



*A Corporate Approach Is Needed to
Provide for a More Effective Tax-Exempt
Fraud Program*

July 6, 2009

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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.

Redaction Legend:

1 = Tax Return/Return Information



TREASURY INSPECTOR GENERAL
FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

July 6, 2009

MEMORANDUM FOR COMMISSIONER, TAX EXEMPT AND GOVERNMENT ENTITIES
DIVISION

Michael R. Phillips

FROM:

Michael R. Phillips
Deputy Inspector General for Audit

SUBJECT:

Final Audit Report – A Corporate Approach Is Needed to Provide for a
More Effective Tax-Exempt Fraud Program (Audit # 200810024)

This report presents the results of our review of the Tax Exempt and Government Entities (TE/GE) Division's Fraud Program. The overall objectives of this review were to determine whether emphasis placed on detecting fraud by TE/GE Division management resulted in a more effective program to identify criminal and civil fraud issues in the tax-exempt sector and to follow up on recommendations from prior Treasury Inspector General for Tax Administration audits¹ of the TE/GE Division's fraud program. In addition, we determined the number of civil fraud assessments and criminal fraud referrals made by the TE/GE Division. This review was conducted as part of the Treasury Inspector General for Tax Administration Office of Audit Fiscal Year 2008 Annual Audit Plan related to the major management challenge of Tax Compliance Initiatives.

Impact on the Taxpayer

In response to our prior reports, each of the TE/GE Division offices implemented changes to their fraud programs, and we found that identifying potential fraudulent activity is included in the work routine of some offices. This approach has resulted in significantly more fraud development cases,² of which most were from one office. However, a more corporate approach

¹ *The Tax Exempt and Government Entities Division Should Pursue Additional Methods to Identify Potential Fraudulent Activities* (Reference Number 2003-10-217, dated September 29, 2003) and *The Tax Exempt and Government Entities Division Is Making Progress to Detect and Deter Fraud Within Its Customer Base, but the Impact Cannot Be Determined at This Time* (Reference Number 2005-10-161, dated September 30, 2005).

² Cases become known as fraud development cases when the examiner, TE/GE Division management, and the Small Business/Self-Employed Division Fraud Office agree that potential fraud exists.



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with centralized oversight is needed to provide for a more effective TE/GE Division fraud program. We believe an effective fraud program will provide greater assurance that the trust placed in the tax-exempt sector by taxpayers and the good work done by most tax-exempt organizations are not tarnished.

Synopsis

In response to our prior reports, each of the five TE/GE Division offices implemented changes to their fraud programs. This approach has resulted in more fraud development cases, application of potential penalties, and further development of cases for criminal prosecution. When we first reviewed the TE/GE Division fraud program, we determined that 11 cases had been referred for possible criminal prosecution during Fiscal Years 2000 through 2002. For Fiscal Years 2006 through 2008, the Small Business/Self-Employed Division Fraud Office approved 48 TE/GE Division cases for fraud development. Of the 48 cases, 32 potentially represent approximately \$37 million of additional revenue which may be forthcoming. The TE/GE Division also assessed \$10 million³ in civil penalties and other related assessments on 4 cases.⁴ In addition, all offices have taken actions to emphasize fraud by providing fraud awareness training to employees, providing resources to assist in detecting fraudulent activity, and obtaining feedback on fraud referrals.

However, we believe that a corporate approach with centralized oversight is needed. The five TE/GE Division offices are at different maturity points in their capabilities to evaluate, address, and monitor the risk of fraud occurring within their respective customer base. We identified the following control gaps in the fraud program.

- Throughout the TE/GE Division, key fraud controls, such as tracking/monitoring fraud development cases and fraud referrals, emphasizing fraud in strategic planning documents, and coordinating with the Criminal Investigation Division to prioritize and improve fraud detection and referral, were implemented in some offices but not implemented in others. This resulted in gaps in controls intended to ensure that fraud is detected and deterred.
- One TE/GE Division office refers information items⁵ to other Internal Revenue Service (IRS) divisions without further development of potential fraud issues, as required by IRS guidelines. This office has encountered potential fraud perpetrated by customers of other IRS divisions (third parties who are outside the jurisdiction of this particular TE/GE

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⁴ See Appendix IV for additional details.

⁵ Information items are referrals of information from one office to another office within the Internal Revenue Service or from outside sources.



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Division office). In Fiscal Year 2005, the Director of this TE/GE Division office issued instructions that examiners should consult their manager to determine if the fraud coordinator and the Small Business/Self-Employed Division fraud technical advisors should be contacted to determine whether to continue development of the fraud issues. When the Small Business/Self-Employed Division Fraud Office agrees that fraud should be developed, it assists in obtaining cooperation with the IRS division that has jurisdiction over the IRS customer committing the fraud. Both offices should then work together to develop their part of the fraud case. However, these guidelines were not being followed.

In addition, this office does not know what happens to the potential fraud issues referred in information items because there is no system in place to track the issues or ensure that any followup occurred. However, if resources are not available in other IRS divisions because of workload priorities, the potential fraud may never be addressed and TE/GE Division management in this office may never know whether customers of other IRS divisions perpetrate fraud on TE/GE Division entities.

The former Commissioner, TE/GE Division, issued a memorandum during our audit (July 2008) that emphasized the importance of identifying and developing fraud cases and also appointed a Division fraud specialist and directed all employees to contact the specialist for assistance in fraud investigations. This is a step in bringing additional consistency to the TE/GE Division fraud program and creating a culture from the top of the Division down that fraud will be identified and pursued in the tax-exempt sector. However, a more corporate approach with centralized oversight is needed to provide for a more effective TE/GE Division fraud program. Unless centralized executive direction and oversight is applied, the fraud program may continue to have critical issues that, if not sufficiently addressed, will prevent the Division from successfully managing fraud risk. This approach will also help ensure that the trust placed in the tax-exempt sector and the good work done by most tax-exempt organizations are not tarnished.

Recommendations

To provide for a more effective TE/GE Division fraud program, we recommended the Commissioner, TE/GE Division, 1) develop and implement a corporate fraud approach for the TE/GE Division, and 2) ensure that all TE/GE Division offices follow IRS procedures and contact the Small Business/Self-Employed Division Fraud Office to determine whether cases with affirmative indications of fraud should be pursued as fraud development cases.

Response

IRS management agreed with our recommendations and provided planned actions to address them. These actions include developing and implementing a corporate fraud approach for the



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TE/GE Division and ensuring that all TE/GE Division offices follow IRS procedures and contact the Small Business/Self-Employed Division Fraud Office when appropriate. Management's complete response to the draft report is included as Appendix VI.

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



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Abbreviations

CI	Criminal Investigation
IRS	Internal Revenue Service
SB/SE	Small Business/Self-Employed
TE/GE	Tax Exempt and Government Entities
TIGTA	Treasury Inspector General for Tax Administration



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Background

The Internal Revenue Service (IRS) Tax Exempt and Government Entities (TE/GE) Division has five offices¹ that serve five different types of tax-exempt customers. Approximately 3 million entities make up this sector, and these entities control more than \$13 trillion in assets. Although generally not subject to Federal income tax, the tax-exempt sector pays more than \$270 billion annually in employment tax and employee income tax withholding.

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Tax fraud is a deliberate, willful violation of Internal Revenue laws and involves obtaining something of value through deceit. In June 2007, the former acting IRS Commissioner stated that while tax-exempt entities provide important services to American citizens, a number of factors in the sector have contributed to a culture that has become more casual about compliance and less resistant to noncompliance. However, TE/GE Division management has been aware that potential fraud occurred in the tax-exempt sector since at least Fiscal Year 2000 and has identified some tax-exempt organizations that were involved with potential fraudulent activities such as hiding and moving funds to other groups and individuals.

