



*The Federal, State, and Local
Governments Office Can Improve
the Workload Selection Process to
Increase Effectiveness*

April 2006

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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.

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TREASURY INSPECTOR GENERAL
FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

April 28, 2006

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 – The Federal, State, and Local Governments Office
Can Improve the Workload Selection Process to Increase Effectiveness
(Audit # 200510029)

This report presents the results of our review of the Federal, State, and Local Governments (FSLG) office's workload selection process. The overall objective of this review was to assess the FSLG office's progress in developing a workload selection system that identifies and prioritizes the compliance activity cases with the highest risk of noncompliance. In Fiscal Year (FY) 2003, the FSLG office indicated that 60 percent of available resources were allocated to outreach activities. Beginning in FY 2004, the FSLG office took actions to achieve a better balance between educational and compliance activities. According to the FSLG Compliance Plan, compliance activities increased from 40 percent to 80 percent of available direct time from FY 2003 to FY 2005, with outreach activities reduced from 60 percent to 20 percent of direct time during the same time period. The increased emphasis on compliance activities was designed to create a more balanced, effective, and informed program.

Synopsis

FSLG office management has implemented a workload selection process to identify and prioritize compliance contact cases¹ for assignment to FSLG office field personnel. This process

¹ Compliance contact cases collectively refer to examinations and compliance checks. A compliance check is a contact with the customer that involves a review of filed information and tax returns of the entity. A compliance check does not directly relate to determining a tax liability for any particular tax period, and a customer may legally choose not to participate in a compliance check.



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includes performing Return Inventory and Classification System (RICS)² queries, judgmentally prioritizing cases based on RICS queries, and determining the appropriate type of compliance activity to conduct (examination versus compliance check). However, FSLG office management acknowledges that effective workload planning for compliance contact cases is a challenge due to the lack of FSLG office compliance benchmarks and baseline measures developed to date. Because the FSLG office has not established baseline measures for a productive examination rate, and compliance checks do not readily lend themselves to measuring the impact on compliance, it is difficult to determine the effectiveness of the workload selection process in identifying potential noncompliance cases. Nonetheless, we reviewed the FSLG office's workload selection process and identified two areas that can be improved to ensure more effective selection of the highest risk cases.

In addition, FSLG office management is not systemically capturing and analyzing the effectiveness of the RICS queries used to identify Federal, State, and local government entities for compliance activity. If this information was systemically captured in a format that can be easily analyzed, it would enable FSLG office management to conduct systemic analyses to determine the RICS queries that result in the identification of more productive casework and provide baseline measures of the level of noncompliance identified. In addition, the selection of cases for assignment to the field specialists involves some subjective decisions by the FSLG Outreach, Planning, and Review office personnel after the queries are run. We have discussed with FSLG office management the practicality of assigning a numeric score to each case to increase consistency and reduce subjectivity during the classification and selection process.

Further, we determined FSLG office personnel are not analyzing the results of closed compliance contact cases to identify the compliance issues identified by FSLG office field specialists. This type of analysis could be used by FSLG office management to identify the common issues developed during compliance contacts and, if appropriate, to incorporate them to improve the effectiveness of the RICS queries. In addition, this analysis could be used to assess the productivity of compliance check cases.

The FSLG office's workload selection system can be improved by systemically capturing and analyzing information from closed cases to identify more productive compliance contact cases.

Recommendation

We recommended the Director, Government Entities, provide the necessary resources to develop an action plan that ensures the needed enhancements to the workload selection process will be timely implemented and monitored. The action plan should include specific actions to separately track the productivity of each RICS query; evaluate the feasibility of developing a scoring

² The RICS contains return and filer information related to the filing and processing of Employee Plans, Exempt Organizations, and Government Entities forms.



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system to assist in the FSLG Outreach, Planning, and Review office workload selection process; analyze the results of the compliance contact cases to identify significant areas of noncompliance and potential education and outreach issues; and build these areas into the RICS queries to identify more productive cases for future compliance activity.

