The Collection Function Develops Quality Fraud Referrals but Can Improve the Identification and Development of Additional Fraud Cases

July 27, 2012

Reference Number: 2012-30-083

This report has cleared the Treasury Inspector General for Tax Administration disclosure review process and information determined to be restricted from public release has been redacted from this document.

Redaction Legend:
1 = Tax Return/Return Information 3(d) = Other Identifying Information of an Individual or Individuals

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HIGHLIGHTS

THE COLLECTION FUNCTION DEVELOPS QUALITY FRAUD REFERRALS BUT CAN IMPROVE THE IDENTIFICATION AND DEVELOPMENT OF ADDITIONAL FRAUD CASES

Highlights

Final Report issued on July 27, 2012

Highlights of Reference Number: 2012-30-083 to the Internal Revenue Service Commissioner for the Small Business/Self-Employed Division.

IMPACT ON TAXPAYERS

Tax fraud is a deliberate and purposeful violation of Internal Revenue laws by those who do not file and properly report their income and expenses. When criminal fraud or civil fraud penalties are not adequately pursued, the IRS's efforts to reduce the Tax Gap and the noncompliance that contributes to it can be undermined. Taxpayers who do not voluntarily pay their share of taxes create unfair burden on taxpayers who timely and fully pay their taxes and can diminish the public's respect for the tax system.

WHY TIGTA DID THE AUDIT

The Fraud Office reported that declined fraud referrals from Fiscal Year 2007 to mid-Fiscal Year 2009 exhibited common weaknesses. In addition, a Fiscal Year 2009 Fraud Customer Survey of the Collection function revealed many respondents do not look for fraud in every case, and many revenue officers (RO) responded that they would not contact a Fraud Technical Advisor for assistance in the future This audit was initiated to assess the effectiveness of the Collection Fraud Referral Program, and whether the Collection Field function is adequately considering, identifying, and developing fraud cases for referral to Criminal Investigation (CI).

WHAT TIGTA FOUND

The Collection Fraud Referral Program has been successful in developing quality criminal fraud referrals. However, there are opportunities to improve the identification and development of Collection function fraud referrals.

ROs may be deterred from looking for fraud because fraud cases are more complex, require extensive additional work, and often do not result in accepted referrals. In addition, technical assistance was not always available to ROs, and management efforts to support fraud development varied.

Civil fraud penalties should be considered on criminal cases declined by CI. TIGTA reviewed all of the 53 Fiscal Year 2010 Collection function fraud referrals declined by CI. There was no documentation showing that civil fraud penalties were considered in 44 (83 percent) of the cases.

The RO, group manager, and Fraud Technical Advisor should review each case for common rejection reasons prior to initiating a lengthy fraud development case. However, 22 (42 percent) of 53 declined referrals were rejected for common rejection reasons. There was no evidence that these common issues were identified. TIGTA also determined that the overage clock was not always properly stopped or restarted in Collection function fraud cases.

WHAT TIGTA RECOMMENDED

TIGTA recommended that the Director, Collection Policy, issue guidance to emphasize potential adjustments of RO inventory levels when cases are in fraud development; revise guidance to require the post-declination meeting include a discussion about the potential for a civil fraud referral; and emphasize that possible barriers to a criminal fraud referral need to be discussed and documented during the case development.

In their response to the report, IRS officials agreed with the recommendations and plan to emphasize inventory control strategies for the development of potential fraud cases and update procedures to include information to be discussed during post-declination and case development meetings.

DEPARTMENT OF THE TREASURY

WASHINGTON, D.C. 20220

TREASURY INSPECTOR GENERAL
FOR TAX ADMINISTRATION

July 27, 2012

MEMORANDUM FOR COMMISSIONER, SMALL BUSINESS/SELF-EMPLOYED DIVISION

FROM: Michael E. McKenney
Acting Deputy Inspector General for Audit

SUBJECT: Final Audit Report – The Collection Function Develops Quality Fraud Referrals but Can Improve the Identification and Development of Additional Fraud Cases (Audit # 201130020)

This report presents the results of our review to determine the effectiveness of the Collection Fraud Referral Program, and whether the Collection Field function[1] is adequately considering, identifying, and developing fraud cases for referral to Criminal Investigation. The review was part of our Fiscal Year 2011 Annual Audit Plan and addresses the major management challenge of Tax Compliance Initiatives.

Management's complete response to the draft report is included as Appendix VI.

Copies of this report are also being sent to the Internal Revenue Service managers affected by the report recommendations.

Please contact me at (202) 622-6510 if you have questions or Frank Dunleavy, Acting Assistant Inspector General for Audit (Compliance and Enforcement Operations), at (213) 894-4470 (Ext. 128).

[1] See Appendix V for a glossary of terms.

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Abbreviations

CI	Criminal Investigation
FTA	Fraud Technical Advisor
FY	Fiscal Year
IRM	Internal Revenue Manual
IRS	Internal Revenue Service
RO	Revenue Officer
SB/SE	Small Business/Self-Employed

Background

Tax fraud is a deliberate and purposeful violation of Internal Revenue laws by those who do not file and properly report their income and expenses. Tax fraud requires both an underpayment and fraudulent intent, and is one of the most egregious forms of noncompliance.

