

TREASURY INSPECTOR GENERAL FOR TAX ADMINISTRATION



Improvements to the Tax-Exempt Compliance Unit Could Reduce Mistakes and Unproductive Examination Referrals

August 16, 2024

Report Number: 2024-100-040

HIGHLIGHTS: Improvements to the Tax-Exempt Compliance Unit Could Reduce Mistakes and Unproductive Examination Referrals

Final Report issued on August 16, 2024

Report Number 2024-100-040

Why TIGTA Did This Audit

The Tax-Exempt Compliance Unit's (TECU) mission is to leverage its resources to increase compliance contacts with taxpayers. The TECU is one unit comprised of six work groups, with each group being assigned one or more workstreams developed by the Tax-Exempt and Government Entities (TE/GE) Division's Compliance, Planning, and Classification function. This audit was initiated to assess the effectiveness of the TECU's efforts to improve tax administration.

Impact on Tax Administration

Most of the TECU's work relates to compliance checks, which are reviews to determine whether a TE/GE taxpayer is compliant with their Federal tax return filings. A compliance check is not an examination, and the taxpayer may legally choose not to participate. It is instead a tool intended to help educate taxpayers as well as encourage their voluntary compliance. Compliance checks allow the IRS to reach more taxpayers at a lower cost than traditional audits.

What TIGTA Found

TECU examiners do not limit their research of taxpayers' accounts to their assigned workstreams and instead conduct additional research to identify any other potentially delinquent returns. In Fiscal Year 2021, the TE/GE Division initiated a Lean Six Sigma project that made 11 recommendations intended to improve TECU operations, including full compliance checks. TECU management believes this practice reduces taxpayer burden and administrative costs by promoting a single contact with the taxpayer.

However, by expanding the scope of each compliance check, TECU employees are manually searching for delinquent returns that could have been identified systemically but were not because they were not part of the selected workstream. The TECU does not have a workstream for taxpayers with multiple delinquencies. Further, these taxpayers could still be contacted multiple times if they are assigned to more than one workstream. For example, if a taxpayer has multiple delinquent returns and is selected for the Combined Annual Wage Reporting-Employment Tax workstream and the Credit Balance Non-Filer workstream, they could receive a separate notice from each workstream requesting the same delinquent returns.

TECU examiners spent almost three times more hours closing each case than they did before the additional research requirement was introduced, and the number of taxpayers reached through a compliance check decreased by more than half. Some cases worked also included mistakes. TIGTA's review of a stratified judgmental sample of 68 closed TECU compliance check cases identified 17 cases for which the TECU did not identify all delinquent returns. Additionally, there were seven cases for which the TECU secured the returns, but the returns were not posted to the taxpayers' accounts.

TECU examiners generally refer cases for examination when the taxpayer only partially responds to them. However, during Fiscal Years 2020 through 2023, only 113 (5 percent) of the 2,132 TECU referrals were assigned to a TE/GE Examination function, and most of those cases were later surveyed or closed without changes. Further, TECU management has not established any quantifiable goals for its performance measures.

What TIGTA Recommended

TIGTA recommended that the Commissioner, TE/GE Division:

- 1) develop a workstream for taxpayers with potentially multiple delinquencies;
- 2) eliminate the requirement for TECU examiners to conduct additional research;
- 3) issue clear and consistent compliance check procedural guidance;
- 4) revise the contact letter to allow taxpayers to submit tax returns electronically;
- 5) better align TECU examination referral guidance with criteria for assigning cases to the Examination functions; and
- 6) establish performance goals.

In its response, the IRS agreed with four recommendations but disagreed with eliminating the additional research requirement and establishing performance goals.



TREASURY INSPECTOR GENERAL
FOR TAX ADMINISTRATION

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

August 16, 2024

MEMORANDUM FOR: COMMISSIONER OF INTERNAL REVENUE

A handwritten signature in cursive script that reads 'Danny R. Verneuille'.

FROM: Danny R. Verneuille
Acting Deputy Inspector General for Audit

SUBJECT: Final Audit Report – Improvements to the Tax-Exempt Compliance Unit Could Reduce Mistakes and Unproductive Examination Referrals (Audit No.: 202310020)

This report presents the results of our review to assess the effectiveness of the Tax-Exempt Compliance Unit's efforts to improve tax administration. This review is part of our Fiscal Year 2024 Annual Audit Plan and addresses the major management and performance challenge of *Tax Compliance and Enforcement*.

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

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Background

The mission of the Tax-Exempt and Government Entities (TE/GE) Division's Tax-Exempt Compliance Unit (TECU) is to leverage its resources to increase compliance contacts with organizations/customers. According to the Internal Revenue Service (IRS), the TECU helps educate TE/GE customers and increase their voluntary compliance by expanding the IRS's ability to proactively help them remain in compliance with the nation's tax laws or to bring them back into compliance through soft/educational letters and compliance checks.

The TECU prepares soft/educational letters for issues that affect segments of the TE/GE Division's customers, like legislative changes. Soft/educational letters are informational in nature and could be based on indications of potential noncompliance by the TE/GE customers. According to TECU management, in Fiscal Year (FY) 2022, 61,207 soft/educational letters were sent to taxpayers. However, there were no letters sent to taxpayers in FY 2023, and none are planned for FY 2024.

Most of the TECU's work relates to compliance checks. A compliance check is a review to determine whether a TE/GE taxpayer is compliant with their Federal tax return filing(s), reporting, and payment requirements. A compliance check is not an examination, and the taxpayer may legally choose not to participate. A compliance check does not directly relate to determining a tax liability for any period. It is instead a tool intended to help educate TE/GE taxpayers, practitioners, plan sponsors, and participants as well as encourage voluntary compliance. In addition, a compliance check is not a discussion, inspection, or a request/review of books and records. Compliance checks allow the IRS to reach more taxpayers at a lower cost than traditional audits.

