Why GAO Did This Study
Audit activities help ensure taxpayers pay the right amount of tax and help address the net $385 billion tax gap—the difference between the amount of taxes paid voluntarily and on time, and the amount owed. Audit programs in W&I mainly cover refundable credits reported on the Form 1040, Individual Income Tax Return. The hundreds of thousands of taxpayers whom W&I interacts with annually during audits make it critical to apply the tax law fairly. Unfair selection would increase burden on taxpayers and reduce public confidence in IRS.

GAO was asked to review W&I’s audit selection process. This report (1) describes the W&I process for selecting tax returns for audit, and (2) determines how well W&I’s audit selection procedures support its mission and goal to apply the tax law fairly. Unfair selection would increase burden on taxpayers and reduce public confidence in IRS.

What GAO Found
Three offices in the Internal Revenue Service’s (IRS) Wage and Investment division (W&I) are responsible for selecting returns for audit. Most returns are selected via computer systems that automatically send notices to taxpayers based on certain criteria, such as the validity of dependents. W&I program officials annually review the criteria and apply updates to the following filing season’s returns. In 2014, about 59 percent of all W&I audits—more than 516,000—were selected with a specialized computer tool called the Dependent Database, while the remainder was selected through a combination of referrals and manual selection methods.

W&I generally has established a positive environment for internal controls but could improve several areas in its audit selection procedures to support its mission. GAO found several procedures that establish a positive environment for promoting internal controls, such as ethics training. In addition, IRS has guidance to help ensure that decisions about updates to audit selection criteria are correctly implemented in its automated systems. However, W&I does not have established objectives for its audit selection process, and existing performance measures focus on audit results rather than audit selection. In addition, W&I has not defined key terms such as “fairness and integrity,” as required by internal control standards. Documented objectives and key terms would help W&I hone the measures it uses to assess its audit selection efforts and bring a consistent understanding of “fairness and integrity” to audit selection staff.

GAO also found that not all elements of the selection process were appropriately documented. For example, W&I does not have clear documentation about how the three offices that select the majority of returns W&I audits interact with one another. Additionally, one guidance document notes that returns with the highest audit potential should be marked, but it does not describe how audit potential is determined or any related internal controls. Documented objectives and key terms would help W&I hone the measures it uses to assess its audit selection efforts and bring a consistent understanding of “fairness and integrity” to audit selection staff.

What GAO Recommends
GAO recommends, among other things, that IRS establish program objectives and definitions of key terms such as “fairness” that apply to audit selection and use those definitions in assessing its selection performance; document selection processes more thoroughly; and document that changes to procedures are done in a timely manner. IRS generally agreed with all seven recommendations and provided additional comments reprinted in appendix II.