

**The Indian Tribal Governments Office Can
Improve the Effectiveness, Consistency,
and Efficiency of Compliance Checks**

September 2005

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INSPECTOR GENERAL
for TAX
ADMINISTRATION

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MEMORANDUM FOR COMMISSIONER, TAX EXEMPT AND GOVERNMENT
ENTITIES DIVISION

FROM: Pamela J. Gardiner
Deputy Inspector General for Audit

SUBJECT: Final Audit Report - The Indian Tribal Governments Office Can
Improve the Effectiveness, Consistency, and Efficiency of
Compliance Checks (Audit # 200510010)

This report presents the results of our review to determine whether the Internal Revenue Service (IRS) Indian Tribal Governments (ITG) office executes compliance checks¹ effectively and consistently to better understand its customers and to identify appropriate remedies for compliance issues and has developed a methodology for measuring the impact of compliance checks on its customer base.

The ITG office is responsible for administering Federal tax laws for the 564 Federally recognized Indian Tribal governments and their approximately 2,100 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 entities.

In summary, ITG office management devotes a significant portion of their Examination resources to conducting compliance checks. However, ITG office management advised us they are currently unable to determine the collective impact of compliance checks on their customers' understanding and compliance with Federal tax laws or the long-term impact on compliance levels. While ITG office management's process for conducting compliance checks enabled the ITG office to better understand tribal entities and

¹ Unlike an examination or audit, a compliance check does not seek to determine a tax liability for any particular period; it is voluntary, and the tribe may refuse to participate in a compliance check without penalty.

identify appropriate remedies for compliance issues, the impact was limited to the specific tribal entities involved with the compliance checks.

ITG office management advised us that measuring the impact of compliance checks on compliance is difficult because information such as reasons for filing delinquent returns is currently not available. However, ITG office management has completed one study and is planning another one to help identify general indicators of overall compliance levels. A second difficulty is the IRS is not always aware of and cannot predict the external factors that may affect a tribal entity's filing behavior. These external factors include periodic tribal management turnovers and the use of accountants, tax attorneys, or other highly experienced payroll specialists by some tribes versus tribes whose bookkeepers may be unfamiliar with the tax laws.

We also found the ITG office field specialists generally followed ITG office management's process for conducting compliance checks for our sample cases. However, the process did not ensure compliance checks were consistently, timely, and efficiently worked; updates to tribal entity information were documented in the Compliance Check Report² and monitored; and compliance check results were used to objectively improve case selection. In addition, we identified instances where a significant number of delinquent returns were obtained and processed, which is not the main focus of compliance checks.

The Outreach, Planning, and Review office Quality Review function staff determined five compliance checks closed in Fiscal Year (FY) 2004 did not qualify for closure as completed compliance checks; however, we noted they were included in the number of completed compliance checks reported by ITG office management in FY 2004. An error in a database report formula and a case closing error resulted in inaccurate information reported from the database. Further, the sample of compliance checks we reviewed was under ITG office management's control throughout the process from assignment through case closure. While this was important for physical inventory control, the database used to track cases through the compliance check process was not an effective or efficient tool for monitoring the progress of cases. Therefore, ITG office management decided to manually monitor cases to better control work in progress and reduce the length of time cases are open.

As a result of ITG office management's emphasis on reducing the time to complete compliance checks, we determined the time it takes to initiate, execute, and close compliance check cases has been significantly reduced. The time period for completing compliance checks dropped from an average of 390 days for those initiated in the third quarter of FY 2002 to an average of 123 days for those initiated in the third quarter of FY 2004. In evaluating the length of time for the ITG office to complete compliance checks, we identified one additional opportunity to further reduce the overall time period - making initial contact with the tribe. Although there was a decrease from 155 to 108 days for the field specialists to contact the tribes, this is longer than what group

² The Compliance Check Report is a template that documents the results of the compliance check. It includes information about the tribal entity and contains the field specialist's assessment of compliance risk. The Compliance Check Report is used to ensure consistency of completed compliance checks.

managers expect. There are currently no time standards for the ITG office field specialists to initiate contact with the tribes for compliance check cases. Finally, we determined the use of current technology would improve the efficiency of preparing Document Transmittals (Form 3210) for compliance checks or other cases that need to be transferred between offices.

We recommended the Director, ITG, Tax Exempt and Government Entities (TE/GE) Division, correct the data for the compliance check cases that were closed incorrectly and revise the formula in the ITG Database³ report that calculates the number of completed compliance checks, require information identified during compliance checks that should be used to update the ITG Database or the IRS Master File⁴ to be recorded on the Compliance Check Report, establish time standards to clarify the expectation of contacting tribes as soon as possible to initiate compliance checks, and consider automating the document transmittal process.

Management's Response: The Commissioner, TE/GE Division, agreed with our recommendations and is implementing corrective actions. ITG office management corrected the data for the compliance check cases that were closed with the incorrect closing code, revised the ITG Database formula that calculates the number of completed compliance checks, and issued guidance requiring initial customer contact within 60 days of case assignment to the group. Additionally, ITG office management is in the process of revising the ITG office work templates. The revised Compliance Check template will include a summary sheet to capture all of the data updates reported during the compliance check. TE/GE Division management considered automating the document transmittal process and decided to address this issue during future development of the TE/GE Division Reporting and Electronic Examination System. 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 Daniel R. Devlin, Assistant Inspector General for Audit (Headquarters Operations and Exempt Organizations Programs), at (202) 622-8500.

³ The ITG Database was developed over the past several years and contains data from the IRS' main database (Master File), the Bureau of Indian Affairs, and other sources on Indian Tribal governments and their related enterprises. The ITG Database records contain more than 200 data fields and include information such as tribal entity data, filing requirements, and line item information from filed returns such as wages paid. The ITG Database is made up in part by the Inventory Database, the Outreach Assignment Database, and the Tribal Compliance Database.

⁴ The IRS database that stores various types of taxpayer account information. This database includes individual, business, and employee plans and exempt organizations data.

