

# GAO Highlights

Highlights of [GAO-17-324](#), a report to congressional requesters

## Why GAO Did This Study

LB&I audits large partnerships and corporations with \$10 million or more in assets and high wealth individuals. These entities pose compliance challenges. For example, IRS reported that the gross underreported income tax of large corporations alone averaged an estimated \$28 billion annually between 2008 and 2010, the most recent data. It is important for LB&I to have adequate controls for its audit procedures and to properly plan and implement its new approach to address noncompliance.

GAO was asked to evaluate how IRS selects returns and is implementing its new compliance approach. Among other objectives, this report (1) assesses the extent that LB&I's documented procedures and policies for its audit selection methods generally reflected relevant internal control principles, (2) assesses the extent that LB&I has a standard process to monitor audit selection decisions, and (3) assesses the extent that LB&I has planned and implemented its new approach to address compliance.

GAO reviewed LB&I procedures and policies for eight selection methods that involved the use of discretion and its plans for implementing a new compliance approach. Given the status of LB&I's plans for and implementation of its new approach, GAO did not assess LB&I's decision to create the approach. GAO held focus groups with LB&I staff responsible for selecting audits, and interviewed IRS officials.

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## IRS RETURN SELECTION

### Improved Planning, Internal Controls, and Data Would Enhance Large Business Division Efforts to Implement New Compliance Approach

## What GAO Found

The Internal Revenue Service's (IRS) Large Business and International division (LB&I) uses a variety of methods, such as computer models and staff reviews of returns, to identify tax returns for audit consideration. From the returns identified, managers and auditors in LB&I field offices select the returns to be audited. For the eight methods LB&I uses for identifying and selecting tax returns for audit (selection methods) that GAO analyzed, LB&I documentation on its procedures and policies generally reflected 4 of the 10 internal control principles GAO reviewed. For example:

- Related to the internal control principle of demonstrating commitment to integrity and ethical values, LB&I auditors who identify tax returns for audit consideration are prohibited from auditing those returns themselves or assigning them to specific individuals for audit. In addition, all LB&I staff completed a required training on ethics and impartiality in 2015, the latest available data.
- Related to the internal control principle of demonstrating a commitment to competence, LB&I's procedures and manuals generally documented its training to help assure the competence of staff involved in audit selection. This training included courses on basic skills as well as instruction on more specific topics.

However, for the other 6 internal control principles GAO reviewed, there were gaps in documentation that limit LB&I's assurance that its selection methods are being implemented as designed and are supporting its objectives. For example:

- Related to the internal control principle of identifying, analyzing, and responding to risk, LB&I documentation did not specify procedures or a process for how to respond to changing circumstances, such as a change in the law, in selecting returns for audit.
- Related to the internal control principle of reporting on issues and remediating related deficiencies, LB&I documentation indicated that problems identified with selection methods were discussed in meetings, but not that corrective action was taken to address them.

GAO also found that LB&I has monitoring directives, but it does not have a standard process for monitoring field staff's audit selection decisions. Without such a process, LB&I lacks reasonable assurance that decisions are made consistently.

LB&I is in the process of implementing a new approach for addressing taxpayer compliance, including how it identifies tax returns for audit. LB&I plans to implement what officials call "campaigns," which are projects focused on a specific compliance-related issue, such as partnerships underreporting certain income, rather than projects focused on the characteristics of whole tax returns. According to LB&I officials, campaigns could include conducting audits as well as other efforts, such as reaching out to taxpayers and tax professionals, issuing guidance, and participating in industry events. LB&I officials said certain audit selection methods that existed prior to the development of campaigns will operate while LB&I implements its campaign approach, and campaigns may subsume some of those methods.

## What GAO Recommends

GAO recommends that IRS address documentation gaps in its selection method procedures and policies related to six internal control principles, develop a standard process to monitor field staff's audit selection decisions, and take seven actions to fully address planning principles in its efforts to implement its new compliance approach. In commenting a draft of this report, IRS agreed with all of the recommendations.

GAO found that LB&I made some progress in implementing its new compliance approach, such as by involving stakeholders in plans and implementing the process for submitting proposals for campaigns. However, LB&I has not fully met five project planning principles set forth in prior GAO work (see table below). Until it fully meets these principles, LB&I management lacks reasonable assurance that its new compliance approach will succeed in accomplishing its overall objectives of encouraging voluntary compliance and fair treatment of taxpayers.

### Large Business and International (LB&I) Division's Plans for New Compliance Approach Assessed against Project Planning Principles as of December 2016

Project Planning Principles	LB&I Actions not yet taken to address the principle
Develop project plan with measurable goals, schedules, and resources.	<ul style="list-style-type: none"> <li>Specific schedule is not set for adopting new campaign projects or establishing criteria for choosing projects.</li> <li>Compliance goals and resource needs are not stated in ways conducive to measurement.</li> </ul>
Evaluate human resources by assessing how needed staff will be acquired and retained.	<ul style="list-style-type: none"> <li>Means to evaluate measures of staff time devoted to working on plan is still being developed.</li> <li>Assessment of human resources is not documented.</li> </ul>
Leverage stakeholder input and incorporate lessons learned by evaluating past performance.	<ul style="list-style-type: none"> <li>Documentation is incomplete on how stakeholder input has been used.</li> <li>Evaluation of past performance did not document lessons learned on selection methods.</li> </ul>
Monitor progress by collecting data to determine effectiveness in achieving the stated goals.	<ul style="list-style-type: none"> <li>Monitoring plans focus on individual projects but not across selection methods overall.</li> <li>Data collection did not include data necessary to assess effectiveness of selection methods.</li> </ul>
Analyze and mitigate risks by evaluating, prioritizing, and documenting risks as well as options for mitigating risks.	<ul style="list-style-type: none"> <li>Plans for analyzing and mitigating the documented risks are not yet implemented.</li> </ul>

Source: GAO analysis of IRS information. | GAO-17-324

View [GAO-17-324](#). For more information, contact James R. McTigue Jr. at (202) 512-9110 or [mctiguej@gao.gov](mailto:mctiguej@gao.gov).