



*The Wage and Investment Division
Compliance Function Should Link
Annual Performance to Long-Term
Goals and Improve Data Collection*

December 2005

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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

December 23, 2005

MEMORANDUM FOR COMMISSIONER, WAGE AND INVESTMENT DIVISION

FROM:

Michael R. Phillips

Michael R. Phillips

Deputy Inspector General for Audit

SUBJECT:

Final Audit Report – The Wage and Investment Division Compliance Function Should Link Annual Performance to Long-Term Goals and Improve Data Collection (Audit # 200540020)

This report presents the results of our review to determine if the Wage and Investment (W&I) Division Compliance function has taken actions in response to previous Treasury Inspector General for Tax Administration (TIGTA) reports by developing long-term goals and related measures.

We issued two audit reports¹ in August 2003 recommending the Commissioner, W&I Division, finalize the long-term goals and related measures that were being developed in the W&I Division Compliance function Concept of Operations.²

Synopsis

The W&I Division Compliance function reported that it had completed actions on the prior TIGTA reports by developing long-term strategic goals.³ However, the W&I Division Compliance function did not directly link these long-term strategic goals to its annual performance goals and measures. This would have helped the Compliance function demonstrate

¹ *More Information Is Needed to Determine the Effect of the Automated Underreporter Program on Improving Voluntary Compliance* (Reference Number 2003-40-180, dated August 2003) and *More Information Is Needed to Determine the Effect of the Discretionary Examination Program on Improving Service to All Taxpayers* (Reference Number 2003-40-185, dated August 2003).

² The Concept of Operations is a framework that includes a defined vision, strategic goals, operational themes, and program capabilities. It identifies key organizational concepts required to achieve the organization's vision.

³ The corrective actions were completed for the Automated Underreporter Program and the Discretionary Exam Program reports identified in footnote 1 in July 2004 and December 2004, respectively.



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annual progress in meeting the long-term goals. It would also have helped determine whether the program goals and measures were on track and, if not, help identify and correct deficiencies. The Government Performance and Results Act of 1993⁴ requires that agency strategic plans identify long-term goals, outline strategies to achieve these goals, and develop annual program goals and measures to demonstrate the results of these activities.

In the Fall of 2004, the Office of the Chief Financial Officer initiated efforts to develop overall long-term Internal Revenue Service (IRS) performance goals to directly support its mission and strategic goals as set forth in the IRS' 2005–2009 Strategic Plan. As part of this process, the W&I Division submitted supporting program information to assist in developing the long-term performance goals affecting its programs, which included the Compliance function.

In addition, the W&I Division Compliance function did not have the necessary data to monitor the Automated Underreporter (AUR) Program's⁵ progress toward improving voluntary compliance. We had reported that the AUR Program did not have sufficient information to address the causes for discrepancies. We also reported that while the AUR Program was able to capture the yield from cases by category, it could not identify the costs associated with working those cases by category. Therefore, management did not know if it cost more to work some cases than others, or if the cost to work those cases exceeded the expected yield.

The W&I Division Compliance function has not yet taken the necessary steps to enhance the AUR Program's ability to track information on the causes for discrepancies identified during case reviews, how these cases were resolved, or the costs associated with these reviews. Knowing this information could help Compliance function management identify what IRS process or systemic change might eliminate or reduce future AUR Program discrepancies or identify opportunities to educate taxpayers on how to avoid discrepancies and report income and deductions correctly. Although the W&I Division Compliance function has not established needed closing/reason codes to capture the causes for discrepancies and how the cases were resolved, it has enhanced the inventory selection process to reduce the number of screened out cases and improve case assessments.

The W&I Division Compliance function originally responded to the prior TIGTA report by stating that it planned to partner with the Modernization and Information Technology Services (MITS) organization to develop a comprehensive management information system. The MITS organization, with the assistance of the W&I Division Compliance function, developed a "white paper" which outlined the justification for the desired system. While the Compliance function has initiated efforts to obtain a new AUR Program management information system, it

⁴ Pub. L. No. 103-62, 107 Stat. 285 (codified as amended in scattered sections of 5 U.S.C., 31 U.S.C., and 39 U.S.C.).

⁵ The IRS' annual matching program used to identify taxpayers that misreport their income. The AUR Program compares the information reported by third parties, such as employers and banks, with what was reported by taxpayers on their individual income tax returns.



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is doubtful the established milestone date can be met. We believe the W&I Division Compliance function should continue its efforts to address the prior TIGTA recommendation by taking the necessary actions to obtain the funding necessary for a new system. This would ensure management had the information needed to track costs associated with AUR Program activities and to establish baselines.

