



*Performance Measures and Improved Case
Tracking Would Help the Exempt
Organizations Function Better
Allocate Resources*

March 13, 2008

Reference Number: 2008-10-057

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.



TREASURY INSPECTOR GENERAL
FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

March 13, 2008

MEMORANDUM FOR COMMISSIONER, TAX EXEMPT AND GOVERNMENT ENTITIES
DIVISION

FROM: *Michael R. Phillips*
Michael R. Phillips
Deputy Inspector General for Audit

SUBJECT: Final Audit Report – Performance Measures and Improved Case
Tracking Would Help the Exempt Organizations Function Better
Allocate Resources (Audit # 200710037)

This report presents the results of our review to assess the Exempt Organizations (EO) function Review of Operations Unit's effectiveness in identifying and evaluating recently established tax-exempt organizations that may not be complying with their stated tax-exempt purposes and/or may not be current with all filing requirements.¹ In addition, we determined whether the results of reviews of recently established tax-exempt organizations were used to identify emerging trends or issues for future compliance work or education and outreach activities. This audit was developed as part of the Treasury Inspector General for Tax Administration Office of Audit's Fiscal Year 2008 Annual Audit Plan related to the Major Management Challenge of tax compliance initiatives.

Impact on the Taxpayer

The President's Management Agenda states that scarce Federal Government resources should be allocated to programs that deliver results. However, the EO function has not defined goals or established an effective tracking system to measure the results of Review of Operations Unit work. As a result, there is a need for EO function management to perform more detailed analyses of completed casework related to recently established tax-exempt organizations to

¹ In August 2005, the EO function established the Review of Operations Unit to review the operations of tax-exempt organizations. This was in response to discussions held by Congress to require informal filings by certain tax-exempt organizations to coincide with their fifth anniversary of being recognized as tax-exempt, which would allow a review by the Internal Revenue Service of the organizations' activities.



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determine if taxpayer funds allocated to this activity are being used wisely and tax-exempt organizations are being contacted only when necessary.

Synopsis

The Review of Operations Unit has implemented a follow-up process to select a sample of tax-exempt organizations that have recently received tax-exempt status from the Internal Revenue Service (IRS). Most of the organizations were selected 3 years after they received their tax-exempt status. We sampled closed cases from these recently established organizations and concluded that, overall, the Review of Operations Unit is processing cases according to Unit procedures to determine if the organizations were operating primarily for the purposes for which they were granted tax-exempt status and were current in filing required returns. IRS records show that 81 percent (525 of 650 cases closed) of these cases were closed with no change, indicating there were no potential noncompliance issues identified in its limited review.

However, we were unable to fully assess the effectiveness of the Review of Operations Unit's work for several reasons. EO function management has not established comprehensive performance measures for the Unit to identify specific Unit goals and assist in measuring its overall success. Also, some case results are not captured on the Review of Operations Unit database to effectively track the Unit's overall accomplishments. For example, the Unit sometimes uses the no change disposal code even though productive actions were taken by the Unit (e.g., changes were made to some tax-exempt organizations' return filing requirements on an IRS database). If this type of positive impact on tax administration is not captured, EO function management could mistakenly believe more than 80 percent of the recently established tax-exempt organizations reviewed by the Review of Operations Unit are being closed without any positive actions and may decide that the benefit or impact of the Unit is low. In actuality, the percentage of cases closed with a positive action may be higher.

Further, EO function management does not analyze the results of Unit casework related to recently established tax-exempt organizations to identify potential issues for future educational and compliance activities. By developing detailed goals for the Unit, establishing performance measures to track the Unit's progress in meeting these goals, and ensuring that accurate data are captured for analysis, the EO function will be better able to evaluate the Unit's success and ensure that the proper level of resources are allocated to the Unit.

Recommendations

We recommended that the Director, EO, establish performance measures for the Review of Operations Unit, track all actions taken by the Unit to help measure its accomplishments, and analyze the results of recently established tax-exempt organizations casework for potential educational and compliance activities.