Response

The Commissioner, Tax Exempt and Government Entities Division, agreed with the recommendation contained in the report. Government Entities function management has developed a written action plan for improving the workload selection process. FSLG office management has revised the Microsoft Access[®] database to separately track the productivity of each RICS query and will analyze FY 2006 data to determine the productivity of each RICS query used in the case selection process. The Director, Government Entities, also considered the feasibility of developing a scoring system to assist in the FSLG office workload selection process and determined it is not feasible. However, FSLG office management will establish folders for each State that will include State-specific information that may affect the information on various line items on the Employer's Quarterly Federal Tax Return (Form 941). FSLG office management believes the use of this information, combined with the RICS queries, will substantially reduce the subjectivity among classifiers (analysts) in case selection. Management's complete response to the draft report is included as Appendix IV.

Copies of this report are also being sent to the Internal Revenue Service managers affected by the report recommendation. Please contact me at (202) 622-6510 if you have questions or Daniel R. Devlin, Assistant Inspector General for Audit (Headquarters Operations and Exempt Organizations Programs), at (202) 622-8500.



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Background

Currently, there are approximately 87,000 Federal Government agencies, State governments, local governments, and quasi-governmental entities in the United States. These governmental entities are generally not subject to Federal income tax; however, they are generally required to file information returns and to file and pay employment and excise taxes. These entities employ 23 million employees (approximately 20 percent of the United States workforce) and pay wages in excess of \$760 billion and employment taxes in excess of \$200 billion annually.

The Federal, State, and Local Governments (FSLG) office in the Government Entities function of the Tax Exempt and Government Entities Division is responsible for providing these 87,000 customers top-quality service by helping them understand and comply with the tax laws. To accomplish its mission, the FSLG office uses a combination of educational and compliance activities to provide service to its customers. The FSLG office was established in Fiscal Year (FY) 2000 as part of the Internal Revenue Service's (IRS) modernization process. Prior to this, addressing the tax compliance issues of Federal, State, and local government entities was the responsibility of several organizational entities within the IRS. As a result, during the initial years, the FSLG office focused primarily on outreach and education to help customers understand IRS filing and reporting requirements and how to accurately and timely file tax returns and any other required returns.

This emphasis can also be seen in how the FSLG office allocated staff resources during this period. In FY 2003, the FSLG office indicated that 60 percent of available resources were allocated to outreach activities. Beginning in FY 2004, the FSLG office took actions to achieve a better balance between educational and compliance activities. According to the FSLG Compliance Plan, compliance activities increased from 40 percent to 80 percent of available direct time from FY 2003 to FY 2005, with outreach activities reduced from 60 percent to 20 percent of direct time during the same time period.

The increased emphasis on compliance activities was designed to create a more balanced, effective, and informed program. The goals of this increased emphasis on compliance include the following:

- Develop baselines for future actions.
- Establish a compliance presence in all the market segments.
- Identify significant areas of compliance for future education and compliance activities.
- Identify significant issues for development of IRS guidance.



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- Determine the effectiveness of the FSLG office's educational efforts and their effects on compliance.
- Identify abusive tax avoidance transactions that FSLG office customers may be facilitating.¹

The FSLG Outreach, Planning, and Review (OPR) office is responsible for the overall operational development, planning, and program monitoring for the FSLG office, including identifying and assigning examinations and compliance checks² (collectively referred to as compliance contact cases) to the field groups. FSLG office group managers provide written requests for compliance contact cases to FSLG OPR office personnel on a periodic basis throughout the year. To identify cases for assignment, the FSLG OPR office analyzes employment tax information on government entities through the Return Inventory and Classification System (RICS).³

In a prior audit,⁴ we reported that 12,878 Federal, State, and local government entities were identified as delinquent during Calendar Years 1999, 2000, or 2001. Additional analysis of these entities showed that 2,697 entities had not submitted the required tax payments (resulting in balances due of \$104 million), and 1,604 entities had not submitted the required tax returns to account for almost \$7.4 billion in tax deposit credits. Tax Exempt and Government Entities Division management believed a significant portion of the delinquent dollar amount represented error conditions or misapplied payments that, when resolved, would result in a zero balance.

