

**The Process for Assigning Cases Should Be
Strengthened to Provide Better Coverage to
Indian Tribal Governments Most in Need of
Compliance Checks**

September 2004

Reference Number: 2004-10-191

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.



DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

INSPECTOR GENERAL
for TAX
ADMINISTRATION

September 28, 2004

MEMORANDUM FOR COMMISSIONER, TAX EXEMPT AND GOVERNMENT
ENTITIES DIVISION

Gordon C. Milbourn III

FROM: Gordon C. Milbourn III
Acting Deputy Inspector General for Audit

SUBJECT: Final Audit Report - The Process for Assigning Cases Should Be
Strengthened to Provide Better Coverage to Indian Tribal
Governments Most in Need of Compliance Checks
(Audit # 200410011)

This report presents the results of our review of the process for identifying and assigning compliance checks of Indian Tribal governments. The overall objective of this review was to determine whether the Indian Tribal Governments (ITG) office of the Tax Exempt and Government Entities (TE/GE) Division took appropriate actions to identify and assign compliance checks to ensure they are conducted in a fair, equitable, and consistent manner.

The ITG office is responsible for administering Federal tax laws related to the 564 Federally recognized Indian Tribal governments and their approximately 2,000 related entities. The ITG office performs compliance checks to understand customer needs and to identify appropriate remedies for compliance issues. Compliance checks are an important part of the ITG office's strategy to reduce the need for enforcement by keeping abreast of trends that are emerging among the tax filing and payment characteristics of tribal-related entities. The ITG office addresses areas with a high risk of noncompliance through outreach, education, or compliance activities. Compliance checks provide valuable information to ITG office management that is not obtained through other types of compliance activities.

In summary, the process used by ITG office management to identify and assign entities in need of compliance checks relies on data analysis of various filing characteristics. Generally, this keeps ITG office group managers and specialists independent of the assignment process. It also provides a basis (based on the results of analysis of tax return and other information of a tribal entity) for the compliance check and allows the

ITG office group manager to provide the Indian Tribal governments assurance that the tribes are not being singled out for reasons other than those identified by the data analyses. We determined that compliance checks were assigned based on the results of the data analyses and workload needs according to the geographic locations or experience level of field specialists.

However, the process did not provide a similar balance of compliance check coverage across the geographical locations for which the ITG office field groups are responsible. For example, 1 field group has contacted 34 percent of the tribes and another group has contacted 80 percent of the tribes in their respective geographical locations. Because the process did not provide similar compliance check coverage, ITG office management may not fully achieve their goals of better understanding their customers and identifying appropriate remedies to compliance issues.

We recommended the Director, ITG, TE/GE Division, provide guidance to ensure an appropriate balance of work is requested to achieve the desired number of compliance checks and coverage for assigned tribes, and gather appropriate data to establish cutoff data scores to aid in determining when one formula used in the data analysis should take priority over another.

Management's Response: The Commissioner, TE/GE Division, agreed with our recommendations and has started taking corrective actions. To ensure that tribes are not underserved and cases that should be worked are ordered, the ITG office has added new management reports that enable the ITG Director to ascertain the workload assignments of each group on an ongoing basis. The Director, ITG, will make directed assignments of work if an imbalance between groups is apparent. Additionally, ITG office management will be undertaking a detailed study to determine whether cutoff scores can be identified and will contrast compliance check results from each formula to determine where the optimal results are realized. 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 recommendations. 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

The Internal Revenue Service's (IRS) Indian Tribal Governments (ITG) office was established in Fiscal Year (FY) 2000 within the Government Entities function of the Tax Exempt and Government Entities Division. The ITG office is responsible for administering Federal tax laws related to the 564 Federally recognized Indian Tribal governments and their approximately 2,000 related entities.¹ Generally, Federally recognized Indian Tribal governments are not subject to Federal income tax. However, tribal-related entities are responsible for various income, employment, and excise taxes; and antimoney laundering and information reporting requirements.

In FY 2001, the ITG office began performing compliance checks² to understand customer needs and to identify appropriate remedies for compliance issues. Initially, tribal governments were assigned for compliance checks because the ITG office had not identified all the tribal-related entities. However, because many of the tribes had a large number of tribal-related entities, these assignments became too cumbersome, and the ITG office redesigned the process to assign compliance checks to individual tribal-related entities (instead of the tribal government) in June 2003.

