
25	Feb	<input type="checkbox"/>	<input type="checkbox"/>			<input type="checkbox"/>	
26	Mar	<input type="checkbox"/>	<input type="checkbox"/>			<input type="checkbox"/>	
27	Apr	<input type="checkbox"/>	<input type="checkbox"/>			<input type="checkbox"/>	
28	May	<input type="checkbox"/>	<input type="checkbox"/>			<input type="checkbox"/>	
29	June	<input type="checkbox"/>	<input type="checkbox"/>			<input type="checkbox"/>	
30	July	<input type="checkbox"/>	<input type="checkbox"/>			<input type="checkbox"/>	
31	Aug	<input type="checkbox"/>	<input type="checkbox"/>			<input type="checkbox"/>	
32	Sept	<input type="checkbox"/>	<input type="checkbox"/>			<input type="checkbox"/>	
33	Oct	<input type="checkbox"/>	<input type="checkbox"/>			<input type="checkbox"/>	
34	Nov	<input type="checkbox"/>	<input type="checkbox"/>			<input type="checkbox"/>	
35	Dec	<input type="checkbox"/>	<input type="checkbox"/>			<input type="checkbox"/>	

Form 1094-C (2015)



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Page 3

Form 1094-C (2015)

Part IV Other ALE Members of Aggregated ALE Group

Enter the names and EINs of Other ALE Members of the Aggregated ALE Group (who were members at any time during the calendar year).

Name	EIN	Name	EIN
36		51	
37		52	
38		53	
39		54	
40		55	
41		56	
42		57	
43		58	
44		59	
45		60	
46		61	
47		62	
48		63	
49		64	
50		65	

Form 1094-C (2015)



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Appendix VI

Form 1095-C, Employer-Provided Health Insurance Offer and Coverage

Form 1095-C Department of the Treasury Internal Revenue Service	Employer-Provided Health Insurance Offer and Coverage Information about Form 1095-C and its separate instructions is at www.irs.gov/form1095c	<input type="checkbox"/> VOID <input type="checkbox"/> CORRECTED	600116 OMB No. 1545-2251 2015												
Part I Employee		Applicable Large Employer Member (Employer)													
1 Name of employee		7 Name of employer													
2 Social security number (SSN)		8 Employer identification number (EIN)													
3 Street address (including apartment no.)		9 Street address (including room or suite no.)													
4 City or town		10 Contact telephone number													
5 State or province	6 Country and ZIP or foreign postal code	11 City or town	12 State or province												
		13 Country and ZIP or foreign postal code													
Part II Employee Offer and Coverage		Plan Start Month (Enter 2-digit number):													
14 Offer of Coverage (enter required code)	All 12 Months	Jan	Feb	Mar	Apr	May	June	July	Aug	Sept	Oct	Nov	Dec		
15 Employee Share of Lowest Cost Monthly Premium, for Self-Only Minimum Value Coverage	\$	\$	\$	\$	\$	\$	\$	\$	\$	\$	\$	\$	\$		
16 Applicable Section 4980H Safe Harbor (enter code, if applicable)															
Part III Covered Individuals		If Employer provided self-insured coverage, check the box and enter the information for each covered individual. <input type="checkbox"/>													
(a) Name of covered individual(s)	(b) SSN	(c) DOB (if SSN is not available)	(d) Covered all 12 months	(e) Months of Coverage											
				Jan	Feb	Mar	Apr	May	June	July	Aug	Sept	Oct	Nov	Dec
17			<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
18			<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
19			<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
20			<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
21			<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
22			<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
For Privacy Act and Paperwork Reduction Act Notice, see separate instructions.				Cat. No. 60706M				Form 1095-C (2015)							



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Appendix VII

Management's Response to the Draft Report



COMMISSIONER
SMALL BUSINESS/SELF-EMPLOYED DIVISION

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

MAR 10 2017

MEMORANDUM FOR MICHAEL E. MCKENNEY
DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: Mary Beth Murphy 
Commissioner, Small Business/Self-Employed Division

SUBJECT: Draft Audit Report - Affordable Care Act: Assessment of Efforts
to Implement the Employer Shared Responsibility Provision
(Audit # 201540333)

Thank you for the opportunity to review and comment on the subject draft audit report. We appreciate TIGTA's constructive review of our development of technology systems and processes to request, capture, and use employer information to implement the employer shared responsibility provision (ESRP) under the Affordable Care Act (ACA). The ESRP applies to Applicable Large Employers (ALEs), defined generally as employers with an average of 50 or more full time employees (including full-time equivalent employees). Under the ACA, ALEs can generally choose to offer coverage to their full-time employees or potentially owe an ESRP. ALEs are also subject to information reporting requirements on offers of coverage to their employees.