The Lean Six Sigma Compliance Check project

In November 2020, the IRS initiated the Lean Six Sigma (LSS) Compliance Check project (hereafter referred to as the LSS project), which reviewed all TE/GE Compliance Units. Prior to the LSS project, the TE/GE Division had three compliance groups: the Exempt Organizations Compliance Unit, the Employee Plans Compliance Unit, and the TECU. The LSS project goals were to:

- Develop a consistent TE/GE Division compliance check process.
- Implement efficiency opportunities.
- Mitigate or eliminate burdensome steps/processes.
- Provide consistent and meaningful real-time feedback on results.
- Develop measure(s) on how well the compliance checks change taxpayer behavior.

The LSS project made 11 recommendations and the TECU took actions to make improvements.¹ The TECU is now one unit comprised of six work groups, with each group being assigned one or more workstreams developed by the TE/GE Division's Compliance, Planning, and Classification (CP&C) function.

¹ See Appendix III for a list of the LSS project recommendations.

Improvements to the Tax-Exempt Compliance Unit Could Reduce Mistakes and Unproductive Examination Referrals

The CP&C function’s interaction with the TECU

Noncompliance issues are identified, developed, classified, and monitored for the TECU by the CP&C function. The creation, development, and review of TECU compliance check workstreams follow the same processes as compliance strategies that are developed for the TE/GE Examination functions.² If approved by the TE/GE Governance Board, the CP&C function monitors the compliance strategies and adjusts as necessary.³ Figure 1 shows the TECU workstreams and the groups assigned to work them.

Figure 1: TECU Workstreams

Project Code	Description	Group(s) Assigned
4292	Credit Balance Non-Filer – Obtain delinquent employment tax returns from organizations who have made payroll deposits.	1 and 5
6588	Form 5500–EZ, <i>Annual Return of A One Participant (Owners/Partners and Their Spouses) Retirement Plan of a Foreign Plan</i> , Non-Filer – Obtain Forms 5500–EZ for terminated retirement plans.	1, 2, 3, 5, and 6
8014	Affordable Care Act Hospital Review Compliance Checks – Address discrepancies between hospital filed tax returns, the information on the hospital website, and the requirements under Internal Revenue Code Section 501(r)(4) identified by the Affordable Care Act Hospital Review group.	6
8032	Form 940, <i>Employer’s Annual Federal Unemployment (FUTA) Tax Return</i> , Non-Filer – Obtain delinquent Forms 940 from organizations who have filed Form 941, <i>Employer’s Quarterly Federal Tax Return</i> , to verify the proper amounts of Federal unemployment tax have been reported to ensure organizations are in full compliance with reporting requirements.	6
8227	Internal Revenue Code Section 4960 Excise Tax – Obtain delinquent excise tax returns for the top five highly compensated employees of a tax-exempt organization.	1 and 3
8258	Form 990–T, <i>Exempt Organization Business Income Tax Return</i> – Obtain delinquent unrelated business income tax returns.	6
8309	Combined Annual Wage Reporting-Employment Tax – Compares the total employee wages reported by the employer on the Form W-2, <i>Wage and Tax Statement</i> , to the wages reported by the employer on the Form 941.	1
N/A	Form 1023–EZ, <i>Streamlined Application for Recognition of Exemption Under Section 501 (c) (3) of the Internal Revenue Code</i> – Temporarily detailed to assist the Determinations unit in the TE/GE Division’s Exempt Organizations function. All TECU examiners previously working Forms 1023-EZ returned to work for the TECU during the completion of the audit.	2, 4, and 5

Source: TE/GE Compliance Unit Program Overview (March 8, 2023) and TECU Procedures.

² Compliance strategies are issues approved by the TE/GE Compliance Governance Board to identify, prioritize, and allocate resources within the TE/GE filing population.

³ The TE/GE Governance Board is comprised of five voting members representing all TE/GE functions including TE/GE Division Counsel. It serves as the governing body over the identification, selection, assignment, and allocation of resources for all TE/GE Division compliance and enforcement activities and ensures that all compliance strategy proposals are reviewed and discussed prior to any case selection. Instead of selecting individual cases with potential noncompliance for examination, compliance strategies identify a group of cases with the same potential noncompliant issue to address a common area of concern across the tax-exempt sector.

Nonfiler notices

Prior to contact by the TECU, TE/GE taxpayers may have also received notices reminding them of their filing requirements. For example, the IRS mails notices to Employee Plan filers who previously filed Forms 5500-EZ reminding them of their obligation to file a return if the return is overdue. Automated notices are also sent to organizations that failed to file Forms 990 series returns.⁴ For example, according to TE/GE management, during FY 2023 the Exempt Organizations function sent 390,119 notices to organizations that failed to file Form 990 series returns as well as an additional 4,302 notices to organizations that failed to file returns for the previous two years.