During a compliance check, a field specialist interviews key personnel in the tribal entity and inquires about other related entities and filing requirements to determine whether all record keeping and information reporting requirements are met. If the ITG office field specialist determines that a tribe is not fully complying with its filing and payment responsibilities, the specialist may follow up with additional outreach or other action to assist the entity or propose an examination³ when warranted.

¹ Tribal-related entities are businesses or enterprises owned and/or controlled by an Indian Tribal government. These entities include casinos, restaurants, medical clinics, housing authorities, gas stations, and a variety of other industries.

² A compliance check is voluntary, and an entity may refuse to have a compliance check performed. It does not include an examination of books and records to determine an entity's liability for taxes.

³ An examination is a review of an entity's books and records to determine the correct tax liability.

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Compliance checks are an important part of the ITG office's strategy to reduce the need for enforcement by keeping abreast of trends that are emerging among the tax filing and payment characteristics of tribal-related entities. The ITG office addresses areas with a high risk of noncompliance through outreach, education, or compliance activities. Compliance checks provide valuable information to ITG office management that is not obtained through other types of compliance activities. Generally, information from the results of the compliance checks, such as new tribal-related entities or filing requirements, is input into the ITG office's database⁴ for future analysis.

ITG office compliance check workload is generally identified through one of three methods:

- The primary method used to identify compliance checks is a process developed by the Outreach, Planning, and Review (OPR) office⁵ for analyzing employment tax and information reporting returns and commercial census data related to the tribes or tribal entities. For analyses performed in FY 2003, six preset formulas and other criteria⁶ were used to rank and assign tribal-related entities for compliance work based on the results of data analyses of tax return and other information of the tribal entity.⁷
- Indian Tribal government leadership may request a compliance check. Tribes often request compliance checks when there is a need for specialized guidance

⁴ The ITG office database was developed by the Outreach, Planning, and Review office in FY 2001 to analyze filing and payment characteristics and control nonexamination activities.

⁵ The OPR office's responsibilities include strategic planning, coordination of ITG office activities, review of work assignments, and workload classification and delivery.

⁶ These formulas and criteria are defined in the OPR office's FY 2003 Workload Selection Plan and are designed to identify workload based on the annual ITG Workplan data analysis. The ITG Workplan is based on market segments that were identified during the data analysis to be areas in need of assistance in complying with the Internal Revenue Code.

⁷ Inventory received from the OPR office may consist of any type of compliance work, including compliance checks, tip compliance reviews, and examinations.

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from the ITG office and when there is a change in leadership or key personnel in the tribe.

- An ITG office field group⁸ may initiate a compliance check when it identifies a need for one based on the manager's or a field specialist's knowledge of the tribe. The approval of the Director, ITG, is required only when certain time and cost thresholds will be exceeded.

For this audit, we concentrated our analysis on the primary method used by the OPR office to identify compliance check workload.

This review was performed at the ITG office National Headquarters in Washington, D.C., the ITG OPR office in Buffalo, New York, and the ITG field offices in Buffalo, New York; Fargo, North Dakota; Las Vegas, Nevada; Santa Ana, California; and San Bernadino, California, during the period January through June 2004. This audit was conducted in accordance with *Government Auditing Standards*. We reviewed the ITG office's computer data for compliance checks as of May 31, 2004, after learning of the redesign of the system of analysis that was effective in June 2003. We did not validate the accuracy or completeness of the ITG office's data for the redesigned analysis. Detailed information on our audit objective, scope, and methodology is presented in Appendix I. Major contributors to the report are listed in Appendix II.

Compliance Checks Were Assigned Based on Data Analyses but Resulted in Inconsistent Geographical Coverage

The process used by ITG office management to identify and assign entities in need of compliance checks relies on data analysis of various filing characteristics. Generally, this keeps ITG office group managers and specialists independent of the assignment process. It also provides a basis⁹ (based on the results of analyses of tax return and other information of a tribal entity) for the compliance

⁸ ITG office field groups are composed of a manager and field specialists who interact with tribes to perform outreach, education, and examination activities.

⁹ The basis could be the result of analysis of tax return and other information that falls outside of a normal predetermined range for an entity or an entity that did not file a tax return and should have.