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Background

The Internal Revenue Service (IRS) Indian Tribal Governments (ITG) office is responsible for administering Federal tax laws for the 564 Federally recognized Indian Tribal governments (tribes) and their approximately 2,100 related entities. The ITG office is part of the Government Entities function of the Tax Exempt and Government Entities (TE/GE) Division.

The mission of the ITG office is to provide its customers top-quality services, by helping them understand and comply with applicable laws, and to protect the public interest by applying the tax law with integrity and fairness to all. To help accomplish its mission, the ITG office works with tribes to lessen the need for enforcement by keeping abreast of trends that are emerging among the tax filing and payment characteristics of tribal entities.

The ITG office began performing compliance checks¹ in Fiscal Year (FY) 2001 to obtain current information on its customers, better understand customers' needs, and identify appropriate remedies to compliance issues. During a compliance check, field specialists interview key personnel in the tribe, inquire about the selected tribal entity, and ask additional questions about filing requirements for the tribe to determine whether all record keeping and information reporting requirements are met. The field specialists enter information obtained during the compliance check on an ITG office Compliance Check Report.²

This review was performed at the ITG office National Headquarters in Washington, D.C.; the ITG Outreach, Planning, and Review (OPR) offices in Buffalo, New York, and Oklahoma City, Oklahoma; and the ITG office field groups in Buffalo, New York; Fargo, North Dakota; Santa Ana, California; and San Bernardino, California, during the period November 2004 through May 2005. The

¹ Unlike an examination or audit, a compliance check does not seek to determine a tax liability for any particular period; it is voluntary, and the tribe may refuse to participate in a compliance check without penalty.

² The Compliance Check Report is a template that documents the results of the compliance check. It includes information about the tribal entity and contains the field specialist's assessment of compliance risk. The Compliance Check Report is used to ensure consistency of completed compliance checks.

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audit was conducted in accordance with *Government Auditing Standards*.

This is the second audit we have conducted of the ITG office's compliance check process. In FY 2004, we reviewed the methodology used by the ITG office to select tribal entities for compliance checks.³ In this audit, we evaluated the ITG office compliance check process from the assignment of the compliance check to the ITG office field group through the closure of the case by the OPR office. Because all compliance checks are subject to quality review, we relied on the quality review reports and did not evaluate the quality of the field specialists' work. Additionally, we did not validate the compliance check data in the ITG Database.⁴ Detailed information on our audit objectives, scope, and methodology is presented in Appendix I. Major contributors to the report are listed in Appendix II.

The Impact of the Compliance Check Process on Voluntary Compliance Cannot Be Determined at This Time

Although ITG office management has devoted a significant portion of their Examination resources to conducting compliance checks in an effort to better understand their customers and to lessen the need for enforcement, they advised us they are currently unable to determine the collective impact of compliance checks on their customers' understanding and compliance with Federal tax laws or the long-term impact on compliance levels. To date, ITG office management's only performance goal for compliance checks is the number conducted each fiscal year. This goal measures the number of tribal entities that receive compliance checks, but it gives little indication of the compliance check's impact on a tribal entity's

³ *The Process for Assigning Cases Should Be Strengthened to Provide Better Coverage to Indian Tribal Governments Most in Need of Compliance Checks* (Reference Number 2004-10-191, dated September 2004).

⁴ The ITG Database was developed over the past several years and contains data from the IRS main database (Master File), the Bureau of Indian Affairs, and other sources on Indian Tribal governments and their related enterprises. The ITG Database records contain more than 200 data fields and include information such as tribal entity data, filing requirements, and line item information from filed returns such as wages paid. The ITG Database is made up in part by the Inventory Database, the Outreach Assignment Database, and the Tribal Compliance Database.

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understanding of its tax obligations and level of voluntary compliance.

In addition, while the ITG office management's process for conducting compliance checks enabled the ITG office to better understand tribal entities and identify appropriate remedies for compliance issues, the impact was limited to the specific tribal entities involved with the compliance checks. ITG office management advised us the Compliance Check Report, used to document the compliance check, was not designed or intended to evaluate the impact of the compliance check on all tribal-related entities. ITG office management also advised us that compliance checks are a momentary snapshot of compliance behavior and issues within a single entity. In addition, they have found there is no compliance relationship between tribal entities (e.g., if one tribal entity is compliant on filing returns, it does not necessarily mean another entity of that same tribe would also be compliant), and there is no method to draw a correlation between the differing entities.

We also identified opportunities to improve the effectiveness, consistency, and efficiency of the compliance check process once cases are assigned to the field groups. This issue is presented in more detail later in the report.

Methodologies to measure the impact of compliance checks have not been implemented

The ITG office compliance check program has been in existence since FY 2001, and ITG office management is continuing to develop the program to make the case selection process more effective and to gather better data from the ITG office customers. However, ITG office management has not implemented a methodology for measuring compliance levels in their customer base, the impact compliance checks have on overall compliance, and whether the ITG office is getting the desired benefit out of the compliance check process. By the conclusion of our audit, ITG management had drafted a research plan to try to measure the impact compliance checks have on overall compliance levels for their customers.

Although the number of compliance checks completed each year has shown an increase from 4 in FY 2001 to 272 in

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FY 2004,⁵ the compliance checks completed each year represent a small portion of the approximately 2,100 entities related to the 564 Federally recognized Indian tribes. ITG office field specialists primarily work examinations and compliance checks, although they may also conduct education and outreach for the tribes. The TE/GE Division's February 3, 2005, Business Performance Review showed that, for FY 2004, the ITG office had 39 Examination Full-Time Equivalents⁶ who closed 313 examination cases and completed 271⁷ compliance checks. While the report does not break down the amount of resources spent on examinations versus compliance checks, it does indicate a significant part of the field groups' inventory is devoted to compliance checks.

The Government Performance and Results Act of 1993⁸ requires major functions of operations to specify their general goals and objectives in annual plans and include outcome-related goals; to determine the skills, technology, and human capital necessary to achieve these goals; and to determine the management information necessary to monitor whether they are achieving their goals. Without an adequate method to measure the compliance levels and the impact compliance checks have on compliance in their customer base, ITG office management cannot determine whether compliance checks are achieving the desired benefits to the Federal Government or to their customers.

