



June 2014

IRS CORRESPONDENCE AUDITS

Better Management Could Improve Tax Compliance and Reduce Taxpayer Burden

GAO Highlights

Highlights of [GAO-14-479](#), a report to the Committee on Finance, U.S. Senate

Why GAO Did This Study

IRS uses correspondence audits (done by mail and the majority of IRS audits) to resolve disputes over tax return reporting of relatively simple issues. Tax observers and IRS itself have concerns that these audits impose unnecessary burden on taxpayers or costs on IRS.

GAO was asked to assess the audit program. In this report, GAO assessed the extent to which (1) IRS correspondence audit notices create unnecessary burden or costs; (2) IRS can determine if the audits are meeting its compliance, burden, and cost goals; and (3) IRS's improvement efforts are likely to deliver the expected benefits.

GAO visited two IRS audit sites, analyzed IRS audit program objectives, measures, and decisions, and documented improvement efforts, and interviewed program officials and IRS tax examiners. GAO compared IRS's practices to internal control guidance and criteria for results-oriented management.

What GAO Recommends

GAO recommends that IRS (1) collect and analyze data on whether IRS is responding timely in revised audit notices, (2) establish program objectives as well as measures that reflect the objectives and strategic goals, (3) document guidance for making decisions with program data, (4) track previously unused program data to provide more performance insights, (5) document the intended and actual benefits of audit improvement efforts, and (6) develop a plan and timeline for implementing the contractor's recommendations. In commenting, IRS described planned actions on all the recommendations.

View [GAO-14-479](#). For more information, contact James R. White at (202) 512-9110 or whitej@gao.gov.

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Better Management Could Improve Tax Compliance and Reduce Taxpayer Burden

What GAO Found

The notices the Internal Revenue Service (IRS) sends during correspondence audits have misled taxpayers by providing unrealistic time frames on when IRS would respond to their correspondence. For example, notices stated that IRS would respond within 30 to 45 days when it has consistently taken several months to do so. Further, as of early 2014, IRS data show that it had not responded timely to more than 50 percent of the correspondence taxpayers sent. In many cases, refunds are held up until the audit is finished. According to IRS tax examiners, notices caused taxpayer frustration and generated unnecessary taxpayer calls to IRS. Furthermore, examiners who answer such calls said they do not know when IRS will respond. IRS recently revised the notices, but the revisions were not based on analysis of historical data nor did IRS have a plan to analyze data to ensure it is responding timely per revised notices.

The taxpayers cannot understand why IRS would send a letter out with such unrealistic time frames and there is no acceptable way we can explain it to them. That is why they are so frustrated. It puts us in a very awkward and embarrassing situation.... I try to gain control of the situation and tell the taxpayer I understand the frustration so that he will calm down so we can make the phone call productive, but this takes time and wastes time for both the taxpayer and me.

Source: tax examiner focus group interview.

IRS does not have information to determine how the correspondence audit program affects its compliance, taxpayer burden, and cost strategic goals. IRS has not documented objectives for the program. While IRS has many program measures such as how many audits are closed annually, they are not linked to the compliance, burden, and cost goals. Thus, it is not possible to tell whether the program is performing better or worse from one year to the next. Beyond the measures, IRS did not have guidance on how IRS managers were to use program data to make decisions. In some cases, the program data being used are incomplete. For example, IRS did not track data on the number of times a taxpayer called IRS or sent documents. Using incomplete information limits insights on the additional revenues identified from IRS's audit investments and on how much burden the audits impose on the taxpayers.

In 2012 IRS began its Correspondence Examination Assessment Project (CEAP) to reduce taxpayer burden. With a contractor, IRS identified five problem areas involving communications with taxpayers, the audit process, expedited audit resolution, resource alignment, and program metrics. CEAP has 19 improvement efforts finished or underway. However, IRS has not defined the intended benefits and tracked the actual benefits. As a result, it will be difficult to determine whether the efforts successfully addressed the problems. The CEAP contractor recommended that IRS develop a tool for better balancing resource allocation between, for example, telephone calls and reviewing correspondence. IRS officials said they would consider the recommendations but did not have a specific plan or timeframe. Thus, it will be difficult to hold IRS managers accountable for ensuring that the recommendations are completed in a timely manner.

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Abbreviations

AUR	Automated underrporter
CEAP	Correspondence Examination Assessment Project
FTE	Full time equivalent
GPRA	Government Performance Results Act
GPRAMA	Government Performance Results Act Modernization Act
EITC	Earned income tax credit
IRM	Internal Revenue Manual
IRS	Internal Revenue Service
SB/SE	Small Business and Self-Employed Division
TDC	Taxpayer Digital Communication
W&I	Wage and Investment Division

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June 5, 2014

The Honorable Ron Wyden
Chairman
The Honorable Orrin Hatch
Ranking Member
Committee on Finance
United States Senate

Auditing tax returns is a critical part of the Internal Revenue Service's (IRS) strategy to ensure tax compliance and address the tax gap, or the difference between taxes owed and those paid on time. IRS most recently estimated the tax gap as \$450 billion for 2006. IRS eventually recovers part of the tax gap through enforcement actions—including audits—and late payments. For 2006, it estimated it would recover \$65 billion, resulting in a net tax gap of \$385 billion.

Most audits are correspondence audits, which are done by mail. For audits closed in fiscal year 2012 of individual tax returns, correspondence audits accounted for:

- Seventy-six percent (1.1 million) of 1.5 million audits, and
- Sixty percent (\$9.2 billion) of \$15.3 billion in recommended additional taxes due and refunds disallowed.¹

Compared to in-person audits conducted at taxpayer locations or IRS offices, correspondence audits are designed to deal with simpler tax issues such as a questionable deduction or credit. Typically the taxpayer is asked to provide supporting documentation by mail. Deciding which returns to audit and preparing audit notices for taxpayers are handled largely through automation. Taxpayer responses to these notices, including any supporting documentation, are reviewed by IRS staff who then decide on whether to recommend any additional tax.

¹Any IRS audit of a tax return can close with the IRS examiner recommending that the taxpayer owes additional tax because the examiner found evidence of misreported income, deductions, credits, and the like. If the tax return claims a refund that has not yet been sent to the taxpayer, IRS may reduce the amount of the refund based on the auditing findings. The audits included returns for tax year 2011 and previous years.

IRS-wide goals for programs such as the correspondence audit program are to address taxpayer noncompliance while minimizing unnecessary burden on the taxpayers being audited and costs. Members of the tax community, and IRS itself, have expressed concerns about the effectiveness of the program at achieving these goals. Concerns include confusing audit notices, delayed IRS responses to taxpayer correspondence, duplicative requests for information from taxpayers, cases that required multiple contacts between IRS and taxpayers to resolve, and telephone help that is not informative. In response, IRS has begun a series of improvement efforts.

You asked that we evaluate the correspondence audit program in terms of its effects on compliance, taxpayer burden, and IRS costs along with potential improvements. Our objectives were to (1) assess the extent to which IRS's correspondence audit notices impose unnecessary burden on taxpayers or create inefficiencies for IRS; (2) assess the extent to which IRS has performance information suitable for determining whether the program is meeting its program objectives as linked to IRS's strategic compliance, taxpayer burden, and cost goals; and (3) describe the status and results of IRS's efforts to improve the correspondence audit program and assess how IRS is ensuring that the changes deliver expected benefits.

To assess the extent to which IRS's correspondence audit notices prompt unnecessary burden on taxpayers or create inefficiencies for IRS, we reviewed program documents, interviewed program officials in the two IRS divisions that conduct correspondence audits, visited and interviewed program officials at two IRS locations (one for each division) where IRS conducts correspondence audits, and conducted six focus group interviews (three for each division) with tax examiners who interact with the audited taxpayers. We also monitored taxpayer phone calls at the two IRS locations and recordings of a nonrepresentative random sample of phone calls received nationwide during a week in September, November, and December 2013.² We compared IRS's processes for contacting taxpayers with internal control standards in the federal government for

²Before telephone calls are routed to an examiner, callers are informed by an IRS recording that the call may be monitored or recorded for quality purposes. According to IRS officials, IRS retains recorded calls for 45 days.

ensuring efficient use of resources.³ To assess the extent to which IRS has performance information for determining how correspondence audits affect compliance, IRS costs, and taxpayer burden, we compared information on correspondence audit program objectives, performance measures, and decision making to guidance on federal program management and internal control standards in the federal government. To describe the status and results of IRS's efforts to improve the correspondence audit program, we reviewed and summarized documentation and interviewed IRS officials on IRS's Correspondence Examination Assessment Project (CEAP), which is an IRS effort to improve the program. We compared information available on the management and benefits of the CEAP effort to criteria on project management on assuring benefits are achieved.⁴ More details on our scope and methodology are in appendix I.

We conducted this performance audit from August 2013 to June 2014 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Background

IRS Audits Compared to Other IRS Enforcement Efforts

IRS has a range of compliance programs intended to ensure that taxpayers are accurately reporting their incomes and tax liabilities on their tax returns. Some of the common ones are:

- **Math error**, which corrects certain obvious errors on tax returns at the time they are filed, such as claiming a credit above the allowed income threshold.

³GAO, *Standards for Internal Control in the Federal Government* ([GAO/AIMD-00-21.3.1](#), November 1999).

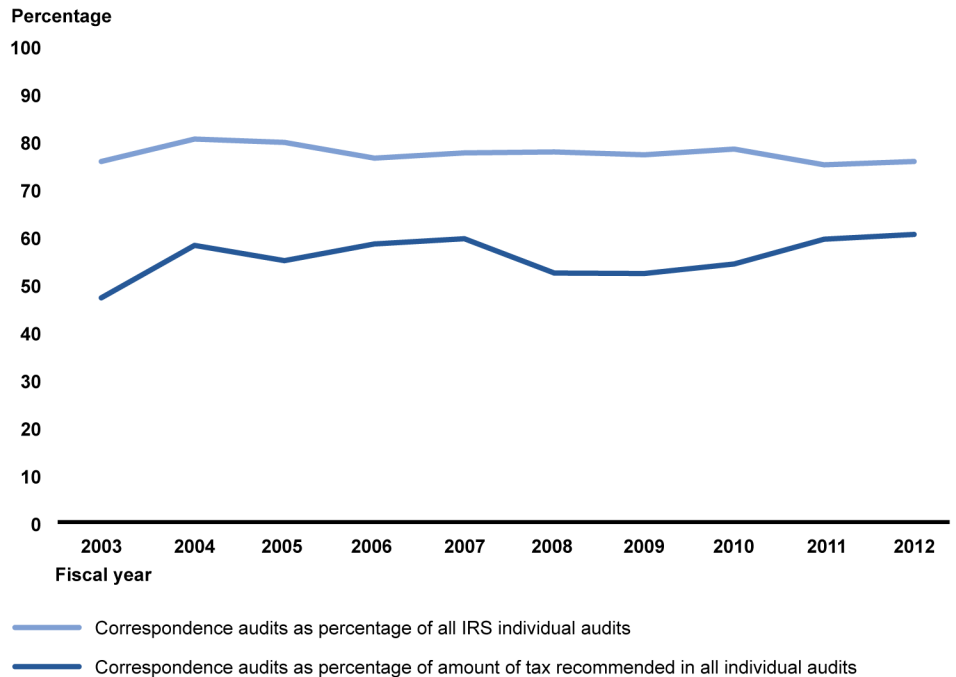
⁴Project Management Institute, *The Standard for Program Management*, 2nd ed. (Newtown Square, Pa.; Project Management Institute, Inc., 2008).

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- **Automated underreporter (AUR)**, which matches income data reported on a tax return with third-party information about income and expenses provided to IRS by employers or financial institutions. Mismatches can result in IRS asking the taxpayer to explain the discrepancy or pay additional tax.
 - **Non-filer**, which uses the third party information to identify people who do not file a required tax return. Some non-filer cases may be forwarded for audit, according to IRS officials.
 - **Audits**, which can be done through correspondence or in-person, focusing on an examination of a taxpayer's books and records to support a position on a tax return.

Comparative
Correspondence Audit
Volume Data

Correspondence audits are the majority of IRS audits and, since 2004, have accounted for the majority of additional tax recommended, as shown in figure 1 below (see appendix II, tables 4 and 5, respectively, for data on the number of individual audits and amount of tax recommended in individual audits).

Figure 1: Correspondence Audits as Compared to Total IRS Individual Audits, Fiscal Years 2003-2012



Source: IRS Data Book information.