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check and allows the ITG office group manager to provide the Indian Tribal governments assurance that the tribes are not being singled out for reasons other than those identified by the data analyses. We determined that compliance checks were assigned based on the results of the data analyses and workload needs according to the geographic locations or experience level of field specialists.

However, the process did not provide a similar balance of compliance check coverage across the geographical locations for which the ITG office field groups are responsible. For example, 1 field group has contacted 34 percent of the tribes and another group has contacted 80 percent of the tribes in their respective geographical locations. Because the process did not provide similar compliance check coverage, ITG office management may not fully achieve their goals of better understanding their customers and identifying appropriate remedies to compliance issues.

Compliance check assignments did not provide a similar balance of coverage among the five field groups

ITG office management's process for assigning compliance checks did not provide a similar balance of coverage among the Indian Tribal governments in the five ITG office field areas.¹⁰ As a result, compliance check coverage among all Indian Tribal governments varied significantly among the five ITG field offices. Therefore, ITG office management may not be identifying the overall emerging trends and compliance issues throughout the population of Indian Tribal governments.

We reviewed all 724 compliance check assignments recorded in the ITG office database from its inception through May 31, 2004, to determine if there was a similar distribution among the population of Federally recognized Indian tribes. We determined that significantly fewer tribes in one field area had compliance checks assigned to their related entities. We discussed the inconsistent geographical

¹⁰ A field area is a geographical territory, including two or more states, assigned to each ITG office field group. Generally, a field group will be responsible for serving the tribes located within its field area.

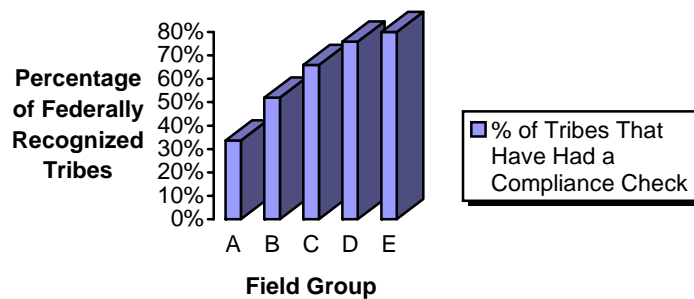
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distribution of compliance checks with ITG office management, and they stated that their data-driven assignment process is not intended to ensure similar coverage of the Federally recognized tribes. However, they acknowledged that some tribes had expressed that they were not getting the same attention that other tribes were.

Figure 1 shows the percentage of Federally recognized Indian tribes within each ITG office field group's area for which a compliance check of at least one tribal-related entity was conducted.¹¹

Figure 1

Distribution of Compliance Checks



Source: The ITG office database tables were used to identify the percentage of Federally recognized tribes that have had a compliance check completed by the field groups (Groups A through E) responsible for the geographical areas in which the tribes are located.

Although the OPR office analysis is the primary method used to identify work for the field groups, ITG office procedures and guidelines also permit the field area groups to initiate work that focuses on specific needs or trends discovered through personal contact, news media, or database analysis.

¹¹ Tribes with compliance checks of more than one tribal-related entity conducted were counted only once. One tribe had compliance checks of 24 entities conducted; however, most tribes had a compliance check of only 1 entity conducted.

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- Four group managers (Groups B, C, D, and E) relied on the OPR office analyst to select the type of workload assigned to their groups. This resulted in a significant percentage of compliance checks being assigned for tribes for which the groups were responsible (ranging from 52 to 80 percent of the tribes).
- The remaining group manager (Group A) primarily requested issue-specific cases and, therefore, has been assigned compliance checks for only 34 percent of the tribes in the group's geographical area. According to this manager, gaming issues (e.g., cash transaction reporting, employment taxes, and information reporting) are a higher priority because approximately one-half of the Indian tribal casinos in the United States are located in the group's field area. The manager stated that many of these tribes are very sophisticated, and the group manager preferred to make initial contact through outreach activities, rather than through compliance checks. Additionally, the tribal-related entities and other IRS business division employees often contact this group's specialists to resolve collection issues. As a result, most of this group's inventory consisted of outreach and tip compliance reviews.