Examination activity during the initial start-up years generally focused on limited scope audits and claims for refunds by FSLG office customers. As part of the Treasury Inspector General for Tax Administration's FY 2006 audit planning, the Director, Government Entities, proposed that we conduct a review of the FSLG office's case selection database because it wanted to build a database that could select the most productive examination cases. This review was performed at the Tax Exempt and Government Entities Division Headquarters in Washington, D.C., as well as the FSLG OPR office and the Gulf Coast Area Office in Austin, Texas. We also contacted

¹ If employment tax schemes are identified as abusive transactions, the FSLG office is responsible for identifying the government entity's role in the scheme and examining the issue. If the abusive tax avoidance transaction involves nonemployment tax, the FSLG office should be alert to facts that may suggest a government entity is engaged in the abusive transaction as an accommodation party (e.g., a government entity may sell or lease a public facility to a private company and then lease the facility back. The government entity does not receive any Federal income tax benefit from this transaction, but under certain circumstances such transactions allow the private company to take large depreciation or rent deductions without assuming any risk of ownership).

² A compliance check is a contact with the customer that involves a review of filed information and tax returns of the entity. A compliance check does not directly relate to determining a tax liability for any particular tax period, and a customer may legally choose not to participate in a compliance check.

³ The RICS contains return and filer information related to the filing and processing of Employee Plans, Exempt Organizations, and Government Entities forms.

⁴ *Additional Management Actions Should Be Taken to Ensure That Government Entities' Customers Meet Their Federal Tax Obligations* (Reference Number 2002-10-123, dated September 2002).



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FSLG office personnel in Schaumburg, Illinois; Rochester, New York; and Philadelphia, Pennsylvania, during the period July through November 2005. The audit was conducted in accordance with *Government Auditing Standards*. Detailed information on our audit objective, scope, and methodology is presented in Appendix I. Major contributors to the report are listed in Appendix II.



Results of Review

Additional Actions Should Be Taken to Improve the Workload Selection Process

FSLG office management has implemented a workload selection process to identify and prioritize compliance contact cases for assignment to FSLG office field personnel. This process includes performing RICS queries, judgmentally prioritizing cases based on RICS queries, and determining the appropriate type of compliance activity to conduct (examination versus compliance check).

For examination cases, the FSLG office's selection process has identified a relatively high percentage of productive cases (cases that have identified noncompliance; e.g., change cases and no change with adjustment cases⁵), as well as examinations that did not identify noncompliance (no change cases; e.g., no adjustments or changes in tax liability). Figure 1 shows the results of examinations performed by FSLG office personnel during FYs 2003-2005.

Figure 1: FSLG Office Examination Results

Fiscal Year	Number of Returns Closed	No Change Percentage	No Change With Adjustments Percentage	Change Percentage
2003	5	20%	0%	80%
2004	214	24%	9%	67%
2005	1,050	37%	2%	61%

Source: FYs 2003-2005 FSLG Audit Information Management System (AIMS) Table 20 (Government Entities Accomplishments by Project Code) Reports.⁶

Compliance checks cannot be measured in the same manner. As previously stated, a compliance check is not an examination of the customer's books and records and does not involve a

⁵ A "no change with adjustment" case applies to no change examined returns if there was an adjustment to income or deduction items (tax base data) but no change in tax liability or refundable credits. Examples of a no change with adjustment case include delinquent returns secured and claims disallowed in full.

⁶ FSLG office management informed us that the AIMS Table 20 Report for FYs 2003 and 2004 does not accurately reflect the number of examinations performed. During this period, FSLG office management stated some completed examination cases were not properly recorded on the AIMS for reporting purposes due to certain error conditions. These error cases were not resolved by FSLG office personnel and, therefore, did not post to the AIMS.



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determination of tax liability. The primary goal of compliance checks is to educate customers about their tax filing requirements. The results of compliance checks are used to develop issues for audit consideration and to identify customer needs for additional education and outreach. One measure used for compliance checks is the number conducted per year. Figure 2 shows the number of compliance check cases completed by FSLG office personnel during FYs 2003-2005.

Figure 2: FSLG Office Compliance Checks Results

Fiscal Year	Number of Compliance Check Cases Completed
2003	690
2004	744
2005	807

Source: FY 2005 Tax Exempt and Government Entities Division Business Performance Review.