ITG office management advised us that measuring the impact of compliance checks on compliance is difficult because information such as reasons for filing delinquent returns is currently not available. However, ITG office management has completed one study and is planning

⁵ These figures were obtained from the ITG office Business Performance Review and the ITG Inventory Database.

⁶ A measure of labor hours in which 1 Full-Time Equivalent is equal to 8 hours multiplied by the number of compensable days in a particular fiscal year. For FY 2004, 1 Full-Time Equivalent was equal to 2,096 staff hours.

⁷ The Business Performance Review reported one less compliance check than what was reflected in the ITG Inventory Database.

⁸ Pub. L. No. 103-62, 107 Stat. 285 (codified as amended in scattered sections of 5 U.S.C., 31 U.S.C., and 39 U.S.C.).

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another one to help identify general indicators of overall compliance levels.

- The TE/GE Division Research and Analysis Office completed a study in April 2005 that examined issues regarding employment tax noncompliance within one market segment. The study analyzed the uncollected assessment data from the Accounts Receivable Dollars Inventory⁹ for four areas of concern. The study reached the following conclusions.
 - The extensive range of uncollected balances (less than \$1 to more than \$150,000) suggests noncompliance may occur for different reasons.
 - In this market segment, the longer the tribal balance remains unpaid, the greater the amount owed.
 - Demographic conditions, such as location, standard of living, population, and tribal size may require different outreach and education programs to address noncompliance for this market segment.

The manager, OPR office, will use these general indicators to determine the best approach for gaining compliance within this market segment and hopes to test remedies for the noncompliance. However, this study will enable ITG office management to draw only broad conclusions about the tribes and entities and does not contain the detailed analysis necessary to determine changes in compliance levels of individual customers.

- ITG office management has drafted a research plan to try to measure the impact compliance checks have on overall compliance levels for their customers. They are considering adding additional data elements, including delinquent return and balance due information, to the ITG Database to capture data that will be needed for the analysis. They plan to obtain and track relevant information, such as the compliance levels in tribes where outreach was performed versus those that did not

⁹ The Accounts Receivable Dollars Inventory represents the total dollar amount due for accounts with a debit balance on the Master File, including any additional assessments plus all other accruals (e.g., interest).

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have any outreach. ITG office management had not yet started this effort at the time of our review but plans to complete their review during Calendar Year 2005.

In addition, the IRS is not always aware of and cannot predict the external factors that may affect a tribal entity's filing behavior. These external factors include periodic tribal management turnovers and the use of accountants, tax attorneys, or other highly experienced payroll specialists by some tribes versus tribes whose bookkeepers may be unfamiliar with the tax laws. These factors may affect the tribe's filing behaviors, and it is difficult for the ITG office to identify and exclude the impact of these factors. For example, the ITG office cannot attribute an increase in a tribe's filing behavior to the ITG office's outreach and education efforts because it may be attributable to something else, such as the tribe hiring a more knowledgeable bookkeeper or accountant. The change in the filing (i.e., increased number of returns filed) is quantifiable; however, the reason for the change is not.

The number of compliance checks completed each year is a valid measure to help ITG office management understand their customers and to identify the customers' tax issues, problems, and concerns. However, they do not measure the impact on voluntary compliance. Until ITG office management can determine the impact compliance checks have on compliance, beyond the number of cases closed, the real value of the compliance check program cannot be determined. Because the ITG office is planning an additional study on the impact of compliance checks on overall compliance, we are not making any recommendations on this issue.

Compliance Checks Can Be Performed More Effectively, Consistently, and Efficiently

We determined the ITG office field specialists generally followed ITG office management's process for conducting compliance checks for our sample cases. This process should result in identification of any new or closed tribal business entities and a determination of the risk of noncompliance of certain key areas contained in the Compliance Check Report. If more specific assistance is needed by the tribe, the specialist can either provide the assistance during the visit or schedule an Education and Outreach visit for the future. In addition, if the tribe agrees to complete an obligation such as submission of a

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delinquent return, or if an examination is needed, the OPR office will schedule additional follow-up work for that tribal entity.

However, the process did not ensure compliance checks were consistently, timely, and efficiently worked; updates to tribal entity information were documented in the Compliance Check Report and monitored; and compliance check results were used to objectively improve case selection. In addition, ITG office management does not have an adequate nationwide management information system to monitor compliance checks assigned to the field specialists.

Work performed on compliance checks was not always consistent with office guidelines

ITG office management developed a Compliance Check Report to ensure ITG office field specialists gathered consistent information about tribal entities during compliance checks. The Compliance Check Report outlines the information that should be obtained during the compliance check. It also provides a place for the field specialist's assessment of the compliance risk for the tribal entity for employment tax, information and cash transaction reporting, tip reporting, and excise taxes and any recommendations for future activity needed for that tribal entity.

We determined ITG office field specialists prepared Compliance Check Reports for all compliance check cases reviewed. However, we identified instances where compliance checks were not completed but were reported as such for FY 2004, items were not completed on the Compliance Check Report, and other instances where a significant number of delinquent returns were obtained and processed, which is not the main focus of compliance checks.

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- The OPR office Quality Review (QR) function staff determined 1 of the 52¹⁰ compliance checks in our sample did not qualify for closure as a completed compliance check. We also noted during our review of the documentation for the 52 sample cases that the OPR office QR function staff identified an additional 4 compliance checks closed in FY 2004 that did not qualify as completed compliance checks. The five cases did not qualify for the following reasons:
 - Two cases were surveyed (closed) before the compliance checks were initiated. Generally, ITG office management does not consider surveyed compliance checks as completed compliance checks. We determined there were other compliance checks in the ITG Inventory Database¹¹ that were closed as surveys but not counted as completed compliance checks.
 - Two cases indicated that the customers declined the compliance checks.
 - One case was incomplete and the work did not qualify the case as a compliance check.