Purpose and Administration of IRS Correspondence Audits

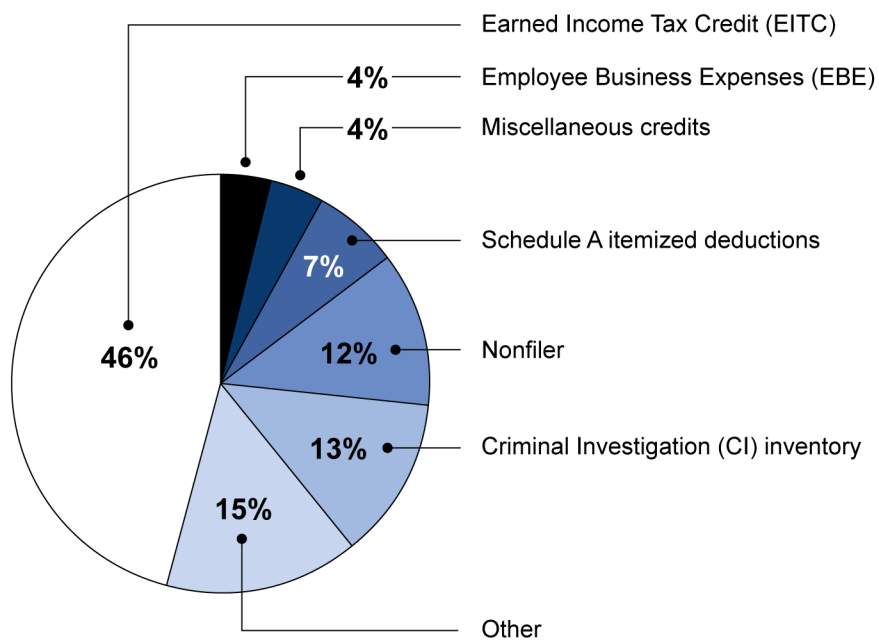
Audits have two compliance effects. First, they directly detect and correct noncompliance by the audited taxpayers. Second, audits indirectly encourage nonaudited taxpayers to comply – often called voluntary compliance. In a recent IRS Oversight Board survey on taxpayer attitudes, 60 percent of taxpayers surveyed said that “fear of an audit” had at least somewhat of an influence on whether they honestly report and pay their taxes.⁵

IRS’s Wage and Investment (W&I) and Small Business and Self-Employed (SB/SE) divisions both do correspondence audits of individual tax returns. These audits cover two broad sets of issues: earned income

⁵IRS Oversight Board, *2013 Taxpayer Attitude Survey*, February 2014 (http://www.treasury.gov/IRSOB/reports/Documents/IRSOB_TAS%202013.pdf, downloaded February 2014).

tax credit (EITC) issues and nonEITC issues.⁶ Each division receives a specified budget amount for each of the two categories. Within these categories, IRS uses 229 discrete project codes to track specific tax issues and related sub issues that can be audited. Each division is responsible for determining how many audits, if any, to do for each issue. Figure 2 shows, for cases closed in fiscal year 2013, the percentage of cases that fell within selected broad categories of issues.⁷

Figure 2: Percentage of Correspondence Audits Closed Categorized by Type of Issue Audited, Fiscal Year 2013



Source: GAO analysis of IRS data.

Note: "other" includes nearly two dozen discrete issues from tax return line items, each of which is 3 percent or less. Total does not add to 100 percent due to rounding.

⁶EITC is a refundable credit used to offset the impact of Social Security taxes on low-income families and to encourage them to seek employment rather than welfare. The amount of the credit individuals receive depends on earned income, the number of qualifying children, and filing status.

⁷Appendix II, figure 4, provides another view of how IRS invests its correspondence audit time on these broad categories of issues for audits closed in fiscal year 2013.

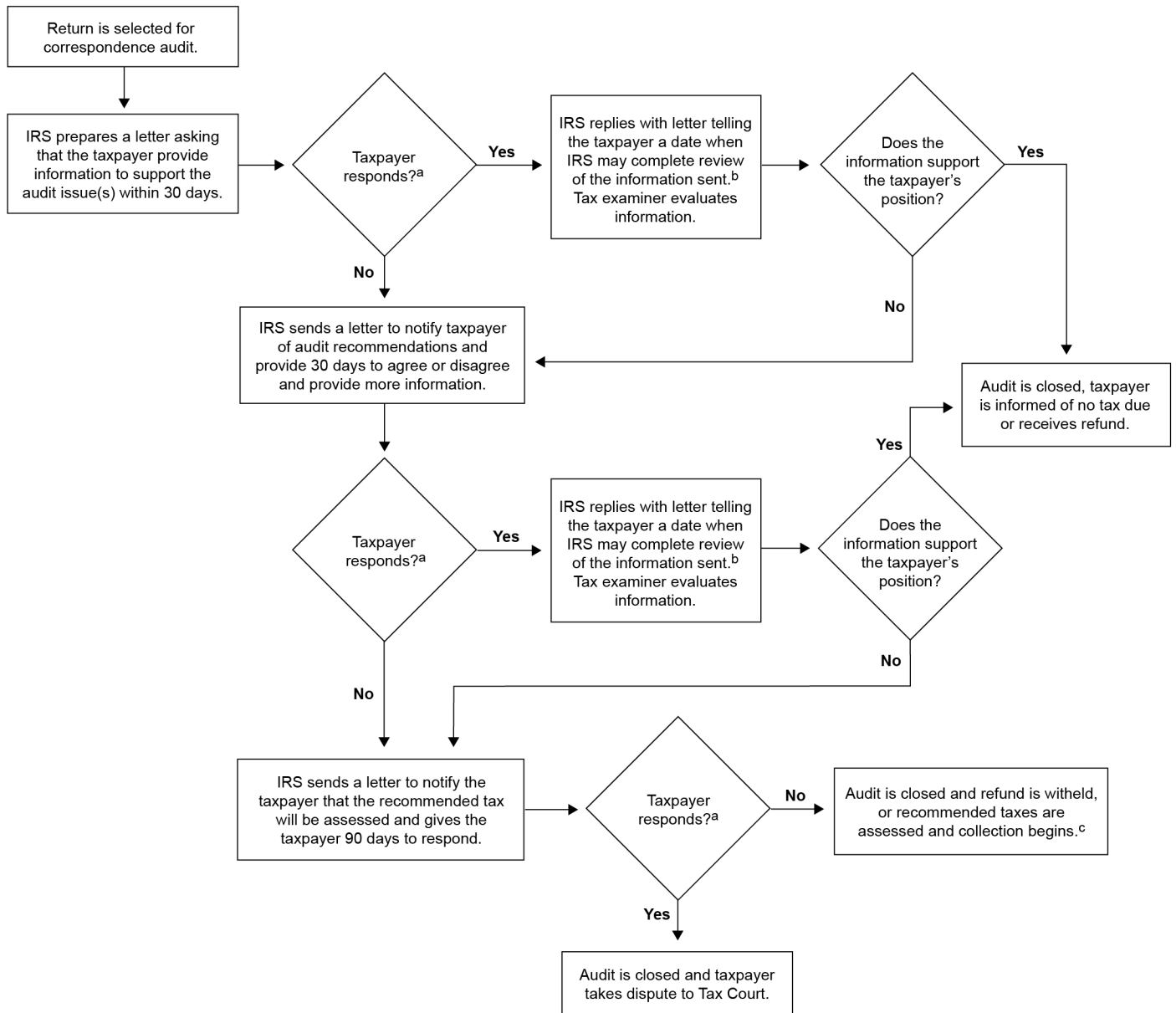
IRS selects most returns for correspondence audit through an automated scoring process. For example, the main determinant for selecting EITC returns for audit is the score from the Dependent Database (DdB). DdB relies on decision rules applied to tax returns claiming EITC and related tax benefits.⁸ Using filters created from various criteria, the DdB creates scores for returns before refunds are disbursed. Returns with the highest scores are selected for audit. According to IRS officials, a few returns are selected for correspondence audit as a result of a manual review after being referred for audit from other parts of IRS, the states, or others.

For any tax issue covered by correspondence audits, IRS can only audit a limited number of returns that the various filters select. As a result, IRS selects issues and numbers of returns to audit based on considerations identified by IRS staff, such as the potential effect on voluntary compliance or to address issues at risk for noncompliance.

The correspondence audit process can take a number of different paths after audit selection, as shown in figure 3. The paths are largely determined by how taxpayers respond to IRS.

⁸These tax benefits include dependency exemptions, filing status, Child and Dependent Care Credit, Child Tax Credit, and education benefits, according to IRS officials.

Figure 3: Simplified Overview of the Correspondence Audit Process as of February 2014



Source: GAO analysis of IRS information.

^aFor simplicity, a “yes” response at this stage means the taxpayer disagreed with IRS and provided information to support the taxpayers’ position on the return. At any stage, taxpayers may agree with the recommended change and pay any tax due.

^bThe notices say that IRS will again contact the taxpayer if IRS needs additional time to review the information. Before February 2014, the notices told taxpayers to expect an IRS response on a certain date.

^cTaxpayers who offer new information may request an audit reconsideration, during which collection action is suspended, according to IRS officials.

IRS tax examiners do the correspondence audits. Tax examiners are the lowest-graded IRS staff who audit returns and are trained to handle correspondence audit-type workload. Located in 10 IRS offices nationwide called campuses (5 campuses for each division), they are to review taxpayer correspondence to make audit determinations.

Examiners also answer telephone calls from taxpayers who call designated correspondence audit toll-free numbers.⁹ In recent years, IRS switched to nationwide routing of calls rather than providing taxpayers phone numbers for specific examiners. The nationwide system links the multiple campuses into a “virtual” call center that is accessed through one toll-free number for each division. The system distributes calls to the next available examiner. This change was to eliminate the need to leave a voice message, and could result in fewer repeat calls.

Performance Management Information and Controls Help Agencies Assure Results and Best Use of Federal Resources

A key practice in results-oriented management of federal agencies is the establishment of agencywide, long-term strategic goals. The Government Performance and Results Act of 1993 (GPRA),¹⁰ which was significantly enhanced by the GPRA Modernization Act of 2010 (GPRAMA),¹¹ requires federal agencies to, among other things, develop strategic plans with long-term, outcome-oriented goals, annual goals linked to achieving the long-term goals, and annual reports on the results achieved.

IRS’s strategic plan includes goals to achieve compliance results at the lowest IRS costs and least taxpayer burden. Under these strategic goals, IRS staff are to (1) direct resources toward enforcement activities that target existing and emerging high-risk areas and that focus on the highest risk of noncompliance, (2) use data and research to make informed

⁹The toll-free lines for correspondence audits differ from other IRS toll-free lines for taxpayers to call about filing returns, arranging for payment of taxes due, clarifying the status of their tax accounts, and the like.

¹⁰Pub. L. No. 103-62, 107 Stat. 285 (Aug. 3, 1993).

¹¹Pub. L. No. 111-352, 124 Stat. 3866 (Jan. 4, 2011).

resource allocations as well as other decisions related to enforcement activities, and (3) minimize the costs and negative effects of tax enforcement programs on taxpayers by respecting taxpayer rights and minimizing taxpayer burden while enhancing the taxpayer experience through improved service to make voluntary compliance easier and expedite resolution.

Standards for internal control in the federal government and federal guidance on performance management call for agencies to establish objectives and performance measures for programs that clearly link to agencywide goals.¹² As our prior work has shown, performance measures are a key tool to help managers assess progress toward the stated agencywide strategic goals and program-level objectives.¹³ Leading agencies seek to establish clear hierarchies of results-oriented performance measures and targets to ensure that the agency is achieving its mission and strategic goals. Such performance measures help agencies make resource decisions and foster accountability to communicate agency progress to Congress and the public.

Internal control is a major part of managing an organization.¹⁴ It comprises the plans, methods, and procedures used to meet missions, goals, and objectives, which supports performance-based management. Internal control, which is synonymous with management control, helps agency program managers achieve desired results and provide reasonable assurance that program objectives are being achieved through, among other things, effective and efficient use of agency resources. In addition, internal control standards in the federal government call for agencies to promptly review, evaluate, and determine

¹²[GAO/AIMD-00-21.3.1](#).

¹³For example, see our findings in GAO, *Program Performance Measures: Federal Agency Collection and Use of Performance Data*, [GAO/GGD-92-65](#) (Washington, D.C.; May 4, 1992); *Agencies' Annual Performance Plans Under the Results Act: An Assessment Guide to Facilitate Congressional Decisionmaking*, [GAO/GGD/AIMD-10.1.18](#) (Washington, D.C.; February 1998); *Results-Oriented Cultures: Creating a Clear Linkage between Individual Performance and Organizational Success*, [GAO-03-488](#) (Washington, D.C.; Mar. 14, 2003); and *Managing for Results: Enhancing Agency Use of Performance Information for Management Decision Making*, [GAO-05-927](#) (Washington, D.C.; Sept. 9, 2005).

¹⁴[GAO/AIMD-00-21.3.1](#).

the proper actions to take in response to findings from audits and other reviews including those making recommendations for improvements.