FSLG OPR office personnel use the following process to identify compliance contact cases for assignment to the field groups. Currently, FSLG OPR office personnel analyze the Employer's Quarterly Federal Tax Return (Form 941) data maintained on the RICS as the main source for compliance work. FSLG OPR office personnel run from 1 to 14 predefined RICS queries to identify line items that appear to be outside the normal ranges when compared to other line items on the Form 941. Based on the results of these queries, FSLG OPR office personnel judgmentally prioritize cases for assignment to the field based on the highest indicators of potential noncompliance. The group managers are responsible for assigning the compliance contact cases to field specialists for review and providing oversight during case processing. The number of FSLG office field specialists responsible for completing compliance contact cases increased from 68 to 81 from the end of FY 2002 through FY 2005, which enabled the FSLG office to increase the number of cases completed.

We interviewed four of the eight group managers to obtain their feedback on the quality of compliance contact cases provided by the FSLG OPR office analysts. Generally, the managers stated the quality of cases was good. One manager stated the current quality of cases is better than a year ago and attributed this to the fact that the group was focusing on a market segment last fiscal year, as opposed to general casework this fiscal year. Another manager stated that, although the RICS has identified noncompliance issues for small to mid-size entities, it was not good at identifying potential compliance problems associated with larger entities involving more complicated issues.

The FSLG office acknowledges that effective workload planning for compliance contact cases is a challenge due to the lack of FSLG office compliance benchmarks and baseline measures developed to date. FSLG office management has indicated their customers have not been the subject of significant research or information gathering activity. As a result, they do not have



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accurate and statistically valid data related to compliance levels and indicators of noncompliance to assist them in selecting productive cases for review.

Because the FSLG office has not established baseline measures for a productive examination rate, and compliance checks do not readily lend themselves to measuring the impact on compliance, it is difficult to determine the effectiveness of the workload selection process in identifying potential noncompliance cases. Nonetheless, we reviewed the FSLG office's workload selection process and identified two areas that can be improved to ensure more effective selection of the highest risk cases:

- **Evaluate the effectiveness of the RICS queries.** FSLG office management is not systemically capturing and analyzing the effectiveness of the RICS queries used to identify Federal, State, and local government entities for compliance activity. If this information was systemically captured in a format that can be easily analyzed, it would enable FSLG office management to conduct systemic analyses to determine the RICS queries that result in the identification of more productive casework and provide baseline measures of the level of noncompliance identified. This would ensure the most productive use of limited FSLG office resources and minimize any potential burden to its customers. In addition, the selection of cases for assignment to the field specialists involves some subjective decisions by FSLG OPR office personnel after the queries are run. We have discussed with FSLG office management the practicality of assigning a numeric score to each case to increase consistency and reduce subjectivity during the classification and selection process. FSLG office management agreed to evaluate the feasibility of a numeric score; however, they advised that assigning a numeric scoring system for FSLG customers would be complicated due to differences in employment tax reporting requirements between the various States and even within a State (e.g., Social Security Administration agreements, retirement plans).
- **Analyze closed cases to identify common issues that can be used to focus future work.** We determined FSLG office personnel are not analyzing the results of closed compliance contact cases to identify the compliance issues identified by FSLG office field specialists, such as the reporting of fringe benefits. This type of analysis could be used by FSLG office management to identify the common issues developed during compliance contacts and, if appropriate, to incorporate them to improve the effectiveness of the RICS queries. In addition, this analysis could be used to assess the productivity of compliance check cases.

FSLG office management should systemically track and analyze the productivity of each RICS query and develop a scoring system to ensure consistency and assess the effectiveness of the workload selection process

Since October 1, 2004, the FSLG office has been securing feedback from field specialists on the quality and productivity of the workload selection process for all compliance contact cases sent



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to the field. Specifically, each case has a unique sheet (Case Selection Survey) that identifies the RICS query/queries used for case identification. The field specialists complete this sheet when they close the case and indicate the issue(s) identified during the compliance contact and whether each query was productive or not (e.g., did an assessment result from the query). The Case Selection Survey sheet was revised in July 2004 to separately track the productivity of each query. As part of the case closing, an FSLG OPR office analyst inputs the data from the sheet into a Microsoft Access[®] database. However, at the end of our fieldwork, we determined the database allowed FSLG OPR office personnel to track only whether the case was productive (yes or no), not whether each query was productive, although FSLG OPR personnel included information related to the productivity of the RICS queries in a narrative format in a comments section of the database. As a result, FSLG OPR personnel cannot easily analyze the narrative information to identify possible issues relating to the productivity of a specific RICS query.