After a case is sent to the OPR office QR function for review, ITG office management generally does not send it back to the field specialist to conduct additional work or to correct any errors. The OPR office QR function will correct any errors that can be corrected and send the case to the OPR office Classification and Delivery Specialist for closure. The OPR office QR function will also notify the specialists through the group managers of

¹⁰ We selected a sample of 55 cases that were assigned and closed on the ITG Inventory Database. However, compliance checks were not conducted for three of the entities in our sample. One entity was an exempt organization and not an ITG office customer, one entity was a defunct business, and another entity declined to have a compliance check conducted. Details of how we selected our sample cases are included in Appendix I.

¹¹ The ITG Inventory Database, which is a subset of the ITG Database, was developed by the OPR office in FY 2001 to analyze filing and payment characteristics and control nonexamination activities, such as compliance checks and tip rate reviews.

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the types of problems they are identifying, to prevent similar problems from occurring in the future.

For the five cases determined by the OPR office QR function to not qualify as completed compliance checks, we noted they were included in the totals reported by ITG office management as completed compliance checks in FY 2004. An error in a database report formula resulted in four of five incomplete cases being reported as complete, and a case closing error (i.e., incorrect closing code input to the ITG Inventory Database) resulted in the fifth incomplete case being reported as complete. We did not evaluate all closed compliance checks for FY 2004, so we do not know the full extent of this issue. However, errors in database formulas and case closing errors can result in inaccurate information reported from the ITG Database. This is especially important in light of the ITG office's annual performance goal measuring the number of compliance checks completed. For example, in FY 2004, ITG office management's performance goal was to complete 265 compliance checks and they reported completing 271 compliance check cases. With at least 5 of the 271 cases being incomplete or incorrectly included in the number of completed compliance checks, ITG office management is at risk of reporting overstated accomplishments for compliance check cases.

- The field specialists did not always include information requiring updates to the ITG Database or the IRS Master File,¹² such as new tribal entities or changes to filing requirements, on the Compliance Check Report. When identifying new or changed information, ITG office field specialists have the option of telephoning or emailing the new information to the OPR office or including the information on the Compliance Check Report. For the cases in our sample, we could not determine how many ITG office field specialists identified the need to update information since this information may have been emailed directly to the OPR office and not documented

¹² The IRS database that stores various types of taxpayer account information. This database includes individual, business, and employee plans and exempt organizations data.

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in the Compliance Check Report. However, in one case, the ITG office field specialist documented on the Compliance Check Report that updated information was obtained and submitted an email requesting that an Employer Identification Number be closed out. Another email was sent approximately 9 weeks later as a reminder. In another case, the follow-up email was sent more than 6 months after the initial request to update filing requirements. If the specific information to be updated is not documented in the Compliance Check Report, ITG office management cannot be assured the updates will be completed. If the updates are not completed timely, unnecessary notices could be sent to the tribes.

- ITG office field specialists obtained 344 delinquent returns for 17 cases (16 tribal entities) related to the cases in our sample. The effort to obtain delinquent returns may have been time consuming because the ITG office field specialists sometimes assisted in preparing returns, shipping returns to the IRS submission processing site,¹³ and processing payments. This work, although important in the interest of promoting voluntary compliance and for reducing the burden on customers, meant the ITG office field specialists could not do other ITG office case work.

The Small Business and Self-Employed (SB/SE) Division is responsible for obtaining delinquent returns for tribal entities in collection status. ITG office management advised us the SB/SE Division may not attempt to procure delinquent returns of tribal entities because of the remote locations of some tribes and because of other higher priority work. The ITG office has responsibility for obtaining delinquent returns not yet in collection status. Our review could not determine if any of the 17 cases were in collection status at the time of the compliance checks.

¹³ The IRS location that processes paper and electronic submissions, corrects errors, and forwards data to the IRS Computing Centers for analysis and posting to taxpayer accounts.

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ITG office management advised us all IRS employees have an obligation to address noncompliance, including obtaining delinquent returns. The ITG office field specialists attempt to obtain delinquent returns during a compliance check, although this is not the sole purpose or focus of compliance checks. Accepting delinquent returns during a compliance check is viewed as a way of providing better service to their customers and as an opportunity to educate tribal entities on their filing obligations. ITG office management was monitoring compliance checks to ensure they were not held open waiting on delinquent returns from the tribes. If the specialist indicates that the tribal entity will be filing a delinquent return, the OPR office Classification and Delivery Specialist will create a follow-up item in the ITG Inventory Database. After a reasonable period of time, the IRS databases are researched to identify whether the return has been filed. If the IRS databases show the return has been received, the follow-up item is closed; otherwise, additional work actions may be considered.

Compliance check results are not used to objectively improve case selection

The effectiveness of the compliance check case selection process could be improved by incorporating the results of completed compliance checks and the field specialists' assessment of the risks of noncompliance into the data analysis. This information is crucial to improving the process of identifying the highest risk cases. From our judgmental sample, we determined the actual compliance risk as determined by the field specialists was often different from what the analyses showed (e.g., most tribal entities were determined to be at low risk of noncompliance instead of the high risk that the data analyses showed). Because compliance check results are not incorporated into the ITG Inventory Database, the ITG office's process will become less reliable in identifying entities with the highest risk of noncompliance. Further, the ITG office may not identify the most significant compliance needs of its customers or identify remedies for the most significant compliance issues.

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We reviewed a judgmental sample of 52 of the 272 compliance check cases closed in FY 2004. Most of the cases included in our sample were scored at a high risk of noncompliance by the OPR office Classification and Delivery Specialist based on the analyses. Although the data analyses identified these entities as high risk, after completing the compliance checks, the field specialists ranked most risk factors as either low risk or not applicable. For example, 27 cases were selected by the OPR office Classification and Delivery Specialist for compliance checks based on one formula indicating a high risk of noncompliance in one area. Upon completion of the compliance checks, the field specialists rated only two entities as a high risk for noncompliance in that area and five entities for a high risk of noncompliance in two other areas that had not been identified by the formula.

In addition, 12 of the 52 compliance check cases in our sample were requested by the tribe or by the ITG office field groups and, therefore, were not selected based on the OPR office Classification and Delivery Specialist data analyses. Twenty returns were secured by the field specialists in three of these cases. However, only two of the three cases had areas rated by the field specialists as high risk for noncompliance. The remaining risk factors for these 12 cases were rated as low or not applicable.