Within a program, projects that use generally recognized good management practices can enhance the chances of success and ensure the best use of resources. One such practice is benefits management, which entails actions and techniques for defining, creating, maximizing, and sustaining benefits. Benefits management requires that projects have clearly defined expected benefits that align with program objectives and strategic goals. This includes having processes to plan, measure, and realize project benefits. Benefits management is to be done throughout a project and includes reporting planned versus actual benefits at various points and forecasting future benefits. As a result, an agency is better able to ensure that the value promised by the project is realized and that decisions are justified and made rationally so that agency resources are used well.¹⁵

Taxpayer Burden, Experience, and Satisfaction

Taxpayer burden is the direct time and money that taxpayers spend to comply with tax laws. In our tax system, taxpayers must spend some time and money on tax compliance. A key concept in tax administration is reducing unnecessary burden. Time-related measures of taxpayer experience or customer satisfaction can be useful in gauging how IRS's administration of the tax law affects taxpayers.

Tax professional groups, congressional stakeholders, and the National Taxpayer Advocate have all raised concerns about taxpayers' burden and experience in the correspondence audit program.¹⁶ According to IRS officials, the comments critical of the program prompted IRS to start a comprehensive program review in 2012, the Correspondence Examination Assessment Project (CEAP). CEAP focused on five problem areas to improve the taxpayer experience and reduce taxpayer burden in undergoing a correspondence audit.¹⁷ IRS used a contractor to support

¹⁵Project Management Institute, *The Standard for Program Management*, 2nd ed. (Newtown Square, Pa.; Project Management Institute, Inc., 2008).

¹⁶For example, see National Taxpayer Advocate, *2011 Annual Report to Congress Volume Two: TAS Research and Related Studies*, IRS Publication 2104-B (Washington, D.C., Dec. 31, 2011).

¹⁷These problems areas are discussed later in this report.

CEAP. Among other things, the contractor developed tools to monitor the status and resolution of issues and helped identify broad improvement areas to guide development of solutions.

Audit Notices Contribute to Taxpayer Burden and IRS Inefficiencies

IRS Has Had Backlogs in Responding to Taxpayers during Correspondence Audits with a Dramatic Increase in 2013

According to IRS data since the end of fiscal year 2011, the program regularly has experienced backlogs in responding to taxpayers who provide documentation in response to IRS's audit notices. In fiscal year 2013, the program experienced dramatic increases in how long it took IRS to review taxpayers' correspondence and related documentation. IRS tracks this increase by how much of its correspondence audit inventory was "overage" (i.e., exceeded a specified number of days before IRS responded to a taxpayer's correspondence). This overage threshold is 30 days for SB/SE and 65 days for W&I.¹⁸ Table 1 shows a snapshot of the overage data as of the end of fiscal years 2011 through 2013 and as of February 2014.

¹⁸These overage data have some limitations in helping understand the taxpayers' audit experience. Beyond SB/SE and W&I having these two different thresholds for determining when IRS's response to correspondence is "overage," SB/SE uses the data as a performance measure with targets while W&I does not. This raises questions about why the taxpayer's experience in receiving a delayed IRS response is viewed differently by the two divisions and, as a result, whether taxpayers across the two divisions receive equal treatment. Regardless, the data provide a snapshot of the percentage of correspondence for which IRS's response is overage at the end of a specified month and are not a cumulative indicator to show IRS's performance over time. For example, the overage data do not indicate how long taxpayers had to wait for IRS to respond, such as the average time in days between IRS receiving correspondence from taxpayers and responding to it. As a result, the data represent more a point-in-time workload indicator than a meaningful gauge of the taxpayer experience.

Table 1: Percentage of Overage Correspondence Inventory, by IRS Division, as of the End of Fiscal Years 2011 through 2013 and the End of February 2014

Date	Percent of Inventory Overage	
	W&I	SB/SE
9/30/2011	29.5%	21.9%
9/30/2012	0.4	11.3
9/30/2013	83.4	78.0
2/28/2014	49.7	77.4

Source: IRS data on overage correspondence.

Note: W&I is the Wage and Investment Division and SB/SE is the Small Business and Self-Employed Division. The percent of inventory overage is a snapshot as of the end of each month. The data show the percentage of the total taxpayer correspondence to which IRS has not yet responded. It is calculated by dividing the correspondence older than a specified number of days (65 days for W&I and 30 days for SB/SE) by the total taxpayer correspondence in the inventory.

IRS officials had not done a study of the reasons, but said that the increase in delayed responses for fiscal year 2013 was caused by several factors, including budget reductions due to the sequester that cut overtime and IRS staff furlough days that cut the resources for working taxpayer correspondence.¹⁹ During this time, taxpayers continued to correspond with IRS, creating a large backlog of documentation to audit. Program officials said that they reacted as soon as budget reductions were communicated, however by then most of the audit notices had already been sent. With IRS's backlog in reviewing and responding to taxpayers' correspondence, taxpayers have been more likely to experience delays in having their audits resolved.

The officials said that since late in fiscal year 2013, IRS has continued to take steps to reduce the backlog, including delaying audit starts until later in the year and lowering telephone level of service goals to direct resources from answering taxpayer calls to reviewing taxpayer correspondence. For example, correspondence audit officials reduced the level of service for answering calls about SB/SE audits from 72 percent of the calls made to 68 percent of the calls made from October 2013 through May 2014.

¹⁹ IRS's approach to absorbing sequester funding cuts in fiscal year 2013 included staff furloughs and reduced overtime pay, among other steps as we recently reported in GAO, *2013 Sequestration: Agencies Reduced Some Services and Investments, While Taking Certain Actions to Mitigate Effects*, [GAO-14-244](#) (Washington, D.C.; Mar. 6, 2014).

Although table 1 shows that IRS had made progress in reducing the backlog as of February 2014, the overage inventories were still well above the 2011 and 2012 year-end levels. An IRS program official said IRS expected to reduce the overage inventories to be at “pre-sequester levels” by the end of fiscal year 2014. Given a reduction in staff resources, IRS has reduced the number of correspondence audits planned for fiscal year 2014, which should help to manage the backlog. Compared to fiscal year 2013 when IRS closed 1,050,373 correspondence audits, IRS plans to close 911,407 in fiscal year 2014—a 13 percent reduction. Even if overage inventories are reduced to pre-sequester levels, table 1 shows that those levels included significant percentages of overage cases, such as at the end of fiscal year 2011.²⁰

IRS Notices Provided Unrealistic Timeframes on When IRS Will Respond, Causing Taxpayer Frustration and Generating Unnecessary Phone Calls

IRS data and our interviews with IRS program officials and tax examiners indicate that IRS has been sending audit notices to taxpayers that contain unrealistic time frames about when taxpayers who send documentation to IRS should expect a response. Until recently, the notices told the taxpayer to expect IRS’s response on a specified date which, according to IRS officials, was usually between 30 to 45 days from the date of the notice. However, in the time period we conducted our review, IRS has consistently been taking several months to respond to taxpayer correspondence. During the time it takes IRS to respond, its systems would periodically send out follow-up notices. As a result, some taxpayers received multiple misleading notices. For example, in one telephone call we listened to, a taxpayer calling IRS said he had received four notices from IRS extending the date to expect an IRS response. In another taxpayer call we heard, we learned that the taxpayer had been waiting more than 5 months for IRS to respond to the taxpayer’s correspondence and that the most recent notice the taxpayer had received said to expect an IRS response by November 3, 2013. When the taxpayer called—on November 7—the examiner said the documentation had not been reviewed and suggested that the taxpayer call again in another month.

In all the tax examiner focus groups, the tax examiners we spoke to consistently agreed that the notices caused problems because taxpayers who did not get a response from IRS within the expected time frame often

²⁰IRS officials pointed out that table 1 also shows the end of fiscal year 2012 as a pre-sequester level of percentage of overage cases.

resorted to calling IRS to find out the status of their audit. Tax examiners told us that many taxpayers expressed frustration and have a poor perception of IRS professionalism and competence after being told that IRS is going to take significantly more time than promised in responding. They said that taxpayer calls prompted by unrealistic timeframes caused examiners to use time unproductively. The examiner's comments below illustrate the effects of such telephone calls.

The taxpayers cannot understand why IRS would send a letter out with such unrealistic time frames and there is no acceptable way we can explain it to them. That is why they are so frustrated. It puts us in a very awkward and embarrassing situation and it takes time to gain control of the conversation in these situations. I try to gain control of the situation and tell the taxpayer I understand the frustration so that he will calm down so we can make the phone call productive, but this takes time and wastes time for both the taxpayer and me.

Source: tax examiner focus group interview.

An important reason for taxpayers' concern about the length of correspondence audits is that, in a substantial portion of cases, refunds are held up until the audit issues are resolved. For example, for a large proportion of EITC audits, the portion of refund being questioned may not be released until the audit is resolved. In fiscal year 2013, nearly half of all correspondence audits—512,727 of 1,050,373—were these “pre-refund” type.

IRS officials acknowledged that taxpayer expectations about audit timeframes are an important aspect of service and have taken actions intended to address the misleading notices. IRS issued a revised publication in January 2014 to better inform taxpayers about the correspondence audit process, including adding a statement that the audit process “can take several months.” In February 2014, IRS began sending revised initial audit notices telling the taxpayers a date by when IRS may complete review of the information sent but did not provide a specific date to expect the IRS's response. The revised notices also

added language informing taxpayers that IRS may require more time to complete its review and will contact them again if that is the case.²¹

It is not clear to what extent these actions will clarify taxpayers' expectations and reduce the number of calls about when IRS will respond. Officials said they revised the notices because tax examiners had reported that the notices prompted taxpayers to call unnecessarily when IRS did not timely respond. However, IRS did not use actual response time data to justify the revisions, nor does IRS plan to analyze data to ensure it is responding timely per revised notices or track whether taxpayers made fewer calls.

IRS officials said they had not considered making regular revisions to the notices to make them as realistic as practical based on current workload. Such revisions would be consistent with IRS's strategic goals on reducing unnecessary taxpayer burden. IRS officials said it took a couple of months to make the recent change to the notice. They further noted that the actual response times can vary significantly across the various IRS locations, depending on the time of the year, type of audit issue, and taxpayer response rate. Unless IRS collects and analyzes data on whether it is responding timely per revised notices, it will be difficult for IRS to make appropriate revisions to the notice so that response times are realistic. Thus, taxpayers may continue to receive misleading information about audit timeframes.

Tax Examiners Waste Time Answering Unnecessary Calls about Audit Time Frames Which Further Delays Audit Work

Based on the telephone calls we listened to and the tax examiners we interviewed, tax examiners who take calls from taxpayers about when their correspondence will be reviewed usually do not know the answer. Calls are routed to an available examiner, not the examiner doing the audit. According to tax examiners, they usually have to tell the taxpayer to wait further—usually for some unknown time.²² In monitoring phone calls, we listened to taxpayers tell the IRS examiner that they were calling

²¹A revision to this second notice said that IRS may not be able to complete its review by a specified date and that IRS would send a third notice to inform taxpayers if that situation arises.

²²Some tax examiners we spoke to in January 2014 said they had started to be forthcoming in telling taxpayers who called that IRS responses to correspondence could be delayed for additional weeks or months because of the backlog.

because the expected response date on a notice had passed without IRS having responded yet.

This cycle of phone calls affects tax examiners' ability to serve taxpayers and close the audits. From talking to groups of IRS tax examiners, we consistently heard from them that such calls about the status of the audit complicates the work that tax examiners are attempting to do, as discussed below.²³ Again, the examiners' comments below are to illustrate the effects of such telephone calls.

- Tax examiners have less time to audit. IRS data for fiscal years 2011 through 2013 show that the time spent by tax examiners on taxpayer calls has been about 7 percent to 9 percent in SB/SE about 12 percent to 13 percent in W&I.²⁴ Answering the calls reduces their time to review correspondence to resolve the audits.²⁵

I try to give them realistic time frames—like 4-6 weeks—and ask that they allow us the time to get to their case. I tell them that the more they call the more it takes time away from doing the paperwork which will make our reply all that much later. I look at the situation and see that it is hard for IRS to get caught up. The shutdown made the backlog worse, and they need to allow us time to work cases but the phone demand keeps us from doing that.

Source: tax examiner focus group interview.

- Tax examiners' time is used less efficiently. IRS examiners said that increased demand to answer taxpayer calls through 2013 had resulted in them more frequently being assigned to answer the calls

²³The quotes that follow are intended to illustrate the themes we heard from these discussions and these calls.

²⁴See appendix II, table 6.

²⁵IRS officials said they encourage examiners to self-assign cases so that telephone calls can be used to resolve audits whenever possible.

rather than review correspondence.²⁶ Some tax examiners said that this makes them less productive in reviewing the correspondence.

It makes the time you have spent on a case unproductive because when you are in the middle of a case and have to go on phone, when you come back it is almost like you have to start all over again because you lose your train of thought on the case. You have to recollect your thoughts all over again.

Source: tax examiner focus group interview.