To assess the productivity of each RICS query, the FSLG OPR office personnel should insert additional fields in the database for each possible RICS query used during the classification process to track the field specialists' assessment of the productivity of the individual RICS queries. When we raised this issue with the responsible FSLG OPR office analyst, the analyst indicated the database would be modified to separately track the productivity of each RICS query.

In addition, the individual RICS query assessments on the Case Selection Survey sheets have not been analyzed by FSLG office personnel. Without a structured process to systemically capture and analyze the productivity of the RICS queries, FSLG office management will not know which RICS queries are good indicators of noncompliance and which may not be. This analysis will enable FSLG office management to make a more informed business decision regarding how to effectively use the RICS queries in their workload selection process and where to focus future compliance contact cases to address the highest areas of noncompliance.

Another area for improvement involves the subjective nature of selecting cases for assignment to the field. As stated previously, FSLG OPR office personnel judgmentally prioritize cases for assignment to the field based on the results of the RICS queries. Prior to October 2004, one analyst was responsible for classifying and selecting all compliance contact cases for the eight FSLG office field groups nationwide. In October 2004, the FSLG office hired an additional FSLG OPR office analyst to assist with the classification and selection process. As a result, each FSLG OPR office analyst is now responsible for the classification and workload delivery for four groups. We believe this process increases the risk of subjectivity and inconsistency in the identification of cases for compliance activity. We discussed with FSLG office management the practicality of assigning a numeric score to each case using some type of weighted average based on the query/queries' prior effectiveness in identifying productive casework. For example, queries that historically have proved to be the most productive in terms of identifying noncompliance issues could be assigned a higher numeric score than the less



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productive queries. Cases with the highest aggregate score could be given a higher priority as potential compliance contact cases.

The FSLG office has not analyzed closed cases to identify issues for future compliance work

Although FSLG office field specialists document the issues identified during the compliance contact cases on the Case Selection Survey sheet, FSLG office personnel have not analyzed these results to identify issues for future compliance contact cases and additional education and outreach activities. This issue was previously raised for compliance check cases. In a prior audit report,⁷ we recommended the FSLG office analyze the results of compliance check cases to identify significant areas of noncompliance for future educational and compliance activities. FSLG office management agreed that this analysis was necessary and indicated they would hire additional resources for the FSLG OPR office to perform this analysis to identify trends, issues, and opportunities for compliance, education, and guidance.

FSLG office management stated that additional resources were hired for the FSLG OPR office; however, the results of the compliance contact cases had not been analyzed by the end of our fieldwork due to increased workloads. An analysis of closed compliance contact cases could show the RICS queries that were most successful (or least successful) in identifying noncompliance issues, which would be valuable for FSLG office management in ensuring future compliance coverage is focused on returns with a higher risk of noncompliance. In addition, the analysis would provide useful information on the compliance issue(s) identified by the field specialist.

We also believe the lack of a detailed action plan related to the development of a workload selection process has limited FSLG office management's progress in this area. A plan that included actions planned, individuals assigned, responsible management official(s), completion dates, expected results, and methods to monitor and report performance would better enable FSLG office management to implement a productive workload selection process, even if the process had to be implemented in various stages based on available resources.

Another factor that may have contributed to limited progress in this area is the high turnover of key management officials within the FSLG office. Since FY 2003, the FSLG office has had four acting or permanent Directors, and the FSLG OPR office has had five acting or permanent managers. During this period, we believe a detailed action plan could have enabled FSLG office management to develop a workload selection system that would best meet the needs of FSLG office personnel in identifying and addressing noncompliance.

⁷ *The Federal, State, and Local Governments Office Needs Additional Information to Assess the Productivity of Compliance Checks and Assist Its Compliance and Outreach Efforts* (Reference Number 2004-10-145, dated August 2004).