The very nature of Collection function work lends itself to numerous areas of fraudulent noncompliance by taxpayers.

The primary objective of the Internal Revenue Service's (IRS) Fraud Program is to foster voluntary compliance of tax laws through the recommendation of criminal prosecutions and civil penalties against taxpayers who evade the assessment or payment of owed taxes. The very nature of Collection function work lends itself to numerous areas of fraudulent noncompliance by taxpayers. Among the IRS operating divisions,[1] the Small Business/Self-Employed (SB/SE) Division's Collection Field function is an important cross-functional partner in the detection and referral of fraud issues.

A Collection Field function revenue officer (RO) should initiate a fraud-related discussion with the group manager at the earliest possible opportunity whenever any indicators of fraud are discovered. If the group manager concurs, the Fraud Technical Advisor (FTA) should be consulted for assistance. The role of the FTA, who works for the Fraud/Bank Secrecy Act function within the SB/SE Division, is critical to the successful and timely development of quality potential fraud referrals and civil fraud penalties. In addition to assisting compliance employees with potential fraud development cases, the FTA serves as the cross-functional liaison and local expert in criminal and civil fraud. When a fraud referral is fully developed, it is submitted to Criminal Investigation (CI) for consideration of prosecution potential. If CI determines the case has prosecution potential, it accepts the referral and completes an investigation. If CI does not feel the case has prosecution potential, it declines the referral.

Criminal fraud results in punitive actions with penalties consisting of fines and/or imprisonment. A tax fraud offense may result in both civil and criminal penalties. The major difference between civil and criminal fraud is the degree of proof required. In criminal cases, the Federal Government must present sufficient evidence to a jury in order to prove guilt beyond a reasonable doubt. However, civil fraud penalties, which are assessed administratively, only require clear and convincing evidence of fraud with intent to evade tax. Due to the lower standard of proof in civil cases, civil fraud penalties may be imposed on a taxpayer who was not convicted of criminal tax evasion.

[1] See Appendix V for a glossary of terms.

IRS management conducts analyses of cases declined by CI. National trends for declined referrals from Fiscal Year (FY) 2007 through mid-FY 2009 for all operating divisions identified three common reasons why a criminal fraud referral was declined by CI. Specifically, CI declined cases that: 1) did not meet the minimum tax criteria, 2) lacked sufficient evidence, or 3) did not establish that the taxpayer willfully intended to defraud the Federal Government.

This review was performed at the IRS Headquarters in Washington, D.C.; the SB/SE Division Headquarters in New Carrollton, Maryland; and Collection function field offices in Laguna Niguel and Los Angeles, California, and Chicago, Illinois, during the period July 2011 through February 2012. We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective. Detailed information on our audit objective, scope, and methodology is presented in Appendix I. Major contributors to the report are listed in Appendix II.

Results of Review

The Collection Fraud Referral Program has been successful in developing quality criminal fraud referrals. However, opportunities exist to improve both the identification and development of Collection function fraud referrals. Specifically:

- Collection Field function employees may be deterred from identifying and pursuing potential Collection function fraud referral cases.
- Civil fraud penalties were not always considered.
- Common fraud referral weaknesses were not identified early in the development process.
- The overage clock was not always properly stopped or restarted.

The Collection Fraud Referral Program Has Been Successful in Developing Quality Criminal Fraud Referrals

The IRS's Fraud and Collection Policy offices have made recent improvements that have contributed to the Collection function having the highest percentage of fraud referrals accepted by CI among all IRS functions that submit referrals. For fraud referrals submitted to CI in FY 2010, Collection function's acceptance rate was 77 percent, compared to the Service-wide rate of 70 percent. Additionally, the acceptance rate of Collection function fraud referrals has increased each year from FY 2008 through FY 2010, indicating fraud development guidance and training is becoming increasingly effective for the Collection function. Figure 1 shows Collection function fraud referrals to CI compared with the Service-wide referrals.

Figure 1: Comparison of Collection Function and Service-Wide Fraud Referrals

	Declined Referrals		Accepted Referrals		Total Referrals		Acceptance Rate	
	Service-Wide	Collection	Service-Wide	Collection	Service-Wide	Collection	Service-Wide	Collection
FY 2008	206	63	419	147	625	210	67%	70%
FY 2009	166	61	334	159	500	220	67%	72%
FY 2010	156	53	369	176	525	229	70%	77%

Source: IRS CI Business Performance Review, dated September 2010 for the Service-wide data. The Collection function specific statistics were provided by CI to the Treasury Inspector General for Tax Administration in July 2011.

The Fraud Handbook[2] has been revised several times over the past few years. One of the revisions added a requirement to include a written Plan of Action for all fraud development cases (effective October 30, 2009). A written Plan of Action helps guide the RO through fraud development in a timely and orderly manner, and helps facilitate the involvement of the group manager and the FTA. This change was made based on best practices identified from Collection function operational reviews conducted by the Fraud and Collection Policy offices during FYs 2007, 2008, and 2009.