- Tax examiners we spoke to said that having to explain audit delays to taxpayers and the resulting negative taxpayer reactions can cause stress. Tax examiners added that they have no realistic time frames to give taxpayers about when to expect a response or resolution. Some examiners said they tell the taxpayers that it might be more than another month or so.

A big part of the problem is that the taxpayer gets this letter that says we will get back to you in 30 days. But right now we are working correspondence received in [at least 7 months earlier]. Because we don't know how far behind other campuses are we don't know what to tell the taxpayer. Also, sometimes taxpayers don't get the same information from one examiner to another. One examiner will tell them one thing, and another examiner will tell them another.

Source: tax examiner focus group interview.

As a result of these complications, correspondence audits have been taking longer. From fiscal years 2009 through 2013, the audits' cycle time have increased from 177 days to 195 days (see table 8 in appendix II). Longer audits tend to prompt more taxpayer phone calls. In W&I fiscal year 2012 taxpayer satisfaction survey results, taxpayers with audits that

²⁶As mentioned earlier in discussing IRS's efforts to reduce the backlog in reviewing taxpayers' correspondence, for the first few months of fiscal year 2014, correspondence audit officials decided to reduce the level of service for answering calls about SB/SE audits, as well as the need to shift as many tax examiners from reviewing taxpayer correspondence to answering taxpayer calls.

took longer than 6 months were more than three times more likely to call for assistance than those with audit lengths less than 4 months.²⁷

Steps to use tax examiner resources more efficiently and provide taxpayers accurate information would be in line with IRS's strategic goals to minimize IRS's costs and unnecessary taxpayer burden. Besides revising the notices to better inform taxpayers of any delays, IRS also could use its capability to record outgoing messages to inform taxpayers calling that IRS is behind on its workload and when to expect a response. Although IRS has not recently used this capability, such a message could divert some calls away from examiners, give the taxpayer more realistic response time expectations, and result in a better use of IRS resources. According to IRS officials, such a message could be recorded quickly and without much cost. Officials said that some staff recalled IRS trying such an outgoing message that had limited effect, but the effort was more than 10 years ago and IRS did not have data on the results. With the costs so low, even a limited benefit would likely be a net gain.

Examiners Usually Do Not Have Access to Taxpayers' Documents When Taxpayers Call

When taxpayers call about their audit, tax examiners answering the phone do not have access to the taxpayers' documentation. All of the documentation sent by the taxpayer is maintained and managed in paper rather than electronic form. For example, if a taxpayer sends documentation through e-fax, the electronic data are printed for the paper audit file. IRS does not keep these data in electronic form because its information system lacks capacity, according to IRS officials.

Instead, tax examiners answering the calls from taxpayers do have access to any electronic notes created about the audit. Tax examiners are to make electronic notes when they review taxpayers' documentation or when they answer taxpayers' calls. If taxpayers' documentation has not yet been reviewed, electronic notes may not exist. Absent any electronic notes, the examiner must rely on the taxpayer's memory of the documentation. When notes exist, examiners said that their quality, completeness, and understandability vary. As a result, taxpayers may receive conflicting instructions from different examiners on what is

²⁷The survey data did not include non-response bias analysis of survey respondents and non-respondents. The survey results may not be generalizable to the entire population. We provide these data to provide a general indication of the extent to which taxpayers call IRS for assistance.

needed to resolve the case. Such conflicts may be less of an issue if examiners were able to access taxpayers' documentation. The following comments from tax examiners illustrate their concerns about not having access to the taxpayer's documents.

- *An examiner who is working the case next needs to be able to tell from case notes the reason decisions were made and specifically what information the taxpayer did not provide that is needed. That is not happening in all cases.*
- *With the current system where we only work part of a case and it is passed on to where another examiner will work it. Also, we receive calls from all over and the case the taxpayer is calling about may be assigned to a campus anywhere so that we cannot provide them the help they are calling for.*
- *If the taxpayer calls and says they sent in a response, we do not have any way to find out what they sent in because we handle phone calls from all over so the correspondence could have been sent anywhere.*

Source: tax examiner focus group interviews.

Every year IRS receives from audited taxpayers millions of pieces of correspondence that IRS staff manually process. As a result, weeks can pass before taxpayer documentation is reviewed and taxpayers may make repeated calls or be asked to resubmit the same documentation.

Given current limitations, IRS has developed information to support a proposal for a system to scan taxpayer documents so that any examiner can access them electronically. The proposed system is to provide the ability to image all incoming correspondence as well as provide an electronic repository for all digital communications received. Proposal documents state that doing so will better enable IRS to retrieve and manage incoming correspondence, assign cases systemically, and allow for the update of mail status.²⁸ The system, which has not yet been funded, is included in a package of information technology projects for which the Administration requested \$36.4 million as part of its fiscal year 2015 budget request.

IRS is aware that its correspondence notice process creates problems for taxpayers. For example, three of the five problem areas identified by the

²⁸IRS also believes that this automation will reduce IRS shipping and storage costs, IRS's aged inventory, and accelerate resolution, which will improve taxpayer satisfaction. IRS estimates that this investment will "break even" in 5 years.

Correspondence Examination Assessment Project cover notices and subsequent communications between taxpayers and IRS:

- Correspondence audit process—viewed as very time consuming and frustrating for the taxpayer, including unclear correspondence, long wait times for phone assistance, and the need for multiple contacts with IRS to resolve an audit issue.
- First-time resolution—resolving taxpayer issues often requires multiple touches via correspondence and/or telephone, with a case frequently handled by different employees. Doing so delays processing/resolution and can provide inconsistent guidance to the taxpayer.
- Electronic communications—the majority of communications between the taxpayer and IRS is through correspondence and telephone, resulting in significant resource consumption, time delays, and misunderstanding leading to additional taxpayer burden.

IRS Does Not Have Performance Information to Determine Whether the Correspondence Audit Program Is Achieving Its Compliance, Burden, and Cost Goals

The Program Does Not Document Its Objectives

Although called for by federal internal control standards and performance management guidance, IRS's correspondence audit program does not have clear, documented objectives that clearly link to IRS strategic goals

on compliance, IRS costs, and taxpayer burden.²⁹ Although program officials and IRS documents made references to “yield, coverage, and risk” as program objectives and discussed how IRS tried to balance them, IRS provided no documentation defining or establishing them as the program objectives or linking them to the IRS-wide strategic goals.³⁰

Without program objectives linked to IRS’s strategic goals, IRS managers will be limited in assessing progress toward the goals and making informed resource allocation decisions. Furthermore, it will be difficult for IRS to communicate agency progress to Congress and the public and thus be held accountable.

Performance Information Is Incomplete in Some Cases and Does Not Link to IRS-wide Strategic Goals

IRS officials described a large volume of information that they call program measures and program data that they said they use to assess performance and make program decisions. Some examples of this performance information are provided below (for complete lists see appendix III, table 10 for program measures and table 11 for program data).

Examples of measures:

- number of audits closed,
- staff full time equivalent (FTE) time applied to the program,
- cycle time in days from the start to closure of the audit,
- customer satisfaction with the audit, and
- level of service in answering telephone calls from taxpayers about the audit.

²⁹The standards for internal control in the federal government and federal guidance on performance management call for agencies to establish objectives and performance measures for programs that clearly link to agencywide goals.

³⁰Although IRS did not have documented definitions of these terms, we previously have reported on the concept of coverage as the percentage of filed returns that are audited and yield as the dollar amounts in additional tax due recommended by audits (for example, see GAO, *Tax Gap: IRS Could Significantly Increase Revenues by Better Targeting Enforcement Resources*, [GAO-13-151](#) (Washington, D.C.; Dec. 5, 2012).

Examples of program data:

- no-change rate (percentage of audits closed without changing the amount of taxes owed),
- additional tax dollars recommended overall and average per return audit,
- agreement rate (percentage of audits closed in which taxpayers agreed with the audit findings),
- average direct examiner time applied per audit, and
- default rate (the percentage of audits closed without a taxpayer response on whether they agreed or disagreed with the audit findings).

While IRS has a large number of such measures and program data, in many cases they are incomplete as indicators of compliance, taxpayer burden or IRS cost, as the following examples illustrate.

Compliance

- Neither the number of audits closed nor any other of IRS's measures show the impact on compliance, particularly if the audit did not uncover any tax changes. As will be discussed further in the next section, many correspondence audits are closed by "default," meaning the taxpayer did not respond to IRS notices to indicate whether the taxpayer agreed or disagreed.
- Additional tax recommended can be abated or otherwise overturned. As indicated in our past reports, we found that the proportion could be significant.³¹ We also found that recommended taxes may never be collected if the taxpayer cannot be found or is bankrupt, or if IRS lacks resources to pursue collection vigorously. We found that from fiscal years 2002-2007, IRS's inventory of unpaid tax debts included as much as \$7.6 billion for which IRS had indefinitely delayed collection action because of limited resources, even though IRS had sent notices to taxpayers to ask for payment. None of IRS's measures or data track dollars actually collected for each audit case.

³¹For example, in each of fiscal years 2002-2007, between around 20 to 30 percent of the total dollars of tax debt removed from IRS's debt inventory was through abatements, as we found in GAO, *Tax Debt Collection: IRS Has a Complex Process to Attempt to Collect Billions of Dollars in Unpaid Tax Debts*, [GAO-08-728](#) (Washington, D.C., June 13, 2008). The other ways debts are removed are through collection or expiration of the 10-year statute of limitation for collection (26 U.S.C. § 6502). The debt inventory includes assessments from audits and other compliance programs and from returns filed with tax due.

Developing measures on the direct impact of correspondence audits on compliance is difficult. As discussed in our past report, an alternative would be to start using proxy measures to provide more insights on the compliance impact rather than relying on the number of closed audits.³² For example, research on how a correspondence audit affects the audited taxpayers' later compliance or how correspondence audits affect the compliance of taxpayers in general could lead to proxy measures on compliance.

Taxpayer burden

- The customer satisfaction rate and telephone level of service are measures of important aspects of the taxpayer experience. IRS conducts surveys by mail of a sample of taxpayers to find out how satisfied they are with IRS's handling of their audits. While the results may not be representative of all taxpayers, the surveys are consistent with what we observed and heard from tax examiners. In recent years, for the taxpayers who chose to respond, the results show that about half are at least somewhat satisfied and about a third are at least somewhat dissatisfied.³³ Taxpayers who telephone IRS also are surveyed on the telephone service they receive. Although the results may not be representative, in a fiscal year 2012 survey of callers to W&I campuses, telephone callers who chose to respond reported relatively high satisfaction, with overall satisfaction of nearly 90 percent and ratings of examiner courtesy, professionalism, and willingness-to-help of higher than 90 percent. However, over a third of callers who responded said the information received did not eliminate the need for further calls. These callers also reported lower satisfaction than the about two thirds that responded saying their calls eliminated the need for further calls or saying they were unsure if they would need to call again. Telephone level of service is the percentage of total telephone calls that are answered or handled, which has recently been around 70 percent.

³²A proxy measure is an attempt to indirectly measure a variable that is difficult to directly measure. For more information on difficulties we found in measuring compliance, see GAO, *Tax Compliance: Better Compliance Data and Long-term Goals Would Support a More Strategic IRS Approach to Reducing the Tax Gap*, [GAO-05-753](#) (Washington, D.C.; July 18, 2005). For more information on what we found on the use of proxy measures to measure the effects of a program on compliance see GAO, *Corporate Tax Compliance: IRS Should Determine Whether Its Streamlined Corporate Audit Process Is Meeting Its Goals*, [GAO-13-662](#), (Washington, D.C.; Aug. 22, 2013).

³³The remaining taxpayers' responses indicated that they were neither satisfied nor dissatisfied.

Cost

- IRS did not have measures or data on other aspects of taxpayer burden that tax practitioners or tax examiners told us frustrated taxpayers, such as the number of calls a taxpayer makes, the number of times a taxpayer has to send documentation, the amount of time spent waiting for a call to be answered or talking on the telephone, the number of calls to resolve the audit, and the amount of documentation sent.³⁴
- IRS had no measures or data on how often taxpayers get resolution of their case after the first contact with IRS, one of the problem areas identified by CEAP.
- Examiner time per audit data reflect some of IRS's direct costs but not costs of time spent on handling taxpayer calls.
- Neither the staff FTE time measure or examiner time per audit data reflect costs generated after the audit such as collection costs.

In addition to the individual measures being incomplete, IRS does not document the linkages between its performance measures and its strategic goals for compliance, burden, and cost. Nor is it always clear from looking at a measure what the linkage is. As noted, for example, increased case closures may or may not be an indicator of improved IRS effectiveness at ensuring compliance, especially if the closures include defaults. Without explicit linkages, assessing progress toward goals is much harder. Furthermore, incomplete information may affect decisions. For example, without an understanding of all of the costs of an audit, IRS managers cannot make informed decisions about the benefits and costs of starting a given audit. This leaves IRS at risk of creating workload, both at the front end of the program where telephone calls are generated, and at the back end where closed audit cases move to IRS collection staff, that it cannot handle at a reasonable burden on taxpayers and cost to itself.