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Response

IRS management agreed with all of our recommendations. The EO function is in the process of developing additional performance measures for the Review of Operations Unit and adding more fields to the Unit's database to capture additional results. In addition, EO function management is currently reviewing the results of cases closed within the Unit or transferred to the EO Examinations function to determine whether the review of recently established tax-exempt organizations should continue. Management's complete response to the draft report is included as Appendix V.

Copies of this report are also being sent to the IRS managers affected by the report recommendations. Please contact me at (202) 622-6510 if you have questions or Nancy A. Nakamura, Assistant Inspector General for Audit (Headquarters Operations and Exempt Organizations Programs), at (202) 622-8500.



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Abbreviations

EO	Exempt Organizations
IRS	Internal Revenue Service



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Background

Organizations that are recognized by the Internal Revenue Service (IRS) as tax-exempt under Section 501(c)(3)¹ of the Internal Revenue Code are eligible to receive tax-deductible contributions from the public. To be recognized as a Section 501(c)(3) tax-exempt organization, an applicant (with certain exceptions) must file an Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code (Form 1023) with the IRS describing its current or planned financial and program activities, organizational documents, and governance structure. After reviewing the Form 1023, the IRS may either deny the application or grant the applicant tax-exempt status. Once an organization is granted tax-exempt status by the IRS, it generally may continue to rely on this initial determination as long as there are no substantial changes in the organization's character, purposes, or methods of operation. Further, when tax-exempt status is granted, it is rarely revoked unless an unfavorable examination is completed. However, an organization may change and grow significantly over time, sometimes in ways inconsistent with its tax exemption.

There has been significant growth in the number of entities recognized as tax-exempt, with more than 70,000 tax-exempt applications processed annually. In Fiscal Year 2006, there were approximately 1.6 million tax-exempt organizations (excluding churches) with \$2.4 trillion in assets and \$1.2 trillion in annual revenues. An organization must disclose on its annual information returns filed with the IRS whether it has made any significant changes to (1) the activities it conducts to further its tax-exempt purposes or (2) its organizing and governing documents. If so, it must describe the changes made and attach the pertinent documents. The IRS has the authority to conduct examinations of tax-exempt organizations to determine if they qualify for continued tax exemption and assess additional taxes for noncompliance. However, each year, the Exempt Organizations (EO) function examines less than 1 percent of existing tax-exempt organizations.

Currently, there is no mechanism in the law requiring a periodic review of the basis for an organization's tax-exempt status. In addition, IRS management has reported that abusive tax schemes involving various types of tax-exempt and government entities appear to have grown. Left unchallenged, such schemes not only undermine confidence in our voluntary compliance tax system but also can undermine support for charitable giving, a unique and important feature of our society. Congress has discussed the possibility of requiring informal filings by certain tax-exempt organizations to coincide with their fifth anniversary of being recognized as tax-exempt. The IRS could then review an organization's activities to assure it is operating exclusively for the purposes for which it was granted tax exemption. The Advisory Committee

¹ Section 501(c)(3) (2006).



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on Tax Exempt and Government Entities² also recommended an operational review at a 3-year, 5-year, or some other appropriate interval after tax exemption is recognized, to focus on actual operations, charitable accomplishments, relationships with insiders, and lobbying and political activity.

In response to these concerns and recommendations, the EO function created the Review of Operations Unit as part of the EO Compliance Area in August 2005. One of the Unit's responsibilities is performing operational reviews of organizations to ensure they are operating in accordance with their tax-exempt purposes and are current with all filing requirements.

This review was performed at the EO Examinations function in Dallas, Texas, the Tax Exempt and Government Entities Division in Washington, D.C., and the EO Compliance Area in Ogden, Utah, during the period June through November 2007. 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 objectives. We believe that the evidence obtained provides a reasonable basis for our finding and conclusions based on our audit objectives. Detailed information on our audit objectives, scope, and methodology is presented in Appendix I. Major contributors to the report are listed in Appendix II.

² This Committee provides a public forum through which to discuss issues and enable the IRS to receive input on the development and implementation of IRS policy.