Results of Review

Most Compliance Check Recommendations Have Been Implemented

The LSS project focused on the TE/GE Division's three previous compliance groups and processes to develop one process that more efficiently uses time and resources. As a result, the TE/GE Division combined its three compliance groups into the TECU. The TECU is functionally aligned under the Government Entities organization, which is within the TE/GE Division's Exempt Organizations/Government Entities function. The LSS project made 11 recommendations and according to IRS management, the TECU has completed the following actions pursuant to these recommendations as of January 2024:

- Standardized and consolidated the individual compliance check processes into one compliance check process.
- Developed standard procedures for handling taxpayers who do not reply to the TECU after initial contact.
- Modified action codes to reflect the number and types of contacts the TECU makes with taxpayers.
- Developed a standardized referral process.
- Developed standard definitions for compliance checks, surveyed, and no-change cases.⁵
- Incorporated the issue data grid into the compliance check process.⁶

⁴ Forms 990 series returns include Form 990, *Return of Organization Exempt from Income Tax*, Form 990-EZ, *Short Form Return of Organization Exempt From Income Tax*, Form 990-N, *Electronic Notice (e-Postcard) for Tax-Exempt Organizations Not Required to File Form 990 or Form 990-EZ*, and Form 990-PF, *Return of Private Foundation*.

⁵ A case selected for a compliance check is closed as "survey" if no contact has been made with the taxpayer or representative, and it was determined that there were no issues that warrant further action.

⁶ The issue data grid is a tool used by the TE/GE Division that collects the results of examinations and compliance checks by each potential noncompliance issue identified and reviewed. The tool is intended to measure the effect of each issue in relation to the overall results, provide meaningful real-time feedback to evaluate the productivity of the workstreams, and identify potential issues for future workstreams.

Improvements to the Tax-Exempt Compliance Unit Could Reduce Mistakes and Unproductive Examination Referrals

- Standardized the disposal codes and action codes used in the embedded case chronology in the Reporting Compliance Case Management System (RCCMS) for the compliance check process.⁷
- Released the TE/GE Division's *Title 26 Compliance Check Procedural Handbook* (hereafter referred to as the compliance check handbook).
- Delivered training on the new compliance check process and the issue data grid.
- Consolidated the TE/GE Division's compliance check letters.

The TECU plans to implement these remaining action items in FY 2024:

- Create a TE/GE Internal Revenue Manual (IRM) that includes the processes and procedures for conducting compliance checks (expected implementation: FY 2024 Third Quarter).⁸
- Establish Tax-Exempt Quality Management System standards and elements for the compliance check process (expected implementation: FY 2024 Fourth Quarter).⁹

Tax-Exempt Compliance Unit Compliance Checks Are Labor Intensive and Some Employees Made Mistakes When Working on Them

TECU examiners do not limit their research of taxpayers' accounts to the potential noncompliant activity as defined by the specific workstreams developed by the CP&C function. Instead, procedures require TECU examiners to conduct research to identify other delinquent returns in addition to the returns required to be secured from the taxpayers as part of the workstream objective. TECU management stated that performing the additional research and securing missing/delinquent returns during a compliance check reduces taxpayer burden and administrative cost by promoting a single contact with the taxpayer. However, if an organization meets the conditions of multiple workstreams, it could be selected for assignment in more than one workstream and could potentially be contacted by more than one TECU group. For example, if a taxpayer has multiple delinquent returns and is selected for the Combined Annual Wage Reporting-Employment Tax workstream and the Credit Balance Non-Filer workstream, they could receive a separate notice from each workstream requesting the same delinquent returns. Conversely, the notices could potentially contain other delinquent returns identified by one workstream and not the other, which could lead to taxpayer confusion.

The TECU does not have a workstream that identifies multiple delinquencies. TECU management stated that there are no controls in place to prevent multiple TECU groups from requesting the same information. For example, the CP&C function does not compare the inventory of the various workstreams to eliminate duplicate assignments, nor does it filter

⁷ The RCCMS is a data system which provides TE/GE personnel with the capability to perform division-wide inventory control, compliance testing, quality management, education, and outreach as well as team examination monitoring.

⁸ The IRM is the primary source of instructions to employees relating to the administration and operation of the IRS. The Manual contains the directions employees need to carry out their operational responsibilities.

⁹ The TE/GE Division's Tax-Exempt Quality Measurement System measures whether an examined case meets quality standards.

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inventory to identify organizations that have multiple potential noncompliant issues before assigning them to the various TECU workstreams. Furthermore, some taxpayers, such as filers of Forms 990 series returns, may also be contacted systemically by other IRS functions when they do not file tax returns.

The compliance check handbook, which was released through the LSS project along with the workstream desk guides, stipulate the processes and steps TECU examiners should take while conducting a compliance check. For example, TECU examiners should “conduct research for full compliance.” A minimum filing check includes:

- The taxpayer’s return(s).
- All related returns that impact the taxpayer’s return(s).
- Any return the taxpayer is responsible for filing or controls.

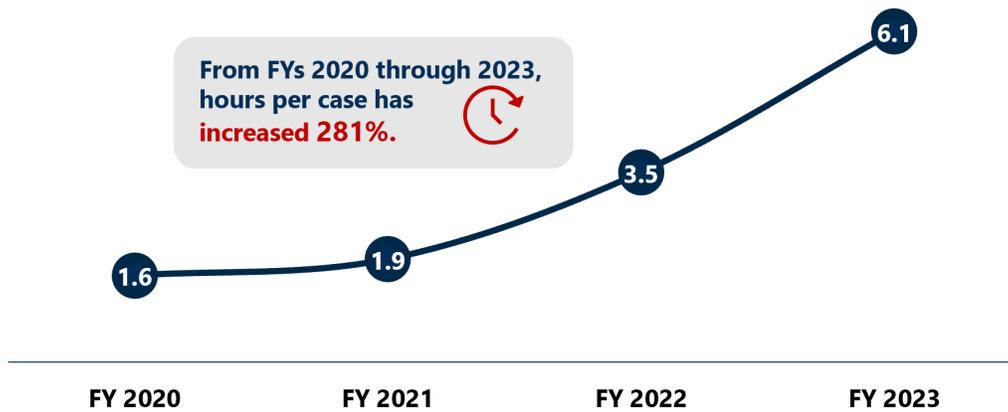
However, the handbook and desk guides do not provide specific guidance for TECU examiners regarding the types of returns that need to be requested for each workstream or define a related return. As a result, TECU examiners spend a significant amount of their time on full-scope compliance reviews in addition to the noncompliance issue for which the workstream was created.