³⁴We could not tell from CEAP documents that IRS provided whether IRS had considered these events as potential measures of the taxpayer experience. IRS had no measures or data on taxpayer burden in terms of time and money spent to deal with the audit. Although IRS has surveyed taxpayers and is collecting data that may provide some insights on the amount of taxpayer burden for audits, these data are not yet available for use in the audit program. According to IRS officials, IRS has data on amount of time spent waiting for a call to be answered or talking on the telephone, but officials did not provide these data as part of the correspondence audit program data used for management information.

As our prior work has shown, performance measures are a key tool to help managers make resource decisions and ensure that the agency is achieving its mission and strategic goals.³⁵ When linked with program objectives and agencywide strategic goals, such measures foster accountability and communicate agency progress to Congress and the public. Without measures that give a clear and complete sense of performance in terms of compliance, burden, and costs, IRS managers and outsiders, including Congress, will not have a very clear understanding of IRS progress towards these goals. As a result, it is not possible to tell from looking at the measures and program data in aggregate whether the correspondence audit program is performing better or worse than in the past.

IRS Did Not Document How the Performance Information Is Used to Make Program Decisions on Tax Issues to Audit

IRS did not document criteria on how its managers were to use the performance information—the measures as well as the program data—to make program decisions such as the number of audits or tax issues to audit. This runs counter to the internal control standards on documenting operational decisions on allocating resources and using performance information to help ensure accountability for effective and efficient use of resources.³⁶ Furthermore, counter to internal controls standards that call for agencies to clearly document significant events, IRS did not document the reasons for the decisions made.

In using the program data to make decisions, for example, program officials talked about how it was preferable to minimize the no-change and default rates while maximizing recommended tax amounts with the lowest examiner time spent possible and rate at which taxpayers agree with the audit findings. However, IRS had not provided guidance on how to weigh the data nor did it have documented tolerances on when a rate or amount was too high or too low. Without such guidance and tolerances, IRS cannot provide reasonable assurance that the program data were being used consistently from year to year to make decisions about the best use of resources in accordance with management intentions about the direction of the program.

³⁵For example, see our findings in [GAO/GGD-92-65](#), [GAO/GGD/AIMD-10.1.18](#), [GAO-03-488](#), and [GAO-05-927](#).

³⁶[GAO/AIMD-00-21.3.1](#).

For example, IRS has not clarified how program managers should view default rates given the other program data being considered. IRS closes audits as defaults when the taxpayer never responded to any IRS notice or responded to some notices but not the last one asking for agreement with a recommended additional tax assessment. These default assessments produce positive outcomes for some IRS program data such as higher recommended tax amounts, more audit closures, and lower no change rates. For example, in fiscal years 2009 through 2013, the no-change rate ranged from 11 percent to 21 percent for all closed correspondence audits. When IRS had contact with the taxpayers throughout the audit and did not close the audit through a default, the no-change rate ranged from 28 percent to 45 percent (see table 9, appendix II).³⁷ In sum, it is difficult to know how to interpret the apparent positive outcomes in program data, such as the no-change rate, given the default rates.

IRS Did Not Use Some Available Data Potentially Useful for Making Decisions

IRS had other data that it does not use that would provide a more complete picture about the compliance results, IRS costs, and taxpayer burden associated with correspondence audits. According to federal internal control standards, managers need accurate and complete information to help ensure efficient and effective use of resources in making decisions.³⁸

For example, as already noted, the amount of additional tax collected as a result of audits provides useful information in addition to the amount of additional tax that the audits recommend. Program officials do not use available data to track these tax collections. We used that data to compute the collection rate compared to the recommended tax amounts from correspondence audits closed in fiscal years 2008 through 2013 as of September 30, 2013 (see table 2).

³⁷Taxpayers may default because they lack documentation to refute IRS's recommended tax change or because they are confused or unable to respond. IRS does not track how often taxpayers who default later provide information to support their position, resulting in IRS abating the additional tax assessments from the correspondence audit.

³⁸[GAO/AIMD-00-21.3.1](#).

Table 2: IRS Collection of Additional Tax Recommended in Correspondence Audits Closed During Fiscal Years 2008 through 2013, as of September 30, 2013

FY	Number of Audits	Amount of recommended tax (in millions of dollars)	Amount of collected tax (in millions of dollars)	Collection rate
2008	1,081,152	\$ 6,518	\$ 4,407	67.6%
2009	1,099,639	7,796	4,474	57.4
2010	1,238,632	8,168	4,469	54.7
2011	1,173,069	8,705	4,535	52.1
2012	1,122,216	9,249	5,143	55.6
2013	1,060,779	8,455	4,240	50.1

Sources: IRS Data Book 2008-2013 for recommended tax amounts and GAO analysis of Enforcement Revenue Information System data for tax collected amounts.

Note: Dollar figures are not adjusted for inflation. Amounts from disallowed claims are not included in the numbers above to the extent they resulted in a refund.

Further analyses could provide more insights about the collection rate and related compliance effects of correspondence audits. Recognizing that not all recommended taxes would be collected or collected soon after the audit, potential analyses could indicate how many years it takes to collect most of these dollars after the correspondence audit was closed. Our analysis shows that typically it can take up to two years to collect half of the tax amounts recommended (see table 12 in appendix IV). Additional analyses could show how much of the tax was collected from withholding or offsetting tax refund claims rather than from taxpayers sending in the money voluntarily or from IRS collection enforcement actions. Another example concerns default rates, which generate automatic tax assessments when taxpayers do not respond to IRS on whether they agree or disagree with the examiner's recommended additional taxes. The analyses could focus on how much or what type of default assessments are more likely to be collected.

IRS also has raw data in its information systems that could provide a better understanding of correspondence audit costs and burden on taxpayers. One example is combining information about direct audit costs with the costs to (1) answer taxpayer calls, and (2) collect additional taxes assessed as a result of the audit to get a more complete measure of the total cost of an audit. Regarding taxpayer burden, IRS has data that could be used to calculate how long taxpayers wait for IRS to respond and for the audit to close and how many cases end with first time resolution.

As was the case with audit notices, IRS has acknowledged problems with its performance measures and how they are used for decision making.

Two of the five problem areas identified in IRS's Correspondence Examination Assessment Project program review are:

- Audit metrics—existing program measures do not place an appropriate emphasis on factors that most impact the taxpayer experience.
- Resource alignment and inventory mix—the audit resource mix remains relatively constant but the case mix varies based on operational goals. This can lead to misaligned resources and skills, increased resource consumption, inconsistent treatment of taxpayers, and additional taxpayer burden.

Benefits of Efforts to Improve the Taxpayer Experience Are Not Clearly Defined and Tracked

In response to various affected and interested parties making comments critical of the correspondence audit program, IRS began CEAP to improve the experience and reduce the burden of taxpayers being audited. With the support of a contractor, IRS team members working on CEAP used several information sources—including tax practitioner groups, National Taxpayer Advocate reports, and open and closed audit files—and identified the five broad potential improvement areas already cited.

Table 3 lists the 19 efforts that IRS initiated in the five problem areas. Although these efforts are intended to yield concrete benefits and may eventually yield them, none of the 11 completed efforts had clearly defined intended benefits or tracked actual benefits as envisioned by the project management criteria.³⁹ Although IRS officials said it is not possible to measure the benefits of some of the efforts, IRS had not yet completed the first step of clearly defining the intended benefits. As a result, clear linkages to the problem statements and CEAP efforts to address them did not exist. For the remaining eight incomplete efforts, their actual benefits have not yet been determined, as table 3 shows. Without clearly defined and tracked benefits, it will be difficult to determine whether the improvement efforts addressed the identified problems and achieved benefits.

³⁹Project Management Institute, *The Standard for Program Management*, 2nd ed. (Newtown Square, Pa.; Project Management Institute, Inc., 2008).

Table 3: Status, Actions, and Information on Actual Benefits of CEAP Efforts to Improve the Correspondence Audit Program

Effort	Status	Actions taken or planned and, if available, results	Actual benefits
Correspondence audit process			
Strategy: Update processes, letters, and publications so that taxpayers can better understand correspondence audit processes and expectations.			
Clarify examiner guidance and reinforce existing guidance	Complete	Updated and posted changes to Internal Revenue Manual and conducted training through June 2013.	Not clearly defined or tracked
Develop new examiner guidance	Complete	Implemented training through June 2013 focused on telephone assistance.	Not clearly defined or tracked
Pilot test a process for initial review of taxpayers' correspondence	Complete	Completed a pilot test in September 2013 with inconclusive results on whether an initial correspondence screening process improved case turnaround.	None achieved
Revise publication to improve clarity and direction to the taxpayer	Complete	IRS Publication 3498-A revised and published in January 2014 (provided to audited taxpayers) for greater clarity, including a flowchart of the process and general statement on how long audits may take to complete.	Not clearly defined or tracked
Revise letters to improve clarity and direction to the taxpayer	In process	Letters 566 and 525 are being revised to add check boxes for taxpayers to indicate tax examiners may leave a phone message. Revised letters are expected to be used beginning in June 2014.	To be determined
First-time resolution			
Strategy: Promote resolution of cases the first time there is interaction with the taxpayer.			
Promote self assignment of cases	Complete	Provided best practices in April 2013 for examiners to assign cases to themselves. Benefits were not clearly defined as project documentation suggested it was to resolve cases faster or in the first contact while IRS officials said it was to address the lack of examiner "ownership" of cases and reducing cycle time. Regardless, IRS did not track results in terms of these or other potential benefits, but instead tracked data on the increase in cases self-assigned and closed in selected months after the promotion effort. The data showed that self assignments increased from an average of 300 a month to 450 a month over the 4 months tracked in the context of a program that closed more than a million cases that year.	Not clearly defined or tracked
Reinforce training and develop job aids	Complete	Implemented self-assignment and professional decision making job aids to support tax examiners and completed training examiners by June 2013.	Not clearly defined or tracked
Pilot emphasizing quick resolution of a case	In process	Began a pilot in January 2014 on quick resolution of a case by using professional decision making tools, resources, and best practices from across campuses. An action plan on pilot results is expected in August 2014.	To be determined

Effort	Status	Actions taken or planned and, if available, results	Actual benefits
Resource alignment and inventory mix			
Strategy: Realign resources based on skill sets and case complexity and improve inventory selection methods.			
Route practitioner phone calls to tax examiners with higher skill level	Complete	Completed work in September 2013 to identify tax examiners and make telephone call routing modifications.	Not clearly defined or tracked
Leverage knowledge sharing around best practices	Complete	Reviewed best practices and determined in July 2013 that no further action was needed as processes and tools already existed within each campus including examiners' access to key Internal Revenue Manual sections, guidance, and technical subject matter experts.	None achieved
Conduct research to improve inventory selection	Complete	Completed research in November 2013 with inconclusive results on relationships between tax return characteristics and desired outcomes (e.g. cycle time, no change).	None achieved
Conduct pilot routing of complex cases to higher-graded examiners	Complete	Was dropped after receiving the inconclusive results from the research completed in November 2013 (see above).	None achieved
Electronic communications			
Strategy: Leverage existing technologies and developing new applications to communicate with the taxpayer will improve taxpayer service and increase IRS efficiency.			
Maximize use of taxpayers faxing documents directly to examiners' electronic in-boxes (also called e-fax)	Complete	Distributed best practices and guidance in February 2013. IRS tracked data on average daily usage in the following three months, which showed an increase of 132 percent compared to prior months. Data tracked three months later showed the increase was down to 72 percent. Project documentation referred to problems with resource consumption and time delays and reducing the need for traditional fax equipment and related maintenance costs. These potential benefits were not clearly defined and IRS did not track these results.	Not clearly defined or tracked
Identify potential self-service application in consultation with practitioners	In process	Developing videos for YouTube, planning to administer a survey in May 2014 on taxpayer preferences, and continuing consultations at practitioner forums in Summer 2014.	To be determined
Survey taxpayers on electronic communication preferences	In process	To be addressed in survey noted above planned for May 2014.	To be determined
Conduct Virtual Service Delivery pilot project	In process	Pilot began in May 2013 to allow taxpayers under audit to go to selected IRS customer service sites to use IRS computers to remotely communicate directly with examiners and allow examiners to view taxpayers' documents. Initial pilot results are expected in August 2014 and the pilot is to continue through the 2015 tax filing season.	To be determined

Effort	Status	Actions taken or planned and, if available, results	Actual benefits
Provide email confirmation that IRS received taxpayer documents	In process	Coordinating with IRS-wide Taxpayer Digital Communication (TDC) effort to securely e-mail the taxpayer in a pilot project to planned for fiscal year 2015.	To be determined
Identify potential correspondence audit applications	In process	Coordinating with TDC effort noted above to pilot ability for taxpayer to determine the status of their case and communicate with IRS through e-mail via a secure portal. It was not clear from documentation whether this effort is considering storing e-fax data in electronic form and making it available to examiners.	To be determined
Audit metrics			
Strategy: Enhance current performance metrics to better reflect performance against key activities that affect customer satisfaction.			
Conduct analyses and evaluations to identify program performance measures that will better reflect the taxpayer experience	In process	Conducted research completed in September 2013 that yielded no useful results. Initiated evaluation project in February 2014 to identify program measures. It is not clear that the study will address having performance measures and targets for answering taxpayer calls as well as for responding to correspondence to resolve audits. Without balanced measures, IRS may hamper the overall taxpayer experience by diverting resources from reviewing correspondence to answering calls to meet telephone service goals.	To be determined

Source: IRS CEAP information.