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Recommendation

To improve the productivity of compliance contact cases and better enable the FSLG office to achieve its goals, the Director, Government Entities, should provide the necessary resources to:

Recommendation 1: Develop an action plan that ensures the needed enhancements to the workload selection process will be timely implemented and monitored. The action plan should document actions planned and indicate individuals assigned to specific actions, responsible management official(s), completion dates, expected results, and methods to monitor and report performance. Specific actions should include:

- Revising the Microsoft Access[®] database to separately track the productivity of each RICS query.
- Evaluating the feasibility of developing a scoring system to assist in the FSLG OPR office workload selection process. Specifically, determine if a weighted scoring system can be developed that consolidates multiple RICS queries into a numeric score based on the highest risk of noncompliance and the difference in the various State reporting requirements. This type of scoring system could ensure consistency and reduce subjectivity among the analysts identifying compliance contact cases.
- Analyzing the results of the compliance contact cases to identify significant areas of noncompliance and potential education and outreach issues, and building these areas into the RICS queries to identify more productive cases for future compliance activity.

Management's Response: The Commissioner, Tax Exempt and Government Entities Division, agreed with this recommendation. Government Entities function management has developed a written action plan for improving the workload selection process. FSLG office management has revised the Microsoft Access[®] database to separately track the productivity of each RICS query. In October 2006, FSLG office management will begin to analyze the data captured for FY 2006 to determine the productivity of each RICS query used in the case selection process. The Director, Government Entities, also considered the feasibility of developing a scoring system to assist in the FSLG office workload selection process and determined it is not feasible. However, FSLG office management will establish folders for each State that will include State-specific information that may affect the information on various line items on the Form 941. FSLG office management believes the use of this information, combined with the RICS queries, will substantially reduce the subjectivity among classifiers (analysts) in case selection.



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Appendix I

Detailed Objective, Scope, and Methodology

The overall objective of this review was to assess the Federal, State, and Local Governments (FSLG) office's progress in developing a workload selection system that identifies and prioritizes the compliance activity cases with the highest risk of noncompliance. To accomplish this objective, we:

- I. Obtained statistical data on FSLG office compliance activity from Fiscal Year (FY) 2003 through FY 2005.
 - A. Obtained available Audit Information Management System reports that showed the number and type of compliance activities closed and the results of these activities.
 - B. Determined the staff resources allocated by the FSLG office to perform compliance activities.
- II. Assessed the process followed by FSLG office management to identify and prioritize compliance activity from FY 2003 through FY 2005.
 - A. Conducted a walk-through of the FSLG office workload selection process.
 - B. Determined if an action plan was prepared in developing the workload selection process.
 - C. Interviewed Outreach, Planning, and Review office personnel to determine the process followed from FY 2003 through FY 2005 to identify and prioritize compliance activity for the FSLG office field groups.
 - D. Identified the available sources of compliance activity and the frequency of use for each source and determined if the FSLG office plans to add new sources of information to improve its workload selection process.
 - E. Assessed how FSLG office management monitors compliance activity casework to ensure the FSLG office meets its compliance goals.
- III. Assessed the process followed by FSLG office management to enhance its workload selection process based on the results of its compliance activities.
 - A. Interviewed Outreach, Planning, and Review office personnel to determine how the results of compliance activities are tracked and analyzed.
 - B. Determined if FSLG office management uses the results of compliance activities to improve their workload selection process and their compliance and outreach efforts.



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- C. Interviewed a sample of FSLG office area managers to obtain their feedback on the quality of cases provided by Outreach, Planning, and Review office personnel.



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Appendix II

Major Contributors to This Report

Daniel R. Devlin, Assistant Inspector General for Audit (Headquarters Operations and Exempt Organizations Programs)

Nancy Nakamura, Director

Jeffrey M. Jones, Audit Manager

Margaret Anketell, Lead Auditor

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Michael McGovern, Auditor



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Appendix III

Report Distribution List

Commissioner C
Office of the Commissioner – Attn: Chief of Staff C
Deputy Commissioner for Services and Enforcement SE
Deputy Commissioner, Tax Exempt and Government Entities Division SE:T
Director, Government Entities, Tax Exempt and Government Entities Division SE:T:GE
Director, Office of Federal, State, and Local Governments, Tax Exempt and Government Entities
Division SE:T:GE:FSL
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Appendix IV