Workstreams should identify a group of cases with the same potential noncompliant issue to address a common area of concern across the tax-exempt sector. The CP&C function’s Issue Identification unit is responsible for identifying issues with the potential for high levels of noncompliance, using unbiased, data-driven approaches. The Issue Identification unit then proposes a high-risk workstream. TE/GE leadership approves the workstreams developed by the Issue Identification unit. However, by expanding the scope of each compliance check to search for other potential filing delinquencies, TECU examiners are manually searching for delinquent returns that the CP&C function could have identified systemically but did not do so because they were not part of the selected workstream. The CP&C function could design a workstream for taxpayers who potentially have multiple delinquencies, which would reduce the risk of them being contacted multiple times by the TECU as well as save time and resources, which would allow the TECU to contact additional taxpayers with potential delinquencies.

The practice of searching for all delinquent returns also negates the potential efficiencies of assigning work to issue-driven workstreams, such as lowering the learning curve for employees and developing better expertise at researching taxpayers’ accounts for known workstream issue(s). Figure 2 shows that the average hours TECU examiners spent working each case has increased every year since FY 2020.

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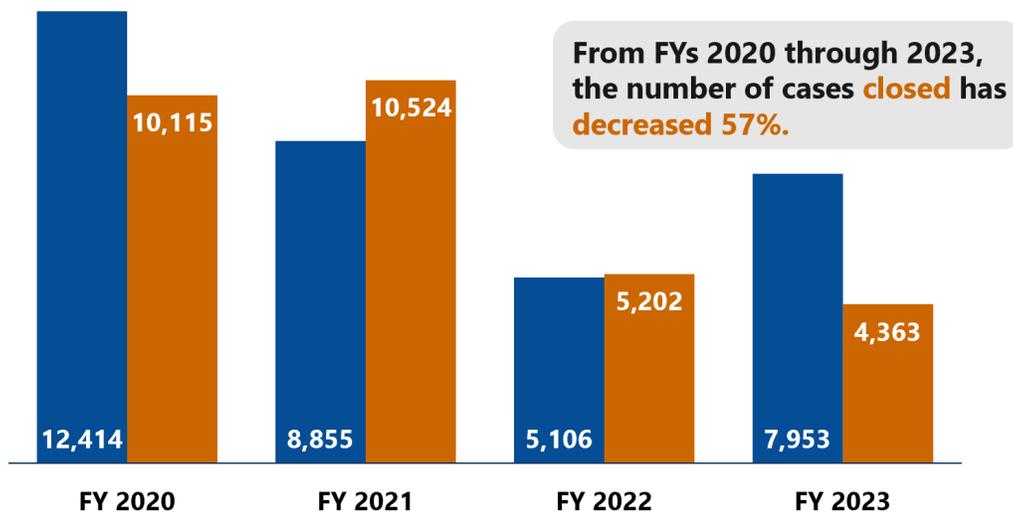
Figure 2: Average Hours Spent per TECU Case (FYs 2020 through 2023)



Source: TE/GE management.

On average, it took TECU examiners 4.5 (281 percent) more hours to close each case in FY 2023 than it did in FY 2020. In addition to taking longer, fewer compliance check cases were worked during the same period. Figure 3 shows how many TECU cases were started and closed during FYs 2020 through 2023.

Figure 3: TECU Compliance Check Cases



Source: TE/GE management.

During FYs 2020 through 2023, the number of closed cases dropped 57 percent. TECU management stated that the temporary reassignment of 32 examiners to the Form 1023-EZ detail, along with the hiring of 29 new employees in FYs 2022 and 2023 contributed to the increase in case hours and a reduction in case closures. In addition, the new compliance check procedures and workstream issue complexity contributed to the increased hours per case and the reduced number of cases closed.¹⁰

¹⁰ The TECU closed 51,256 Forms 1023-EZ applications in FY 2022, and 48,172 Forms 1023-EZ applications in FY 2023.

Improvements to the Tax-Exempt Compliance Unit Could Reduce Mistakes and Unproductive Examination Referrals

Further, employees made mistakes when searching for delinquent returns outside of their assigned workstream. We reviewed a stratified judgmental sample of 68 closed TECU compliance check cases and identified:¹¹

- 17 cases for which all delinquent returns were not requested.
- 7 cases for which the TECU secured the delinquent returns, but the returns were not posted to the taxpayer's account.¹²
- 44 cases for which employees correctly followed TECU procedures.

TECU letters instruct taxpayers to file their delinquent return(s) with the TECU instead of advising taxpayers to file their delinquent returns electronically. After receipt of the paper return, TECU examiners should forward the secured return(s) to the appropriate IRS campus for processing. TECU management stated that they require the TECU to secure delinquent returns because it promotes efficient use of resources while allowing the TECU to close the case with the proper disposal code to accurately capture the compliance outcome of the case. However, this process requires employee involvement, which can lead to errors and delays. Providing taxpayers with the option to file their returns electronically could reduce errors and is consistent with the IRS's strategy of encouraging more taxpayers to file their returns electronically.