Recommendations

The Commissioner, W&I Division, should ensure the W&I Division Compliance function's annual performance goals and measures directly support and can demonstrate progress in achieving the long-term performance goals that apply to the Compliance function. The W&I Division should also take the necessary steps to implement the prior TIGTA recommendation to capture case review data on the causes for the noted discrepancies and how the cases were resolved.

Response

IRS management agreed with one of our recommendations and disagreed with the other. When the IRS long-term goals are finalized, W&I Division management will reassess our first recommendation. Corrective actions may include modifying the W&I Division's Concept of Operations to support accomplishment of appropriate long-term goals.

While IRS management agrees that data on specific discrepancies in AUR Program cases and how these cases were resolved would be valuable, they do not plan to add closing/reason codes to the existing AUR Program due to budget constraints which are not likely to change. In addition, they believe that implementing additional process codes would adversely affect the rate and volume of cases closed by the AUR Program.

Instead, the IRS will continue to conduct research studies as part of its overall initiative to improve case scoring and selection methodology. In addition, it will expand the new selection methodology successfully used in identifying the most productive Earned Income Tax Credit inventory to all AUR Program inventory. IRS management believes this approach accomplishes the overall objective of improving the AUR Program and that Program results over the last 5 years, reflecting a 60 percent increase in productivity, indicate their efforts have achieved that objective. Management's complete response to the draft report is included as Appendix V.

Office of Audit Comment

The planned corrective action should improve AUR Program productivity. However, we believe the Commissioner, W&I Division, should ensure the planned research studies also capture data



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on what caused the discrepancies and how the cases were resolved. Capturing this data would provide the W&I Division Compliance function needed data to monitor progress toward improving voluntary compliance.

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 Scott Macfarlane, Acting Assistant Inspector General for Audit (Wage and Investment Income Programs), at (925) 210-7027, extension 102.



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Background

The Wage and Investment (W&I) Division serves approximately 120 million taxpayers. Through its Compliance function, the W&I Division conducts examinations of individual tax returns and collects any outstanding taxes due. The W&I Division Compliance function mission is to fairly and effectively assist taxpayers in the determination and fulfillment of their tax obligations by providing accurate and consistent application of the tax law and by using a risk-based approach to exam and collection.

“To provide for the establishment of strategic planning and performance measurement in the Federal Government”

The Government Performance and Results Act of 1993

The Government Performance and Results Act of 1993 (GPRA)¹ was enacted by Congress, in part, to “improve the confidence of the American people in the capability of the Federal Government, by systematically holding Federal agencies accountable for achieving program results.” The GPRA was intended to switch the focus of Federal Government programs from “staffing” to “outcomes,” expressed in the real differences Federal Government agencies make in people’s lives. The

GPRA was created as a guide for improving the efficiency and effectiveness of Federal Government programs by establishing agency systems operating under a set of long-term goals focused on program performance and results measurement. The overriding objective was to improve each agency’s performance and to provide much needed objective information to Congressional and Executive Branch decision makers to assist them in appropriating and allocating Federal funds. The law required each executive agency to prepare multi-year strategic plans, annual performance plans, and performance reports on prior year accomplishments.

The President’s Management Agenda (PMA) was first issued in Fiscal Year (FY) 2002 and has been an emphasis each year thereafter. The PMA recognized that in the 8 years since the enactment of the GPRA, agency progress toward the use of performance information for program management was discouraging. Agency performance measures were recognized as being ill-defined and not properly integrated into agency budget submissions and in the management and operation of agency programs.

“The American people should be able to see how government programs are performing and compare performance and cost across programs.”

The President's Management Agenda

¹ Pub. L. No. 103-62, 107 Stat. 285 (codified as amended in scattered sections of 5 U.S.C., 31 U.S.C., and 39 U.S.C.).



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The PMA outlined the President's strategy for improving management and performance in the Federal Government. It contained five overall Government-wide initiatives and nine agency-specific goals intended to improve Federal Government management and to deliver results that matter to the American people. The PMA stressed the need to provide a greater focus on results-oriented performance management as set forth under the GPRA. Through the strategic planning process, agencies were expected to identify high quality strategic goals, long-term performance goals, and outcome measures and to use those goals and measures to accurately monitor the performance of programs.² Agencies were also expected to begin integrating the strategic planning process with budget formulation. The lack of consistent performance information and a reporting framework for performance, budgeting, and accounting impedes an agency's ability to provide meaningful performance reports to Congress and the Executive Branch. The expected results of focusing on performance management using the strategic planning process would be better performance; better control over resources used and accountability for results; better service; and standard, integrated budgeting, performance, and accounting information.

In 2002, the Performance Assessment Rating Tool (PART) was developed as a process for

"The PART looks at all factors that affect and reflect program performance, including program purpose and design, performance measurement, evaluations and strategic planning, program management, and program results."