Several factors have made it easier for tax-exempt entities to be involved in abusive or fraudulent activities and have made it more difficult for TE/GE Division management to identify and quantify the amount of fraud that exists.

- Some tax-exempt entities have not established independent, empowered, and active boards of directors to ensure that tax-exempt organizations serve public purposes and do not misuse or squander the resources and their trust.
- Tax-exempt entities are not required to file income tax returns (they generally file information returns on their tax-exempt activities).
- Tax-exempt entities can be used by individuals, who are customers of other IRS divisions (third parties), to perpetrate fraud. The organizational structure of the IRS often prevents TE/GE Division employees from performing examinations of customers of other IRS divisions.

¹ These include the Exempt Organizations and Employee Plans functions; and the Federal, State, and Local Governments, Indian Tribal Governments, and Tax Exempt Bonds offices within the Government Entities function.



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In October 2000, the IRS reorganized into four divisions² and delegated each division responsibility for developing procedures and establishing priorities for serving its customers. While this new organizational structure enabled each division to establish end-to-end accountability for its respective customer base, it resulted in a fragmented approach to the accomplishment of IRS-wide programs, such as the National Fraud Program. This weakness created an opportunity for fraud and, at the same time, made it more difficult for the IRS to identify and address fraud issues.

In June 2007, the former acting Commissioner also stated weak governance³ practices in the tax-exempt sector and the need for an even stronger enforcement presence by the TE/GE Division continued to provide opportunities for tax-exempt customers to remain involved with abusive or questionable transactions and for tax-exempt entities to be used by third parties to accommodate abuse. Allowing fraud and abusive activities to exist in the tax-exempt sector violates not only the law and tax regulations, it also violates the trust that citizens have in the large majority of charities, foundations, and other groups that do good work in the United States. Accordingly, since Fiscal Year 2005, TE/GE Division management has increased their enforcement efforts.

The IRS National Fraud Program is established within the Small Business/Self-Employed (SB/SE) Division and is responsible for coordinating the establishment of IRS-wide fraud strategies, policies, and procedures to enhance enforcement of the tax law. It also provides Fraud Referral Program coordination for all IRS divisions to identify and develop fraud cases and to reduce the amount of time spent on the cases. The IRS has documented that identifying and developing potential fraud is a priority that should be considered in all examinations.

TE/GE Division management's fraud efforts are conducted as part of the National Fraud Program. If indications of fraud are identified by TE/GE Division employees, the SB/SE Division Fraud Office provides guidance during development of the fraud case. When the SB/SE Division Fraud Office is satisfied that TE/GE Division employees have gathered enough evidence, the case is referred to the Criminal Investigation (CI) Division for consideration for criminal prosecution.

The Treasury Inspector General for Tax Administration (TIGTA) has conducted one audit of the IRS-wide National Fraud Program.⁴ We recently reported that the SB/SE Division emphasized

² The structure of the IRS was modified to eliminate geographical organizations and reorganized into divisions serving groups of taxpayers. The IRS' four divisions include the TE/GE, the Large and Mid-Size Business, the Wage and Investment, and the Small Business/Self-Employed Divisions.

³ Governance is defined as the establishment of policies, and continuous monitoring of their proper implementation, by members of the governing body of an organization. It includes mechanisms required to balance the powers of the members (with the associated accountability) and their primary duty of enhancing the prosperity and viability of the organization.

⁴ *Management Has Emphasized the Fraud Program, but Opportunities Exist to Further Improve It* (Reference Number 2007-30-179, dated September 18, 2007).



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the National Fraud Program, but a review of examination cases showed that examiners did not always adequately identify fraud indicators, fully develop fraud issues, contact a fraud technical advisor⁵ when appropriate, or timely discuss substantial understatement of income with the group manager. As a result of not properly identifying or fully developing potential fraud issues, the IRS may not deter noncompliance and could fail to collect revenue in the form of income tax and could fail to assess civil and criminal penalties. In addition, if the IRS does not address tax fraud among those who generally do not comply, voluntary tax compliance may decrease among those taxpayers who generally do comply.

The TIGTA also conducted two prior audits of the TE/GE Division fraud program. In Fiscal Year 2003,⁶ we reported that the TE/GE Division started taking steps to improve its fraud program and generally implemented the guidelines for the National Fraud Program with the exception of one function which coordinated the development of fraud issues directly with the CI Division. The TIGTA also identified that the TE/GE Division was not giving information items⁷ with the potential of fraud priority treatment and that abusive schemes were not being considered for criminal fraud potential. In Fiscal Year 2005,⁸ the TIGTA reported that each TE/GE Division office had individually taken steps to improve its respective fraud program, but we could not determine the impact of those improvements because they were recent or still in the process of being implemented.

The current audit of the TE/GE Division fraud program was conducted while the Division was developing and implementing its Fiscal Year 2009 work plans. As a result, this report might not reflect the most current status of the IRS' efforts to identify and address fraud within the tax-exempt sector.

This review was performed at the TE/GE Division Headquarters and the SB/SE Division Fraud Office in Washington, D.C.; the Exempt Organizations field office in Chicago, Illinois; the Employee Plans field office in Atlanta, Georgia; the Indian Tribal Governments field office in Buffalo, New York; the Federal, State, and Local Governments Compliance and Program Management Office in Austin, Texas; and the Tax Exempt Bonds field office in Denver, Colorado, during the period February 2008 through April 2009. We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to

⁵ Fraud technical advisors are employed in the SB/SE Division and are available to assist in fraud investigations and offer advice on matters concerning tax fraud to all IRS employees.

⁶ *The Tax Exempt and Government Entities Division Should Pursue Additional Methods to Identify Potential Fraudulent Activities* (Reference Number 2003-10-217, dated September 29, 2003).

⁷ Information items are referrals of information from one office to another office within the IRS or from outside sources.

⁸ *The Tax Exempt and Government Entities Division Is Making Progress to Detect and Deter Fraud Within Its Customer Base, but the Impact Cannot Be Determined at This Time* (Reference Number 2005-10-161, dated September 30, 2005).



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provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. Detailed information on our audit objectives, scope, and methodology is presented in Appendix I. Major contributors to the report are listed in Appendix II.



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Results of Review

Fraud Development Cases Have Increased, but the Tax-Exempt Fraud Program Could Be More Effective if Fully Implemented in All Offices

In response to our prior reports, each of the five TE/GE Division offices implemented changes to their fraud programs. This approach has resulted in more fraud development cases, application of potential penalties, and further development of cases for criminal prosecution. When we first reviewed the TE/GE Division fraud program, we determined that 11 cases had been referred to the CI Division, and 4 were accepted for possible criminal prosecution during Fiscal Years 2000 through 2002. For Fiscal Years 2006 through 2008, the SB/SE Division Fraud Office approved 48 TE/GE Division cases for fraud development.⁹ Of the 48 cases, 32 potentially represent approximately \$37 million of additional revenue which may be forthcoming. The TE/GE Division also assessed \$10 million¹⁰ in civil penalties and other related assessments on 4 cases.¹¹ In addition, all offices have taken action to emphasize fraud by providing fraud awareness training to employees, providing resources to assist in detecting fraudulent activity, and obtaining feedback on fraud referrals.

However, a more corporate approach with centralized oversight is needed to provide for a more effective TE/GE Division fraud program. The five TE/GE Division offices are at different maturity points in their capability to evaluate, address, and monitor the risk of fraud occurring within their respective customer base. In addition, unless centralized executive direction and oversight is applied, the Division's fraud program may continue to have critical issues that, if not sufficiently addressed, will prevent the Division from successfully managing fraud risk. The Commissioner, TE/GE Division, and the executive team need to take action to determine the emphasis that should be placed on fraud throughout all offices within the TE/GE Division to foster voluntary compliance and ensure tax-exempt sector fraud cases are adequately considered for potential penalties or criminal prosecution. This will help ensure that the trust placed in the tax-exempt sector and the good work done by most tax-exempt organizations are not tarnished.