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Results of Review

Additional Information Will Assist in Evaluating the Performance of and Allocating Resources for the Review of Operations Unit

Overall, the Review of Operations Unit properly processed cases related to recently established tax-exempt organizations. When processing cases, the Unit takes actions to ensure the accuracy of tax-exempt organizations' accounts, which also provides a benefit to other EO function units relying on the account data. It developed a process to sample tax-exempt organizations that had recently received tax-exempt status and followed that process. For example, the Unit selected tax-exempt organizations approximately 3 years after they had received exempt status and determined if they appeared to be operating in accordance with their tax-exempt purposes and were current with all filing requirements.

However, we were unable to fully assess the effectiveness of the Review of Operations Unit's work for several reasons.

EO function management has not established comprehensive performance measures for the Unit to identify specific Unit goals and assist in measuring its overall success. Also, some case results are not captured on the Review of Operations Unit database to effectively track the Unit's overall accomplishments. Further, EO function management does not analyze the results of Review of

We were unable to fully assess the effectiveness of the Review of Operations Unit because performance measures have not been established and case results are not being captured effectively.

Operations Unit casework related to recently established tax-exempt organizations to determine the effectiveness of the Unit's work and identify potential issues for future educational and compliance activities. By developing detailed goals for the Unit, establishing performance measures to track the Unit's progress in meeting these goals, and ensuring that accurate data are captured for analysis, the EO function will be better able to evaluate the Unit's ability to bring organizations into compliance and ensure that the proper level of resources are allocated to the Unit.

The EO function implemented a process to follow up on recently established tax-exempt organizations but should develop performance measures

The Review of Operations Unit was originally implemented to complete compliance reviews on tax-exempt organizations to determine whether they are operating in accordance with their tax-exempt purposes and are current with their filing requirements. Unit personnel review



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information available on the Integrated Data Retrieval System,³ filed returns, applications for tax exemption, and the Internet to assess the organizations' operations and make recommendations for further actions. These reviews also include identifying indicators of fraud, evidence of unrelated business income and employment tax issues, and excessive compensation issues. If no potential compliance issues are identified, the Review of Operations Unit will close the case as "No Change." Generally, if potential compliance issues are identified, the Unit will transfer the case to the EO Examinations function for further review.

We reviewed a statistical sample of 98 cases closed as "No Change" in the Unit from July 1, 2006, through June 30, 2007. All of the 98 cases involved recently established tax-exempt organizations, 94 (96 percent) of the 98 cases were properly processed. For the four incorrectly processed cases, Unit personnel did not ensure that all returns were filed as required or did not update the Integrated Data Retrieval System to correctly reflect the organization's filing requirements. The Unit planned to reopen these four cases to properly address all potential compliance issues.⁴

From its inception in August 2005 through July 2007, the Review of Operations Unit closed 2,750 cases for all of its various programs, including work-related to recently established tax-exempt organizations, and other casework in support of major EO function compliance initiatives, such as credit counseling and political activity by tax-exempt organizations. Figure 1 shows approximately 24 percent (650 of 2,750 cases) of the Unit's work was focused on a periodic follow-up of recently established tax-exempt organizations.

**Figure 1: Review of Operations Unit Workload Analysis
(August 2005 through July 2007)**

	Total Review of Operations Unit Closed Cases	Recently Established Closed Cases Only
No Change Closures	1,948 (71 percent)	525 (81 percent)
Miscellaneous Closures	191 (7 percent)	28 (4 percent)
Transfers to the EO Examinations Function	611 (22 percent)	97 (15 percent)
Total Case Closures	2,750	650

Source: Review of Operations Unit database.

The President's Management Agenda states that scarce Federal Government resources should be allocated to programs that deliver results. However, the EO function has not developed

³ An IRS computer system capable of retrieving or updating stored information; it works in conjunction with a taxpayer's account records.

⁴ See Appendix IV for additional details.



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comprehensive performance measures⁵ for the Review of Operations Unit. Since the Unit's inception in August 2005, the only performance measure established for it is the number of cases closed. The current goal is 1,500 case closures annually. Without performance data to measure the productivity and impact of the Review of Operations Unit, the EO function cannot determine the best way to allocate its resources. EO function management is considering the use of measures such as the number of days to process a case, hours per case, and use of the proper disposal code when cases are closed.