When the ITG office was initially formed, outreach and education activities were the main focus of the ITG office as a means of introducing its services to customers. However, the ITG office now uses compliance checks to identify areas in which its customers may be having problems complying with the Internal Revenue Code (I.R.C.) and then performs outreach and education activities to correct the problems. The Group A field group manager still prefers to perform outreach and education during the initial visit to a tribe.

Although the identification process uses tax filing data to objectively rank tribal-related entities based on filing characteristics, actual assignment of compliance checks is often based on workload needs according to the geographic locations or experience level of field specialists in addition to overall filing characteristics among the population of tribal-related entities. For example, some group managers requested work for specific states or tribes to obtain work for field specialists in those locations. One group manager

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tended to request a type of work other than compliance checks. Although these factors had merit when considered individually for each case, when combined on a nationwide basis, these factors allowed ITG office field groups to have inconsistent compliance check coverage of the Indian Tribal governments for which they are responsible.

Compliance checks were assigned based on the results of the data analyses

The ITG office process for assigning compliance checks assured that tribal entities most in need of a compliance check were assigned first. For Tax Year 2001 returns, the ITG office primarily used two of the six formulas (Formulas A and B) to assign compliance checks. These two formulas¹² were used to select 232 of the 266 compliance check assignments for the period July 2003 through May 2004. We identified that, for Formulas A and B, compliance checks were assigned based on the results of the OPR office data analysis or some other predetermined criteria.

The purpose of our analysis was to determine whether the ITG office's actions ensured compliance checks were identified and assigned in a fair, equitable, and consistent manner. Tribal-related entities displaying the characteristics of needing a compliance check were given a lower data score (e.g., 0.00 would represent the greatest need for a compliance check), and the entities with less need for a compliance check were given a higher data score (e.g., 20.00 would generally represent much less of a need for a compliance check).

- **Formula A** was used by the ITG office to select 162 of the 266 compliance check assignments we reviewed. At the time of our review, the database contained a total

¹² We reviewed the 2 formulas used to select 232 of the 266 compliance checks during the period of our review. These formulas are designed to address noncompliance identified in the OPR office's annual data analysis. The remaining four formulas were not used as often and could not be trended.

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population of 1,805¹³ entities that met the criteria for a compliance check under Formula A.

- For the 162 entities assigned for compliance checks we reviewed, the data scores ranged from 0.00 to 3.83. Most (132) of the 162 entities had a data score of 0.00, the highest possible.
- The data score for 790 of the 1,805 entities was 0.00 (the total of 790 entities includes the 132 entities noted above). Some of the 790 entities (including the 132) were assigned for compliance checks or some other type of compliance work. However, 362 entities with the highest data score (0.00) were available to be, but were not, assigned for compliance checks.

¹³ All duplicate assignments and compliance checks involving I.R.C. Section 501(c)(3) cases were eliminated from the population.

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Figure 2: Formula A

Field Group	Number of Entities Assigned to the Group for Compliance Checks	Range of Data Scores of Compliance Checks Assigned by Group		Entities With a 0.00 Data Score That Were Not Assigned
		High Data Score	Low Data Score	
A	14	0.00	0.06	64
B	22	0.00	0.00	120
C	21	0.00	0.00	78
D	26	0.00	3.83 ¹⁴	73
E	79	0.00	3.33 ¹⁵	27
Totals:	162			362

Source: Treasury Inspector General for Tax Administration analysis of data from the ITG office database.

- **Formula B** was used by the ITG office to select 70 of the 266 compliance check assignments we reviewed. At the time of our review, the database contained a total population of 939 entities that met the criteria for a compliance check under Formula B.
 - For the 70 entities assigned for compliance checks we reviewed, the data scores ranged from 0.00 to 7.15. The range of data scores assigned to each field group varied widely. For example, in 1 group, the data scores ranged from 0.00 to 3.82. In another, they ranged from 0.01 to 7.15. Although the 70 compliance checks were generally assigned according to the data scores within each group, when considered nationwide, the assignment practices for Formula B did not meet the fairness goal for

¹⁴ Group D had 2 compliance check cases with a score greater than 0.00.

¹⁵ Group E had 27 compliance check cases with a score greater than 0.00. However, most of these assignments are from a market segment that the OPR office has identified as needing compliance checks.

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compliance checks. To achieve this goal, compliance checks should have been assigned within the same range of scores for each group.