In addition, Form 11661-A, *Fraud Development Recommendation - Collection*, has been improved, including the addition of checklist items to the Plan of Action section. Also, because existing guidance allows the Plan of Action to be prepared on any of three formats,[3] IRS management told us that revisions are in process to improve consistency. IRS management plans to update FTA guidance to require that the Plan of Action be electronically attached or inserted into the Form 11661-A. This change will help ensure that all Plans of Action are consistently associated with the Form 11661-A, which is controlled by the FTAs.

Collection Field Function Employees May Be Deterred From Identifying and Pursuing Potential Collection Function Fraud Referral Cases

While the IRS encourages its employees to be cognizant of potential fraud violations, the detection and deterrence of fraud is every RO's responsibility. The Internal Revenue Manual (IRM) states that ROs are responsible for identifying potential fraud and referring that taxpayer to CI.[4] In addition, when indications of fraud are identified and the group manager concurs, Collection function employees should contact the FTA for assistance. The role of the FTA is critical to the successful and timely development of potential fraud referrals.

During FYs 2008 and 2009, the IRS's Fraud and Collection Policy offices conducted fraud operational reviews of five of the seven Collection function areas. The IRS's reviews identified potential barriers that may be deterring ROs from pursuing fraud cases. For example, the following excerpts appeared in one or more of the five Collection function area fraud operational reviews:

- *ROs admitted they are more likely to pursue fraud development cases when they have an "understanding manager."*

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[2] IRM 25.1 (Dec. 27, 2011).

[3] IRM 25.1.2.2(5) (Oct. 30, 2009) states the Collection Fraud Development Plan of Action may be documented: 1) in the form of a memorandum, 2) on page two of Form 11661-A, or 3) on Form 11660, *Fraud Development Plan*.

[4] IRM 5.1.11.6.2 (Jan. 15, 2010).

- *ROs also indicated that fraud is a lower priority; and it has to compete with higher priorities like overage and other inventory or management conflicts. It was evident that management sets the tone for fraud development.*
- *It was strongly suggested by the ROs and FTAs that the group managers exercise any inventory relief possible to show their "real" encouragement and support for the Fraud Program.*
- *Some group managers are reducing RO inventory levels when active fraud development work is present. This practice emphasizes the fact that fraud development is a priority and enhances the RO's ability to coordinate and develop both civil and criminal actions while balancing the demands of their remaining inventory.*

Additionally, in FY 2009, the Fraud Office conducted an employee survey to solicit opinions about the Fraud Program in the Collection Field function.[5] Results of the survey showed that only about 51 percent of nonmanagerial respondents review every case for fraud indicators. The survey also showed that about 27 percent of nonmanagerial respondents, who had previously developed a potential fraud referral, would not contact an FTA for assistance in the future.

Furthermore, we conducted several interviews[6] which showed that potential barriers reported in the IRS's operational reviews and the employee survey may still persist. Collection Field function personnel, at all levels, told us that ROs may be deterred from looking for fraud because fraud cases are complex. Fraud referrals generally involve significant amounts of work, and often include multiple related taxpayer accounts associated with a primary case. Some referrals can take several months to develop, sometimes even exceeding one year. Much of the work involves numerous in-depth investigative steps, such as issuing multiple summonses and reviewing complicated bank and corporate records.

Complicating the extensive work needed to develop a fraud case, fraud development may also be deterred because:

- Technical assistance is not always available.
- Developed cases may not be referred to, or accepted by CI.
- Management efforts to support fraud development varied.

[5] Of the 1,881 Collection function personnel who responded to this FY 2009 survey, 1,504 (80 percent) were from field operations.
[6] Interviews at the three Collection function field sites included three Territory managers, seven group managers, 16 ROs, three FTAs, and one FTA manager.

Technical assistance is not always available

The FTAs are expected to help inexperienced ROs, who may not possess the skills needed to plan and develop a fraud referral. However, as of the end of FY 2011, there were only 36 designated FTAs throughout the country. These 36 FTAs were responsible for assisting 5,619 ROs, which is an average of 156 ROs for each FTA. This ratio can affect the availability of the FTAs and limit the amount of time they have to help all ROs who need assistance. Four of the five Collection function area fraud operational reviews noted that a lack of regular, ongoing FTA involvement caused cases to linger in fraud development status and increased case hours. Territory managers in those operational reviews suggested the number of FTAs are "too thin" to cover the Collection function. To address this issue, one operational review included a suggestion that more experienced ROs could assist with the development of fraud cases.

Developed cases may not be referred to, or accepted by CI

CI considers many factors when deciding on the prosecution potential of a criminal fraud investigation. ROs can become discouraged if their efforts do not result in an accepted criminal fraud referral. Sometimes, after extensive amounts of work, the FTA recognizes that there is insufficient evidence and the case does not result in a referral to CI. In addition, even when an RO's extensive work does result in an actual fraud referral to CI, it is sometimes declined by CI for uncontrollable factors.[7] During this review, we were informed of instances of months and months of "wasted time" which often discouraged ROs who have never worked a fraud referral case from further pursuing a referral, even when signs of fraud existed in one of their cases.

Management efforts to support fraud development varied

Collection function management does not always use available options to accommodate fraud referral work. Different management styles and perceptions of expectations cause varying degrees of emphasis on the Fraud Referral Program.