Although the number of fraud development cases and fraud referrals have significantly increased since we first reviewed the TE/GE Division fraud program, the increase is due to one office placing substantial emphasis on fraud and implementing most of our prior recommendations.

⁹ Cases become known as fraud development cases when the examiner, TE/GE Division management, and the SB/SE Division Fraud Office agree that potential fraud exists.

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¹¹ See Appendix IV for additional details.



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We based our conclusion on the need for a more corporate approach with centralized oversight in the TE/GE Division fraud program on the following:

- Throughout the TE/GE Division, key fraud controls, such as tracking/monitoring fraud development cases and fraud referrals, emphasizing fraud detection and referral in strategic planning documents, and coordinating with the CI Division to prioritize and improve fraud detection and referral, were implemented in some offices but not implemented in others. This resulted in gaps in controls intended to ensure that fraud is detected and deterred in all offices.
- In one of five offices, information items with fraud potential are not discussed with its fraud coordinator or with the SB/SE Division fraud technical advisor, are not tracked, and no assurance is provided that they are addressed by other IRS divisions. Information items are prepared when employees identify suspicious and possibly inappropriate activity by taxpayers who are customers of other IRS divisions. This represents a gap in controls because TE/GE Division employees do not have jurisdiction over customers of other IRS divisions and cannot continue the fraud research or fully develop the potential fraud issue. However, if resources in the other divisions are not available because of workload priorities, the potential fraud may never be addressed and TE/GE Division management in this office may never know whether customers of other IRS divisions perpetrate fraud using TE/GE Division entities.

During the audit, we discussed our overall observations about the TE/GE Division fraud program with the former Commissioner, TE/GE Division. He stated that the decision to allow the five offices to design and implement their own fraud programs was due to the fact that he believed management of the five offices better understood their respective technical issues and would have the best ideas for implementing the fraud program for their specific customers. Taking this approach has merit because of the complexities in the five TE/GE Division offices with their distinct and unique customer bases (e.g., small volunteer community organizations, hospitals, churches, sovereign Indian tribes with large casinos, large pension funds, and Federal, State, and Local Government entities).

The former Commissioner also stated that he preferred letting each office implement its own fraud programs and determine what works and does not work before trying to standardize processes across the TE/GE Division. However, during our audit, the former Commissioner, TE/GE Division, issued a memorandum (July 2008) to all Division employees that emphasized the importance of identifying and developing fraud cases to foster confidence in the tax system and compliance with the law. The former Commissioner also appointed a Division fraud specialist and directed all employees to contact the specialist for assistance in fraud investigations. Although no other responsibilities were noted in the memorandum, this is a step in bringing additional consistency to the TE/GE Division fraud program and in creating a culture from the top of the Division down that fraud will be identified and pursued in the tax-exempt sector.



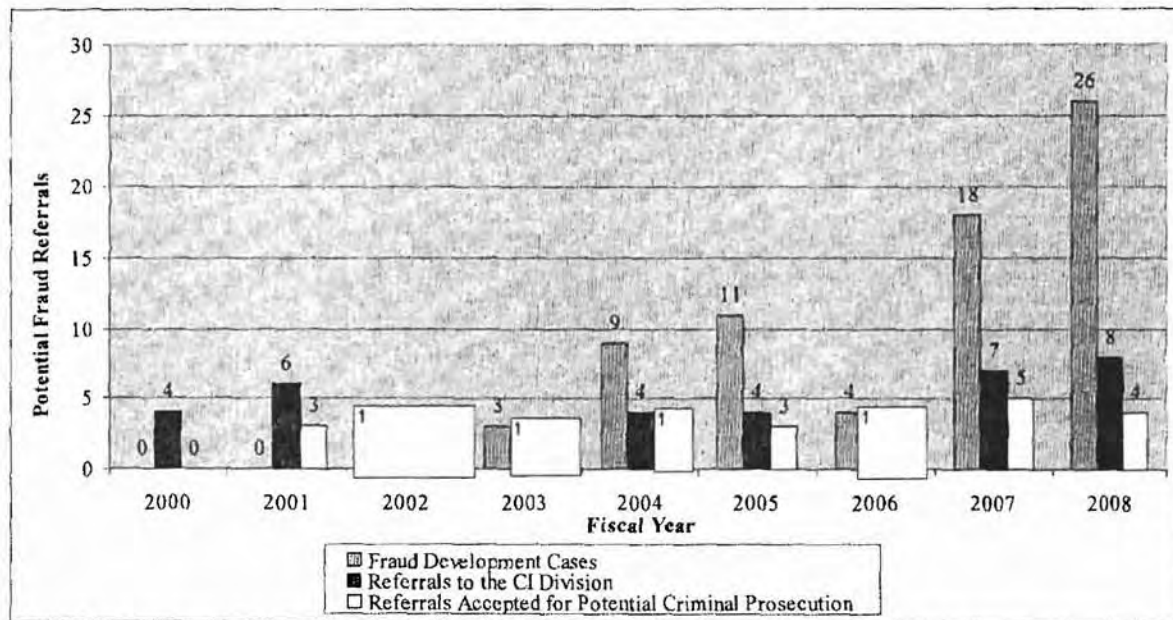
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The following provides additional details and observations on the growth of the TE/GE Division fraud program since our first audit.

The number of fraud development cases and fraud referrals has increased

The number of TE/GE Division cases approved for fraud development by the SB/SE Division Fraud Office and referred to the CI Division for potential prosecution has increased since Fiscal Year 2000. Figure 1 shows the total number of TE/GE Division cases accepted for fraud development under the IRS' National Fraud Program and referred to and accepted by the CI Division for further development and potential criminal prosecution.

Figure 1: Total Number of Fraud Development Cases, Referrals to the Criminal Investigation Division, and Referrals Accepted for Potential Criminal Prosecution (Fiscal Years 2000 through 2008)



Source: The number of fraud development cases was not available for Fiscal Years 2000 and 2001. Fraud development cases for Fiscal Years 2002 through 2008 were compiled from analysis of the SB/SE Division's National Fraud Database. Fraud referrals and referrals accepted by the CI Division for Fiscal Years 2000 through 2008 were provided by CI Division management. There was no independent source of data to validate referrals for Fiscal Years 2000 through 2005. Referrals from Fiscal Years 2006 through 2008 were reconciled with information provided by TE/GE Division management to validate their accuracy.

For Fiscal Years 2006 through 2008, the SB/SE Division Fraud Office approved 48 TE/GE Division cases for fraud development. Of the 48 cases, 32 (71 taxpayer accounts) potentially



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represent approximately \$37 million¹² of additional revenue which may be forthcoming. The status¹³ of the 48 cases as of September 30, 2008, is as follows:

- 17 of 48 cases were referred to the CI Division for further development and potential criminal prosecution.
 - 10¹⁴ of 17 cases were accepted by the CI Division for potential criminal prosecution and assessment of \$11 million.
 - 6 of 17 cases were declined by the CI Division for further development.
- 9 of 48 cases were closed prior to referral to the CI Division.
- 22 of 48 cases include indications of potential fraud that are being developed by the TE/GE Division and SB/SE Division Fraud Office with potential assessments of \$26 million.

In addition, the TE/GE Division assessed an additional \$10 million¹⁵ in civil penalties and other related assessments on 4 cases.¹⁶

This represents a substantial increase from Fiscal Years 2000 through 2002 when we first reviewed the TE/GE Division fraud program. For that time period, 11 referrals were forwarded to the CI Division and 4 were accepted for development and potential prosecution.