EO function management should improve how closed case information is captured and perform analyses of closed case results

Improvements can be made in how case results are captured on the Review of Operations Unit database to effectively track the Unit's overall accomplishments. In addition, no analyses have been completed of the Unit's work related to recently established tax-exempt organizations either closed in the Review of Operations Unit or transferred to the EO Examinations function to assess the productivity of the cases and identify potential areas for additional compliance and/or educational activities.

The Review of Operations Unit should capture more accurate information on its database to better portray the results of its work. The Unit uses a limited number of disposal codes (used to describe the outcome of the case reviews) on its database to track the actions taken by its personnel on the cases (e.g., "No Change" or "transfer to EO Examinations function"). Because the Unit uses very few disposal codes other than "No Change" it is difficult for EO function management to determine the impact of the Unit's actions. In 20 (20 percent) of 98 "No Change" cases we reviewed, either the cases were closed using the wrong disposal code or new disposal codes/fields on the database could be used to better track the effectiveness of the Unit.⁶ In 16⁷ of the 20 cases, the Unit used the "No Change" disposal code even though productive actions were taken by the Unit (e.g., changes were made to some tax-exempt organizations' return filing requirements on an IRS database). For the remaining four cases, the Unit made a minor closing error (one case was closed as "No Change" without taxpayer contact, but contact was made by the Unit) or Unit personnel either should have used an existing disposal code other than "No Change" (one case) or a disposal code was not available that accurately tracked the actions taken on the case (two cases).

We believe these types of actions should be tracked because they benefit other EO function units relying on the account data. For example, updating an organization's filing requirements to show it is not required to file returns will eliminate unnecessary future contacts by the

⁵ Performance goals are estimates of results expected for a given period of time. They are included in plans as indicators of what an organizational unit wants to achieve.

⁶ See Appendix IV for additional details.

⁷ In one case, the Unit also used the wrong disposal code when closing it. To avoid double counting, we did not include this issue as a closing error.



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EO function to follow up on the nonfiled returns. If case results showing this type of positive impact are not captured, EO function management could mistakenly believe more than 80 percent (see Figure 1) of the recently established tax-exempt organizations reviewed by the Review of Operations Unit are being closed without any positive actions and may decide the benefit or impact of the Unit is low. In actuality, the percentage of cases closed with a positive action may be higher.

In addition, the Review of Operations Unit database could track additional information related to the identified issues for cases transferred for examination work. The current Review of Operations Unit database is unable to capture more than one potential examination issue⁸ identified per case, although up to three issues could be documented in the case file. By capturing all issues identified by the Unit for potential compliance activity, EO function management will have more complete information available for future analyses.

EO function management stated the “No Change” disposal code was used because management wanted to track whether the Review of Operations Unit contacted organizations during its case processing. Two “No Change” disposal codes are often used by the Unit: “no change with taxpayer contact” and “no change without taxpayer contact.” This was an operational decision to measure the differences between the Review of Operations Unit and another EO function unit. However, now that the Review of Operations Unit has been reviewing recently established tax-exempt organizations for 2 years, we believe there is an opportunity to improve the data captured to analyze the true impact of the Unit.

Additional analyses of closed case results should prove beneficial. When the Review of Operations Unit identifies an issue(s) in a recently established tax-exempt organization case that requires further review, it transfers the case to the EO Examinations function. To determine how well the Unit is identifying issues for the EO Examinations function, it is important to track a case through to the final examination results. The Unit uses project codes to track cases by the various programs worked in the Unit, such as recently established tax-exempt organization cases, credit counseling cases, and political activity cases.

However, the Review of Operations Unit project code is often changed when a case is transferred from the Unit to the EO Examinations function. Therefore, we could not determine if the EO Examinations function identified noncompliance or assessed additional taxes on the recently established tax-exempt organization cases that were transferred from the Review of Operations Unit. If the EO function were able to trace recently established cases through to their final disposition in the EO Examinations function, EO function management could decide if the Review of Operations Unit is identifying productive cases and determine the correct allocation of resources that should be dedicated to recently established tax-exempt organization casework. Without this information, it will be difficult for the EO function to make a data-driven decision in this regard.