ROs are expected to work multiple cases and the complexity and number of cases assigned generally depends on their grade level. Because it is important for ROs to timely work these cases, the IRS has established an overage clock that keeps track of how long a case has been assigned to a particular RO. When a case becomes overaged, it can negatively affect both the taxpayer and the group manager's evaluation of the RO's performance. Because fraud cases are more complex and time consuming, the overage clock should be stopped when a case enters into fraud development.

Even though the overage clock should be stopped on a case in fraud development, the clock on the rest of the RO's inventory continues to run. To help address the possibility that the other

[7] Factors beyond the control of the RO can cause CI to decline a fraud referral. For example, CI may believe a case would be too difficult to present to the average jury.

cases in an RO's inventory become overaged, group managers have the ability to adjust an RO's inventory on a case-by-case basis to reduce workload when an RO has an open fraud referral.

However, only one of seven group managers at the three Collection field sites we visited indicated that his or her inventory is adjusted for fraud referrals. Notably, this group had five open fraud development cases at the time of our interviews. Most of the ROs at the other groups told us that they had not worked a fraud referral case in many years.

When inventory levels are not adjusted, there is a possibility that the rest of an RO's inventory will become overaged and the RO will receive increased scrutiny (perceived or actual) by his or her manager. This condition can discourage the RO from pursing a fraud referral, even when there are indications of fraud. In addition, legal restrictions do not allow managers to recognize an RO, in performance evaluations or awards, for identifying or working a fraud referral. Although efforts have been made by Collection function management to encourage fraud development, some ROs believe the only reward they get for working a long, complex fraud case is an overaged inventory.

If all Collection function employees are not willing or motivated to identify and pursue potential fraud cases, it can undermine the IRS's efforts to reduce the Tax Gap and the noncompliance that contributes to it. Additionally, if employees in all groups are not provided similar accommodations to lessen workload for fraud cases, inequitable treatment of taxpayers may occur. By not adequately pursuing criminal fraud when warranted, the IRS may not only lose the confidence of those complying with the tax laws, but also risk more fraudulent activity from noncompliant taxpayers.

Recommendation

Recommendation 1: The Director, Collection Policy, SB/SE Division, should issue guidance to emphasize potential adjustments to RO inventory levels when cases are in fraud development when appropriate, and indicate that experienced ROs can mentor less experienced ROs through the fraud process in consultation with the FTA.

> ***Management's Response:*** IRS management agreed with this recommendation and will issue guidance to the Area directors to emphasize the inventory control strategies present in IRM 1.4.50.2.1 for the development of potential fraud cases when appropriate.

Civil Fraud Penalties Were Not Always Considered

Even when a potential fraud referral is declined by CI or the taxpayer is not convicted of criminal tax evasion, civil fraud penalties may be imposed because there is a lower standard of proof. Civil fraud penalties, which can be as much as 75 percent of the additional tax due to fraud, can be assessed for fraudulently omitting income on a filed tax return or failing to file a tax return.

The responsibility for assessing civil penalties lies with the Examination function. Therefore, when an RO identifies fraud, he or she must discuss with the group manager and the FTA the possibility of referring the case to the Examination function. In addition, Fraud Standard Operating Procedures[8] require that after CI declines a referral, the FTA should conduct a post-declination meeting with the RO and the group manager to discuss the declined criminal referral and alternative means of civil closure. This meeting would be an opportune time to discuss the possibility of referring the case to the Examination function. However, the procedures do not specifically require a discussion about the potential for referring the case to the Examination function during the post-declination meetings.

We reviewed all of the 53 FY 2010 Collection function fraud referrals declined by CI and determined:

- In 44 (83 percent) of the 53 cases, there was no documentation showing that civil fraud penalties were considered.
- In 45 (85 percent) of the 53 cases, there was no evidence that post-declination meetings were held.

IRS management stated that the ROs, group managers, and FTAs are not expected to be knowledgeable about when civil fraud penalties are warranted. All three FTAs that we interviewed indicated that they do not discuss the possibility of civil fraud penalties. ***3(d)*** ****************************3(d)** ****************************3(d)*** **************3(d)***************. In addition, one of the FY 2008 Collection function area fraud operational reviews identified the need to establish a formal process for involving the Examination function in Collection function fraud cases.

Because the potential for civil fraud penalties is not always addressed, the cases are not always referred to Examination for consideration of the penalty. We determined that 10 of the 53 FY 2010 Collection function fraud referral cases declined by CI had potential for development of civil fraud penalties, but there was no evidence that the cases were referred to the Examination function or that the potential for civil fraud penalties was discussed. While all of these cases warranted discussion of the penalty, ********************1******************** *********************************1************************************ *****1***********.[9]

[8] IRS Document 12722, *National Fraud Program Standard Operating Procedures*, (May 2009).
[9] As of May 31, 2012, the investigation for this case had not been concluded.

Recommendation

Recommendation 2: The Director, Collection Policy, SB/SE Division and the Director, Fraud/Bank Secrecy Act, SB/SE Division, should revise guidance to require post-declination meetings include a discussion about the potential for referring the case to Examination function for consideration of civil fraud penalties, if applicable to the case. This discussion should be documented appropriately.