As mentioned in the Background section of this report, we conducted an earlier review of the ITG office's process for selecting compliance checks based on the risk of noncompliance. Based on the results of this audit, we have determined that the selection process needs improvement to better identify high-risk areas. We are further developing this issue in another audit;¹⁴ therefore, we did not make any recommendations in this report related to this issue.

¹⁴ *The Indian Tribal Governments Office Should Reevaluate the Compliance Check Program to Make the Best Use of Its Limited Resources* (Draft report dated August 16, 2005).

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Compliance check cases were under management control, but the process for tracking cases is not effective or efficient

The sample of compliance checks we reviewed was under ITG office management's control throughout the process from assignment through case closure. While this was important for physical inventory control, the database used to track cases through the compliance check process was not an effective or efficient tool for monitoring the progress of cases. Specifically, the database identifies the field specialists that compliance checks are assigned to but does not provide the current status of actions taken to complete the cases.

After creation of the ITG office in FY 2000, ITG office management developed several stand-alone databases to manage the ITG office workload and to maintain information that had been collected on ITG office tribes. ITG office management advised us these databases perform their individual functionality well and, collectively, they have contributed to a reduction in cycle time. However, the databases cannot be considered a nationwide management information system that provides the necessary inventory control over all case work. The databases are not integrated and do not allow updates of status information between the databases. This makes the process labor intensive for the management staff to determine why cases do not progress efficiently and what assistance the specialist or manager may need to keep the case on track.

We determined the following from our review of a sample of 52 of the 272 compliance check cases closed in FY 2004:

- The ITG Inventory Database is used as a master inventory listing for controlling compliance checks while they are being worked. This Database is maintained by the OPR office and is primarily used at the Headquarters level. Reports and listings of case inventory are generated to monitor compliance check inventory and to periodically reconcile the OPR office's records with the inventory in the field offices.
- Each of the five field group managers has a database, separate from the ITG Database, to control cases in the

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group's inventory. The databases list all work ongoing in the groups, including examinations, outreach activities, and compliance checks. These databases were developed by the OPR office for the five ITG office field groups and contain information, such as the current status of case work, that is not included on the ITG Inventory Database.

- Document Transmittals¹⁵ (Form 3210) were generally used to transfer all cases from originating to receiving offices. The originating office either prepared the Forms 3210 manually or prepared and printed the Forms 3210 from a template on its computer.

Because the ITG Inventory Database does not track the status of compliance check cases after cases are sent to field groups, ITG office management decided to manually monitor cases to better control work in progress and reduce the length of time cases are open. During the second quarter of FY 2004, the OPR office began generating a report containing a listing of each group's inventory (for example compliance check and examination cases) for the Director, ITG. This new inventory report is an example of an improvement ITG office management has made to the ITG Inventory Database and resulted in the decrease in overall cycle time for compliance checks. The Director calls each group manager approximately every 2 months to discuss the group's inventory and progress on cases. One example of why it may be beneficial to call the group manager would be on a case that has been open for an extended period of time because the particular field specialist was working on a higher priority special project rather than the case. While we recognize there will always be a need for management to conduct workload reviews, enhancement of the Database structure to include incremental cycle time data would allow for a more targeted discussion and could lead to improved productivity gains. At present, the ITG office captures incremental cycle time

¹⁵ Transmittal documents list the specific cases being sent by the originating office and enable the receiving office to confirm receipt of the cases using the same document. The recipient should verify receipt of the specific items listed, sign and date the acknowledgement copy, and mail the acknowledgement copy back to the originator.

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data on closed cases only. Expanding tracking to include open inventory would improve the currency of cycle time data and allow for an expedited improvement where opportunities are found.

ITG office management advised us they are not planning on expanding the functionality of their databases because the TE/GE Division Reporting and Electronic Examination System will provide case management, inventory control, and routing capabilities. However, at the time of our review, the TE/GE Division Reporting and Electronic Examination System was still in development and is not scheduled to be piloted until January 2006. The pilot is scheduled for a limited number of groups within the TE/GE Division and will have only limited capability.

The time period for completing compliance checks can be reduced further

Prior to the third quarter of FY 2003, the OPR office Classification and Delivery Specialist assigned all entities within an Indian tribe as one compliance check. This practice resulted in more time required to complete compliance checks because many tribes owned multiple entities. During the third quarter of FY 2003, the ITG office changed from assigning compliance checks for the entire tribe to assigning compliance checks to individual entities within a tribe. As a result of reviewing only one entity and ITG office management's emphasis on reducing the time to complete compliance checks, we determined the time it takes to initiate, execute, and close compliance check cases has been significantly reduced.

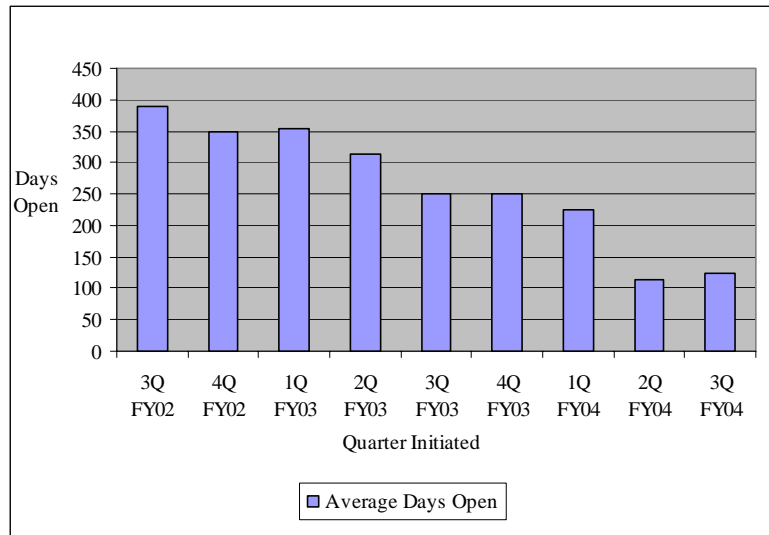
The ITG Inventory Database includes the dates the compliance checks are assigned to the groups and when they are completed. We evaluated the length of time compliance check cases were open from OPR office selection to closure for the population of 476¹⁶ closed compliance check cases in the ITG Inventory Database. We compared the time periods for compliance checks initiated from the third quarter of

¹⁶ There were 481 closed compliance checks in the ITG Inventory Database. Four cases were initiated during FY 2001, and one case was initiated during the fourth quarter of FY 2004, so we dropped them from this analysis.