⁸ Examples of examination issues include delinquent filings, incomplete filings, and political activities.



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In addition to determining the productivity of cases transferred from the Review of Operations Unit, the EO function could use the results of closed cases to identify needed internal training. For example, the EO function Special Review Unit (a different Unit) conducted a review of examinations closed as “No Change” that originated in the Review of Operations Unit to determine, in part, if the cases were properly closed by the EO Examinations function. This analysis showed that the majority of cases were properly closed by EO Examinations function. However, the Special Review Unit determined many of the cases reviewed involved a specific type of tax-exempt organization. As a result, EO function management determined that additional internal training within the Review of Operations Unit may be necessary in this area to better process these cases and determine whether they should be referred for examination.

Analyses of recently established tax-exempt organization cases closed in the Review of Operations Unit or transferred to the EO Examinations function could also provide input to EO function management in determining the need for additional taxpayer education and compliance activities. For example, if closed case results show that recently established tax-exempt organizations are not always filing required returns, additional taxpayer educational activities could be conducted to assist this type of organization in understanding filing obligations. Similarly, closed case results could reveal compliance trends in recently established tax-exempt organizations. If any trends are identified, the EO function could divert resources to a special project(s) to bring recently established tax-exempt organizations back into compliance.

Improved tracking of issues identified by the Review of Operations Unit and overall case results will ensure EO function management has complete and accurate data for conducting ongoing analyses, which could be used to ensure the Unit is focusing its limited resources on the most productive areas, transferring productive cases for review to the EO Examinations function, and reducing taxpayer burden by limiting taxpayer contact for tax-exempt organizations that are compliant with their filing requirements. These analyses could also support future resource allocation decisions.

During our fieldwork, EO function management stated that statistical projections of case results may be completed in the future to determine if common issues are being identified for Review of Operations Unit cases. In addition, management indicated that the Unit’s review of recently established tax-exempt organizations has not resulted in many transfers to the EO Examinations function (97 cases over a 2-year period). Therefore, results have yet to be analyzed.

Recommendations

The Director, EO, should:

Recommendation 1: Establish performance measures for the Review of Operations Unit to assist management in evaluating the productivity of the Unit and aid in allocating resources within the EO function.



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Management's Response: IRS management agreed with this recommendation. The EO function is currently developing additional performance measures for the Review of Operations Unit.

Recommendation 2: Improve the type of closed case information captured on the Review of Operations Unit database (such as new disposal codes and/or additional data fields) to more clearly measure the accomplishments of the Unit.

Management's Response: IRS management agreed with this recommendation. EO function management is amending the Unit's database to capture more case review results.

Recommendation 3: Analyze the results of recently established tax-exempt organization cases closed in the Review of Operations Unit or transferred by the Unit for examination to evaluate its productivity and assess whether any common issues were identified for potential internal training needs and future compliance and/or educational activities.

Management's Response: IRS management agreed with this recommendation. The EO function is reviewing a sample of closed cases to determine whether to continue performing a sample review of recently established tax-exempt organizations and if possible training needs exist.



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Appendix I

Detailed Objectives, Scope, and Methodology

The overall objectives of this review were to assess the EO function Review of Operations Unit's effectiveness in identifying and evaluating recently established tax-exempt organizations that may not be complying with their stated tax-exempt purposes and/or may not be current with all filing requirements. In addition, we determined whether the results of reviews of recently established tax-exempt organizations were used to identify emerging trends or issues for future compliance work or education and outreach activities. To accomplish our objectives, we:

- I. Assessed the process the Tax Exempt and Government Entities Division follows to identify and evaluate recently established tax-exempt organizations that may not be complying with their stated tax-exempt purposes and/or may not be current with all filing requirements.
 - A. Interviewed Tax Exempt and Government Entities Division Data Analysis Unit personnel to assess the process followed to identify and select the sample of recently established tax-exempt organizations for evaluation by the Review of Operations Unit each year.
 - B. Interviewed applicable EO function management to determine the current process followed to identify and evaluate whether tax-exempt organizations are operating in accordance with their approved tax-exempt purposes and are current with all filing requirements.
 - C. Interviewed EO Examinations function management to determine the process for assigning and reviewing cases transferred from the Review of Operations Unit.
 - D. Interviewed EO function management to determine the goals of the Review of Operations Unit and identified any performance measures established by management to measure the effectiveness of the Unit in achieving established goals.
- II. Determined any results of the EO function's efforts (in both the Review of Operations Unit and EO Examinations function) to identify and review cases to ensure recently established tax-exempt organizations are operating for their approved tax-exempt purposes and filing all required returns.
 - A. Obtained statistics from the Review of Operations Unit's database on the EO function's efforts to identify and review cases, including the number of tax-exempt organizations identified, number of tax-exempt organizations reviewed, and results of the reviews.



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- B. Determined the number of case transfers made from the Review of Operations Unit to the EO Examinations function for further review and the results of the transfers.
 - C. Interviewed applicable EO function management to determine whether results of recently established tax-exempt organization reviews and examinations are used to identify any emerging trends or issues for future compliance work or future education and outreach activities.
- III. Determined whether recently established tax-exempt organization cases that should have been transferred to the EO Examinations function for further development were not identified and referred by the Review of Operations Unit as required.
- A. Obtained a download from the Review of Operations Unit's database of all 291 cases closed from July 1, 2006, through June 30, 2007, without being transferred for an examination.
 - B. Selected and reviewed a random sample of 98 cases from the universe of 291 closed cases to identify any that should have been transferred for an examination. We computed a statistical sample size using a 90 percent confidence level, ± 5 percent precision rate, and 10 percent expected error rate.

Data validation methodology

We obtained extracts from the Review of Operations Unit database as well as the Returns Inventory Classification System during our review. Validations performed included ensuring that only appropriate data were included in each field and that the time period for the data met our requirements. We determined all data received were sufficiently reliable for our use.

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 the following internal controls were relevant to our audit objectives: the EO function's policies, procedures, and practices for planning, managing and monitoring the Review of Operations Unit efforts to review recently established tax-exempt organizations. We evaluated these controls by interviewing management, reviewing applicable information, and analyzing closed cases.



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Appendix II

Major Contributors to This Report

Nancy A. Nakamura, Assistant Inspector General for Audit (Headquarters Operations and Exempt Organizations Programs)
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Jeffrey M. Jones, Audit Manager
Cheryl J. Medina, Lead Auditor
Julia M. Moore, Senior Auditor
David P. Robben, Senior Auditor



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Appendix III

Report Distribution List

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Deputy Commissioner for Services and Enforcement SE
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Director, Exempt Organizations, Tax Exempt and Government Entities Division SE:T:EO
Chief Counsel CC
National Taxpayer Advocate TA
Director, Office of Legislative Affairs CL:LA
Director, Office of Program Evaluation and Risk Analysis RAS:O
Office of Internal Control OS:CFO:CPIC:IC
Audit Liaison: Director, Communications and Liaison, Tax Exempt and Government Entities
Division SE:T:CL



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Appendix IV

Outcome Measures

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

Type and Value of Outcome Measure:

- Reliability of Information – Actual; four taxpayer accounts affected (see page 3).

Methodology Used to Measure the Reported Benefit:

We reviewed a statistically valid sample of 98 cases from a universe of 291 cases closed by the Review of Operations Unit from July 1, 2006, through June 30, 2007, involving recently established tax-exempt organizations. In four cases, additional actions should have been taken prior to case closure by Unit personnel, who did not ensure all returns were filed as required or did not update the IRS database to correctly reflect each organization's filing requirements. The Unit planned to reopen these four cases to properly address all potential compliance issues.

Type and Value of Outcome Measure:

- Reliability of Information – Potential; 59 taxpayer accounts affected (see page 3).