> **Management's Response:** IRS management agreed with this recommendation and plans to update the relevant IRM section and Fraud Standard Operating Procedures to include information to be discussed during the post-declination meeting.

Common Fraud Referral Weaknesses Were Not Identified Early in the Development Process

Although CI accepted 77 percent of the fraud referrals submitted by the Collection function in FY 2010, our review of the declined cases identified an opportunity to potentially improve the productivity and reduce the resources expended by all organizations involved. Many of the declined cases included rejection reasons that could have been identified by the Collection function or the FTA early in fraud development or even before development began. Specifically, one or more of the following declination reasons were present in 22 (42 percent) of the 53 FY 2010 Collection function fraud referrals rejected by CI:

- CI already had an open case on the taxpayer or promoter of the scheme in five (9 percent) of the 53 declined cases.
- Taxpayer's age or health issues presented problems with jury appeal in six (11 percent) of the 53 declined cases.
- Venue issues existed with the taxpayer's residence or where tax returns were filed in four (8 percent) of the 53 declined cases.[10]
- A pattern of fraud in multiple years was not provided or shown in nine (17 percent) of the 53 declined cases.
- Form 12153, *Request for a Collection Due Process or Equivalent Hearing*, was not forwarded to Appeals, or the matter was still pending in Tax Court in two (4 percent) of the 53 declined cases.

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[10] Venue is established based on the taxpayer's place of residence and/or where the tax return was prepared and submitted. In these four cases, either venue had not been established for the CI field office to which the case was submitted or the case was submitted to the incorrect field office.

We recognize that the existence of one or more of these conditions may not necessarily result in a decision not to pursue a fraud case. However, at a minimum, if a case includes a common fraud referral rejection condition, the RO, group manager, and FTA should discuss the current trends within the jurisdiction of the case to decide if it is prudent to continue with fraud development. We found no evidence that these conditions were identified and discussed prior to referral to CI.

One criterion for the fraud development Plan of Action is to guide the case to its appropriate conclusion in a timely manner. Notwithstanding, there does not appear to be any guidance or controls to help prevent the inefficient use of resources that can be associated with pursuing a time-consuming fraud development case.

Form 11661-A[11] includes a Plan of Action section that has a checklist of a few items to consider during fraud development. However, the checklist does not include items that would help the early identification or discussion of criminal case weaknesses.

In addition, one of the Collection function area fraud operational reviews reported that some ROs are of the opinion that the FTAs are not acting as liaisons to CI, which would allow the ROs to avoid "*wasting time developing cases CI is never going to accept.*" It also stated that the FTAs should know and advise the ROs about what types of cases are preferred by CI.

When a potential fraud case is unnecessarily developed by the Collection function and/or submitted to CI with potential rejection conditions that could have been identified earlier, resources are unnecessarily expended in the Collection function, Fraud/Bank Secrecy Act function, and CI. For the 22 fraud referrals that displayed one or more potential rejection conditions, the average case was worked and monitored by the RO, group manager, and the FTA in fraud development for 174 calendar days. Additionally, after they were submitted as criminal fraud referrals, the 22 referrals were evaluated by CI for an average of 62 calendar days before being declined.

Recommendation

Recommendation 3: The Director, Collection Policy, SB/SE Division and Director, Fraud/Bank Secrecy Act, SB/SE Division, should emphasize that possible barriers to a criminal fraud referral need to be discussed and documented during the case development with the FTA, RO, and group manager.

> ***Management's Response:*** IRS management agreed with this recommendation and will revise IRM 25.1.2 to include discussion between the FTA and RO of possible barriers to criminal fraud referral during the case development meeting.

[11] At the time of our review, the current version of Form 11661-A was dated October 2010.

The Overage Clock Was Not Always Properly Stopped or Restarted

The overage clock should be stopped for Collection function cases in fraud development in order to promote work on time-consuming fraud cases and help keep the cases from becoming overaged. However, we determined that the overage clock was not stopped and/or restarted as required for 13 of the 19 fraud development cases reviewed.[12] Our analysis of those 13 exception cases revealed that the delays stopping the overage clock averaged 168 calendar days after development began, and the delays restarting the overage clock averaged 118 calendar days after development ended.

After the FTA approves the Form 11661-A, the group manager, or his or her designee, should input necessary Collection function and Integrated Data Retrieval System codes to stop the overage clock and prevent the case from being included in systemic case aging reports.[13] When the case is no longer in fraud development status[14] or FTA involvement is withdrawn, the group manager should be notified and should remove or reverse necessary codes to restart the overage clock.

Fraud Program management explained that the overage clock is not always stopped because they believe that stopping the clock is only an internal option. However, the benefit of stopping the overage clock is to promote work on time-consuming fraud cases and help keep those cases from becoming overaged, which require heightened scrutiny on the part of management. Therefore, the ROs may be discouraged from pursuing potential fraud if their managers do not adhere to this requirement, which was implemented as a motivational tool. We brought this issue to management's attention during this review even though we are not making a recommendation.