There are also inconsistencies between the compliance check handbook and some of the workstream desk guides. For example, the compliance check handbook instructs TECU examiners to research the organizations' accounts for all delinquent returns for each workstream. However, five of the 10 current desk guides instruct TECU examiners not to look for other delinquent returns and to focus only on the workstream issue assigned.¹³ TECU management stated that some of the workstreams were in place prior to the creation of the compliance check handbook and their desk guides have not been updated.

Adding a TECU workstream for multiple delinquencies and eliminating the requirement to conduct full filing compliance checks in the other workstreams would allow the TECU to focus on the areas of noncompliance considered to be the highest risk by TE/GE leadership; potentially reduce human errors; and better align with the TECU's mission to leverage its resources and substantially increase compliance contacts with organizations/customers, which would improve overall compliance.

¹¹ We selected a stratified judgmental sample of 68 cases from a total population of 3,480 closed TECU compliance check cases. For three of the 10 workstreams, we reviewed their entire population because there were fewer than 10 cases. We used judgmental sampling for the remaining seven workstreams due to the availability of resources and the prevalence of identified errors. A judgmental sample is a nonprobability sample, the results of which cannot be used to project to the population.

¹² The tax returns may not have been posted due to the backlog in processing of returns during the Coronavirus Disease 2019 Pandemic. Six cases were posted after we completed our case review.

¹³ The procedures for the Form 5500-EZ workstream are silent on whether a TECU examiner should complete a full review. However, some of the entities identified in the workstream could be outside the TE/GE Division's areas of responsibility. Therefore, TECU examiners are told to search for other delinquent returns only for entities within the TE/GE Division's authority.

Improvements to the Tax-Exempt Compliance Unit Could Reduce Mistakes and Unproductive Examination Referrals

The Commissioner, TE/GE Division, should:

Recommendation 1: Consider developing a TECU workstream for taxpayers that potentially have multiple delinquencies.

Management's Response: The IRS agreed with this recommendation stating that the TE/GE Division will consider developing a TECU workstream for taxpayers that have multiple delinquencies in accordance with procedures outline in IRM 4.70.5.

Recommendation 2: Eliminate the requirement for TECU examiners to conduct additional research on the taxpayer's account beyond the noncompliance issue assigned in the TECU workstream.

Management's Response: The IRS disagreed with this recommendation stating that the TE/GE Division conducts additional research to reduce taxpayer burden and administrative cost by avoiding multiple contacts with a taxpayer to resolve identified compliance issues in a single taxpayer engagement.

Office of Audit Comment: The practice of searching for all delinquent returns negates the potential efficiencies of assigning work to issue-driven workstreams such as developing better expertise at researching taxpayers' accounts for the assigned workstream issue, which would allow the TECU Division to contact more taxpayers with potential delinquencies. Furthermore, if a workstream is established pursuant to Recommendation 1, taxpayers with potential multiple delinquencies could be systemically identified instead of relying on TECU examiners to manually research taxpayer accounts.

Recommendation 3: Issue clear and consistent procedural guidance for TECU examiners to follow when conducting compliance checks.

Management's Response: The IRS agreed with this recommendation stating that the TE/GE Division will review and update procedures for TECU examiners to follow when conducting compliance checks.

Recommendation 4: Revise the initial contact letters to provide taxpayers the option to submit the requested returns electronically.

Management's Response: The IRS agreed with this recommendation stating that consistent with enterprise-wide digitalization efforts, the TE/GE Division will research and identify available electronic filing options and update the initial contact letter.

Examination Functions Did Not Work Most Tax-Exempt Compliance Unit Referrals

The TECU generally refers cases to the CP&C function for selection and assignment to the TE/GE Examination functions when the taxpayer provides a partial response. During FYs 2020 through 2023, the TE/GE Examination functions worked 113 (5 percent) of the 2,132 TECU referred cases. The remaining 2,019 referred cases were not worked by the TE/GE Examination functions. Figure 4 shows how many cases were referred and worked by the TE/GE Examination functions in FYs 2020 through 2023.

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Figure 4: Cases Referred to the TE/GE Examination Functions (FYs 2020 through 2023)

Fiscal Year	Referred to Examination	Referred Cases Worked by Examination ¹⁴	Percent of Referred Cases Worked
2020	351	30	9%
2021	833	46	6%
2022	659	27	4%
2023	289	10	3%
Total	2,132	113	5%

Source: CP&C Planning and Monitoring.

Additionally, many of the cases that were worked and closed by the TE/GE Examination functions did not result in any changes to the case. Figure 5 shows the results of the 88 examined cases that had been closed as of February 2024.

Figure 5: Results of TECU Referred Cases Worked and Closed by the TE/GE Examination Functions¹⁵

Fiscal Year	2020	2021	2022	2023
No Change	7	11	2	0
Change	14	21	8	0
Survey	8	12	5	0
Referred Cases Worked	29	44	15	0

Source: CP&C Planning and Monitoring.

Over the four-year period, 45 (51 percent) of the 88 closed cases were either surveyed or closed without changes to the taxpayers' accounts. The IRS associates a high percentage of examined returns with recommended adjustments as being more productive than examinations that result in no changes. Such work causes unnecessary burden on taxpayers and wastes the IRS's limited resources. Furthermore, taxpayers may legally choose not to participate in a compliance check because it is a tool intended to help educate TE/GE taxpayers, practitioners, plan sponsors, and participants as well as encourage voluntary compliance. In addition, these taxpayers would still be subject to the Examination functions' selection criteria regardless of if they were referred by the TECU or not.

The compliance check handbook provides instructions on how to make an examination referral:

- The TECU examiner completes the Form 5666, *TE/GE Referral Information Report*.
- The TECU examiner closes the case with the referral disposal code.
- The lead examiner/manager approves the case and sends the completed Form 5666 to the CP&C referral mailbox.