We attributed the increase in the number of fraud development cases and fraud referrals to improvements in the TE/GE Division fraud program. Specifically, we observed the one office that placed a substantial amount of emphasis on its fraud program and implemented the majority of our previous recommendations achieved the most success in terms of fraud development cases and fraud referrals. This is one of the largest offices in the TE/GE Division and is responsible for most of the recommended revenue assessments. Two other offices had success in terms of fraud development cases and fraud referrals but did not identify as many cases. Figure 2 shows

¹² See Appendix IV for additional details.

¹³ This status represents only the 48 cases identified from SB/SE Division Fraud Office data that were approved for fraud development from Fiscal Years 2006 through 2008 and does not take into consideration cases that may have already been in process from prior years. Therefore, the numbers discussed in this status will not always agree with Figure 1

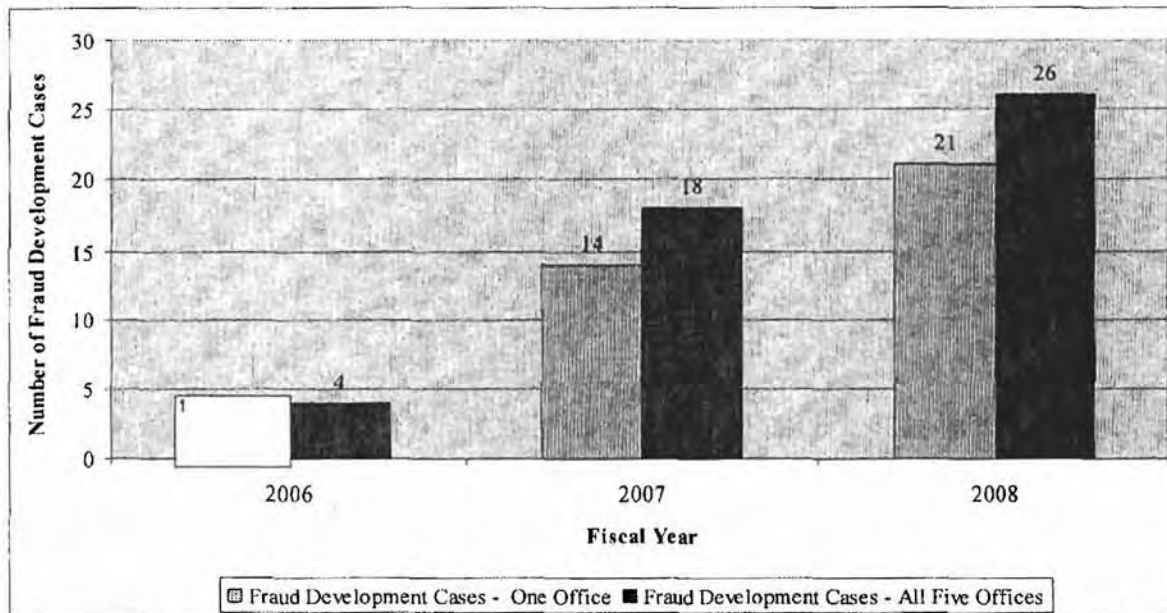
¹⁶ See Appendix IV for additional details.



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the increase in the number of fraud development cases for Fiscal Years 2006 through 2008 from one office compared to the five offices in the entire TE/GE Division.

Figure 2: Comparison of Fraud Development Cases in One Office to All Fraud Development Cases in the TE/GE Division (Fiscal Years 2006 through 2008)



Source: Fraud development case information for Fiscal Years 2006 through 2008 was compiled from analysis of the SB/SE Division National Fraud Database. This information was compared to information provided by TE/GE Division management to validate its accuracy.

More importantly, the increase in fraud development cases and fraud referrals may be attributed to TE/GE Division management learning more about where fraud vulnerabilities exist in the tax-exempt sector. They focused on identifying how third parties perpetuate fraudulent acts by using tax-exempt entities to conceal taxable income or steal cash or property for personal gain.

Enforcement actions were taken to ensure compliance

Employees in four of five TE/GE Division offices¹⁷ know the appropriate steps to take when indications of fraud are identified. Our review of documentation from 25 cases¹⁸ identified that examiners documented potential fraudulent activity including omission of income, claiming false expenses and/or deductions, filing altered and/or false documents, evading payment, or misusing

¹⁷ In one office, there were no examination cases containing fraud indicators for review.

¹⁸ The 25 cases reviewed were either provided by TE/GE Division management or selected by TIGTA auditors from case inventories to determine if appropriate actions were taken after identifying indications of fraud.



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the tax-exempt organization status; and coordinated with SB/SE Division fraud technical advisors, CI Division management, or their respective fraud coordinators.¹⁹

Several TE/GE Division fraud coordinators also informed us that they now receive more questions regarding fraud issues and/or requests for assistance to develop fraud cases. For example, one fraud coordinator received telephone calls from employees daily; whereas, fraud coordinators in other offices received telephone calls much less frequently. This indicates that identifying potential fraudulent activity is included in the work routine of some of the TE/GE Division offices.

Enforcement activities outside the IRS National Fraud Program are also conducted in most TE/GE Division offices and have the effect of reducing fraud that may occur in the tax-exempt sector.

- One office works with other Federal Government agencies, such as the Federal Bureau of Investigation and the Financial Crimes Enforcement Network, to address criminal activity within the tax-exempt sector.
- Another office uses civil penalties to enforce the Internal Revenue Code and provide a deterrent against abusive and fraudulent transactions. From Fiscal Years 2006 through 2008, 19 entities were assessed more than \$50 million in civil penalties, of which more than \$44 million has been collected. This approach is taken to encourage voluntary compliance while providing a deterrent against abusive and fraudulent transactions and because of the difficulty of prosecuting cases before juries that may not understand the complex legal issues.
- Several offices referred practitioners such as lawyers and accountants to the IRS Office of Professional Responsibility to prevent them from practicing before the IRS when evidence of significant inappropriate activity was identified. We could not determine the total number of practitioners referred to the Office of Professional Responsibility by the TE/GE Division.

The TE/GE Division fraud program could be more effective with consistent implementation of key controls

The TE/GE fraud program is not as effective as it could be due to insufficient implementation of key fraud controls. To reach this conclusion, we assessed actions that TE/GE Division management has taken to 1) implement prior TIGTA recommendations, 2) emphasize the importance of fraud detection and deterrence to employees and customers, and 3) coordinate with other IRS divisions and fraud groups in developing and working fraud development cases

¹⁹ Fraud coordinators are employed in all five TE/GE Division offices. Their responsibilities include assisting in the development of fraud referrals and providing case coordination with the SB/SE Division Fraud Office and the CI Division.



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and fraud referrals. Figure 3 defines the colors (red, yellow, and green) we used in Figure 4 in our assessment of TE/GE Division fraud controls. See Appendix V for additional details on the assessments we made for each key fraud program control.