The Office of Management and Budget

assessing individual agency program performance. The PART contains a series of questions designed to provide a consistent approach to rate programs across the Federal Government. According to the PART, long-term goals should cover 5-10 years and be consistent with the periods for the strategic goals used in the agency's strategic plan. The individual programs should also have a limited

number of specific long-term performance measures, with targets and timeframes that focus on outcomes and meaningfully reflect the purpose of the program.

Taxpayers are responsible for filing returns that report the full amount of taxes owed and paying any taxes that are due. The Internal Revenue Service (IRS) mission is to provide America's taxpayers with top quality service by helping them understand and meet their tax responsibilities and by applying the tax law with integrity and fairness to all. To help meet this mission, the IRS' 2005–2009 Strategic Plan identified its strategic goals to improve taxpayer service, enhance enforcement of the tax law, and modernize the IRS through its people, processes, and technology. To enhance enforcement of the tax law, the IRS has established various compliance programs designed to assure taxpayers fully and accurately report and pay any taxes that are due.

² A strategic goal is a general statement of aim or purpose and is required under the GPRA to be included in the strategic plan. The strategic plan should also set a level of performance for each strategic goal (long-term performance goals) containing quantitative targets against which actual achievement can be compared. A performance goal is comprised of a performance measure with targets and timeframes.



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The W&I Division's strategic planning process covers a 2-year period. The W&I Division Strategy and Program Plan addresses the IRS strategic goals, the applicable budget programs, and one or more strategic plan objectives supported by the W&I Division base program activities. The Strategy and Program Plan is updated every year and makes reference to many of the annual performance goals and measures used in each program. The measures identified are the current year targets, revisions to the targets if necessary, and the next year's projected targets. The W&I Division Strategy and Program Plan is directly linked to the IRS' Strategic Plan.

This audit was initiated as a follow-up to the two prior reviews³ we completed involving the PART process. One of our objectives was to determine what steps the W&I Division Compliance function has taken since our last reviews to develop long-term goals and measures. During prior reviews of the Compliance function programs, we recommended the Commissioner, W&I Division, ensure that long-term goals and related measures be developed. For the Automated Underreporter (AUR) Program⁴ and the Discretionary Examination Program, we recommended that the long-term goals be finalized and a consistent method used to measure progress toward the long-term goals. In response to our prior reports, the Commissioner, W&I Division, agreed to finalize the long-term goals in the Concept of Operations (ConOps).⁵

We are also evaluating what progress the W&I Division Compliance function has made in capturing sufficient information to show what actions resolved completed AUR Program cases and in identifying costs associated with working cases in specific case categories. During a prior review, we reported that additional closing codes were needed to explain why cases were screened out or closed. We also reported that the W&I Division Compliance function had no way to identify costs associated with working cases. In response, the Compliance function agreed to partner with the Modernization and Information Technology Services (MITS) organization to develop a comprehensive management information system.

This audit was performed at the W&I Division Headquarters in Atlanta, Georgia, the Office of the Chief Financial Officer in Washington, D.C., and the Office of the Chief Information Officer in Ogden, Utah, during the period October 2004 through September 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.

³ *More Information Is Needed to Determine the Effect of the Automated Underreporter Program on Improving Voluntary Compliance* (Reference Number 2003-40-180, dated August 2003) and *More Information Is Needed to Determine the Effect of the Discretionary Examination Program on Improving Service to All Taxpayers* (Reference Number 2003-40-185, dated August 2003).

⁴ The IRS' annual matching program used to identify taxpayers that misreport their income. The AUR Program compares the information reported by third parties, such as employers and banks, with what was reported by taxpayers on their individual income tax returns.

⁵ The ConOps is a framework that includes a defined vision, strategic goals, operational themes, and program capabilities. It identifies key organizational concepts required to achieve the organization's vision.



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Results of Review

The Wage and Investment Division Compliance Function Needs to Incorporate Long-Term Goals Into the Annual Planning Process

The W&I Division Compliance function reported that it had completed actions on the prior Treasury Inspector General for Tax Administration (TIGTA) reports by including long-term strategic goals in its ConOps.⁶ However, these long-term strategic goals were never directly linked to the W&I Division's operational priorities supporting the IRS strategic goals outlined in the W&I Division FY 2005–2006 Strategy and Program Plan. As designed, the Strategy and Program Plan did not address the strategic goals identified in the ConOps or any other long-term goals established specifically for the W&I Division or its Compliance function. In addition, the ConOps long-term strategic goals were not used by management when they set annual performance goals and measures used within the Compliance function programs in FY 2005.