- In addition, we determined that the ITG office database indicated 23 of the 939 entities had lower data scores (indicating greater need for a compliance check) than some of the 70 entities assigned to the field that we reviewed. Upon further review of manual files, ITG office management advised us that the 23 entities either had been previously assigned for a compliance check or there was a reason for not assigning them for a compliance check; however, the ITG office database did not contain a complete history on these entities to readily determine this.

In addition, the OPR has not determined the point at which compliance patterns diminish for each formula and how to compare the data scores of the various formulas to know which data scores and which formulas should take priority.

Ensuring Indian Tribal governments and their related entities comply with applicable tax laws and regulations is crucial for maintaining public confidence and fairness in tax administration. Lapses in compliance by ITG office customers, including reporting payments such as wages and gaming winnings and remitting and withholding Federal taxes, affect compliance for other IRS customers. By not assigning compliance checks on an equitable basis among the Federally recognized tribes, the ITG office may not be accurately identifying emerging filing and payment trends, resolving the most significant universe of compliance problems, or identifying appropriate remedies for emerging trends to meet its goal of reducing the need for future enforcement.

Recommendations

1. The Director, ITG, should provide guidance for field group managers to ensure an appropriate balance of work is requested to achieve the desired number of compliance checks and coverage for their assigned tribes.

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Management's Response: To ensure that tribes are not underserved and cases that should be worked are ordered, the ITG office has added new management reports that enable the ITG Director to ascertain the workload assignments of each group on an ongoing basis. The Director, ITG, will make directed assignments of work if an imbalance between groups is apparent.

2. The Director, ITG, should gather appropriate data to establish cutoff data scores for the different formulas used in the data analysis, to aid the OPR office analyst in determining when one formula should take priority over another.

Management's Response: ITG office management will be undertaking a detailed study to determine whether cutoff scores can be identified and will contrast compliance check results from each formula to determine where the optimal results are realized.

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Appendix I

Detailed Objective, Scope, and Methodology

The overall objective of this review was to determine whether the Indian Tribal Governments (ITG) office of the Tax Exempt and Government Entities Division has taken appropriate actions to identify and assign compliance checks to ensure they are conducted in a fair, equitable, and consistent manner. To accomplish this objective, we:

- I. Determined if ITG office management has developed an effective process to assess compliance patterns and to identify and prioritize the population of Indian Tribal governments¹ for compliance checks.
 - A. Interviewed the Director, ITG; the Outreach, Planning, and Review (OPR) office manager; and the five field group² managers to identify their processes for assessing compliance patterns and identifying and prioritizing the population of tribal-related entities³ for compliance checks.
 - B. Reviewed ITG office management's work plans, data assessments, written procedures, and other guidance for assessing compliance patterns and identifying and prioritizing the population of Indian Tribal governments for compliance checks.
 - C. Determined if ITG office management's use of data analyses resulted in the identification and prioritization of compliance patterns for all Federally recognized Indian Tribal governments.
 - D. Analyzed ITG office management's use of data analyses to assess Indian Tribal governments' need of assistance in complying with the Internal Revenue Code, and to identify and prioritize the population of Indian Tribal governments for compliance checks. We reviewed the 266 compliance check assignments made for the period July 2003⁴ through May 2004 for Tax Year 2001 returns.

¹ There are currently 564 Indian Tribal governments that are Federally recognized by the United States Bureau of Indian Affairs.

² Field groups are composed of a manager and field specialists who interact with tribes to perform outreach, education, and examination activities.

³ Tribal-related entities are businesses or enterprises owned and/or controlled by an Indian Tribal Government. These entities include casinos, restaurants, medical clinics, housing authorities, gas stations, and a variety of other industries.

⁴ The ITG office converted the compliance check assignment process from tribal governments to entities in June 2003. We began the period of our analysis in July 2003, to avoid single tribal government assignments that would be recorded in the database as multiple compliance checks of the tribal-related entities and to ensure the same tax data were being used for computations.