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FY 2002 through the third quarter of FY 2004. Figure 1 reflects the significant decrease in the amount of time to complete a compliance check, from an average of 390 days for those initiated in the third quarter of FY 2002 to an average of 123 days for those initiated in the third quarter of FY 2004.

**Figure 1: Closed Compliance Check Cases
Average Number of Calendar Days Open
by Quarter Initiated**



Source: Analysis of ITG Inventory Database.

In evaluating the length of time for the ITG office to complete compliance checks, we identified one additional opportunity to further reduce the overall time period. From our sample, we compared the 27 cases initiated prior to the third quarter of FY 2003 to the 19 cases initiated during or after the third quarter of FY 2003. Our analysis focused on the amount of time taken to complete each step of the compliance check process. These dates were not always maintained in the ITG Inventory Database or the field groups’ databases, so we obtained them through our review of the sample cases and document transmittals used when the cases were shipped between ITG offices.

The results of our analyses are displayed in Figure 2.

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**Figure 2: Analyses of Sample Compliance Check Cases Initiated
Prior to and During or After the Third Quarter of FY 2003¹⁷**

| Steps in the Compliance Check Process | Average Calendar Days Before Third Quarter of FY 2003 | Average Calendar Days for Third Quarter of FY 2003 or After |
|---|--|--|
| Group Manager Receipt to Field Specialist Assignment | 27 | 9 |
| Field Specialist Receipt to First Contact with the Tribe | 155 | 108 |
| Tribal Contact to Start Date | 81 | 32 |
| Start Date to Completion by Field Specialist | 146 | 49 |
| Group Manager Review | 4 | 6 |
| Quality Review | 7 | 12 |
| Total Average Days To Complete Above Steps | 453 | 248 |
| Longest Open | 711 | 444 |
| Shortest Open | 279 | 105 |

Source: Analysis of Treasury Inspector General for Tax Administration's sample of ITG office compliance check case files.

Figure 2 notes a significant decrease in the average number of days for most categories tested. The total average number of days decreased from 453 days (approximately 15 months) prior to the third quarter of FY 2003 to 248 days (approximately 8 months) for cases initiated during or after the third quarter of FY 2003. This is an average decrease of 205 days (approximately 7 months) per case. The slight increase in time for the QR function was caused by a reduction in the QR function staff during the last half of FY 2004.

The one step in the process with the potential for further reduction is making initial contact with the tribe. Although there was a decrease from 155 to 108 days for the field specialists to contact the tribes, this is longer than what group managers expect. However, because this time period

¹⁷ The number of days for the categories tested will not add up to the total average days open because the time required to mail cases from one location to another is not included in the individual steps, but the mail time is included in the total average days open.

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is not tracked on the ITG Inventory Database, ITG office management was not aware of the extent of these delays in contacting the tribes. ITG office management advised us their practice is to order compliance check cases when their groups needed work. In addition, although the ITG office field specialists normally research IRS databases to obtain the current status of the tribal entity's account before they contact the tribe, the group managers generally expect their field specialists to initiate the cases as soon as possible. One group manager expected cases to be initiated within 30 to 45 days. There are currently no time standards for the ITG office field specialists to initiate contact with the tribes for compliance check cases.

Automatically creating electronic Forms 3210 should result in more efficient handling of cases

ITG office managers and employees prepare Forms 3210 by manually preparing the Form 3210 or by preparing a computer template. When preparing the document, all information must be typed or written in. However, use of current technology would improve the efficiency of preparing Forms 3210 for compliance checks or other cases that need to be transferred between offices, such as examinations.

The information needed to complete preparation of Forms 3210 is stored in the ITG Database. These data fields include the entity name, Employer Identification Number, date, control number, etc. Form 3210 templates could be created in a computer database report format and drop down menus added for the specific tribal information for each field group. Creating the Forms 3210 in a database environment would not only increase the efficiency of creating the Forms 3210 and the accuracy of information on the Forms 3210, it would make them more consistent and create an electronic rather than a paper record of the case movement between offices.

Recommendations

The Director, ITG, TE/GE Division, should:

1. Correct the data in the ITG Inventory Database for the compliance check cases that were closed with the

The Indian Tribal Governments Office Can Improve the Effectiveness, Consistency, and Efficiency of Compliance Checks

incorrect closing code and revise the formula in the ITG Database that calculates the number of completed compliance checks.

Management's Response: ITG office management corrected the data for the compliance check cases that were closed with the incorrect closing code and revised the ITG Database formula that calculates the number of completed compliance checks.

2. Require information identified during compliance checks that should be used to update the ITG Database or the IRS Master File to be recorded on the Compliance Check Report. This new requirement would not affect the practice of emailing the information to the OPR office.

Management's Response: ITG office management is in the process of revising the ITG office work templates. The revised Compliance Check template will include a summary sheet to capture all of the data updates reported during the compliance check.

3. Clarify the expectation of contacting tribes as soon as possible by establishing time standards for the field groups to initiate compliance checks.

Management's Response: The ITG Director issued guidance requiring initial customer contact within 60 days of case assignment to the group.

4. Consider automating the document transmittal process.

Management's Response: TE/GE Division management considered automating the document transmittal process and decided to address this issue during future development of the TE/GE Division Reporting and Electronic Examination System.

Detailed Objectives, Scope, and Methodology

Our overall objectives were to determine whether the Indian Tribal Governments (ITG) office executes compliance checks effectively and consistently to better understand its customers and to identify appropriate remedies for compliance issues and has developed a methodology for measuring the impact of compliance checks on its customer base.