¹⁴ Figures 4 and 5 do not reconcile because some referred examination cases have not been closed.

¹⁵ As of February 2024, none of the FY 2023 referred cases selected by the Examination functions had been closed.

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- The manager closes the case.

While the handbook explains how to complete a referral, it provides no instruction on the types of cases that should be referred to examination.

Once received by the CP&C function, analysts review the referral for examination potential and other factors, such as grade and location of the tax examiners, available resources, and balancing the examination workplan priorities. If the CP&C analyst determines that the case warrants examination, the case will be assigned to the appropriate Examination function (most often within the Employee Plans function or the Exempt Organizations function). CP&C management stated that they did not refer most TECU referral cases to the TE/GE Examination functions because of the experience and location of the tax examiners, limited resources available, and balancing the examination workplan priorities. However, TECU and CP&C management have not established focused criteria for referring cases to the Examination functions. Instead, TECU management stated that TECU examiners generally refer cases to examination when there is only a partial response from the taxpayer.

The CP&C function's goal is to complete each review within three months of receipt, and management estimates that it takes CP&C analysts approximately 30 minutes to review and approve or disapprove each referred case. Additional time is spent by TECU examiners when preparing and approving referrals that are unlikely to be worked by the Examination functions. We estimate CP&C analysts spent approximately \$73,315 reviewing 2,019 referrals sent to the TE/GE Examination functions that were not selected to be worked.

Recommendation 5: The Commissioner, TE/GE Division, should better align procedural guidance for TECU examination referrals with CP&C criteria for assigning cases to the Examination functions.

Management's Response: The IRS agreed with this recommendation stating that the TE/GE Division will review and revise applicable procedures to ensure better alignment between TECU examination referrals and CP&C criteria for assigning cases to the Examination functions.

Performance Measures Do Not Have Goals

The TECU assesses its performance based on the number of hours worked per case, case closures, days to closure, and change rates. Figure 6 shows the performance results for each of these categories for FYs 2020 through 2023.

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Figure 6: TECU Performance Results (FYs 2020 through 2023)

Fiscal Year	Hours per Case	Closures	Days to Close Case	Change Rate ¹⁶
2020	1.6	10,115	84	78%
2021	1.9	10,524	104	70%
2022	3.5	5,202	79	68%
2023	6.1	4,363	69	79%

Source: CP&C Planning and Monitoring.

However, the TECU has not established any quantifiable goals for its performance measures. TECU management stated that they plan to develop and implement standards for measuring quality for compliance check workstreams as part of the Tax-Exempt Quality Management System but did not commit to establishing goals for performance measures.

Various statutory and regulatory provisions require the IRS to set performance goals for organizational units and to measure the results achieved by those units. For example, the Government Accountability Office's *Standards for Internal Control in the Federal Government* states that Government entities should use actual results against qualitative and numeric targets to report on agency progress in delivering its administrative responsibilities.¹⁷ Additionally, the Government Performance and Results Act of 1993 requires agencies to prepare annual performance plans for their programs that show quantifiable, measurable performance goals, indicators and comparisons to actual results.¹⁸

According to the IRM, each measure should have targets based on the previous year's results, historical patterns, and the anticipated mix of resources available.¹⁹ All levels of the organization can establish targets to support organizational strategies and plans.²⁰ Targets should be included in documents that are distributed broadly both within and outside the organization.²¹ Other units and functions within the TE/GE Division have goals for the number of cases started and closed each year. For example, the Employee Plans Examination function had a goal to start 450 and close 570 compliance strategy cases in FY 2023. Additionally, the Exempt Organizations Examination function had a goal to start 866 and close 663 data-driven approach cases in FY 2023.

Performance goals also help measure how organizations perform relative to past performance. Without goals, the performance measures do not provide a full perspective about progress and improvements in the TECU. Further, the TECU may be unable to fully determine if it is efficiently and effectively using IRS resources without performance goals.

¹⁶ A no-change compliance check is a case when no delinquent returns are secured.

¹⁷ Government Accountability Office, GAO-14-704G, *Standards for Internal Control in the Federal Government* (Sept. 2014).

¹⁸ Pub. L. No. 103-62, 107 Stat. 285 (codified as amended in scattered sections of 5, 31, and 39 U.S.C.).

¹⁹ IRM 1.5.1.2(c), *Performance Measures Quick Reference* (June 30, 2023).

²⁰ IRM 1.5.1.6(3), *Setting Targets or Performance Goals* (June 30, 2023).

²¹ IRM 1.5.1.6.1(2), *Communicating Targets* (June 30, 2023).

Improvements to the Tax-Exempt Compliance Unit Could Reduce Mistakes and Unproductive Examination Referrals

Recommendation 6: The Commissioner, TE/GE Division, should establish performance goals that provide perspective on progress and improvement in the TECU.

Management's Response: The IRS disagreed with this recommendation stating that the TECU already has performance measures that allow the TE/GE Division to evaluate program performance and identify needed changes or improvements.

Office of Audit Comment: Although it is important to establish performance measures, the IRM also requires measures to have targets which can then be compared to actual results to measure progress.