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1. Identified the 6 formulas and other criteria used to select the 266 compliance check assignments and analyzed data used to assess and rank the compliance patterns for the 2 formulas used to select 232 of the 266 compliance checks.⁵
 2. Determined if the OPR office assigned compliance checks to the ITG office field groups based on its assessment of compliance patterns.
- E. Compared the results of interviews with ITG office management, review of procedures and other guidance, and the Treasury Inspector General for Tax Administration (TIGTA) review of ITG office management's use of data analyses to determine if the assessment of compliance patterns was fair, equitable, and consistent.
- II. Determined if ITG office management has developed an effective process to assign compliance check workload to ensure fair, equitable, and consistent treatment of Indian Tribal governments.
- A. Interviewed the OPR office manager and the five field group managers and identified their processes for assigning compliance checks for Indian Tribal governments.
 - B. Reviewed OPR office procedures and other guidance for assigning compliance check workload for Indian Tribal governments.
 - C. Reviewed the field groups' procedures and other guidance for assigning compliance checks for Indian Tribal governments.
 - D. Analyzed the ITG office's process for assigning compliance checks for Indian Tribal governments. We reviewed all 724 compliance check case assignments recorded in the ITG office's database from its inception through May 31, 2004, and determined if there was a similar distribution among the population of Federally recognized Indian tribes.
 - E. Compared the results of interviews with ITG office management, review of procedures and other guidance, and the TIGTA analysis of ITG office management's assignment of workload to determine if the assignment process was fair, equitable, and consistent.

⁵ For the remaining 34 compliance check assignments we reviewed, no formula or criteria were used to select 21; other criteria were used to select 11; and the remaining 4 formulas were used to select 2 assignments.

**The Process for Assigning Cases Should Be Strengthened to Provide Better Coverage to
Indian Tribal Governments Most in Need of Compliance Checks**

Appendix II

Major Contributors to This Report

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Appendix III

Report Distribution List

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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
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SEP 22 2004

MEMORANDUM FOR ACTING DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: Steven T. Miller *STM/Sarah Hall*
Commissioner, Tax Exempt and Government Entities

SUBJECT: The Process for Assigning Cases Should Be Strengthened to Provide Better Coverage to Indian Tribal Governments Most in Need of Compliance Checks (Audit # 200410011)

I am pleased to respond to your report concerning our Compliance Check process. The review considered classification and assignment of Compliance Checks within our Indian Tribal Governments (ITG) function.

I am pleased that the audit confirmed that ITG's Compliance Checks were assigned based on the results of data analyses, and that our processes helped ensure fairness and consistency. In addition, the processes we use help to ensure the most important use of field resources. We agree, as well, that we can improve consistency of coverage across our field groups, and can improve the way we prioritize the various selection criteria.

RECOMMENDATION 1:

The Director, ITG, should provide guidance for field group managers to ensure an appropriate balance of work is requested to achieve the desired number of Compliance Checks and coverage for their assigned tribes.

CORRECTIVE ACTION 1:

The audit reflected that Compliance Check assignments did not provide a similar balance of coverage among the five field groups. In particular, one group did not order sufficient work to keep current with the accomplishments of the remaining groups. As a result, the tribes in that group were underserved, and cases that should have been worked were not ordered. To remedy that problem, ITG has added new management reports that enable the ITG Director to ascertain the workload assignments of each group on an ongoing basis. The ITG Director will make directed assignments of work if an imbalance between groups is apparent.

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2

IMPLEMENTATION DATE:

Completed

RESPONSIBLE OFFICIAL:

Director, Indian Tribal Governments, Tax Exempt and Government Entities

CORRECTIVE ACTION MONITORING PLAN:

These actions have been completed.

RECOMMENDATION 2:

The Director, ITG, should gather appropriate data to establish cutoff data scores for the different formulas used in the data analysis, to aid the OPR office analyst in determining when one formula should take priority over another.

CORRECTIVE ACTION 2:

While the establishment of cutoff scores has been an integral part of our strategy to assign the best work, until recently we lacked sufficient data to accurately perform such an analysis. We now have over 500 completed Compliance Checks, and will be undertaking a detailed study to determine if cutoff scores can be identified. In conjunction with that, we will also contrast the results achieved from each formula to determine where the optimal results are realized.

IMPLEMENTATION DATE:

January 15, 2005

RESPONSIBLE OFFICIAL:

Director, Indian Tribal Governments, Tax Exempt and Government Entities

CORRECTIVE ACTION MONITORING PLAN:

We will monitor this corrective action through the Business Performance Review (BPR) process of the Commissioner of Internal Revenue, and the Joint Audit Management Enterprise System (JAMES) of the Treasury Department.