Like the implementation of most new and significant legislation, the implementation of these ACA provisions was a broad, complex and substantial undertaking for the IRS, a process that required the development of new information technology systems, processes, tax forms, instructions, educational materials, training, outreach, etc. Throughout this process, we worked closely and had ongoing and significant collaborations with our stakeholders – taxpayers, their representatives and other private sector stakeholders – to facilitate implementation in a manner that was informed by our taxpayers' experience, responsive to stakeholder feedback, and maintained the appropriate balance between compliance burden and risk.

To that end, the IRS identified the information that ALEs need to provide to comply with the information reporting requirements and administered effective outreach and education for employers and tax preparation firms. We established a help desk dedicated to providing assistance to filers who were experiencing difficulty in filing their information returns. We conducted several sessions with external groups, including hosting an ACA roundtable discussion at IRS, and in response to the feedback received, we provided transition relief for employers and other filers, allowing for additional time for compliance with the information reporting requirements. We developed and provided training for IRS employees who will be conducting the post filing compliance activities as well as employees from the Taxpayer Advocate Service



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and Appeals. We also designed compliance plans that detail actions the IRS plans to take to identify ALEs that may be liable for the ESRP and ALEs that did not file the required information returns.

We have also implemented significant changes to our systems to date. In addition to developing the new ACA Information Return (AIR) system, we updated the Service Center Recognition Image Processing System (SCRIPS). AIR receives and processes both e-filed and paper information returns filed by the marketplaces (Forms 1095-A, *Health Insurance Marketplace Statement*), insurance providers (Forms 1095-B, *Health Insurance Coverage*) and ALEs (Forms 1094, *Transmittal of Employer-Provided Health Insurance Offer and Coverage Information Returns*/1095-C, *Employer-Provided Health Coverage*). Since 2015, AIR has received and processed over 340 million documents, including rejecting documents with errors and notifying transmitters when corrections were necessary.

As noted in your report, we experienced some errors in the systemic processing of the 2015 information returns. Again, given the volume of the data that was being received and the relative newness of the system developed to receive it, issues such as these are part of the progressive process by which significant legislation is implemented – requiring continual adaptations on the IRS side, and transition relief on the taxpayer side. We have taken corrective action to mitigate these errors prior to receiving the TY2016 information returns. Also, we have already begun sending notification letters to ALEs who we believe were required to file the Form 1094/1095-C information returns and have not done so.

Also, your report discusses the cancellation of the ACA Case Management system (ACM-CA). It is important to note that this decision was premised on the need to develop a broader IRS-wide case management system, rather than building ad-hoc new case management systems for different and emerging purposes or issues. To that end, the IRS has been working on an Enterprise Case Management System (ECM) – which will provide an IRS-wide solution for performing case management functions using a common infrastructure platform and common services. The investments and architecture structure for the ACM-CA were recalibrated into the ECM effort, allowing the IRS to continue to capitalize on these investments but with a broader impact.

We disagree with your outcome measure because it does not reflect a measurable impact that TIGTA's recommendations will have on tax administration. While conducting this audit, TIGTA identified an error, subsequently corrected, that was unrelated to implementation of the ACA provisions. TIGTA's recommendations would not have prevented, and did not correct, this systemic error.



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Attached is a detailed response outlining our corrective actions to address your recommendations. If you have any questions, please contact me, or a member of your staff may contact, Joseph L. Wilson, Director, ACA Project Office at (470) 639-2919.

Attachment



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Attachment

RECOMMENDATION 1:

Ensure that SCRIPS data are timely transferred to the ACA Information Returns system for PY 2017. This should include ensuring that the system can adequately handle the capacity of paper Forms 1094-C and 1095-C transmissions for TIN validation.

CORRECTIVE ACTION:

We agree with this recommendation. The AIR Paper Processing – Taxpayer Identification Number Validation (TINV) defect (IM02471931 SCRIPS large volume processing fails at TINV interface) in Filing Season (FS) 2016 was driven by large file submissions from SCRIPS. This problem was resolved in May 2016 by implementing Interface Control Document (ICD) updates that instituted file size boundaries for SCRIPS transfers and by scaling the AIR solution to intake and process files up to 5GB in size.