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[12] We reviewed a judgmental sample of 30 cases to determine if the overage clock was stopped and restarted as required. However, 11 of the 30 cases were immediate referrals that bypassed the fraud development phase. A judgmental sample is a nonstatistical sample, the results of which cannot be used to project to the population.
[13] IRM 25.1.8.8, *Aging of Collection Fraud Cases*, (Nov. 4, 2008), details the specific codes and processes used to stop and restart the overage clock. Also, systemic case aging reports are generated by the ENTITY Case Management System.
[14] A case is deemed no longer in fraud development status on the date CI's Declination Memorandum is received by the RO, or 30 calendar days after the date of the Declination Memorandum if the Integrated Collection System does not notate receipt of the memorandum or indicate FTA involvement is continuing.

Appendix I

Detailed Objective, Scope, and Methodology

The overall objective of this review was to determine the effectiveness of the Collection Fraud Referral Program, and whether the Collection Field function is adequately considering, identifying, and developing fraud cases for referral to CI.

To accomplish this objective, we:

I. Evaluated the adequacy of fraud referral guidance provided to the Collection Field function.

   A. Reviewed applicable fraud referral guidance within the IRM, the IRS Fraud website and periodicals, standard operating procedures, and ROs training materials.

   B. Obtained and analyzed quality review results from the National Quality Review System[1] and the Embedded Quality Review System to determine if any Collection Fraud Referral Program guidance or training areas were recently identified for improvement and subsequent actions taken by management.

II. Identified the types and volumes of Collection function fraud cases referred, and evaluated statistics such as acceptance rates and resulting civil fraud penalties assessed.

   A. Analyzed the content of Collection function fraud referral statistics received from CI.

      1. Validated the accuracy of Collection function fraud referral statistics provided by comparing the Collection function statistics with Service-wide statistics.

      2. Evaluated Collection function fraud referral statistics to identify any trends or other noteworthy conclusions that could be drawn.

III. Determined if the Collection Field function is adequately developing and submitting fraud referrals.

   A. Reviewed all 53 FY 2010 Collection function fraud referral cases rejected by CI.

      1. Analyzed the reasons CI declined the referrals.

      2. Determined if any civil fraud penalties were assessed on the Taxpayer Identification Numbers associated with the 53 declined cases reviewed. We generated Treasury Inspector General for Tax Administration Data Center Warehouse extracts of all civil fraud penalty assessments that posted after

[1] See Appendix V for a glossary of terms.

FY 2009 and then matched all the Taxpayer Identification Numbers associated with the 53 cases to those extracts.

Validity and reliability of data from computer-based systems:
For the Treasury Inspector General for Tax Administration Data Central Warehouse data extracts noted in Step III.A.2., we relied on the validations performed by the Treasury Inspector General for Tax Administration's Strategic Data Services Division staff on the Returns Transaction Files.

3. Identified which of the cases potentially should have been referred to the Examination function for consideration to assess civil fraud penalties by comparing the facts of the cases to criteria that supports assessment of either of the two fraud penalties: 1) IRM 20.1.5.12.2 is the criteria to assess the civil fraud penalty on filed returns, and 2) IRM 25.1.7.2 is the criteria for sufficient support to assess the civil fraud penalty on nonfiled returns.

4. Reviewed the Integrated Collection System case histories to determine if notes reveal: 1) the FTA had a meeting with the RO and group manager after CI declined the referral, and 2) civil fraud penalties were discussed or a referral to the Examination function was made or considered to address the potential penalties.

5. Estimated the potential revenue that could be generated if declined Collection function fraud referrals were properly referred to the Examination function for consideration of civil fraud penalties when warranted.

B. Reviewed 30 of the 53 FY 2010 Collection function fraud referrals rejected by CI to assess the adequacy of stopping the overage clock for cases in fraud development status.

IV. Determined the adequacy of emphasis placed on identifying, considering, and developing fraud in the training, operational reviews, and performance feedback provided to the Collection Field function staff for the offices in our scope.

A. Evaluated performance expectations of group managers and ROs to determine if there were any commitments/expectations related to fraud referrals.

B. Obtained the most recent training records for the ROs and group managers to determine the extent of their fraud training.

C. Analyzed the feedback given to each RO included in their FYs 2010 and 2011 mid-year and end-of-year appraisals dealing with identifying, considering, and developing fraud.

D. Reviewed Collection function area operational reviews conducted by the Fraud and Collection Policy offices.

E. Interviewed the ROs, group managers, Territory managers, and FTAs at each of the offices in our scope to obtain their opinions and input about the Collection Fraud Referral Program.

Internal controls methodology

Internal controls relate to management's plans, methods, and procedures used to meet their mission, goals, and objectives. Internal controls include the processes and procedures for planning, organizing, directing, and controlling program operations. They include the systems for measuring, reporting, and monitoring program performance. We determined the following internal controls were relevant to our audit objective: IRS policies and procedures to determine the effectiveness of the Collection Fraud Referral Program, and whether the Collection Field function is adequately considering, identifying, and developing fraud cases for referral to CI. We evaluated these controls by reviewing source materials, interviewing Collection function and Fraud/Bank Secrecy Act function personnel, and reviewing all 53 declined FY 2010 Collection function fraud referrals.