Management's Response to the Draft Report



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

RECEIVED
APR 07 2006

APR 07 2006

MEMORANDUM FOR DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: Steven T. Miller, Commissioner *Steven T. Miller*
Tax Exempt and Government Entities *by Sarah Halligan*

SUBJECT: Response to Draft Audit Report – The Federal, State and
Local Governments Office Can Improve the Workload
Selection Process to Increase Effectiveness (Audit # 200510029)

The Tax Exempt and Government Entities (TE/GE) Operating Division requested the Treasury Inspector General for Tax Administration (TIGTA) to conduct this audit to review the workload selection process in our Federal, State and Local Governments (FSLG) function, and to suggest improvements to increase the effectiveness of FSLG's compliance program. We are grateful for the thorough work performed by TIGTA and for its recommendations. We also appreciate the time spent by TIGTA in understanding FSLG's case selection procedures and the expeditious manner in which it conducted the audit. We have already implemented a number of TIGTA's recommendations. We believe they will result in improvements in FSLG's workload selection process and in assessing the productivity of compliance check cases.

RECOMMENDATION 1

Develop an action plan that ensures the needed enhancements to the workload selection process will be timely implemented and monitored. The action plan should document actions planned, indicate individuals assigned to specific actions, responsible management official(s), completion dates, expected results and methods to monitor and report performance.

CORRECTIVE ACTION

A written action plan has been developed.

COMPLETION DATE

Completed.

RESPONSIBLE OFFICIAL

Director, Government Entities



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RECOMMENDATION 2

Specific actions should include: Revise the Microsoft Access® database to separately track the productivity of each Return Inventory and Classification Systems (RICS) query.

CORRECTIVE ACTION

FSLG revised the data base as recommended.

COMPLETION DATE

Completed.

RESPONSIBLE OFFICIAL

Director, Government Entities

RECOMMENDATION 3

Specific actions should include: Evaluate the feasibility of developing a scoring system to assist in the FSLG, Outreach Planning and Review (OPR) office workload identification process. Specifically, determine if a weighted scoring system can be developed that consolidates multiple RICS queries into a numeric score based on the highest risk of noncompliance and the difference in the various state reporting requirements. This type of scoring system could ensure consistency and reduce subjectivity among the classifiers identifying compliance contact cases.

CORRECTIVE ACTION

We considered whether a scoring system of the sort recommended for workload identification is feasible for FSLG, but concluded that it is not. The Form 941 has very few line items, and the information reported on them is not necessarily a true indicator of whether a Federal, State and local government employer is or is not meeting its employment tax obligations. This is because many factors can affect such obligations and solely relying on the information on Form 941 can be misleading.

However, in response to TIGTA's recommendation, the FSLG OPR office will establish folders for each State. The folders will include: State-specific information that may affect the information on various line items on Form 941 (e.g., whether the State has executed a section 218 agreement, including subsequent modifications, with the Social Security Administration; what type of pension plan the state or local government provides for its employees; information gathered by FSLG during outreach events that is state specific and affects the State's employment tax obligations, and summaries of data gathered from prior compliance actions conducted within a given State and/or market segment). FSLG's use of this information, when combined with the RICS queries, will substantially reduce the subjectivity among classifiers in case selection.



*The Federal, State, and Local Governments Office Can Improve
the Workload Selection Process to Increase Effectiveness*

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COMPLETION DATE

September 15, 2006

RESPONSIBLE OFFICIAL

Director, Government Entities.

RECOMMENDATION 4

Specific actions should include: Analyze the results of the compliance contact cases to identify significant areas of noncompliance and potential education and outreach issues and build these areas into the RICS queries to identify more productive cases for future compliance activity.

CORRECTIVE ACTION

FSLG began separately tracking the productivity of each Case Selection Query on January 3, 2006. The analysis of the data captured for FY 2006 will begin in October 2006, and will continue thereafter, on an on-going basis. The results of the analysis will determine the productivity of each RICS query in the case selection process.

COMPLETION DATE

November 15, 2006

RESPONSIBLE OFFICIAL

Director, Government Entities

If you have any questions, please contact me at (202) 283-2500 or a member of your staff may contact Sunita Lough, Director, Federal, State and Local Governments at (202) 283-9665.