In the Fall of 2004, the Office of the Chief Financial Officer (CFO) initiated efforts to develop overall long-term IRS performance goals to directly support its mission and strategic goals as set forth in the IRS' 2005–2009 Strategic Plan. The intent was to set one or two long-term performance goals for each of the eight budget programs.⁷ As part of this process, the W&I Division submitted supporting program information for the draft IRS long-term goals affecting its programs, including the Compliance function. The IRS has committed to publish long-term performance goals as an amendment to the published IRS' 2005–2009 Strategic Plan. W&I Division management is waiting approval of the proposed long-term goals before incorporating them into the annual strategic planning process.

Under the GPRA and the PART, agencies are expected to develop annual performance plans⁸ and to follow those plans toward the accomplishment of the overall long-term performance goals set for the agency. The purpose is to develop an organizational strategy focused on results-oriented management. The GPRA requires that strategic plans identify long-term performance goals, outline strategies to achieve those goals, and develop annual program goals and measures to demonstrate the results of their activities. The strategic planning process should

⁶ The corrective actions were completed on the AUR Program and the Discretionary Exam Program reports identified in footnote 3 in July 2004 and December 2004, respectively.

⁷ The IRS' eight budget programs are: Assistance, Outreach, Processing, Examination, Collection, Investigation, Regulatory Compliance, and Research.

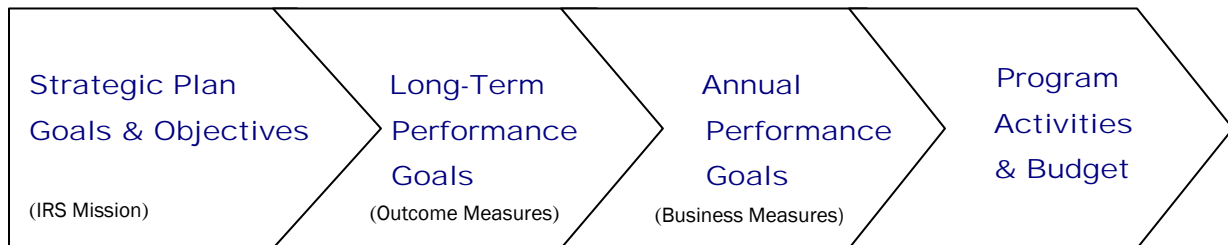
⁸ The W&I Division's annual performance plan is the *W&I Strategy and Program Plan*.



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accurately guide and monitor the W&I Division Compliance function's progress in meeting long-term goals through annual performance goals and measures.

Chart 1: IRS Strategic Planning



Source: CFO's Draft Long-Term Performance Goals Guidance.

For the FY 2005–2006 strategic planning process, the W&I Division followed the format provided by the CFO for preparing the Strategy and Program Plan. The format focused on the IRS' strategic goals, but did not require the W&I Division to identify and address long-term program goals as required under the GPRA. Historically, W&I Division Compliance function management developed annual performance goals and measures, adjusting for priorities, without focusing specifically on long-term goals. The Compliance function's focus was on general operational themes established in the ConOps. However, these operational themes were not specifically related to the accomplishment of the long-term goals. The annual performance goals and measures were the principle means by which the Compliance function measured the annual success of its programs.

In response to our last report, the W&I Division agreed to finalize the long-term goals and establish a consistent method to measure progress toward accomplishing the long-term goals. While the W&I Division reported that this action was complete, our review of the final version of the ConOps showed that the strategic goals were not linked to the annual performance goals and measures. The Director, Compliance, stated that the ConOps' strategic goals were merely "targets" for the Compliance function to strive toward, but expectations for attainment were "fluid" and the long-term strategic goals were subject to change. We were informed that the purpose of the strategic goals was to ensure that W&I Division Compliance function programs are on the same track and going in the same direction.

We believe that when the long-term performance goals are finalized, the Compliance function will need to directly link its annual performance goals and measures to the appropriate long-term performance goals. This will demonstrate annual progress in meeting the long-term performance goals. It will also help determine whether the annual performance goals and measures are on track and, if not, help identify and correct deficiencies in the strategic planning of the program. Without this link, the W&I Division Compliance function will not have an established foundation from which they can demonstrate results-oriented management in achieving the long-term goals. Aligning programs to the appropriate long-term performance goals makes it easier to demonstrate progress and improvement in programs over time. Long-term performance



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goals help managers see the big picture of where a program is headed and how it is integrated and aligned to budget and performance. In addition, under the PMA if a program can not demonstrate continued performance in accomplishing an agency's long-term performance goals, future funding could come into question.

Recommendation

Recommendation 1: The Commissioner, W&I Division, should ensure the W&I Division Compliance function's annual performance goals and measures directly support and can demonstrate progress in achieving the long-term performance goals that apply to the Compliance function.