Appendix II

Major Contributors to This Report

Margaret E. Begg, Assistant Inspector General for Audit (Compliance and Enforcement Operations)
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Glen Rhoades, Audit Manager
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Appendix III

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Director, Collection Policy, Small Business/Self-Employed Division SE:S:ESC:CP
Director, Filing and Payment Compliance, Wage and Investment Division SE:W:CP:FPC
Chief Counsel CC
National Taxpayer Advocate TA
Director, Office of Legislative Affairs CL:LA
Director, Office of Program Evaluation and Risk Analysis RAS:O
Office of Internal Control OS:CFO:CPIC:IC
Audit Liaisons:
- Chief, Criminal Investigation SE:CI
- Commissioner, Small Business/Self-Employed Division SE:S
- Commissioner, Wage and Investment Division SE:W

Appendix IV

Outcome Measure

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

Type and Value of Outcome Measure:

- Increased Revenue – Potential; ***************************1*******************
  ********************************1************* (see page 7).

Methodology Used to Measure the Reported Benefit:

Our calculation is based on our review of all of the 53 FY 2010 Collection function fraud referrals declined by CI. We determined that 10 of the 53 FY 2010 Collection function fraud referral cases declined by CI had potential for development of civil fraud penalties, but there was no evidence that the cases were referred to the Examination function or that the potential for civil fraud penalties was discussed. *****************1*****************************
1**************************.
1*****************************
*************************************1*******************************.

Our calculation assumes that the civil fraud penalties would have been recommended and assessed by the Examination function and sustained upon any taxpayer appeal on the entire amount of taxes owed had the ********************************1******************
***********************1*******************************.

Appendix V

Glossary of Terms

Campuses – The data processing arm of the IRS. The campuses process paper and electronic submissions, correct errors, and forward data to the Computing Centers for analysis and posting to taxpayer accounts.

Collection Due Process Form – Form 12153, *Request for a Collection Due Process or Equivalent Hearing*, is used by taxpayers who are issued certain lien or levy notices to request a Collection Due Process hearing with the IRS Office of Appeals.

Collection Field Function – The unit in the Area Offices consisting of ROs who handle personal contacts with taxpayers to collect delinquent accounts or secure unfiled returns.

Collection Function Area – There are seven Collection function areas, or separate regions, as follows: California, Central, Gulf States, Midwest, North Atlantic, South Atlantic, and Western.

Data Center Warehouse – Architecture used to maintain critical historical data that have been extracted from operational data storage and transformed into formats accessible to an organization's analytical community.

Embedded Quality Review System – The Embedded Quality Review System allows managers to provide timely feedback to individual employees through performance reviews.

ENTITY Case Management System – A database that includes Collection Field function inventory, including time reporting on each case, and produces reports that can be used at the individual, group, Territory, Area, and national levels. ENTITY information can assist managers in analyzing group activity and inventory using a broad range of criteria.

Fiscal Year – A 12-consecutive-month period ending on the last day of any month, except December. The Federal Government's fiscal year begins on October 1 and ends on September 30.

Fraud/Bank Secrecy Act Function – Within the IRS's SB/SE Division, the Fraud/Bank Secrecy Act function provides oversight and direction for fraud policy and operations Service-wide and examines for compliance with Bank Secrecy Act[1] requirements. The Fraud/Bank Secrecy Act function is comprised of three components, one of which is the National Fraud Program.

[1] Pub. L. No. 91-508, 84 Stat. 1114 to 1124 (1970) (codified as amended in scattered sections of 12 U.S.C., 18 U.S.C., and 31 U.S.C.).

Fraud Technical Advisor – An FTA serves as the cross-functional liaison/resource and local expert in criminal and civil fraud, advising Collection Field function personnel on the interpretations of laws, policies, and procedures governing fraud. The FTA also plays an important role in fraud awareness and training.

Integrated Collection System – An information management system designed to improve revenue collections by providing ROs with access to the most current taxpayer information, while in the field, using laptop computers for quicker case resolution and improved customer service.

Integrated Data Retrieval System – An IRS computer system capable of retrieving or updating stored information; it works in conjunction with a taxpayer's account records.

IRS Operating Division – The IRS Restructuring and Reform Act of 1998[2] prompted the IRS to reorganize itself into operating divisions to closely resemble the private sector model of organizing around customers with similar needs. That reorganization resulted in the current four primary operating divisions at the IRS: Wage and Investment, Large Business and International, Small Business/Self-Employed, and Tax Exempt and Government Entities.

National Fraud Program – The National Fraud Program is one component under the Fraud/Bank Secrecy Act function and is administered by the Fraud Office. The main purpose of the National Fraud Program is to provide customer service to all operating divisions within the IRS in identifying and developing potential fraud cases.

National Quality Review System – The National Quality Review System allows national reviewers to evaluate Collection function files to determine whether the ROs complied with quality attributes established by the IRS.

Overage Clock – A system that tracks the aging of a case once it is assigned to the Collection Field function.

Returns Transaction Files – The Treasury Inspector General for Tax Administration Data Center Warehouse contains two returns transaction files that are updated weekly. The Individual Master File Returns Transaction File includes line item information and amounts from filed individual returns and schedules. The Business Master File Returns Transaction File is grouped by return type and includes line item information and amounts from filed business returns.