IRS Had No Plan for Evaluating Recommendations to Develop a Workload Selection Model and a Resource Allocation Tool

IRS's CEAP contractor recommended that IRS take steps beyond those shown in table 3 to improve how it selects cases for audit and allocates resources between answering taxpayers' telephone calls and reviewing correspondence.

The contractor found during the CEAP review that IRS's approach to selecting cases used numerous separate analytical efforts that focused on different objectives. The contractor said that IRS needs a coordinated, service-wide approach to modeling workload selection with uniform methodology that is flexible enough to optimize specific objectives.⁴⁰

In addition, the contractor recommended that IRS develop a resource planning and simulation tool to allocate resources across key audit functions, citing primarily telephone and correspondence work. The

⁴⁰The contractor further recommended that, as part of selecting audit workload, IRS investigate the feasibility of incorporating a measure of the likelihood of collecting additional taxes recommended in the audit.

contractor noted that existing resources are allocated to maintain target levels of phone service and that remaining resources are allocated to doing the audits. The contractor noted that receiving additional calls diverts resources from doing the audits. Without tools to help IRS balance these two aspects, IRS may be adversely affecting the overall taxpayer experience by excessively diverting resources to either telephone or correspondence work. The contractor's recommendation is consistent with our finding on how telephone calls IRS received due to delays in responding and misleading notices to taxpayers reduced the amount of time examiners had to actually review correspondence and resolve audits, resulting in even further delays. According to the contractor, such a tool would allow for

- testing various scenarios for allocating resources between telephone phone and correspondence work to determine the impact on key metrics,
- enhancing decision making by performing impact analyses based on the scenarios, and
- assisting in determining the "sweet spot" for allocating resources to optimize both case productivity and telephone level of service, while achieving customer satisfaction targets.

Although IRS officials said that the recommendations would be considered, as of January 2014, they had no plan or specific timeline for doing so. Officials said they would evaluate the recommendations after most other CEAP-related work had been done. However, according to internal control standards, program managers should promptly evaluate findings from reviews that identify deficiencies or opportunities for improvements.⁴¹ Managers should resolve the matters by taking corrective action or making improvements within established time frames. If they disagree with the findings or recommendations, program managers should demonstrate that those findings or recommendations are either invalid or do not warrant action. Without timely follow up on the contractor's recommendations, it will be difficult to hold IRS managers accountable for ensuring that any needed improvements are made. Furthermore, IRS may delay or miss opportunities to better select workload, allocate resources, reduce taxpayer burden, or otherwise improve correspondence audit results.

⁴¹[GAO/AIMD-00-21.3.1.](#)

Conclusions

The correspondence audit program has a large role in ensuring tax compliance. It directly touches more than 1 million taxpayers annually and affects the voluntary compliance of many more. However, concerns have been expressed about unnecessary burdens imposed on taxpayers and unnecessary costs incurred by IRS. The concerns are magnified by the size of the program.

Our visits to IRS sites and our analyses of IRS data found unnecessary burden imposed on taxpayers with unclear notices generating phone calls that IRS examiners were not prepared to answer while refunds are delayed. IRS acknowledged these problems, including cases that take more than half a year to close and an inability to close what are intended to be fairly simple correspondence audit cases in a single contact with taxpayers. This unnecessary burden has obvious implications for IRS resources. The question is what to do about the unnecessary burden and cost.

IRS's management of the program can be improved both at the frontline level where it has contact with taxpayers and at strategic levels where decisions about the volume of audits and resource allocation are made. At the frontline level, IRS could provide more realistic audit notices. To the extent that IRS can be realistic about audit time frames, IRS tax examiners are less likely to receive taxpayer calls about the status of the audit leaving them more time to actually audit. Recorded telephone messages provide another option to serve the same end.

At a strategic level, IRS could benefit from more information on performance that is clearly linked to IRS's strategic goals of compliance, low taxpayer burden and low cost. This would include program objectives with document linkages to the high level goals, program measures that reflect program objectives, and documented guidance on how the various objectives and measures are to be weighed against each other. With reduced resources, IRS faces difficult decisions on how many audits to do overall and on what specific compliance issues to audit. If IRS does not make good decisions, IRS risks missing noncompliance and burdening many taxpayers, wasting scarce resources. Because documentation on the criteria and data used to make decisions are missing, IRS does not have reasonable assurance that it is making these decisions cost effectively and taking actions to achieve better results.

To help inform management decisions, IRS could make better use of raw data already in its information systems that clearly relate to compliance, burden, or costs. This includes data on how much additional tax IRS

collects as a result of the audit, the total costs associated with audits, and burden related data such as the number of cases that are resolved with a single contact.

IRS's 19 CEAP efforts have potential to improve the correspondence audit program. However those improvements may not be realized unless IRS states the expected benefits and tracks whether the benefits were achieved. In addition, IRS has yet to establish plans or time frames to evaluate whether to act on its CEAP contractor's recommendations to improve the audit program, such as by balancing the allocation of resources between providing taxpayers telephone assistance and reviewing their correspondence.

Recommendations for Executive Action

We recommend that the Commissioner of the Internal Revenue Service take the following nine actions:

To reduce the need for taxpayer calls, ensure that IRS is providing taxpayers with more realistic time frames on when IRS will respond, and more efficiently use IRS resources, collect data to analyze whether IRS is responding within the time frames cited in the revised audit notices. If IRS delays are continuing, further revise the notices to provide more realistic response times based on the data and take other appropriate actions to ensure efficient use of IRS tax examiner resources. For example, IRS could choose to provide taxpayers who call IRS with a recorded message notifying them of delays in IRS responding and when to expect an IRS response.

To clarify the desired results of the correspondence audit program and its linkages to IRS-wide activities:

- Establish formal program objectives.
- Ensure that the program measures reflect those objectives.
- Clearly link those measures with strategic IRS-wide goals on ensuring compliance in a cost-effective way while minimizing taxpayer burden.

To better inform decisions being made about the correspondence audit program, document how the decisions are to be made using the performance information (including criteria and tolerances used). IRS should also track and use other program data that have not been used to provide more complete performance information. Examples of data that could be tracked and used include:

-
- how much of the recommended tax amounts is collected over time;
 - other costs beyond the direct audit time, such as the costs to answer taxpayer calls per audit, assess the recommended tax, and collect those tax assessments; and
 - taxpayer burden and experience such as how often audits are resolved in one contact, how often taxpayers correspond or call, and how long taxpayers wait for IRS to respond to their documents and for the audit to close.

To better ensure an effective investment of resources in the CEAP efforts:

- Clearly document the intended benefits of ongoing efforts to address identified problems, and the process for measuring and tracking actual benefits.
- Develop a plan and timeline for implementing the CEAP contractor's recommendations on possible ways to improve the (a) selection of correspondence audit workload and (b) allocation of resources between providing telephone assistance and reviewing taxpayer correspondence to resolve audits or develop justifications for not implementing the recommendations.

Agency Comments and Our Evaluation

We provided a draft of this report to IRS for review and comment. The Deputy Commissioner for Services and Enforcement at IRS provided written comments, which are reprinted in appendix V. Those comments focused on the challenges that the correspondence audit program has faced during a period of reduced funding as well as sequestration and furloughs. The comments also pointed to efforts IRS has underway or planned to improve the program. IRS plans to take action on all nine of our recommendations although its comments were not clear on the details of some actions for four of the recommendations as summarized below.

- For our two recommendations on reducing the need for taxpayer calls by providing them with more realistic timeframes on when IRS would respond, IRS agreed to collect and analyze data on its response times and, based on that information, make any needed changes to its letters and phone messages to better reflect realistic timeframes. Thus, if implemented effectively, IRS's actions should address the intent of these recommendations.
- For our three recommendations on clarifying the audit program's desired results, IRS agreed to ensure that the program objectives and

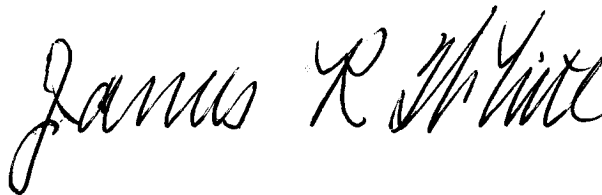
measures established would be linked with the IRS wide goals. Thus, if implemented effectively, IRS's action should address the intent of these three recommendations.

- For our two recommendations on better informing program decisions, IRS agreed to take action to document the correspondence audit original planning process but IRS did not mention whether it would document how all audit program significant decisions are to be made using performance information, as we recommended. We continue to believe that documenting how audit program decisions are made is important. As we noted in the report, without documenting operational decisions on allocating resources and using performance information, IRS lacks assurance of accountability for effective and efficient use of resources. IRS also said it would evaluate the feasibility of using other data to provide more complete performance information, as we recommended.
- For our two recommendations on better ensuring an effective investment in the CEAP effort, IRS agreed to document the expected benefits of its ongoing efforts, as we recommended. Although IRS said it will continue to pursue efforts to improve workload selection and maximize resource usage, IRS did not comment on whether it would develop a plan and timeline for implementing the CEAP contractor's recommendations on ways to improve workload selection and resource allocation in the correspondence audit program or justifications for not implementing the recommendations, as we recommended. We continue to believe it is important that IRS develop a plan and timeline for implementing these recommendations or justifying not doing so. As we noted in the report, without timely follow-up on the contractor's recommendations, it will be difficult to hold IRS managers accountable for ensuring that any improvements needed are made. Furthermore, IRS may delay or miss opportunities to better select workload, allocate resources, reduce taxpayer burden, or otherwise improve the correspondence audit results without implementing these recommendations.

As agreed with your offices, unless you publicly announce the contents of this report earlier, we plan no further distribution until 30 days from the report date. At that time, we will send copies to the Chairmen and Ranking Members of other Senate and House committees and subcommittees that have appropriation, authorization, and oversight responsibilities for IRS. We will also send copies of the report to the Secretary of the Treasury, Commissioner of Internal Revenue, and other

interested parties. In addition, this report is available at no charge on the GAO website at <http://www.gao.gov>.

If you or your staff have any questions or wish to discuss the material in this report further, please contact me at (202) 512-9110 or whitej@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. Key contributors to this report are listed in appendix VI.

A handwritten signature in black ink that reads "James R. White". The signature is written in a cursive, flowing style.

James R. White
Director, Tax Issues
Strategic Issues Team

Appendix I: Scope and Methodology

To assess the extent to which IRS's correspondence audit notices impose unnecessary burden on taxpayers or create inefficiencies for IRS, we reviewed program documents and interviewed program officials in the Wage and Investment (W&I) and Small Business and Self-Employed (SB/SE) divisions. We visited and interviewed program officials at two locations (one for each division) where IRS conducts correspondence audits: Atlanta (W&I) and Memphis (SB/SE). While visiting these locations we viewed IRS work processes for reviewing correspondence to make audit determinations and handling taxpayer phone calls. In addition, we conducted six focus group interviews by telephone with tax examiners selected at random (three for each division) who conduct audits in locations across the country. We also monitored taxpayer phone calls at the two IRS locations we visited and listened to recordings of a nonrepresentative random sample of 100 phone calls received nationwide during a week in September, November, and December 2013.¹ We selected these time frames to ensure the widest possible coverage of potential taxpayer experience in the time period for which we reviewed the program. The results of the analyses of tax examiner group data and of the phone calls are not generalizable to all examiners and calls. Instead the results from both data collections are used to identify key issues occurring in the current time period in conjunction with the other forms of data we collected. We also spoke to members and representatives of tax practitioner groups.² We selected the groups based on their recognized experience in tax matters and their having made public comments on their experiences in dealing with correspondence audits.

To describe taxpayers' satisfaction with IRS's handling of correspondence audits and related telephone service, we reviewed and summarized selected data from IRS's fiscal year 2012 surveys conducted by mail and telephone. To assess the reliability of the survey data, we reviewed survey documentation (including descriptions of survey methodologies and the survey questions of interest to us for reporting purposes) and the sampling approach used in the surveys, including response rates. The

¹Before telephone calls are routed to an examiner, callers are informed by an IRS recording that the call may be monitored or recorded for quality purposes. IRS retains recorded calls for 45 days.