Methodology Used to Measure the Reported Benefit:

We reviewed a statistically valid sample of 98 cases from a universe of 291 cases closed by the Review of Operations Unit from July 1, 2006, through June 30, 2007, involving recently established tax-exempt organizations. Our case review identified 20 (20 percent) of 98 cases that could be better tracked on the Review of Operations Unit database to improve the reliability of the data. We computed the outcome measure by multiplying the 20 percent error rate times the universe of 291 cases, resulting in a projection of 59 taxpayer accounts affected.

Improved tracking of issues identified by the Unit and overall case results will ensure EO function management has complete and accurate data for conducting ongoing analyses, which could be used to ensure the Unit is focusing its limited resources on the most productive areas, transferring productive cases for review to the EO Examinations function, and reducing taxpayer burden. These analyses could also support future resource allocation decisions.



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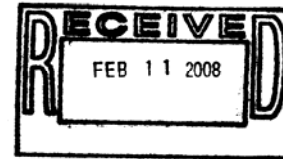
Appendix V

Management's Response to the Draft Report




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

FEB 08 2008



MEMORANDUM FOR DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: 
Steven T. Miller
Commissioner, Tax-Exempt and Government Entities

SUBJECT: Performance Measures and Improved Case Tracking Would
Help the Exempt Organizations Function Better Allocate
Resources (Audit #200710037)

We have reviewed your draft report on the effectiveness of the Exempt Organizations function's Review of Operations Unit in reviewing recently established tax-exempt organizations to determine if they are complying with their stated tax-exempt purpose, and if they are current with their filing requirements.

We established the Review of Operations (ROO) Unit in August 2005. We initially formed the ROO to perform compliance reviews of recently established tax-exempt organizations, but have expanded its role to include support of major EO compliance initiatives. We appreciate both your recommendations for improvement and your observations that, overall, the ROO properly processed cases related to recently established tax-exempt organizations.

The original performance measurement we established for the ROO was the number of actual closures per fiscal year compared to planned closures. In FY 2007, the Exempt Organizations Examination Division and the ROO began to assess the performance of the ROO and to consider additional performance and quality measures, including those that would assist in the analysis of the results of various projects.

We recognize the benefit of targeted performance and quality measures in determining the effectiveness of the ROO, and are currently considering new measurement systems. Your recommendations complement our efforts, and we agree with them. Our response to your recommendations may be found in the attachment. We concur with your statement of measurable benefits on tax administration. If you have any questions concerning this response, please contact Lois Lerner at (202) 283-2300.

Attachment



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2

Recommendation 1:

Establish performance measures for the Review of Operations Unit to assist management in evaluating the productivity of the unit and aid in allocating resources within the EO function.

Corrective Action:

We agree with this recommendation. We are currently developing additional performance measures. Among the measurements under consideration are cycle time, hours per case, percentage of organizations forwarded to Classification for each project, and number of Exempt Organizations Business Master File (EOBMF) updates performed by the ROO staff.

Implementation Date:

December 31, 2008

Responsible Official:

Director, Exempt Organizations Examinations

Recommendation 2:

Improve the type of closed case information captured on the Review of Operations Unit database (such as new disposal codes and/or additional data fields) to more clearly measure the accomplishments of the Unit.

Corrective Action:

We agree with this recommendation. We are amending the ROO database to add additional data fields to capture information about issues found and the results of reviews (e.g., obtaining filed returns and updating the EOBMF).

Implementation Date:

December 31, 2008

Responsible Official:

Director, Exempt Organizations Examinations

Recommendation 3:

Analyze the results of recently established tax-exempt organization cases closed in the Review of Operations Unit or transferred by the Unit for examination, to evaluate its productivity and assess whether any common issues were identified for potential internal training needs and future compliance and/or educational activities.



*Performance Measures and Improved Case Tracking Would
Help the Exempt Organizations Function Better
Allocate Resources*

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Corrective Action:

We agree with this recommendation. We are currently reviewing a sample of closed cases and will prepare a report addressing whether to continue doing a sample review, whether substantive issues are referred to the field, whether the cases are appropriately handled in the field, the reasons returns are surveyed in the field, and possible training needs for ROO and field employees.

Implementation Date:

December 31, 2008

Responsible Official:

Director, Exempt Organizations Examinations