To accomplish these objectives, we:

- I. Determined whether ITG office management has established guidelines for effective and consistent control and execution of compliance checks and scheduling of follow-up activities, as appropriate.
 - A. Interviewed ITG office management and ITG office field group managers to identify their procedures for effective and consistent control and execution of compliance checks and scheduling of follow-up activities, when appropriate.
 - B. Researched the Internal Revenue Manual to identify documented procedures for effective and consistent control and execution of compliance checks and scheduling of follow-up activities, when appropriate.
 - C. Developed flowcharts to gain an understanding of ITG office management's process for the control and execution of the compliance checks and the scheduling and completion of follow-up activities.
- II. Determined the effectiveness and consistency of the control and execution of compliance checks and scheduling of follow-up activities.
 - A. Obtained the most current ITG Inventory Database¹ to identify the compliance checks closed during Fiscal Year (FY) 2004 and the Quality Review function database.
 - B. Selected a judgmental sample of 52² compliance check cases, out of the 272 closed during FY 2004, from the ITG Inventory Database for review. This sample was selected by taking 10 cases from each of the 3 ITG office market segments (Alaska Tribes, Gaming, and Nongaming) and 5 cases from each of the 5 field groups. We selected the sample judgmentally due to time constraints.

¹ The ITG Inventory Database, which is a subset of the ITG Database, was developed by the Outreach, Planning, and Review office in Fiscal Year 2001 to analyze filing and payment characteristics and control nonexamination activities, such as compliance checks and tip rate reviews.

² We selected a sample of 55 cases that were assigned and closed on the ITG Inventory Database. However, compliance checks were not conducted for three of the entities in our sample. One entity was an exempt organization and not an ITG office customer, one entity was a defunct business, and another entity declined to have a compliance check conducted.

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- C. Determined whether the inventory controls were operating as intended to provide assurance that compliance checks were under management's control at the following transfer points: from the ITG Outreach, Planning, and Review (OPR) office to the field group manager, from the field group manager to the ITG office field specialist, from the ITG office field specialist to the group manager, from the group manager to the Quality Review function, and from the Quality Review function to the OPR office for database update and case closure. We evaluated delays in transferring the compliance checks between the transfer points.
 - D. Evaluated the Compliance Check Reports for the sample of cases to determine whether the compliance check reviews were complete and consistent according to ITG office guidelines.
 - E. Selected all 18 compliance check cases with recommended follow-up activities indicated on the Database, from the 272 cases closed during FY 2004, and determined whether the follow-up activities had been scheduled and completed.
- III. Determined whether ITG office management has established basic goals for FY 2005 for the compliance check program and developed a methodology to measure the effectiveness of their compliance check process and the impact their compliance check process has on improving compliance in their customer base.
- A. Determined whether ITG office management has developed a method to measure compliance levels in their customer base.
 - B. Determined whether the ITG office has developed a method to measure the impact their compliance check process has on overall compliance.
 - C. Determined whether the ITG office established numeric goals for compliance checks completed and whether this goal has been met in the past.
 - D. Determined whether there is a time standard for completing compliance checks, either formal or informal.
 - E. Determined whether there is a time standard for completing recommended follow-up actions.

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Consistency, and Efficiency of Compliance Checks**

Appendix II

Major Contributors to This Report

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Appendix III

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Appendix IV

Outcome Measures

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

Type and Value of Outcome Measure:

- Reliability of Information – Actual; five compliance check cases for five Indian tribal entities erroneously included in counts of completed compliance checks (see page 6).

Methodology Used to Measure the Reported Benefit:

We identified that the Quality Review staff of the Indian Tribal Governments (ITG) Outreach, Planning, and Review office determined 5 of the 272 compliance checks closed in Fiscal Year 2004 did not qualify for closure as completed compliance checks. However, these five cases were included in the number of completed compliance checks reported in Fiscal Year 2004. The five cases did not qualify for the following reasons:

- Two cases were surveyed (closed) before the compliance checks were initiated. Generally, ITG office management does not consider surveyed compliance checks as closed compliance checks. We determined there were many other compliance checks in the ITG office's database that were closed as surveys but not counted as closed compliance checks.
- Two cases indicated the customers declined the compliance checks.
- One case was incomplete, and the work did not qualify the case as a compliance check.

Indian Tribal Governments Office Compliance Check Process

A compliance check is a review conducted by an Indian Tribal Governments (ITG) office field specialist under Title 26 of the Internal Revenue Code. It is not an examination of books and records. Rather, it represents an opportunity for the ITG office field specialist to better understand the customer through both a review of the customer's filing requirements, as well as a discussion of the customer's tax issues, problems, and concerns. Guidelines for conducting compliance checks are in the Internal Revenue Manual.

A compliance check is clearly different from an examination¹ or an audit in that it does not seek to make a determination of tax liability. The ITG office field specialists are instructed to inform the taxpayer that a compliance check does not qualify as an inspection under Section 7605(b) of the Internal Revenue Code² or as an audit for purposes of Section 530 of the Revenue Act of 1978.³ The scope of the compliance check is limited to a check of documents that have already been voluntarily supplied to the Internal Revenue Service (IRS) or informational forms that are not actually in the IRS' possession (e.g., Employee's Withholding Certificate (Form W-4)). The taxpayer's books and records should not be requested or examined. Compliance checks are voluntary, and taxpayers can decline the compliance check. The Outreach, Planning, and Review (OPR) office Classification and Delivery Specialist identifies tribal entities most in need of compliance checks, creates the case files, and sends them to the field groups. The group managers assign the cases to their field specialists to conduct the compliance checks. The ITG office field specialists document the results of the compliance checks in the Compliance Check Report template. The template includes the following information:

- Tribal contacts, activities, and Employer Identification Numbers for tribal-related enterprises.
- Assessment of the compliance risk for employment tax, information reporting, anti-money laundering statute violations, tip reporting, and excise tax.
- Customer concerns and requests for assistance.
- Recommendations for future activity (e.g., examinations, and education and outreach).
- A closing letter to the tribe, sent by the Quality Review (QR) function staff.

¹ An examination or audit is a review of an entity's books and records for the purpose of determining the correct tax liability.

² 26 U.S.C. § 7605(b) (1988).

