



Treasury Inspector General for Tax Administration Office of Audit

CLASSIFIERS ARE ELIMINATING LESS PRODUCTIVE TAX RETURNS FROM THE AUDIT STREAM, BUT THEIR WORK NEEDS CLOSER MONITORING

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Highlights

Highlights of Report Number: 2010-30-096 to the Internal Revenue Service Commissioner for the Small Business/Self-Employed Division.

IMPACT ON TAXPAYERS

Internal Revenue Service (IRS) statistics show that fewer audits initiated by updated scoring formulas are being closed with no recommended tax changes. This indicates the IRS is better focusing its audit resources on tax returns posing the greatest compliance risk and not burdening compliant taxpayers with an audit.

WHY TIGTA DID THE AUDIT

The audit was initiated because the IRS is investing considerable effort to obtain current compliance data needed to update the Discriminant Index Function (DIF) formulas. Assigning a DIF score is the first part of a multistep process designed to select tax returns for which an audit is most likely to result in a material tax change. After the DIF assigns a score, the returns with the highest scores are reviewed by classifiers.

Classifiers have a critically important role in the process because they use their experience and judgment to determine which DIF-initiated tax returns warrant an audit and which can be accepted as filed. The objective of this audit was to determine how well classifiers in the Small Business/Self-Employed Division are assessing the compliance risk on individual tax returns selected by the updated DIF formulas.

WHAT TIGTA FOUND

Classifiers are doing a good job of eliminating less productive tax returns from the DIF audit stream. However, reviews to monitor the quality of their work were not always conducted in accordance with IRS procedures. This warrants attention because the IRS is phasing out the manual classification process and moving to an automated process where classifiers will be widely dispersed across the country. As a result, these reviews will be important for assuring classifiers are learning and adapting to the new automated

environment while consistently applying their expertise and skills during the classification process.

WHAT TIGTA RECOMMENDED

TIGTA recommended that the Director, Examination Planning and Delivery, Small Business/Self-Employed Division: 1) issue a memorandum to managers reemphasizing the existing requirements for controlling and monitoring the quality of the classification process, 2) establish a mechanism to monitor how well managers are complying with the existing requirements, and 3) develop and implement a data collection instrument to ensure an adequate sample of tax returns is reviewed.

IRS management agreed with the recommendations and plans to take appropriate corrective actions. The Director, Examination Planning and Delivery, Small Business/Self-Employed Division, plans to issue a memorandum to Examination Area Directors on the topic of sample return reviews to be done during the classification process. Also, the Director, Examination Planning and Delivery, Small Business/Self-Employed Division, plans to recommend that Examination Area Directors include a review of the quality of the classification process in their respective Examination Area Operational Reviews. To ensure an adequate sample of classified/selected returns is reviewed, IRS management plans to develop a data collection instrument to be used for collecting this information.

READ THE FULL REPORT

To view the report, including the scope, methodology, and full IRS response, go to:

<http://www.treas.gov/tigta/auditreports/2010reports/201030096fr.pdf>

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