Revenue Officer – Employees in the Collection Field function who attempt to contact taxpayers and resolve collection matters that have not been resolved through notices sent by IRS campuses.

Tax Gap – The Tax Gap is the difference between taxes that are legally owed and taxes that are paid on time.

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[2] Pub. L. No. 105-206, 112 Stat. 685 (codified as amended in scattered sections of 2 U.S.C., 5 U.S.C. app., 16 U.S.C., 19 U.S.C., 22 U.S.C., 23 U.S.C., 26 U.S.C., 31 U.S.C., 38 U.S.C., and 49 U.S.C.).

Taxpayer Identification Number – A permanent number for identification of the tax account for every taxpayer. The Employer Identification Number is used to identify a taxpayer's business account. The Social Security Number is used as the account number of an individual taxpayer.

Territory Manager – Territory managers are responsible for planning, organizing, coordinating, monitoring, and directing their respective programs through subordinate managers (including group managers) who are geographically dispersed throughout the assigned Territory.

Appendix VI

Management's Response to the Draft Report

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

COMMISSIONER
SMALL BUSINESS/SELF-EMPLOYED DIVISION

July 5, 2012

RECEIVED
JUL 5 2012
BY: JAF

MEMORANDUM FOR MICHAEL R. PHILLIPS
DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: Faris R. Fink
Commissioner, Small Business/Self-Employed Division

SUBJECT: Draft Audit Report – The Collection Function Develops Quality Fraud Referrals but Can Improve the Identification and Development of Additional Fraud Cases (Audit # 201130020)

Thank you for the opportunity to review your draft report titled: "The Collection Function Develops Quality Fraud Referrals but Can Improve the Identification and Development of Additional Fraud Cases" (Audit # 201130020). The Collection Fraud Referral Program has been continuously successful in developing high quality criminal fraud referrals. In fact, the Collection Function has the highest percentage of fraud referrals accepted by Criminal Investigation (CI) among all IRS functions that submit referrals. This is a resounding affirmation of our commitment to fostering voluntary compliance with the tax laws through the identification and pursuit of badges of fraud against taxpayers who evade the assessment or payment of owed taxes.

We agree with your recommendations and appreciate your acknowledgement of the efforts we have already taken to ensure that the Collection Fraud Referral Program is robust and successful. There are some opportunities to improve the identification and development of criminal fraud referrals. While benefits arising from cases in development are difficult to quantify, we agree with the monetary benefit described in Appendix IV.

Attached is a detailed response that outlines our corrective actions. If you have any questions, please contact me, or a member of your staff may contact Scott D. Reisher, Director, Collection Policy, Small Business/Self-Employed Division at (202) 283-7361.

Attachment

Attachment

RECOMMENDATION 1:
The Director, Collection Policy, SB/SE Division, should issue guidance to emphasize potential adjustments to RO inventory levels when cases are in fraud development when appropriate, and indicate that experienced ROs can mentor less experienced ROs through the fraud process in consultation with the FTA.

CORRECTIVE ACTION:
We will issue guidance to the Area Directors to emphasize the inventory control strategies present in IRM 1.4.50.2.1 for the development of potential fraud cases when appropriate.

IMPLEMENTATION DATE:
December 15, 2012

RESPONSIBLE OFFICIAL(S):
The Director, Collection Policy, SB/SE Division

CORRECTIVE ACTION MONITORING PLAN:
IRS will monitor this corrective action as part of our internal management system of controls.

RECOMMENDATION 2:
The Director, Collection Policy, SB/SE Division and the Director, Fraud/Bank Secrecy Act, SB/SE Division should revise guidance to require post-declination meetings include a discussion about the potential for referring the case to Examination function for consideration of civil fraud penalties, if applicable to the case. This discussion should be documented appropriately.

CORRECTIVE ACTION:
1. We will update the relevant IRM section and Fraud Standard Operating Procedures to include information to be discussed during the post-declination meeting, and the appropriate case documentation.
2. We will report the actual monetary benefit derived per Appendix IV.

IMPLEMENTATION DATE:
1. April 15, 2013
2. July 15, 2013

RESPONSIBLE OFFICIAL(S):
The Director, Collection Policy, SB/SE Division and the Director, Fraud/Bank Secrecy Act, SB/SE Division

CORRECTIVE ACTION MONITORING PLAN:
IRS will monitor this corrective action as part of our internal management system of controls.

2

RECOMMENDATION 3:
The Director, Collection Policy, SB/SE Division and Director, Fraud/Bank Secrecy Act, SB/SE Division should emphasize that possible barriers to a criminal fraud referral need to be discussed and documented during the case development with the FTA, RO, and group manager.

CORRECTIVE ACTION:
We will revise IRM 25.1.2 to include discussion between the FTA and RO of possible barriers to criminal fraud referral during the case development meeting.

IMPLEMENTATION DATE:
April 15, 2013

RESPONSIBLE OFFICIAL(S):
The Director, Collection Policy, SB/SE Division and Director, Fraud/Bank Secrecy Act, SB/SE Division

CORRECTIVE ACTION MONITORING PLAN:
IRS will monitor this corrective action as part of our internal management system of controls.