³ Section 530 of the Revenue Act of 1978, Public Law 96-600, 92 Stat. 2885 (1978) as amended by Public Law 96-167, 93 Stat. 1278 (1979); Public Law 96-541, 95 Stat. 3204 (1980); Public law 97-248, 96 Stat. 552 (1982); and Public Law 104-188, 110 Stat. 1766 (1996).

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If the ITG office field specialist determines the tribe is not fully complying with its filing and payment responsibilities, the field specialist can take one or more of the following actions:

- Work to correct minor problems immediately.
- Schedule another visit to follow up with additional outreach or other action to assist the taxpayer.
- Propose an examination when warranted.

Upon completion of the compliance check, the field specialist returns the case to the group manager where it is reviewed for completeness. The manager then forwards the case to the OPR office QR function where the case is further reviewed using written Quality Standards. All compliance checks are subject to quality review. The QR function staff evaluates the ITG office field specialist's documentation and actions based on established standards. If the QR function identifies problems with the compliance check that require additional work by the field specialist, the compliance check is returned to the field. If no problems requiring additional work are identified, the closing letter is mailed to the tribe, and the compliance check is sent to the ITG office Classification and Delivery Specialist for closure in the ITG Inventory Database.⁴ Closing actions include updates to the ITG Inventory Database such as adding new entities, deleting entities that are no longer owned by the tribe, updating filing requirements, and updating tribal contacts. The ITG office Classification and Delivery Specialist also inputs and tracks actions identified during the compliance checks for later follow-up, such as monitoring accounts to determine whether returns have been filed.

⁴ The ITG Inventory Database, which is a subset of the ITG Database, was developed by the OPR office in Fiscal Year 2001 to analyze filing and payment characteristics and control nonexamination activities, such as compliance checks and tip rate reviews.

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Appendix VI

Management's Response to the Draft Report



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

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MEMORANDUM FOR DEPUTY INSPECTOR GENERAL FOR AUDIT

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

SUBJECT: The Indian Tribal Governments Office Can
Improve the Effectiveness, Consistency, and
Efficiency of Compliance Checks
(Audit # 200510010)

I am pleased to respond to your report concerning our Compliance Check process. The review considered control and closure processes for Compliance Checks performed within our Indian Tribal Governments (ITG) function.

We believe the ITG management information system, although perhaps not elegant, functions well and ably serves the needs of the Director and managers of ITG. As stated in the report, the ITG Database contains over 200 fields, many relating to the tracking of inventory and cycle time. The report's observation that the database may be inadequate to monitor Compliance Checks is inconsistent with our experience and our results in managing the program.

The report suggests that the addition of further data fields or the integration of regional databases into a national database would improve case monitoring. We agree that there are opportunities for improvement here, and we are working to make such improvements as our TE/GE Reporting and Electronic Examination System (TREES) comes on line. We also believe, however, that the active engagement of ITG managers with employees has resulted in very effective case monitoring, because this engagement enables ITG to get behind the data to discover and discuss causal information. As a small organization, ITG may be able to accomplish this in a way a large organization cannot.

As the report notes, ITG has made remarkable progress in reducing Compliance Check cycle time by two-thirds. We believe that the engagement of managers and employees that began to occur in early FY 2004 was a major factor in this accomplishment. (The bar graph on page 16 of the report shows that the greatest decrease in cycle time occurred in the same quarter that this engagement began.) Nonetheless, we concur that further improvement can be made.

The Indian Tribal Governments Office Can Improve the Effectiveness, Consistency, and Efficiency of Compliance Checks

RECOMMENDATION 1:

Correct the data in the ITG Inventory Database for the compliance check cases that were closed with the incorrect closing code, and revise the formula in the ITG Database that calculates the number of completed compliance checks.

CORRECTIVE ACTION 1:

The data and formula errors were remedied during the audit, and the corrected number of Compliance Checks closed during FY 2004 is now properly reflected as 267, which still exceeded the FY 2004 goal. We concur that the errors affected five cases.

IMPLEMENTATION DATE:

Completed.

RESPONSIBLE OFFICIAL:

Director, Indian Tribal Governments, Tax Exempt and Government Entities.

CORRECTIVE ACTION MONITORING PLAN:

This action has been completed.

RECOMMENDATION 2:

Require information identified during compliance checks that should be used to update the ITG Database or the IRS Master File to be recorded on the Compliance Check Report. This new requirement would not affect the practice of emailing the information to the OPR.

CORRECTIVE ACTION 2:

We are in the process of revising all of the ITG work templates, both for content and format. The revised ITG Compliance Check template includes a summary sheet to capture all of the data updates reported during the Compliance Check.

IMPLEMENTATION DATE:

January 15, 2006.

RESPONSIBLE OFFICIAL:

Director, Indian Tribal Governments, Tax Exempt and Government Entities.

CORRECTIVE ACTION MONITORING PLAN:

We will monitor this corrective action through regular business processes including the Business Review Process of the Commissioner of Internal Revenue, and the Inventory Tracking and Closure system of the Treasury Department.

The Indian Tribal Governments Office Can Improve the Effectiveness, Consistency, and Efficiency of Compliance Checks

RECOMMENDATION 3:

Clarify the expectation of contacting tribes as soon as possible by establishing time standards for the field groups to initiate compliance checks.

CORRECTIVE ACTION 3:

The ITG Director has issued guidance that all Compliance Check cases must have initial contact with the entity within 60 days from assignment to the group by OPR.

IMPLEMENTATION DATE:

Completed.

RESPONSIBLE OFFICIAL:

Director, Indian Tribal Governments, Tax Exempt and Government Entities.

CORRECTIVE ACTION MONITORING PLAN:

This action has been completed.

RECOMMENDATION 4:

Consider automating the document transmittal process.

CORRECTIVE ACTION 4:

TEGE has considered this recommendation and will address it as the division continues to develop and implement TREES.

IMPLEMENTATION DATE:

Completed.

RESPONSIBLE OFFICIAL:

Director, Indian Tribal Governments, Tax Exempt and Government Entities.

CORRECTIVE ACTION MONITORING PLAN:

This action has been completed.