Management's Response: IRS management agreed with this recommendation. When the IRS long-term goals are finalized, W&I Division management will reassess this recommendation. Corrective actions may include modifying the W&I Division's ConOps to support accomplishment of appropriate long-term goals.

The Wage and Investment Division Compliance Function Does Not Have the Necessary Data to Monitor the Automated Underreporter Program's Progress Toward Improving Voluntary Compliance

The AUR Program does not have sufficient information to address the causes for discrepancies

In August 2003, we reported⁹ that the AUR Program data did not capture what caused the identified discrepancies and how they were resolved. New closing/reason codes could explain why a case was screened out or closed; for example, the taxpayer misinterpreted the tax law and claimed an erroneous credit or deduction, when an IRS document was missing from the case file, or the taxpayer provided additional information that was not provided on the return.

The Compliance function has yet to implement the suggested AUR Program data changes to capture information on what caused the discrepancies and how they were resolved. However, in response to another TIGTA report in July 2005,¹⁰ the Compliance function did take action to establish three new closing codes for taxpayers whose social security numbers were compromised. This would allow the Compliance function to track and monitor cases resulting from identity theft.

⁹ *More Information Is Needed to Determine the Effect of the Automated Underreporter Program on Improving Voluntary Compliance* (Reference Number 2003-40-180, dated August 2003).

¹⁰ *A Corporate Strategy Is Key to Addressing the Growing Challenge of Identity Theft* (Reference Number 2005-40-106, dated July 2005).



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To establish long-term goals and measures, W&I Division Compliance function management needs meaningful outcome data from which to analyze and measure the AUR Program's progress toward improving voluntary compliance. A recent Government Accountability Office report¹¹ recognized that

"... [while] IRS is developing a system intended to capture better examination data, IRS does not have firm or specific plans to develop better data on the reasons for noncompliance, even though the lack of such data makes it harder to decide whether it should address areas of noncompliance through nonenforcement efforts, such as designing clearer forms or publications, or enforcement efforts."

The National Taxpayer Advocate testified¹² that

"... all we (IRS) know about noncompliant taxpayers is the nature of their noncompliance, not the underlying reasons for it. We know whether taxpayers are nonfilers, or underreporters, or nonpayers. If we don't understand the reasons for noncompliance, we run the risk of a shotgun approach. We may hit someone with serious enforcement actions when a less drastic approach might work and might have better long-term compliance effects."

Knowing whether taxpayers are unintentionally or intentionally noncompliant with specific tax provisions is critical to the IRS for deciding whether its efforts to address specific areas of noncompliance should focus on nonenforcement or enforcement activities. Establishing meaningful closing/reason codes is the key to this type of analysis.

Although the W&I Division Compliance function did not establish needed closing/reason codes to capture the causes for discrepancies and how the cases were resolved, it did focus on enhancing the inventory selection process to reduce the number of screened out cases and improve case assessments. For example, in FY 2004, the AUR Program reported it closed approximately 2.1 million cases; the breakdown of case closures is depicted in Chart 2.

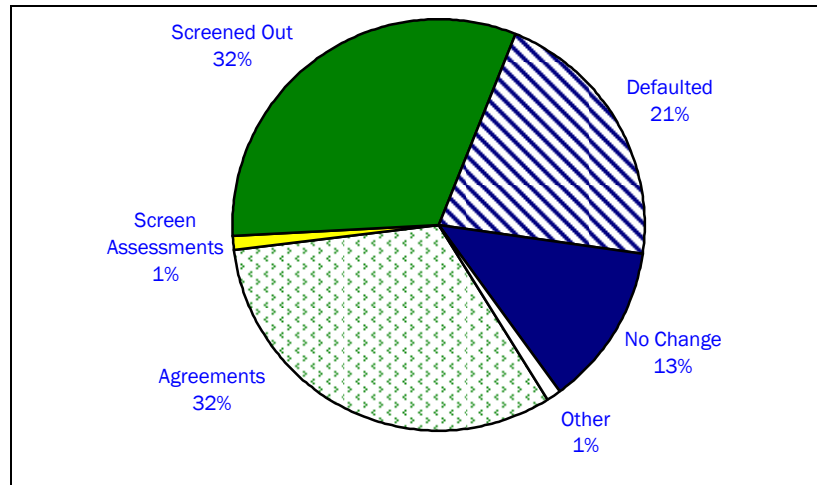
¹¹ *TAX COMPLIANCE: Better Compliance Data and Long-Term Goals Would Support a More Strategic IRS Approach to Reducing the Tax Gap* (GAO-05-753, dated July 2005).

¹² Statement of Nina E. Olson, National Taxpayer Advocate, before the United States Senate Committee on Finance on the Tax Gap, April 14, 2005.