²The groups are American Institute of Certified Public Accountants, National Association of Enrolled Agents, National Association of Tax Professionals, and the National Society of Accountants.

survey data IRS provided did not include non-response bias analysis of survey respondents and non-respondents. The survey the results may not generalizable to the entire population of audited taxpayers. Nevertheless, we use the high-level survey results along with results from our interviews and other data collection to provide a general indication of taxpayers' experiences with IRS's services. In general, the survey results are consistent with the other data we collected in our interviews and document reviews. We determined that the data we used from the IRS surveys were sufficiently reliable for the purposes of this engagement. We compared IRS's processes for contacting taxpayers with criteria for reducing unnecessary burden and efficiently using federal resources, including IRS's strategic goals, Internal Revenue Manual (IRM) guidance, and the standards for internal control in the federal government.³

To assess whether IRS knows how correspondence audits affect compliance, IRS costs, and taxpayer burden, we compared information on correspondence audit program objectives and performance measures to guidance on federal program management, including the *Standards for Internal Control in the Federal Government* ([GAO/AIMD-00-21.3.1](#), November 1999).⁴ In addition, we compared IRS's correspondence performance measures to guidance on results-oriented management for federal programs, including guidance on implementing GPRA and GPRAMA, to assess the extent to which the measures were clearly linked to program objectives and IRS strategic goals.⁵ We compared the documentation IRS had on its decision-making process to internal control standards related to documentation of internal control. To determine the amounts and percentages of audit tax recommended amounts that were collected, we analyzed Enforcement Revenue Information System data contained in IRS's Compliance Data Warehouse. To assess the reliability of the data, we reviewed IRS data dictionaries describing relevant data elements, conducted electronic testing of those data elements, and

³Internal Revenue Service, *IRS Strategic Plan 2009-2013*, Publication 3744 (4-2009) (http://www.irs.gov/file_source/pub/irs-pdf/p3744.pdf, downloaded July 31, 2013); IRM 22.24.1 Burden Reduction Activities (http://www.irs.gov/irm/part22/irm_22-024-001.html, downloaded Sept. 18, 2013); [GAO/AIMD-00-21.3.1](#).

⁴ [GAO/AIMD-00-21.3.1](#).

⁵GPRA, as enhanced by GPRAMA, is the primary legal framework through which agencies are required to set strategic goals, measure performance, and report on the degree to which goals were met.

consulted with IRS officials knowledgeable of the data elements. We compared the results of our analyses with data in IRS's Audit Information Management System – Computer Information System database, to include review of selected cases to assess consistency of results. We determined that these data were sufficiently reliable for the purposes for which they were used in this engagement.

To describe the status and results of IRS's efforts to improve the correspondence audit program, we reviewed and summarized documentation and interviewed IRS officials on IRS's Correspondence Examination Assessment Project (CEAP) and CEAP efforts to link improvements to IRS's strategic goals and identify, measure, and track benefits of the efforts. We compared information on the management of CEAP to project management guidance on benefits management and project governance in the Project Management Institute's *The Standard for Program Management*, 2nd ed. (Newtown Square, Pa.; Project Management Institute, Inc., 2008).

Appendix II: Profile of IRS Correspondence Audits

Table 4: Number and Percentage of Correspondence Audits Compared to All IRS Audits of Individual Tax Returns, Fiscal Years 2003-2013

Fiscal year	Number of individual audits	Number of individual correspondence audits	Correspondence audits as a percent of all individual audits
2003	849,297	642,839	75.7 %
2004	1,007,874	810,486	80.4
2005	1,215,308	968,073	79.7
2006	1,283,950	981,165	76.4
2007	1,384,563	1,073,224	77.5
2008	1,391,581	1,081,152	77.7
2009	1,425,888	1,099,639	77.1
2010	1,581,394	1,238,632	78.3
2011	1,564,690	1,173,069	75.0
2012	1,481,966	1,122,216	75.7
2013	1,404,931	1,060,779	75.5

Source: GAO analysis of IRS audit data.

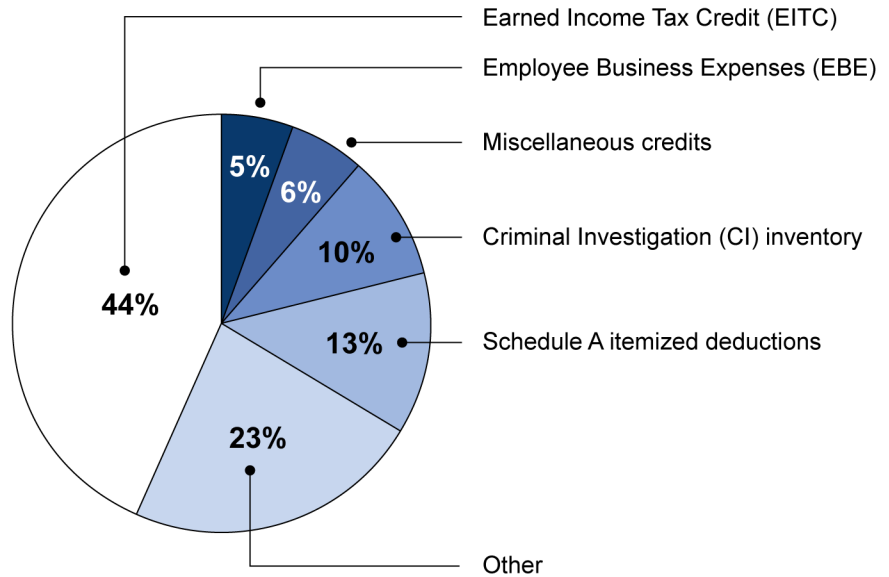
Table 5: Amount (Adjusted for Inflation) and Percent of Additional Taxes Recommended in Correspondence Audits Compared to All IRS Audits of Individual Tax Returns, Fiscal Years 2003-2013

Fiscal year	Amount of tax recommended (in billions)		Correspondence audits as a percentage of the amount of individual audit recommended tax amounts ^a	Amount of tax recommended adjusted for inflation (in billions)	
	Individual audits	Correspondence audits		Individual audits	Correspondence audits
2003	\$ 4.6	\$2.1	47.1 %	\$5.7	\$ 2.7
2004	6.2	3.6	58.1	7.6	4.4
2005	13.4	7.3	54.9	15.8	8.7
2006	13.0	7.6	58.4	14.9	8.7
2007	15.7	9.3	59.5	17.5	10.4
2008	12.5	6.5	52.3	13.6	7.1
2009	14.9	7.8	52.2	16.1	8.4
2010	15.1	8.2	54.2	16.1	8.7
2011	14.7	8.7	59.4	15.4	9.1
2012	15.3	9.2	60.4	15.8	9.5
2013	14.0	8.4	60.2	14.3	8.6

Source: GAO analysis of IRS audit data.

^aPercentages are not precise due to rounding.

Figure 4: Percentage of Total Examiner Time Spent Doing Audits of Various Broad Types of Issues, Cases Closed in Fiscal Year 2013



Source: GAO analysis of IRS data.

Note: total does not add to 100 percent due to rounding.

LEGEND

CI (Criminal Investigation) Inventory - Examinations of clients of tax return preparers who appear to prepare false or fraudulent returns.

Miscellaneous credits - This contains the Adoption Credit, the American Recovery and Reinvestment Act Credits, Child Care Credit and the Education Credit.

Other- Includes nearly two dozen issues that each account for less than 5 percent of the audits, such as estate and gift tax, and alimony.

Appendix II: Profile of IRS Correspondence Audits

Table 6: Amounts and Percentage of Tax Examiner Time Spent Providing Telephone Assistance, Fiscal Years 2011-2013

Fiscal year and division	Total Examiner FTEs ^a	Examiner FTEs providing telephone assistance	Percentage of examiner FTEs providing telephone assistance
FY 2011			
W&I	1606.8	205.1	12.8
SB/SE	1509.9	110.3	7.3
Total	3116.7	315.4	10.1
FY 2012			
W&I	1529.2	175.5	11.5
SB/SE	1404.7	111.7	8.0
Total	2933.8	287.2	9.8
FY 2013			
W&I	1418.17	174.2	12.3
SB/SE	1302.2	118.0	9.1
Total	2720.3	292.2	10.7

Source: GAO analysis of IRS data.

^aFTE, or full time equivalent, equals one staff year.

Note: W&I is the Wage and Investment Division and SB/SE is the Small Business and Self-Employed Division. Totals may not add due to rounding.

Table 7: Data Tracked in IRS Disposition Reports for the 10 Most Frequently Audited Issues in Correspondence Audits Closed by IRS Divisions in Fiscal Year 2013

Type of issue	Audits closed	Tax Dollars recommended (in millions)	Dollars per Return	Hours per case	How cases were closed ^a					Cycle time in days
					Agreed	Default with no contact	Default with contact	No change	Appeal/petition	
W&I										
EITC	336,077	\$1,551.3	\$4,699	1.0	17.3%	52.6%	20.5%	9.4%	0.4%	209
CI Inventory	107,398	\$490.0	\$4,560	1.1	40.2%	40.4%	18.5%	0.7%	0.2%	200
Misc Credits	35,028	\$82.4	\$2,476	1.7	30.6%	21.6%	22.5%	24.2%	1.1%	198
Schedule A	27,453	\$69.0	\$2,514	3.5	24.0%	14.8%	12.0%	48.3%	1.0%	169
Other Discretionary	22,453	\$50.2	\$2,236	1.7	18.3%	23.5%	19.3%	37.1%	1.8%	197
Non-Filer	16,978	\$887.1	\$52,254	0.5	13.5%	82.5%	2.6%	0.2%	1.1%	170
Misc Referrals	6,984	\$121.5	\$17,404	1.7	29.2%	35.3%	24.0%	9.8%	1.7%	176
Alimony	6,934	\$18.2	\$2,620	2.5	28.2%	11.4%	18.6%	39.3%	2.7%	187
Test Cases	6,361	\$26.4	\$4,160	2.1	24.3%	16.7%	12.1%	45.7%	1.2%	169
ME & UA	4,273	\$14.5	\$3,420	1.7	26.2%	23.8%	23.1%	26.1%	0.8%	145
Total^b	583,929	\$3,350.0	\$5734	1.2	23.9%	44.4%	19.0%	12.2%	0.6%	203

Appendix II: Profile of IRS Correspondence Audits

Type of issue	Audits closed	Tax Dollars recommended (in millions)	Dollars per Return	Hours per case	How cases were closed ^a					Cycle time in days
					Agreed	Default with no contact	Default with contact	No change	Appeal/petition	
SB/SE										
EITC	146,391	\$556.4	\$3,846	1.9	19.5%	52.9%	19.7%	7.6%	0.3%	198
Non-Filer	108,230	\$3,301.6	\$30,506	0.4	8.8%	87.6%	2.4%	0.6%	0.6%	175
Schedule A	42,823	\$145.3	\$3,395	2.0	38.3%	21.0%	10.0%	29.3%	1.4%	169
EBE	38,459	\$101.9	\$2,649	2.0	35.5%	33.8%	15.7%	13.5%	1.6%	196
Schedule C	30,421	\$120.4	\$3,959	2.0	33.8%	31.9%	14.6%	17.3%	2.4%	202
CI Inventory	24,830	\$115.2	\$4,640	1.0	42.6%	52.3%	2.9%	1.9%	0.3%	196
BMF Inventory	14,878	\$30.3	\$2,036	0.4	82.9%	0.01%	0.99%	16.1%		102
FRP	10,113	\$259.3	\$25,647	1.0	29.4%	60.7%	8.4%	0.5%	1.0%	148
Misc Credits	9,923	\$24.5	\$3,126	2.4	36.3%	14.2%	15.7%	32.6%	1.2%	158
Misc Referrals	8,042	\$141.1	\$17,561	2.9	23.7%	47.9%	19.3%	6.8%	2.3%	194
Total^c	466,655	\$4,872.3	\$3,347.8	1.2	26.0%	50.0%	11.7%	11.5%	0.8%	186

LEGEND

CI (Criminal Investigation) Inventory – Generally consists of examinations of clients of tax return preparers who appear to prepare false or fraudulent returns.

ME & UA – The Math Error and Unallowable programs identifies returns during the initial phase of tax return processing through predefined rules that are programmed into the IRS filing systems.

Miscellaneous credits – Includes the Adoption Credit, the American Recovery and Reinvestment Act Credits, the Child Care Credit, and the Education Credit.

Other discretionary – Includes the recovery of erroneous refunds, and certain high score returns and other process code cases.

Schedule A – Itemized deductions.

Test cases – Primarily used to gather statistical compliance data such as through the National Research Project.

BMF inventory – Business Master File Returns - includes Employment Tax Non-Filers and pilot tests of document matching for corporate filers.

FRP – Frivolous Return Program identifies returns where the taxpayer is presenting a frivolous argument.

Misc. referrals – The bulk of this inventory is duplicate taxpayer identification number cases.