IMPLEMENTATION DATE:

Implemented

RESPONSIBLE OFFICIAL:

Associate Chief Information Officer, Applications Development

CORRECTIVE ACTION MONITORING PLAN:

N/A

RECOMMENDATION 2:

Develop processes to identify and resolve SCRIPS transmission errors that prevent processing by the ACA Information Returns system. This should include a process to identify incorrectly formatted data resulting from schema validation errors associated with paper Forms 1094-C and 1095-C transmissions coming from the SCRIPS.

CORRECTIVE ACTION:

We agree with this recommendation. Enhancements have been made to the FS2017 AIR Management Console (AMC) to display schema errors (Rational Team Concert (RTC) 80880 FS2017 Enhancement: AMC not showing all Electronic and Paper schema errors to Main Development).

IMPLEMENTATION DATE:

Implemented

RESPONSIBLE OFFICIAL:

Associate Chief Information Officer, Applications Development



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CORRECTIVE ACTION MONITORING PLAN:

N/A

RECOMMENDATION 3:

Develop processes to ensure that the SCRIPS scanning process accurately captures Forms 1094-C and 1095-C data. This should include updating internal guidance as appropriate.

CORRECTIVE ACTION:

We will review existing processes and determine where they can be enhanced or supplemented to ensure Forms 1094-C, and 1095-C are accurately scanned and transcribed by the Service Center Recognition Image Processing System.

IMPLEMENTATION DATE:

February 15, 2018

RESPONSIBLE OFFICIAL:

Director, Submission Processing, Customer Account Services, Wage and Investment Division

CORRECTIVE ACTION MONITORING PLAN:

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

RECOMMENDATION 4:

Ensure that all error code business rules function as intended prior to the 2017 Filing Season.

CORRECTIVE ACTION:

We agree with this recommendation. The IRS conducted a test to ensure established requirements associated with error code business rules functioned as intended during Filing Season (FS) 2017. The test was completed on December 28, 2016, prior to the FS2017 start date of January 23, 2017.

IMPLEMENTATION DATE:

Implemented

RESPONSIBLE OFFICIAL:

Associate Chief Information Officer, Enterprise Services

CORRECTIVE ACTION MONITORING PLAN:

N/A



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RECOMMENDATION 5:

Ensure that the description included in the error files for e-filed Forms 1094-C and 1095-C contain sufficient information to allow employers to correct errors.

CORRECTIVE ACTION:

We agree with this recommendation. Enhancements were made on January 17, 2017, for FS2017 to provide a greater level of detail in the Error Data File for transmitters.

IMPLEMENTATION DATE:

Implemented

RESPONSIBLE OFFICIAL:

Associate Chief Information Officer, Applications Development

CORRECTIVE ACTION MONITORING PLAN:

N/A

RECOMMENDATION 6:

Establish a time frame for employers to correct errors identified on Forms 1094-C and 1095-C.

CORRECTIVE ACTION:

We disagree with the recommendation. Tax year 2015 is the first mandatory year for the filing of the information returns. Treasury guidance extended good faith effort consideration for transmitters. Our current instructions include a statement that corrections should be filed as soon as possible after detection. Considering the relative complexity of the form, recent enactment, and the extension of good faith effort, at the current time, we disagree with your recommendation.

Moreover, the general rule under Internal Revenue Code section 6724 and the related regulations is that the section 6721 and section 6722 penalties may be waived for all information returns, including ACA-related information returns, if a failure to timely furnish or file a statement or return is due to reasonable cause, that is, the reporting entity demonstrates that it acted in a responsible manner and the failure is due to significant mitigating factors or events beyond the reporting entity's control.

Adopting the recommendation would go beyond the requirements of existing regulations and treat ACA-related information returns different from other information returns. We will reevaluate the need for additional written guidance in the future should data indicate both increasing penalty application and substantial increase of rejected returns not resubmitted within 60 days and considering the applicability of "Good Faith Effort" in future years.



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IMPLEMENTATION DATE:

N/A

RESPONSIBLE OFFICIAL:

Director, Examination ACA Project Office, Small Business/Self-Employed Division

CORRECTIVE ACTION MONITORING PLAN:

N/A

RECOMMENDATION 7:

Ensure that Forms 1094-C and 1095-C management reports correctly report error statistics.

CORRECTIVE ACTION:

We agree with this recommendation. All error reports have been revised to assure all error codes pertaining to the 1094-C and 1095-C forms are accurately reported.

IMPLEMENTATION DATE:

Implemented

RESPONSIBLE OFFICIAL:

Associate Chief Information Officer, Applications Development

CORRECTIVE ACTION MONITORING PLAN:

N/A