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Chart 2: FY 2004 AUR Program Closed Cases



Source: *AUR Closures by Disposition (August 2005)*.

[Definitions: [Screened Out](#) – Discrepancy was resolved during the screening process (no contact with the taxpayer). [Agreements](#) – taxpayers agreed to the additional assessments. [Defaulted](#) – IRS issued a statutory notice of deficiency to taxpayers who did not respond to the additional assessment. [Screen Assessments](#) – assessments identified during the screening process.]

In FY 2005, the AUR Program reported that it had successfully reduced the screened out rate to 24 percent for the 10-month period ending in July 2005. While this effort by itself may have been effective in identifying more productive cases to work, it still does not address the reasons why these taxpayers were noncompliant.

In its 2005–2009 Strategic Plan, the IRS recognized that noncompliance may not be deliberate and can stem from a wide range of causes, including lack of knowledge, confusion, poor record keeping, differing legal interpretations, unexpected personal emergencies and temporary cash flow problems. However, some noncompliance is willful, even to the point of criminal tax evasion. Knowing this information could help Compliance function management identify what IRS processing or systemic change might eliminate or reduce future discrepancies or identify opportunities to educate taxpayers on how to avoid discrepancies and report income and deductions correctly. Compliance function management also needs this information to establish baselines to measure the AUR Program’s progress toward improving voluntary compliance.

However, the W&I Division did not take the necessary steps to add the needed closing/reason codes to the existing AUR Program data information system to capture the causes of identified discrepancies and how the cases were resolved. While there was agreement under our prior audit, the W&I Division now believes that requiring the input of additional codes would be an unacceptable burden on the case reviewers.

In our opinion, the addition of closing/reason codes would be beneficial. Having the additional noncompliant data could help with the ongoing enhancement of the AUR Program case selection



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process, resulting in improved assessments in subsequent years. The additional codes would also help to identify noncompliant situations where alternative nonenforcement actions could possibly improve voluntary compliance. Until the causes for the noncompliant activity are identified, documented, evaluated, and addressed, the noncompliant activities will persist.

Recommendation

Recommendation 2: The Commissioner, W&I Division, should implement the agreed corrective action of adding closing/reason codes to the existing AUR Program data information system to capture data on what caused the discrepancies and how the cases were resolved. Capturing this data will allow the W&I Division Compliance function to monitor progress toward improving voluntary compliance.

Management's Response: While IRS management agrees that data on specific discrepancies in AUR Program cases and how these cases were resolved would be valuable, they do not plan to add closing/reason codes to the existing AUR Program due to budget constraints which are not likely to change. In addition, they believe that implementing additional process codes would adversely affect the rate and volume of cases closed by the AUR Program.

Instead, the IRS will continue to conduct research studies as part of its overall initiative to improve case scoring and selection methodology. In addition, it will expand the new selection methodology successfully used in identifying the most productive Earned Income Tax Credit inventory to all AUR Program inventory. IRS management believes this approach accomplishes the overall objective of improving the AUR Program and that Program results over the last 5 years, reflecting a 60 percent increase in productivity, indicate their efforts have achieved that objective.

Office of Audit Comment: The planned corrective action should improve AUR Program productivity. However, we believe the Commissioner, W&I Division, should ensure that the planned research studies also capture data on what caused the discrepancies and how the cases were resolved. Capturing this data would provide the W&I Division Compliance function needed data to monitor progress toward improving voluntary compliance.

The AUR Program does not identify costs associated with working cases by category

In August 2003, we reported that the AUR Program was able to capture the yield from cases by category but could not identify the costs associated with working cases in each category. Therefore, management did not know if it cost more to work some cases than others, or if the cost to work those cases exceeded the expected yield. We stated that cost should be a factor considered when selecting cases to work.



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Management's plan was to develop a comprehensive Management Information System.

Since the current management information system is unable to capture the costs associated with working cases, the Compliance function responded to our report stating that it planned to partner with the MITS organization to develop a comprehensive management information system. The W&I Division Compliance function was to have the new management information system in place to identify outcome measures and accurately monitor the overall performance of the AUR Program by June 30, 2006.

However, while the Compliance function initiated efforts toward addressing its management information system needs, it is doubtful that the established milestone date will be met. In October 2004, the MITS organization had two vendors present systems that might be used to meet the needs of the AUR Program. The Chief, AUR, and the MITS Chief, AUR Section, informed us that the desired system would provide the W&I Division Compliance function with enhanced capabilities to track closing actions, manage and direct the inventory, identify the most productive cases, and identify costs related to working cases. The MITS organization, with the assistance of the W&I Division Compliance function, also developed a "white paper" which outlined the justification for the needed system. However, Compliance function officials informed us that, under existing funding levels, the recommended system was considered cost prohibitive, with an initial cost of \$2.2 million and \$340,000 each year thereafter for the annual software renewal.