Schedule C – Sole proprietorship deductions.

Source: IRS audit data.

^aPercentages may not add to 100 due to rounding.

^bTotal W&I numbers includes 18 issues closed by correspondence audits that are not broken out because of the small number of cases, e.g., Schedule E, excise taxes and the 10 percent penalty.

^cTotal SB/SE numbers includes 24 issues closed by correspondence audits that are not broken out because of the small number of cases, e.g., excise tax, first time home buyer and estate and gift tax audits.

Table 8: Average Cycle Time in Days for Correspondence Audits, Fiscal Years 2009-2013

Fiscal year	Days in W&I	Days in SB/SE	Total
2009	177	178	177
2010	165	180	171
2011	186	177	182
2012	198	184	191
2013	203	186	195

Source: IRS audit data.

Note: W&I is the Wage and Investment Division and SB/SE is the Small Business and Self-Employed Division.

Table 9: Audits Closed with No Tax Changes for All Closures and Closures with Taxpayer Contact, Fiscal Years 2009-2013

Fiscal year	Number of audits closed with no change	Number of audits closed overall	No change closures as a percent of all audit closures	Number of audits closed with taxpayer contact	No change closures as a percent of contact closures
2009	118,308	1,095,441	10.8	420,828	28.1
2010	166,305	1,241,082	13.4	601,821	27.6
2011	241,158	1,176,382	20.5	542,416	44.5
2012	167,138	1,114,252	15.0	455,853	36.7
2013	124,994	1,050,373	11.9	392,618	31.8

Source: GAO analysis of IRS audit data.

Note: A contact closure is one where the taxpayer responded to the IRS audit notice (i.e., excludes default closures when the taxpayer did not respond to IRS's final audit notice whether or not the taxpayer agreed with the recommended tax changes, even if the taxpayer had responded to earlier notices).

Appendix III: IRS Correspondence Audit Program Performance Measures and Data

Table 10: Correspondence Audit Program Performance Measures That Have Targets

Measure ^a
1. Full time equivalents (FTEs) ^b
2. Audit closures ^b
3. Closures per FTE ^b
4. Closures more than \$200,000 and more than \$1 million in recommended tax assessments ^c
5. Cycle time to cover the calendar days from the audit start to audit closure
6. Customer satisfaction—percent satisfied
7. Phone customer satisfaction—percents satisfied and dissatisfied
8. Embedded quality for paper accuracy, timeliness, and professionalism
9. Embedded quality for telephone accuracy, timeliness, and professionalism
10. Level of service in answering taxpayer telephone calls
11. Employee satisfaction ^d
12. Percentage overage mail (end of month snapshot) ^d

Source: IRS.

Note: W&I is the Wage and Investment Division and SB/SE is the Small Business and Self-Employed Division. FTE equals one staff year. EITC is the Earned Income Tax Credit. TEFRA audits refer to audits done under the Tax Equity and Fiscal Responsibility Act.

^aUnless otherwise noted, measures and related targets are established separately for both EITC and non-EITC audits by W&I and SB/SE.

^bSB/SE has separate submeasures of this measure for work particular to that division.

^cW&I measure for non-EITC audits only.

^dSB/SE only.

Table 11: Correspondence Audit Program Data Used for Management Information

For EITC and nonEITC audits
1. Dollars recommended
2. Dollars recommended per return (excluding claims)
3. Revenue protected dollars
4. Revenue protected volume
5. New audit starts
6. Audit reconsideration new starts
7. Audit reconsideration current inventory
8. Audit reconsideration closures
9. Audit reconsiderations closed at an IRS campus ^a
10. Total nonfiler closures for individual taxpayers ^a
11. Aged closures (>365 days)
12. Overage mail ^b

**Appendix III: IRS Correspondence Audit
Program Performance Measures and Data**

For EITC and nonEITC audits

13. Total mail

14. Percentage of aged mail to total mail

15. Percentage of aged mail to started audit inventory

16. Adherence to schedule^c

For NonEITC audits only

17. W&I starts higher than \$200,000

Source: IRS.

Note: W&I is the Wage and Investment Division and SB/SE is the Small Business and Self-Employed Division. FTE, or full time equivalent, equals one staff year. EITC is the Earned Income Tax Credit.

^aSB/SE only.

^bW&I only.

^cThe percentage of time campuses provided the planned number of staff to answer telephone assistance calls.

Appendix IV: Analysis of Audit Recommended Tax Amounts Collected by Fiscal Year

Table 12: Cumulative Percentage of Audit Recommended Tax Amounts Collected in Each Fiscal Year for Audits Closed in Fiscal Years 2008-2013

Fiscal year audit closed	Fiscal year collection rate					
	2008	2009	2010	2011	2012	2013
2008	53.0%	61.1%	63.9%	65.7%	66.8%	67.6%
2009	—	43.7	51.0	54.3	56.2	57.4
2010	—	—	45.2	51.3	53.5	54.7
2011	—	—	—	43.6	50.0	52.1
2012	—	—	—	—	50.1	55.6
2013	—	—	—	—	—	50.1

Sources: IRS Data Book 2008-2013 for recommended tax amounts and GAO analysis of Enforcement Revenue Information System data for tax collected amounts.

Appendix V: Comments from the Internal Revenue Service



DEPUTY COMMISSIONER

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

May 28, 2014

Mr. James White
Director, Tax Issues
U.S. Government Accountability Office
Washington, D.C. 20548

Dear Mr. White:

Thank you for the opportunity to comment on the draft report titled "IRS Correspondence Audits: Better Management Could Improve Tax Compliance and Reduce Taxpayer Burden (GAO-14-479)." As your review noted, the correspondence audit program plays a significant role in ensuring tax compliance. It directly touches over one million taxpayers annually and affects the voluntary compliance of many more.

It is important to note that reductions in the IRS budget have stretched enforcement resources across the agency. In Fiscal 2014, the IRS budget had been reduced by nearly \$850 million less compared to Fiscal 2010. During the same period, the IRS has seen the number of key enforcement personnel drop by 3,000 positions.

We appreciate your acknowledgment that this review was conducted during a challenging period for the correspondence examination program due to budget reductions, fiscal year (FY) 2013 sequestration, and early FY 2014 furloughs. We have to make assumptions about the budget and the monies that will be available to execute against our audit plans. As we discussed with your staff, we have historically developed our audit plans assuming we would have full funding including, funding for overtime and attrition hiring. The Fiscal 2013 budget proved to be a very difficult budget year for us. By the time the Fiscal 2013 budget was finalized, we had already started a significant number of audits. A large number of taxpayers continued to respond on the cases in process, causing a backlog in reviewing and responding to taxpayer correspondence, and our reduced budget did not enable us to use overtime to address the backlog. To minimize similar risks in future years, we have revised our FY 2015 planning to better align our resources with our audit plans. As such, in developing our 2015 audit plan, we will consider existing staffing and funding levels with no overtime or attrition.

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The table below shows a quick snapshot of impact of budget reductions on our staffing:

Correspondence Exam Staffing	FY11	FY12	FY13
Total Full Time Equivalents (FTE) Realized	3,101	2,924	2,705
% Change from Prior Year	--	-5.7%	-7.5%
Change from FY11			-12.8%

Despite the challenges, we have been working to improve this program and value your review and analysis of our process, program measures, and improvement efforts. As noted in the report, the aged correspondence percentage, which was 0.4% for the Wage and Investment Division (W&I) and 11.3% for the Small Business/Self-Employed Division (SB/SE) at the end of FY 2012, climbed as high as 83.4% for W&I and 78.0% for SB/SE at the end of FY 2013. We continue to see progress in managing the correspondence and, as of March 2014, have achieved significant reductions.

We have other efforts underway which will impact the correspondence examination program. We are already analyzing the efficiency and effectiveness of the taxpayer phone inquiry process, and considering what modifications are needed to improve the utility of that process. We are working on finding the optimal balance between applying resources to handling taxpayer phone inquiries and applying those resources to handling taxpayer correspondence. The President's budget for 2015 includes funding for Document Imaging, an initiative which should improve our ability to manage correspondence and address taxpayer inquiries.

In addition, we are looking at a plan to realign our compliance operations within the SB/SE and W&I Divisions. The concept being reviewed would consolidate compliance related operations. This will reduce organizational duplications, increase operational efficiency, and help us more quickly identify emerging compliance risks. Streamlining compliance related operations will provide taxpayers with improved customer service and easier contact for handling their issues.

Your report also recognized our cross functional efforts in the Correspondence Examination Assessment Project (CEAP). The original purpose of CEAP was to evaluate and address internal and external feedback concerning the correspondence examination program. Although much of the feedback was anecdotal, we considered every comment and addressed all concerns. While the impact of some changes cannot be directly measured, recent practitioner and customer feedback indicates that our improvement efforts have enhanced the taxpayer experience. We remain committed to improving our responsiveness to taxpayers.

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We appreciate the valuable feedback you have provided. Responses to your specific recommendations are enclosed. If you have questions, please contact me or a member of your staff may contact Karen Schiller, Commissioner, Small Business/Self-Employed Division at (202) 317-6500.

Sincerely,



John M. Dalrymple
Deputy Commissioner for Services and Enforcement

Enclosure

Enclosure

**GAO Recommendations and IRS Responses to
GAO Draft Report: IRS Correspondence Audits – Better Management Could
Improve Tax Compliance and Reduce Taxpayer Burden
(GAO-14-479)**

Recommendation 1: To reduce the need for taxpayer calls, ensure that IRS is providing taxpayers with more realistic timeframes on when IRS will respond, and more efficiently use IRS resources, collect data to analyze whether IRS is responding within the timeframes cited in the revised audit notices. If IRS delays are continuing, further revise the notices to provide more realistic response times based on the data and take other actions appropriate to ensure efficient use of IRS tax examiner resources. For example, IRS could choose to provide taxpayers who call IRS with a recorded message notifying them of delays in IRS responding and when to expect an IRS response.

Comments: The IRS agrees it is important to provide taxpayers accurate information which may in turn reduce the need for additional taxpayer inquiries. We will collect and monitor data related to response timeframes and use that information to initiate programming changes to our letters and phone messages if realistic timeframes are not being reflected.

Recommendation 2: To clarify the desired results of the correspondence audit program and its linkages to IRS-wide activities,

- Establish formal program objectives.
- Ensure that the program measures reflect those objectives.
- Clearly link those measures with strategic IRS-wide goals on ensuring compliance in a cost effective way while minimizing taxpayer burden.

Comments: The IRS strives to ensure our program goals and objectives reflect the overall IRS strategic goals. We will review our current documentation and ensure there is a clear link establishing the correspondence audit program objectives and measures with the overall IRS-wide goals and objectives. We will update official guidance as warranted (e.g., program letters, IRM, etc.).

Recommendation 3:

To better inform decisions being made about the correspondence audit program, document how the decisions are to be made using the performance information (including criteria and tolerances used). IRS should also track and use other program data that has not been used to provide more complete performance information.

Examples of data that could be tracked and used include:

- How much of the recommended tax amounts is collected over time
- Other costs beyond the direct audit time, such as the costs to answer taxpayer calls per audit, assess the recommended tax, and collect those tax assessments.

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- Taxpayer burden and experience such as how often audits are resolved in one contact, how often taxpayers correspond or call, and how long taxpayers wait for IRS to respond to their documents and for the audit to close

Comments: We will thoroughly document the original plan development process. We will also evaluate the methodology used in several existing studies to determine the most productive use of collectability data. While we believe we adequately capture time spent within our program area, we will evaluate the feasibility of collecting and using additional data.

Recommendation 4: To better ensure an effective investment of resources in the CEAP efforts,

- Clearly document the intended benefits of ongoing efforts to address identified problems, and the process for measuring and tracking actual benefits.
- Develop a plan and timeline for implementing the CEAP contractor's recommendations on possible ways to improve the (a) selection of correspondence audit workload and (b) allocation of resources between providing telephone assistance and reviewing taxpayer correspondence to resolve audits or develop justifications for not implementing the recommendations.

Comments: We will document the expected benefits of ongoing changes with the understanding that some program improvements are not measurable (e.g. direct impact on customer satisfaction). While we had contractor support, these recommendations were made by a cross functional team that included Taxpayer Advocate Service, Appeals, SB/SE and W&I Research functions, Office of Compliance Analytics, and both correspondence exam functional Business Operating Divisions. We will continue to pursue our efforts with our Research functions to further improve our workload selection and maximize our resource usage.

Appendix VI: GAO Contact and Staff Acknowledgments

GAO Contact

James R. White, (202) 512-9110 or whitej@gao.gov

Acknowledgments

In addition to the contact named above, Tom Short, Assistant Director; Jehan Chase; David Dornisch; George Guttman; Ted Hu; Ronald W. Jones; Jay McTigue; Donna Miller; Edward Nannenhorn; Albert Sim; Jim Wozny; and John Zombro made key contributions to this report.

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