Appendix I

Detailed Objective, Scope, and Methodology

The overall objective of this audit was to assess the effectiveness of the TECU's efforts to improve tax administration. To accomplish our objective, we:

- Determined if the TECU examiners followed the required processes and procedures when performing their compliance checks.
 - Obtained and reviewed the TE/GE Division's *Title 26 Compliance Check Process Procedural Handbook* and the workstream desk guides to determine the phases and steps needed to complete a TECU case.
 - Reviewed and validated RCCMS reports to identify TECU cases closed for each workstream from June 2022 through May 2023.
 - Reviewed a stratified judgmental sample of 68 closed TECU compliance check cases to determine if TECU examiners properly followed compliance check phases and steps to complete the case.¹
 - Discussed any exceptions cases with TECU management.
 - Determined the status of planned LSS project actions and non-implemented recommendations.
- Determined the TECU's overall effect on changing taxpayer behavior/tax administration.
 - Assessed the TECU performance measures used to evaluate the success of the TECU program.
 - Determined the effectiveness of the processes for identifying and selecting the TECU workstreams.
 - Interviewed TECU management to determine the process for referring cases for examination.
 - Obtained and reviewed TECU case closure and examination referral data from FYs 2020 through 2023 for each workstream to determine the results of the closed cases.

Performance of This Review

This review was performed with information obtained from the TE/GE Division in Covington, Kentucky, and Washington, D.C., during the period February 2023 through March 2024. 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.

¹ A judgmental sample is a nonprobability sample, the results of which cannot be used to project to the population.

Improvements to the Tax-Exempt Compliance Unit Could Reduce Mistakes and Unproductive Examination Referrals

Major contributors to the report were Bryce Kisler, Assistant Inspector General for Audit (Management Services and Exempt Organizations); Carl Aley, Director; David Bueter, Audit Manager; Richard Kemble, Lead Auditor; John Jarvis, Senior Auditor.

Data Validation Methodology

We performed tests to assess the reliability of the TECU closed case data from FYs 2020 through 2023 by matching them to the case data in the RCCMS database. We evaluated the data by 1) performing electronic testing of required data elements, 2) reviewing existing information about the data and the system that produced them, and 3) interviewing agency officials knowledgeable about the data. We determined that the data were sufficiently reliable for purposes of this report.

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: TECU policies and procedures followed when conducting compliance checks. We evaluated these controls by reviewing the policies, procedures, and training documents and interviewing IRS employees who participated in the LSS project and performed compliance checks. Additionally, we reviewed a stratified judgmental sample of 68 closed TECU compliance check cases to evaluate whether the procedures were being followed.

Outcome Measure

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

Type and Value of Outcome Measure:

- Inefficient Use of Resources – Potential; an estimated \$73,315 spent by CP&C analysts reviewing 2,019 referrals to the TE/GE Examination functions that were not selected to be worked (see Recommendation 5).

Methodology Used to Measure the Reported Benefit:

We determined that during FYs 2020 through 2023, the TECU referred 2,132 cases for examination. Of the 2,132 referred cases, 2,019 (95 percent) were not selected to be worked by the TE/GE Examination functions. It takes CP&C analysts approximately 30 minutes to review and approve or disapprove each referred case, meaning analysts spent an estimated 1,010 hours reviewing the 2,019 referrals not selected for examination. Using the IRS's FY 2023 Enforcement Appropriation budget's estimated fully burdened average salary of \$150,985 per IRS employee, we estimate that the IRS spent approximately \$73,315 reviewing referrals that were not selected to be worked.

- $[(1,010 \text{ hours worked} / 2,080 \text{ hours per year}) \times \$150,985 = \$73,315]$.

Appendix III

Lean Six Sigma Compliance Check Project Recommendations

Number	Recommendation
1	Develop a TE/GE compliance check process to bring consistency across workstreams for the TECU.
2	Use the issue data grid as the Examination function uses it.
3	Develop measurements that measure the TECU's mission.
4	Standardize and clarify all compliance check related term definitions, procedures, processing, closing codes, letters, disposal codes, and action codes across all the compliance units.
5	Increase approval times, <i>i.e.</i> , referrals, closures, updates, <i>etc.</i>
6	Clarify and define measures.
7	Decrease approval times for Employment Codes (Federal, State, local employment tax specific).
8	Coordinate with the CP&C function to develop a streamlined referral process.
9	Increase time to post submitted tax returns.
10	Shorten the deadlines for responses to initial contact letters.
11	Create a TE/GE IRM for compliance check processes/procedures.

Source: *Compliance Check LSS Project Recommendations Listing.*

Management's Response to the Draft Report



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

July 22, 2024

MEMORANDUM FOR DANNY VERNEUILLE
ACTING DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: Edward T. Killen 
Commissioner,
Tax-Exempt and Government Entities Division (TE/GE)

SUBJECT: Draft Audit Report – Improvements to the Tax-Exempt
Compliance Unit Could Reduce Mistakes and Unproductive
Examination Referrals (Audit # 202310020)

Thank you for the opportunity to review and comment on the subject draft audit report: "Improvements to the Tax-Exempt Compliance Unit Could Reduce Mistakes and Unproductive Examination Referrals." We appreciate your recognition of the progress TE/GE has made in implementing process improvements to its compliance check program to increase both productivity and taxpayer service in resolving non-filing and other compliance issues through non-examination contact. We also appreciate your evaluation of the program's effectiveness and recommendations to further leverage our resources to increase compliance contacts with TE/GE taxpayers.

As noted in your report, TE/GE reorganized three compliance functions and processes, creating the Tax Exempt Compliance Unit (TECU) and unified processes, resulting in more efficient use of resources. Since its formation, TECU has implemented significant procedural improvements, including standardizing the compliance check process and completing the TE/GE Division's Title 26 Compliance Check Procedural Handbook. The new process improves consistency and processing efficiency through standard, improved procedures for referrals; the use of enhanced data such as action codes and disposal codes; and improved correspondence. TECU has successfully delivered training to its employees on the compliance check process.