Figure 3: Definition of Colors

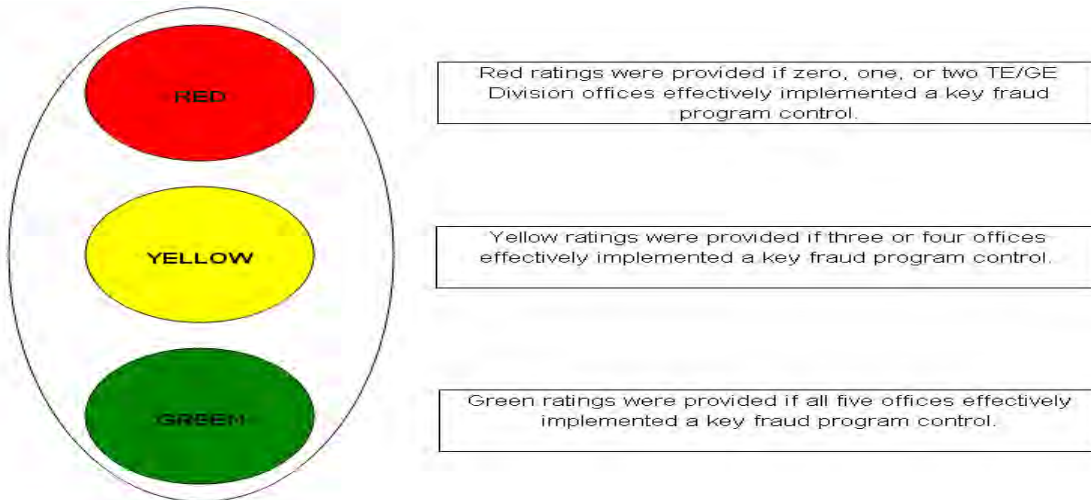


Figure 4: TIGTA Assessment of Key Fraud Program Controls in the TE/GE Division

	Status		
	Red	Yellow	Green
Key Fraud Program Controls			
Implementing Prior TIGTA Recommendations			
Performing Assessments to Identify Areas Vulnerable to Fraud		Yellow	
Providing Fraud Awareness Training to Employees			Green
Alerting Customers of Potential Fraud Scenarios		Yellow	
Enhancing Inventory Systems to Track and Monitor Potential Fraud Development Cases and Referrals		Yellow	
Providing In-Depth Training to TE/GE Division Fraud Coordinators		Yellow	



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	Status		
	Red	Yellow	Green
Key Fraud Program Controls			
Establishing a Process to Evaluate Internal/External Allegations of Fraud			Green
Coordinating With the CI Division to Prioritize Fraud Issues	Red		
Emphasizing the Importance of Fraud to Employees			
Emphasizing Fraud in Strategic Documents (e.g., Strategic Plans, Annual Examination Letters, or Annual Work Plans)		Yellow	
Emphasizing Fraud Scenarios That Were Identified and the Tools and Techniques for Employees to Use to Identify Fraud	Red		
Maintaining an Up-To-Date Fraud Handbook		Yellow	
Providing Staffing to Assist in Detecting Fraudulent Activities			Green
Providing Fraud Coordinators to Assist and Help TE/GE Division Employees Develop Referrals		Yellow	
Coordinating With Other IRS Divisions and Fraud Groups			
Communicating With the CI Division to Improve the Identification, Development, and Referral of Potential Fraud Issues		Yellow	
Coordinating With the SB/SE Division Fraud Office	Red		
Receiving Feedback on Fraud Referrals			Green

Source: Discussions with TE/GE and SB/SE Divisions management and review of strategic documents.

The Commissioner, TE/GE Division, did not ensure that the above controls were implemented in all TE/GE Division offices. As a result, the culture created by executive management in the Division and within all of the five offices did not sufficiently reinforce the importance of identifying fraud within the tax-exempt sector. For example, one office, for the most part, did not implement several of our recommendations for an effective fraud program because of the belief that its customers were victims, not perpetrators, of fraud. In addition, this office did not continue development of fraud issues when they were identified because it had no jurisdiction over the IRS customers that potentially committed criminal acts against TE/GE Division



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customers. Because of this belief, management had not emphasized fraud and had not taken steps similar to those taken by other offices within the TE/GE Division to alert their customers of outside attempts to commit fraud. As a result, fraud could be occurring undetected, and it may be allowed to continue.

The TE/GE Division could more effectively manage referrals of third-party information items

In addition to making improvements to its overall fraud program, the TE/GE Division can make improvements to how it manages the referral of individuals who potentially misuse tax-exempt entities to perpetuate fraud such as evading taxes, claiming false deductions, or omitting income. These individuals generally have a relationship with the tax-exempt entity but are not customers of the TE/GE Division. In these situations, fraud can occur and go undetected because TE/GE Division examiners do not have jurisdiction over or access to third-party bank records and other financial information.

When TE/GE Division management identifies customers of other IRS divisions involved in potential criminal acts related to tax-exempt entities, one of two actions are generally taken to resolve the issue:

- TE/GE Division management may refer information items to other IRS divisions; however, no further action may be taken to resolve the questioned issues. Other IRS divisions may assign the information items into their examination workload, but at other times may not have the resources to expend examining the information items because of workload priorities. Therefore, taking this course of action may not resolve the potential fraud issue.
- TE/GE Division management may contact an SB/SE Division fraud technical advisor and if together they determine that the information item should be further pursued as fraud, SB/SE Division assistance will be provided to obtain cooperation with the IRS division that has jurisdiction over the customer committing fraud. Both offices should then work together to develop their part of the fraud case. SB/SE Division Fraud Office management stated that this is the course of action that should be taken to ensure third-party issues are resolved.

One TE/GE Division office refers information items with potential fraudulent issues to other IRS divisions and does not contact its own fraud coordinator or SB/SE Division fraud technical advisors because of the belief that its customers were victims of fraud rather than perpetrators. During the audit, we reviewed several cases where examiners identified indications of fraud perpetrated by third-party customers of another IRS division that potentially affected a tax-exempt entity. The information items were referred to the IRS division with jurisdiction for the third-party accounts, but the TE/GE Division office did not know what happened to the cases after the information items left their office because there was no system in place to track the



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cases or ensure that any follow up occurred. After we brought the information items to their attention, TE/GE Division management stated they should have taken additional actions, such as contacting the SB/SE Division fraud technical advisor to ensure that the potential fraud issue was properly addressed. In addition, in Fiscal Year 2005, the Director of this TE/GE Division office issued instructions that examiners should consult their manager to determine if the fraud coordinator and the SB/SE Division fraud technical advisors should be contacted to determine whether to continue development of the fraud issues. However, these guidelines were not being followed.

When examiners identify indications that third parties have perpetuated fraud on tax-exempt entities and information items are forwarded to other divisions, TE/GE Division management has no control over whether the information items will be examined for potential fraud. If the information items are not examined and fraud is actually occurring, the fraud may continue and will not be addressed through civil penalties or criminal prosecution because TE/GE Division management does not have the authority to examine customers of other IRS divisions. When this occurs, it may result in lost revenue to the Federal Government because the third parties will continue to avoid paying tax and, more importantly, the fraud will continue to exist. This condition can occur in all five TE/GE Division offices and is important because most fraud issues identified within the TE/GE Division are perpetrated by customers of other IRS divisions, yet TE/GE Division management has no assurance that the potential fraud will be addressed.

A corporate approach is needed to manage fraud risk

The challenge for the Commissioner, TE/GE Division, is to determine how best to ensure that a consistent and effective fraud program is implemented in all of the TE/GE Division offices, while still allowing each of the five offices to manage the technical aspects of their individual programs. Because management within the five TE/GE Division offices has determined individually how to implement a fraud program within their offices, some offices are left without processes and procedures to prevent and detect fraud, and at least one office is struggling to understand how fraud risk management fits into its daily operations. A more corporate approach with centralized oversight is needed to provide for a more effective TE/GE Division fraud program. Unless centralized executive direction and oversight is applied, the TE/GE Division's fraud program may continue to have critical issues that, if not sufficiently addressed, will prevent the TE/GE Division from successfully managing fraud risk. A more effective fraud program will provide assurance that the trust placed in the tax-exempt sector by taxpayers and the good work done by most tax-exempt organizations are not tarnished.



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Recommendations

To provide for a more effective TE/GE Division fraud program, the Commissioner, TE/GE Division, should:

Recommendation 1: Develop and implement a corporate fraud approach with centralized oversight for the TE/GE Division. This approach should include implementing key controls to identify and address fraud in the tax-exempt sector and implementation of corrective actions to previously agreed to TIGTA recommendations.