In our August 2003 report, we recommended that the W&I Division improve the AUR Program's current management information system to capture data sufficient to establish baselines and to measure performance against long-term measures and goals. The PMA directed Federal Government agencies to not only identify high quality outcome goals and measures, but also to establish needed baselines and accurately monitor program performance against the established long-term goals and measures. The PART also required agencies to choose performance measures that meaningfully reflect the mission of the program, not merely ones for which there are data. In addition, agencies were also to begin integrating program performance into the budget process by identifying associated program costs.

At this time, we are not making an additional recommendation as an outstanding recommendation exists to develop a comprehensive management information system. As such, the W&I Division Compliance function should continue its efforts to address the prior TIGTA recommendation by taking the necessary actions to obtain the funding necessary for the new system. The Compliance function will not be able to determine the actual costs associated with working cases until its system needs are met. Since some cases cost more to work than others and the cost to work certain cases can exceed the expected yield, we believe cost would be a major factor when selecting cases to work. Since the Compliance function does not have the resources necessary to work all cases, cost data are important to effectively prioritize case selections.



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Appendix I

Detailed Objective, Scope, and Methodology

The overall objective of this review was to determine if the Wage and Investment (W&I) Division Compliance function has taken actions in response to previous Treasury Inspector General for Tax Administration reports by developing long-term goals and related measures. To accomplish our objective, we:

- I. Determined if the Compliance function had complied with the intent of the Government Performance and Results Act of 1993,¹ the President's Management Agenda, and the Performance Assessment Rating Tool criteria by establishing long-term goals to promote continued improvement toward meeting its overall mission of fairly and effectively assisting taxpayers in the determination and fulfillment of their tax obligations.
- II. Determined if each Compliance function long-term goal had annual performance measures to help demonstrate progress in achieving the goal. To make this assessment, we evaluated the W&I Division Compliance function's Automated Underreporter (AUR) Program,² Discretionary Examination Program, and Compliance Services Collection Operations Program.
- III. Evaluated the Compliance function's progress towards taking corrective actions and establishing baselines for long-term goals and measures by following up on the two major findings identified in a previous AUR Program audit report.³ Specifically, we determined management's progress toward:
 - A. Capturing sufficient information to show what actions resolved completed AUR Program cases.
 - B. Identifying costs associated with working AUR Program cases within each specific case category.

¹ Pub. L. No. 103-62, 107 Stat. 285 (codified as amended in scattered sections of 5 U.S.C., 31 U.S.C., and 39 U.S.C.).

² The Internal Revenue Service's annual matching program used to identify taxpayers that misreport their income. The AUR Program compares the information reported by third parties, such as employers and banks, with what was reported by taxpayers on their individual income tax returns.

³ *More Information Is Needed to Determine the Effect of the Automated Underreporter Program on Improving Voluntary Compliance* (Reference Number 2003-40-180, dated August 2003).



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Appendix II

Major Contributors to This Report

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Appendix III

Report Distribution List

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 Senior Operations Advisor, Wage and Investment Division SE:W:S



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Appendix IV

Wage and Investment Division Compliance Function Strategic Goals

The strategic goals listed in the Wage and Investment Division Compliance function Concept of Operations were:

- Strategically select cases most appropriate for available resources and identify delivery mechanisms to get those cases to the employees' integrated desktop in the most efficient manner.
- One hundred percent of employees have access to 100 percent of the information they need.
- Improve identification of noncompliant taxpayers and improve selection of noncompliant cases to work.
- By year Y, more than X percent of taxpayers are in full compliance.
- Increase by 50 percent the number of taxpayers who can come into full compliance via self-assist and/or self-correct by 2007.
- Resolve compliance issues within the current tax year by 2012.
- Fifteen percent of compliance issues can be handled systemically, without human interaction, by 2012.
- Eighty percent of compliance issues not handled automatically are resolved with first human contact.
- Improve overall employee satisfaction score to 75 percent.
- X percent of taxpayers are satisfied with the timeliness, accuracy, professionalism, and quality of their interactions with the Compliance function.
- By 2007, all Compliance function processes and systems employ quality management mechanisms.



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Appendix V

Management's Response to the Draft Report



COMMISSIONER
WAGE AND INVESTMENT DIVISION

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
ATLANTA, GA 30308

NOV 18 2005

RECEIVED
NOV 22 2005

MEMORANDUM FOR MICHAEL R. PHILLIPS
DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: *for* Richard J. Morgante *Patricia D. Watson*
Commissioner, Wage and Investment Division

SUBJECT: Draft Audit Report – The Wage and Investment Division
Compliance Function Should Link Annual Performance to
Long-Term Goals and Improve Data Collection
(Audit # 200540020)

I appreciate your recognition of the IRS-initiated efforts to develop long-term, outcome-oriented goals to directly support the IRS mission. All of the Operating Divisions, including Wage and Investment (W&I), and W&I Compliance provided substantive input, feedback and support to these efforts.