TIGTA recommended that TE/GE eliminate the requirement for TECU examiners to conduct additional research on the taxpayer's account beyond the noncompliance issue assigned in the TECU workstream. TE/GE disagrees with the recommendation. TE/GE conducts this additional research to identify and secure missing returns during a compliance check, which reduces taxpayer burden and administrative cost by avoiding multiple contacts with a taxpayer. Conducting this research during a compliance check

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increases efficiency by resolving identified compliance issues in a single taxpayer engagement. Efficiency gained on an individual case by not conducting this research would be offset by potential unaddressed noncompliance or future contacts with taxpayers.

Finally, TIGTA recommended that TE/GE establish performance goals that provide perspective on progress and improvement in the TECU. TE/GE agrees with TIGTA that it is important to establish TECU performance goals consistent with other programs in TE/GE; however, we disagree with the recommendation because the TECU already has a comprehensive suite of performance measures that are set at the beginning of each fiscal year and that are monitored throughout the year. This important part of the annual TE/GE workplan process provides actionable data to evaluate operational performance and identify needed actions or changes within the TECU.

We appreciate the opportunity to review and comment on the draft report. Attached is our response with planned corrective actions to your recommendations. If you have any questions, please contact Robert Malone, Director, Exempt Organizations and Government Entities, TE/GE at robert.malone@irs.gov, or Adrian Gonzalez, Director, Compliance, Planning and Classification, TE/GE at adrian.f.gonzalez@irs.gov.

Attachment

**Improvements to the Tax-Exempt Compliance Unit Could Reduce
Mistakes and Unproductive Examination Referrals**

Attachment

**Corrective Actions for TIGTA Audit Draft Report –
Improvements to the Tax-Exempt Compliance Unit Could Reduce Mistakes and
Unproductive Examination Referrals (Audit # 202310020)**

Recommendation 1:

The Commissioner, TE/GE Division, should consider developing a TECU workstream for taxpayers that potentially have multiple delinquencies.

Planned Corrective Action:

The IRS agrees with this recommendation. TE/GE will consider the development of a TECU workstream for taxpayers that have multiple delinquencies in accordance with procedures outlined in Internal Revenue Manual section 4.70.5.

Implementation Date:

7/15/2025

Responsible Official(s):

Director, Compliance, Planning & Classification, TE/GE

Corrective Action Monitoring Plan:

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

Recommendation 2:

The Commissioner, TE/GE Division, should eliminate the requirement for TECU examiners to conduct additional research on the taxpayer's account beyond the noncompliance issue assigned in the TECU workstream.

Planned Corrective Action:

The IRS disagrees with this recommendation. TE/GE conducts additional research to reduce taxpayer burden and administrative cost by avoiding multiple contacts with a taxpayer to resolve identified compliance issues in a single taxpayer engagement.

Implementation Date:

N/A

Responsible Official(s):

N/A

Corrective Action Monitoring Plan:

N/A

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Recommendation 3:

The Commissioner, TE/GE Division, should issue clear and consistent procedural guidance for TECU examiners to follow when conducting compliance checks.

Planned Corrective Action:

The IRS agrees with this recommendation. TE/GE will review and update procedures for TECU examiners to follow when conducting compliance checks.

Implementation Date:

08/15/2025

Responsible Official(s):

Director, Government Entities, TE/GE

Corrective Action Monitoring Plan:

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

Recommendation 4:

The Commissioner, TE/GE Division, should revise the initial contact letter to provide taxpayers the option to submit the requested returns electronically.

Planned Corrective Action:

The IRS agrees with this recommendation. Consistent with enterprise-wide digitalization efforts, TE/GE will research and identify available electronic filing options and update the initial contact letter as appropriate.

Implementation Date:

02/15/2026

Responsible Official(s):

Director, Government Entities, TE/GE

Corrective Action Monitoring Plan:

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

Recommendation 5:

The Commissioner, TE/GE Division, should better align procedural guidance for TECU examination referrals with CP&C criteria for assigning cases to the Examination functions.

**Improvements to the Tax-Exempt Compliance Unit Could Reduce
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Planned Corrective Action:

The IRS agrees with this recommendation. TE/GE will review and revise applicable procedures to ensure better alignment between TECU examination referrals and CP&C criteria for assigning cases to the examination functions.

Implementation Date:

08/15/2025

Responsible Official(s):

Director, Government Entities, TE/GE

Corrective Action Monitoring Plan:

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

Outcome Measure:

Inefficient Use of Resources – Potential; an estimated \$73,315 spent by CP&C analysts reviewing 2,019 referrals to the TE/GE Examination functions that were not selected to be worked. (See Recommendation 5)

IRS Response:

The IRS agrees. TE/GE takes seriously all referrals it receives and accordingly utilizes resources for their review. As discussed above, in connection with the related recommendation, TE/GE will review and revise applicable procedures to ensure better alignment between TECU examination referrals and CP&C criteria for assigning cases to the examination functions.

Recommendation 6:

The Commissioner, TE/GE Division, should establish performance goals that provide perspective on progress and improvement in the TECU.

Planned Corrective Action:

The IRS disagrees with this recommendation. TECU already has performance measures that allow TE/GE to evaluate program performance and identify needed changes or improvements.

Implementation Date:

N/A

Responsible Official(s):

N/A

Corrective Action Monitoring Plan:

N/A

Abbreviations

CP&C	Compliance, Planning, and Classification
FY	Fiscal Year
IRM	Internal Revenue Manual
IRS	Internal Revenue Service
LSS	Lean Six Sigma
RCCMS	Reporting Compliance Case Management System
TECU	Tax-Exempt Compliance Unit
TE/GE	Tax-Exempt and Government Entities



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

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

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