Management's Response: IRS management agreed with this recommendation. The TE/GE Division Compliance Issues Counsel, now vested with centralized oversight, will develop and implement a corporate fraud approach for the TE/GE Division. This will include implementing key controls, where they do not already exist, to identify and address fraud in the tax-exempt sector and implementing corrective actions to previously agreed TIGTA recommendations pertaining to fraud.

Recommendation 2: Ensure that all TE/GE Division offices follow IRS procedures and contact the SB/SE Division Fraud Office to determine whether cases with affirmative indications of fraud should be pursued as fraud development cases.

Management's Response: IRS management agreed with this recommendation. The TE/GE Division Compliance Issues Counsel will ensure, to the extent they may not already be doing so, that all TE/GE Division offices follow relevant IRS procedures and contact the SB/SE Division Fraud Office to determine whether affirmative indications of fraud should be pursued as fraud development cases.



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Appendix I

Detailed Objectives, Scope, and Methodology

The overall objectives of this review were to determine whether emphasis placed on detecting fraud by TE/GE Division management resulted in a more effective program to identify criminal and civil fraud issues in the tax-exempt sector and follow up on recommendations from prior TIGTA audits of the TE/GE Division's fraud program. In addition, we determined the number of civil fraud assessments and criminal fraud referrals made by the TE/GE Division. To accomplish these objectives, we:

- I. Evaluated the emphasis¹ the TE/GE Division placed on improving its fraud program.
 - A. Followed up on recommendations in all five TE/GE Division offices from the Fiscal Years 2003 and 2005 TIGTA audit reports² involving the TE/GE Division fraud program and determined whether corrective actions were implemented.
 - B. Determined whether TE/GE Division management (Division level and all five offices) emphasized the importance of identifying and referring potential criminal and civil fraud issues and provided the tools and resources necessary to improve the effectiveness of its fraud program.
 - C. Determined whether TE/GE Division management (Division level and all five offices) had coordinated with other IRS operating divisions to enhance its fraud program.
- II. Evaluated whether the actions taken by TE/GE Division management to emphasize and improve the fraud program resulted in the identification of potential indicators and actual referrals of criminal and civil fraud issues for further development and prosecution.
 - A. Determined from review of a judgmental sample of 25 available examination case files whether employees in all 5 TE/GE Division offices identified and followed up on cases where fraud indicators were present.

¹ For the purpose of this audit, "emphasis" was judged by determining whether TE/GE Division management ensured 1) corrective actions from prior audits were taken, 2) strategic documents emphasized fraud, 3) fraud-related documents and training were adequate, 4) resources were assigned to detect fraud, 5) adequate coordination existed with other divisions, and 6) examiners considered fraud when fraud indicators were present.

² *The Tax Exempt and Government Entities Division Should Pursue Additional Methods to Identify Potential Fraudulent Activities* (Reference Number 2003-10-217, dated September 29, 2003) and *The Tax Exempt and Government Entities Division Is Making Progress to Detect and Deter Fraud Within Its Customer Base, but the Impact Cannot Be Determined at This Time* (Reference Number 2005-10-161, dated September 30, 2005).



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- B. Determined whether fraud coordinators received more³ questions regarding fraud issues.
- C. Determined whether fraud coordinators received more requests for assistance to develop fraud cases.
- D. Determined whether TE/GE Division management in all five Division offices referred practitioners (i.e., lawyers and accountants) to the IRS Office of Professional Responsibility for potential criminal or civil fraud issues.
- E. Identified the number of potential criminal and civil fraud development cases identified by the TE/GE Division (all five offices), approved by the SB/SE Division Fraud Office, and referred to the CI Division since our last report. We performed Integrated Data Retrieval System⁴ account research to determine the current status or final disposition of the cases, including tax, penalty, and interest assessments. Data on the Integrated Data Retrieval System were not assessed to determine its validity and reliability.

Internal Controls Methodology

Internal controls relate to management's plans, methods, and procedures used to meet their mission, goals, and objectives. Internal controls include the processes and procedures for planning, organizing, directing, and controlling program operations. They include the systems for measuring, reporting, and monitoring program performance. We determined that the following internal controls were relevant to our objectives: TE/GE Division and SB/SE Division Fraud Office policies, procedures, and practices for identifying and referring potential fraud issues. We evaluated these controls by interviewing management, reviewing applicable information, and reviewing potential fraud cases referred to the SB/SE Division Fraud Office and the CI Division by TE/GE Division offices.

³ For the purpose of this audit, "more" is defined as an increase since the Fiscal Year 2005 TIGTA audit report on the TE/GE Division's Fraud Program.

⁴ IRS computer system capable of retrieving or updating stored information; it works in conjunction with a taxpayer's account records.



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Appendix II

Major Contributors to This Report

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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
Chief, Criminal Investigation Division SE:CI
Commissioner, Small Business/Self-Employed Division SE:S
Deputy Commissioner, Tax Exempt and Government Entities Division SE:T
Director, Employee Plans, Tax Exempt and Government Entities Division SE:T:EP
Director, Exempt Organizations, Tax Exempt and Government Entities Division SE:T:EO
Director, Government Entities, Tax Exempt and Government Entities Division SE:T:GE
Chief Counsel CC
National Taxpayer Advocate TA
Director, Office of Legislative Affairs CL:LA
Director, Office of Program Evaluation and Risk Analysis RAS:O
Office of Internal Control OS:CFO:CPIC:IC
Audit Liaisons:
 Chief, Criminal Investigation Division SE:CI:S:PS
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 Commissioner, Tax Exempt and Government Entities Division SE:T:CL



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Appendix IV

Outcome Measures

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

Type and Value of Outcome Measure:

- Increased Revenue – Actual; 4 taxpayer accounts affected, \$10,000,000¹ (see page 5).

Methodology Used to Measure the Reported Benefit:

The reported benefit is based on the number of TE/GE Division accounts where tax or civil fraud penalties were assessed since our prior audit report recommendations in Fiscal Years 2003 and 2005. These assessments made during Fiscal Years 2006 through 2008 are due in part to the implementation of corrective actions based on TIGTA's prior recommendations to improve the TE/GE Division fraud program.

Four customer account examinations in the TE/GE Division resulted in civil fraud penalties and other related assessments totaling approximately \$10 million. This information was identified through various TE/GE Division records and verified through account research on the IRS Integrated Data Retrieval System² and other supporting documentation.

Type and Value of Outcome Measure:

- Increased Revenue – Potential; 71 taxpayer accounts affected, \$37,000,000 (see page 5).

Methodology Used to Measure the Reported Benefit:

The reported benefit is based on the number of TE/GE Division accounts where indications of potential tax fraud were identified since our prior audit report recommendations in Fiscal Years 2003 and 2005. These fraud development cases are due in part to the implementation of corrective actions based on TIGTA's prior recommendations to improve the TE/GE Division fraud program.

¹

² IRS computer system capable of retrieving or updating stored information; it works in conjunction with a taxpayer's account records.



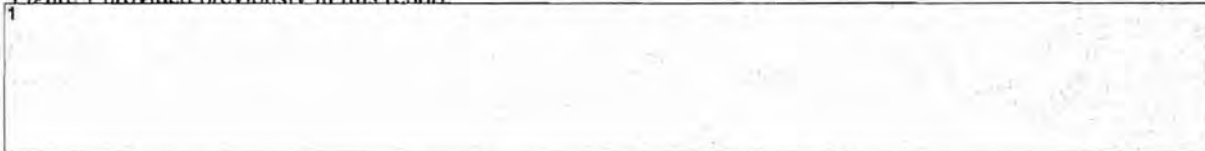
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For Fiscal Years 2006 through 2008, the SB/SE Division Fraud Office approved 48 TE/GE Division cases for fraud development. Of the 48 cases, 32 potentially represent approximately \$37 million of additional revenue which may be forthcoming. The status³ of the 32 cases as of September 30, 2008, is as follows:

- 10⁴ cases were accepted by the CI Division for potential criminal prosecution and assessment of \$11 million.
- 22 cases include indications of potential fraud that are being developed by the TE/GE Division and SB/SE Division Fraud Office with potential assessments of \$26 million.