Two other IRS efforts currently underway will further crystallize the Service's goals over the short and long-term. The first, IRS' Taxpayer Assistance Blueprint, will provide a roadmap to capture the needs and preferences of taxpayers. In doing so, it will generate recommendations for addressing goals in the services provided to taxpayers as well as a long-term approach for assessing the delivery of individual taxpayer assistance.

The second of these efforts, the Modernization Vision and Strategy, will identify business areas of focus for IRS modernization over the next five years. This will enable IRS to develop enterprise information technology modernization goals that leverage current successes to achieve additional successes in strategic areas.

When IRS finalizes its Servicewide long-term performance goals and completes these other efforts, we will be in a better position to modify our Compliance Concept of Operations (ConOps) to support accomplishment of the appropriate long-term goals.



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Additionally, while your report acknowledges the enhancements we made to the inventory selection process in Automated Underreporter (AUR), it should be noted that the AUR program is overall much more efficient today than it was five years ago, reflecting a 60 percent increase in productivity over that period of time.

Results of our research studies and other initiatives are also noteworthy. Working with IRS Research, Analysis and Statistics, as well as W&I Research, we have completed two screen-out studies, a no-change study and a repeater study. Information gathered from the screen-out and no-change studies improved the matching process by eliminating false or incorrect cases; thus, improving overall productivity. Our screen-out rate dropped from 30 percent to 20 percent, with a significant decline in the no-change rate as well. The recently completed repeater study identified reasons why some taxpayers repeatedly underreport that will help us develop outreach/educational efforts to address this behavior.

A related test to increase coverage and modify taxpayer behavior included sending soft notices to a small volume of low-dollar repeat underreporter taxpayers. No taxpayer that received this notice in Tax Year (TY) 2003 repeated the same behavior in TY 2004. We will expand this test to 2,000 taxpayers for TY 2004.

Finally, as part of the Earned Income Tax Credit (EITC) initiative, a new methodology was used to select the AUR inventory to be worked. The new method uses approximately 90 different data elements per case to identify the most productive cases to work. This is a vast improvement over our current methodology that uses five years of historical data on a limited number of variables. We plan to expand this new methodology to select all AUR inventory for TY 2005.

Attached are our comments to your recommendations. If you have any questions, please call me at (404) 338-7060, or members of your staff may contact Jim Grimes, Director, Compliance, at (404) 338-9904.

Attachment



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Attachment

RECOMMENDATION 1

The Commissioner, W&I Division, should ensure the W&I Division Compliance function's annual performance goals and measures directly support and can demonstrate progress in achieving the long-term performance goals that apply to the Compliance function.

CORRECTIVE ACTION

We agree, in concept, with this recommendation. When the agency's long-term goals are finalized we will reassess your recommendation. Corrective action(s) may include modifying our ConOps to support accomplishment of appropriate long-term goals.

IMPLEMENTATION DATE

October 15, 2006

RESPONSIBLE OFFICIAL

Director, W&I, Compliance

CORRECTIVE ACTION MONITORING PLAN

We will monitor this corrective action as part of our internal management control system.

RECOMMENDATION 2

The Commissioner, W&I Division, should implement the agreed corrective action of adding closing/reason codes to the existing AUR Program data information system to capture data on what caused the discrepancies and how the cases were resolved. Capturing this data will allow the W&I Compliance Division to monitor progress toward improving voluntary compliance.

CORRECTIVE ACTION

While we agree that data on specific discrepancies in AUR cases and how these cases were resolved would be valuable, we do not plan to add closing/reason codes to the existing AUR Program. The current budget situation precludes us from taking this action at this time and is not likely to change. In addition, because of the high volume of cases worked annually in the AUR program and the short time devoted to each case, implementing additional process codes would place an additional burden on AUR tax examiners and adversely affect the rate and volume of cases they close.

However, we will continue to conduct research studies as part of our overall initiative to improve case scoring and selection methodology. In addition, we intend to expand the new selection methodology successfully used in identifying the most productive EITC inventory to all AUR inventory.



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We believe this approach accomplishes the overall objective of improving the AUR program. Program results over the last five years, reflecting a 60 percent increase in productivity, indicate our efforts have achieved that objective.

IMPLEMENTATION DATE
N/A

RESPONSIBLE OFFICIAL
N/A

CORRECTIVE ACTION MONITORING PLAN
N/A