Information regarding TE/GE Division accounts being worked by the CI Division was identified from the SB/SE Division National Fraud Database and verified using Referral Report of Potential Criminal Fraud Cases (Form 2797), which is used to refer cases by the SB/SE Division Fraud Office to the CI Division. Information regarding TE/GE Division accounts being worked with the SB/SE Division Fraud Office was identified from the SB/SE Division National Fraud Database and verified using Fraud Development Status (Form 11661), which is used by the SB/SE Division Fraud Office to approve cases from the TE/GE Division for fraud development.

³ This status only represents the 48 cases identified from SB/SE Division Fraud Office data that were approved for fraud development from Fiscal Years 2006 through 2008 and does not take into consideration cases that may have already been in process from prior years. Therefore, the numbers discussed in this status will not always agree with Figure 1 provided previously in this report.





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Appendix V

Tax Exempt and Government Entities Division Fraud Program Details

The TE/GE Division fraud program is not as effective as it could be due to inconsistent implementation of key fraud controls in the five TE/GE Division offices. To reach this conclusion, we assessed actions that TE/GE Division management has taken to 1) implement prior TIGTA recommendations, 2) emphasize the importance of fraud to employees, and 3) coordinate with other IRS divisions and fraud groups. Figure 1 below provides details on our assessment of each of these three key areas using a red, yellow, and green rating system. Red ratings were provided if zero, one, or two TE/GE Division offices effectively implemented a key fraud program control. A yellow rating was provided if three or four offices effectively implemented a key fraud program control, and a green rating was provided if all five offices effectively implemented a key fraud program control.

Figure 1: TIGTA Assessment of Key Fraud Program Controls in the TE/GE Division

Key Fraud Program Control	Status		
	Red	Yellow	Green
<u>Implementing Prior TIGTA Recommendations</u>			
TE/GE Division management should perform assessments to identify areas vulnerable to fraud. (Recommended in the September 2003 and September 2005 TIGTA Reports)		Yellow	
<ul style="list-style-type: none"> - One of four offices developed a formal risk assessment. However, this control was rated yellow because three additional offices incorporated fraud indicators and/or provided information about areas vulnerable to fraud in training material that was presented to their respective employees. - In the fifth office, TE/GE Division management did not agree to perform a risk assessment, as the TIGTA recommended. Management stated it was not prudent to conduct a risk assessment for their respective customer base because the information would quickly become outdated. 			



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		Status		
		Red	Yellow	Green
Key Fraud Program Control				
TE/GE Division management should provide fraud awareness training, including technical examples. (Recommended in the September 2003 and September 2005 TIGTA Reports)				
	<p>Five of five offices provided fraud training.</p> <ul style="list-style-type: none"> - Two of five offices provided general fraud awareness training. One of the offices provided classes on several occasions, and one office did not provide fraud awareness training until May 2008 when it provided a 1 hour class for employees. - Two additional offices sent employees to specialized fraud training, including forensic accounting, expert witness, Federal Bureau of Investigation seminars, and Advanced Financial Techniques at a Federal Law Enforcement Training Center. - The fifth office provided fraud training to employees on specific industry technical issues on several occasions. 			
TE/GE Division management should alert customers of potential fraud scenarios identified within their customer base. (Recommended in the September 2005 TIGTA Report)				
	<ul style="list-style-type: none"> - Four of five offices alerted their customers about fraud-related scenarios through the use of presentations, Internet postings, articles, and/or publications. In one of the four offices, the fraud coordinator prefers not discussing fraud-specific matters with their customers during presentations. - The fifth office did not alert its customers advising that they are not perceived as a significant risk to perpetrate fraud and, therefore, the need to present fraud scenarios is not appropriate or useful. 			
TE/GE Division management should enhance inventory systems to track and monitor the potential fraud cases and fraud referrals and the results of examinations, investigations, and referrals. (Recommended in September 2005 TIGTA Report)				
	TE/GE Division was planning to use two new inventory systems and employ them, to the degree possible, to track fraud cases while they remain in the TE/GE Division's control. The two tracking systems in			



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		Status	
		Yellow	Green
Key Fraud Program Control			
	<p>TE/GE Division management's response were under development and had not been brought online.</p> <p>We identified the following alternative actions:</p> <ul style="list-style-type: none">- Three of five offices have tracking systems that range from very basic to moderately sophisticated.• One office began tracking its fraud development cases in October 2006 by using a computer spreadsheet consisting of information including the name of the assigned examiner, date fraud development was approved, and date the referral was submitted to the CI Division. However, at the time of our review, information in the log was inaccurate or not up-to-date, and management could not easily identify the current status of certain cases. Management did not always receive information from the field agents regarding fraud development cases and fraud referrals and sometimes had to go directly to the agents to determine the status or location of the case or referral. That office reconciled its fraud development cases and fraud referrals against the SB/SE Division Fraud Office database once a year. We attempted to reconcile this information with the SB/SE Division Fraud Office database and discrepancies were found.• A second office maintained a less comprehensive computer spreadsheet of open and closed fraud development cases and fraud referrals. The open and closed spreadsheet included potential fraud cases that were referred to the SB/SE Division Fraud Office. <p style="text-align: center;">1</p> <ul style="list-style-type: none">• The third office maintained a complex spreadsheet used to track pertinent data from the cases under development and after referral.		



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		Status		
		Yellow	Green	
Key Fraud Program Control				
	<ul style="list-style-type: none"> - The remaining two offices do not have tracking systems to monitor fraud development cases and fraud referrals. 			
TE/GE Division management should provide more in-depth fraud training for fraud coordinators. (Recommended in the September 2003 TIGTA Report)				
	<ul style="list-style-type: none"> - Two of five offices sent fraud coordinators to specialized training. - All five offices ensured their fraud coordinators attended at least one SB/SE Division Fraud Summit. - Although only two of five offices sent fraud coordinators to specialized fraud training, this control was elevated to yellow because all five offices did send their fraud coordinators to the SB/SE Division Fraud Summits at least once. 			
TE/GE Division management should establish a process to evaluate external or internal identified allegations or issues of potential fraud. (Recommended in the September 2003 TIGTA Report)				
	<ul style="list-style-type: none"> - TE/GE Division management issued instructions to the one applicable office on giving priority treatment to information items in which fraud is suspected. However, five of five offices now have processes to evaluate external or internal allegations of potential fraud. These instructions require employees to gather appropriate evidence and seek guidance from their fraud coordinator and manager if indications of fraud are identified. 			
TE/GE Division management should coordinate with the CI Division to determine which potential fraud issues to prioritize for referral. (Recommended in the September 2003 TIGTA Report)				
	<ul style="list-style-type: none"> - TE/GE Division management from one of five offices coordinated with the CI Division to determine which fraud issues to prioritize. 			



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		Status		
		Red	Yellow	Green
Key Fraud Program Control				
<u>Emphasizing the Importance of Fraud to Employees</u>				
Did strategic planning documents (Strategic Plans, Annual Work Plans, Annual Examination Letters, etc.) emphasize that identifying and developing fraud issues should be considered throughout the Division?				
	- Documents such as Strategic Plans, Annual Work Plans, Annual Examination Letters, etc. were identified in four of five offices that emphasized identifying and developing fraud issues.			
Did documents provided to employees highlight fraud scenarios that were identified and the tools and techniques for employees to use to identify fraud?				
	<p>Documents from three offices and the TE/GE Division executive office were identified that emphasized fraud. However, only one of the four offices issued the documents prior to the TIGTA advising TE/GE Division executives of our planned audit of the TE/GE Division's fraud program.</p> <ul style="list-style-type: none"> - In July 2008, after we initiated this audit, the Commissioner, TE/GE Division, issued a memorandum that emphasized the importance of identifying and developing fraud cases to foster confidence in the tax system and compliance with the law. The Commissioner also appointed a Division fraud specialist and directed all employees to contact the specialist for assistance in fraud investigations. Although no other responsibilities were noted in the memorandum, this is a step in bringing additional consistency to the TE/GE Division fraud program. - The second memorandum, issued in February 2007, addressed the increased use of tax-exempt entities to improperly shield income or assets from taxation and the importance of agents being alert to the detection of fraud indicators in all cases. - In February 2008, one office included fraud-related scenarios in the SB/SE Division Fraud Office newsletter and, in October and December 2008, included successful fraud referral stories in its own newsletter. In addition, the office had drafted fraud scenarios for inclusion in future SB/SE Division Fraud Office newsletters or its own newsletter. 			



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		Status		
		Red	Yellow	Green
Key Fraud Program Control				
	<p>- The third memorandum was issued in July 2008, after this audit was initiated, and expressed the importance of recognizing integrity-related issues and taking timely action to address such issues.</p> <p>Note: This key control is rated red because while three offices and the TE/GE Division Commissioner's office issued documents, only one of the offices issued the memorandums prior to the TIGTA advising TE/GE Division executives of the planned audit.</p>			
Did the TE/GE Division section of the Fraud Handbook contain up-to-date information on how to identify and develop potential fraud cases for referral?				
	<p>- Four of five offices are enhancing and updating the TE/GE Division section of the Fraud Handbook. The information includes guidance on developing and referring potential fraud issues; however, only one office plans to include examples of fraud scenarios unique to its customer base. This is important because it provides TE/GE Division employees with current guidelines about the TE/GE Division fraud program.</p>			
Did TE/GE Division management provide staffing to assist in the detection of fraudulent activities?				
	<p>- A fraud specialist was designated for the TE/GE Division. All offices designated fraud coordinators, one office organized an investigative group, and a third office designated a group to work fraud issues.</p>			
Did fraud coordinators help develop fraud issues and were they available to assist other employees?				
	<p>- Fraud coordinators in four of five offices helped develop fraud issues and were available to assist other employees.</p>			



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		Status		
		Red	Yellow	Green
Key Fraud Program Control				
<u>Coordinating With Other IRS Divisions to Enhance the Fraud Program</u>				
Did TE/GE Division management communicate with the CI Division to improve the identification, development, and referral of potential fraud issues?			Yellow	
	<ul style="list-style-type: none"> - TE/GE Division management in three of five offices met with CI Division management to improve the identification, development, and referral of potential fraud issues. - TE/GE Division representatives from four of the five offices met with representatives from the CI Division, the SB/SE Division Fraud Office, and the IRS Special Counsel to establish a Fraud Oversight Work Group¹ in March 2005 to improve coordination of potential fraudulent activity within their respective areas. However, the Oversight Work Group did not meet again after the initial meeting was held and no improvements had been made yet. 			
Did TE/GE Division management work with the SB/SE Division Fraud Office to develop a strategy for identifying criminal and civil fraud issues?		Red		
	<ul style="list-style-type: none"> - TE/GE Division management in one of five offices worked with the SB/SE Division Fraud Office to develop a strategy for identifying criminal and civil fraud issues within the tax-exempt sector. 			
Did TE/GE Division management develop a method to measure the success (feedback loop) of fraud referrals?				Green
	<ul style="list-style-type: none"> - TE/GE Division offices receive information from either the SB/SE Division Fraud Office or the CI Division on the disposition of all cases. 			

Source: TIGTA discussions with TE/GE and SB/SE Divisions management and review of strategic documents.

¹ The Fraud Oversight Workgroup was established in March 2005 by representatives from four of the TE/GE Division's five offices and met with representatives from the CI Division, the SB/SE Division Fraud Office, and the IRS Special Counsel to improve coordination of potential fraudulent activity within their respective areas.



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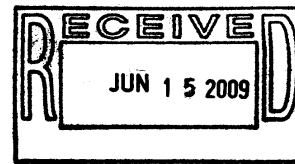
Appendix VI

Management's Response to the Draft Report



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

JUN 15 2009



MEMORANDUM FOR DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: Sarah Hall Ingram *[Signature]*
Commissioner, Tax Exempt and Government Entities

SUBJECT: Response to Draft Audit Report – A Corporate Approach is Needed to Provide for a More Effective Tax-Exempt Fraud Program. (Audit # 200810024)

I am pleased to respond to your draft audit report concerning the Tax-Exempt and Government Entities Division's program for detecting fraud among our taxpayer base and for referring fraud cases to the Criminal Investigation Division for consideration for criminal prosecution.

As you note, TE/GE implemented a number of changes to its fraud program since you last reviewed our program in 2003 and 2005. One result has been that the number of criminal fraud referrals between 2006 and 2008 increased 336% over the number between 2000 and 2002. In addition, all five TE/GE offices have emphasized fraud through fraud awareness training for employees, by providing resources to assist in detecting fraudulent activity, and by obtaining feedback on fraud referrals.

Recognizing the distinct characteristics of each of our five taxpayer groups, we have charged each TE/GE function with implementing a fraud program tailored to the characteristics of each individual taxpayer group. However, we agree with your observation that our overall program would now benefit from central oversight. Accordingly, we have vested oversight over the entire TE/GE fraud program in the TE/GE Compliance Issues Council. We have created a fraud working group on the Council and have given it direct functional fraud authority. The Compliance Issues Council is chaired by the TE/GE Senior Technical Advisor and its members include senior representatives from each taxpayer function: Employee Plans, Exempt Organizations and Government Entities.

We appreciate your continued interest in the effectiveness of TE/GE's fraud program.



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Our responses to your recommendations appear on the attachment.

We concur with your assessment of the measurable benefit to tax administration.

Attachment



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Attachment

Recommendation 1

The Commissioner, TE/GE, should develop and implement a corporate fraud approach with centralized oversight for the TE/GE Division. This approach should include implementing key controls to identify and address fraud in the tax-exempt sector and implementation of corrective actions to previously agreed TIGTA recommendations.

Corrective Action

The TE/GE Compliance Issues Council, now vested with centralized oversight for fraud issues in TE/GE, will develop and implement a corporate fraud approach for TE/GE. This will include implementing key controls, where they do not already exist, to identify and address fraud in the tax-exempt sector, and implementing corrective actions to previously agreed TIGTA recommendations pertaining to fraud.

Implementation Date

June 15, 2010.

Responsible Official

TE/GE Senior Technical Advisor

Recommendation 2

The Commissioner, TE/GE, should ensure that all TE/GE Division offices follow IRS procedures and contact the SB/SE Fraud Office to determine whether cases with affirmative indications of fraud should be pursued as fraud development cases.

Corrective Action

The TE/GE Compliance Issues Council, now vested with centralized oversight for fraud issues in TE/GE, will ensure, to the extent they may not already be doing so, that all TE/GE Division offices follow IRS relevant IRS procedures and contact the SB/SE Fraud Office to determine whether cases with affirmative indications of fraud should be pursued as fraud development cases.



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Effective Tax-Exempt Fraud Program*

Implementation Date

June 15, 2010

Responsible Official

TE/GE Senior Technical Advisor