



*Successfully Processing Large Corporate  
Tax Returns Electronically Was a  
Major Accomplishment, but Eliminating  
More Compliant Returns From the  
Audit Stream Is a Work in Progress*

**May 19, 2011**

**Reference Number: 2011-30-048**

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..

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## HIGHLIGHTS

### **SUCCESSFULLY PROCESSING LARGE CORPORATE TAX RETURNS ELECTRONICALLY WAS A MAJOR ACCOMPLISHMENT, BUT ELIMINATING MORE COMPLIANT RETURNS FROM THE AUDIT STREAM IS A WORK IN PROGRESS**

## Highlights

**Final Report issued on May 19, 2011**

Highlights of Reference Number: 2011-30-048 to the Internal Revenue Service Commissioner for the Large Business and International Division.

### **IMPACT ON TAXPAYERS**

Implementing the electronic filing (Modernized e-File) system and requiring large corporations to use it were major accomplishments. The benefits of the Modernized e-File system are enabling the Large Business and International (LB&I) Division to better meet the expectations for efficient, modern service among the large corporations it serves.

### **WHY TIGTA DID THE AUDIT**

This audit was conducted in response to a suggestion by the Internal Revenue Service (IRS) Oversight Board and was part of our Fiscal Year 2011 Annual Audit Plan addressing the major management challenge of Tax Compliance Initiatives. The overall objective of this review was to evaluate the progress the LB&I Division is making to take advantage of the opportunities offered by electronic filing (*e-file*).

### **WHAT TIGTA FOUND**

As envisioned in the LB&I Division's business case, meaningful work process improvements have been realized in the years after large corporations were required to *e-file*. Notably, the accomplishments include reducing the costs associated with the inefficiencies of manually processing paper returns, while enhancing customer

service and increasing availability of taxpayer information. Corporate taxpayers also report that *e-filing* has reduced the time and expense (burden) they spend filing their tax returns and related forms.

Due to numerous process improvement projects to enhance its audit process for corporations, it is very difficult, if not impossible, to isolate the impact *e-filing* is having on audit productivity. However, when compared to the years before *e-filing* was mandated for large corporations, LB&I Division statistics show that corporate audits are taking less time and generating more additional recommended taxes.

Although *e-filing* was expected to provide the LB&I Division with the capability to eliminate more compliant taxpayers from its audit stream, this key benefit has not been realized. In each of the fiscal years since mandatory *e-filing* was introduced for large corporations, a higher percentage (roughly one out of four) of corporate returns audited in the Industry Case Program were closed with no adjustment when compared to any of the three fiscal years preceding its introduction.

### **WHAT TIGTA RECOMMENDED**

TIGTA recommended that the Commissioner, LB&I Division, ensure projects that are taking advantage of *e-file* data to enhance how returns are identified and selected for audit include methodologically sound plans in evaluating project outcomes. TIGTA also recommended that the Commissioner, LB&I Division, assess the current methods of promoting and sharing best practices for working with *e-file* data and use the assessment, as well as the observations in this report, to adjust current methods, as needed, to better meet examiner needs.

In their response to the report, IRS officials agreed with the recommendations and they plan to (1) develop, document, and carry out evaluation plans to assess project results for workload selection processes and (2) assess the relative effectiveness of the LB&I Division's current methods of promoting and sharing best practices for working with *e-file* data and record an improved Web-based training session for employee use.



TREASURY INSPECTOR GENERAL  
FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY  
WASHINGTON, D.C. 20220

May 19, 2011

**MEMORANDUM FOR** COMMISSIONER, LARGE BUSINESS AND INTERNATIONAL  
DIVISION

*Michael R. Phillips*

**FROM:**

Michael R. Phillips  
Deputy Inspector General for Audit

**SUBJECT:**

Final Audit Report – Successfully Processing Large Corporate Tax Returns Electronically Was a Major Accomplishment, but Eliminating More Compliant Returns From the Audit Stream Is a Work in Progress (Audit #201030004)

This report presents the results of our review to evaluate the progress the Large Business and International Division is making to take advantage of the opportunities offered by electronic filing. The review was conducted in response to a suggestion by the Internal Revenue Service (IRS) Oversight Board and is part of our Fiscal Year 2011 Annual Audit Plan addressing 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 IRS managers affected by the report recommendations. Please contact me at (202) 622-6510 if you have questions or Margaret E. Begg, Assistant Inspector General for Audit (Compliance Enforcement Operations), at (202) 622-8510.



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## *Abbreviations*

FY	Fiscal Year
IC	Industry Case
IRS	Internal Revenue Service
LB&I	Large Business and International
LIN	Large Business and International Imaging Network
PDF	Portable Document File
PY	Processing Year
TIGTA	Treasury Inspector General for Tax Administration
XML	Extensible Markup Language



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## *Background*

The Large Business and International (LB&I) Division (formally called the Large and Mid-Size Business Division) serves the Nation's largest corporations and developed the business case<sup>1</sup> that laid the foundation for the current electronic filing (Modernized e-File) system that large and small corporations are using to electronically file (*e-file*) their tax returns and related forms.<sup>2</sup> As outlined in its business case, the LB&I Division anticipated that the move from manually processing paper tax returns to a Modernized e-File system would improve its ability to support the Internal Revenue Service's (IRS) overall mission and strategic objectives and deliver other key benefits. These other benefits generally centered on enhancing its continuing efforts to better meet large corporate taxpayer expectations for efficient, modern service while increasing the effectiveness of its audits and related compliance activities. Specifically, the benefits included:

- Improving customer service to taxpayers by reducing and addressing taxpayer problems faster, standardizing acknowledgements, and providing better account maintenance to taxpayers.
- Achieving operational efficiencies by supporting the long-range modernization initiatives of *e-file*, reducing processing and storage costs, and improving the accuracy of processing tax forms.
- Facilitating the timely processing of tax forms and providing timely, consistent, and reliable information by capturing 100 percent of the information provided by taxpayers.
- Allowing the LB&I Division to identify potential abusive tax shelters through "top down" risk assessments immediately after return filing.
- Developing a Comprehensive Issue Management Strategy with the increased amount of data available to perform trend and issue analysis to make the audit process more focused on noncompliance.
- Improving employee satisfaction by providing revenue agents with better information and tools.

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<sup>1</sup> See Appendix V for a Glossary of Terms.

<sup>2</sup> *Final Streamlined Business Case Analysis, Large and Mid-Size Business Division, 1120/1120S Electronic Filing*, (dated December 14, 2001).



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In response to our recommendation in an earlier report,<sup>3</sup> the IRS Commissioner agreed to consult with the Office of Chief Counsel and the Department of the Treasury in evaluating the feasibility and impact of legally mandating corporations to *e-file*. Subsequently, in January 2005, the Department of the Treasury issued temporary regulations<sup>4</sup> that required corporations with assets of \$50 million or more and that file 250 or more returns per year (including income tax, excise, employment tax, and information returns) to *e-file* their corporate income tax return. This mandate was expanded in November 2007<sup>5</sup> to include corporations with \$10 million or more in total assets that file 250 or more returns a year.

Implementing the Modernized e-File system to process corporate tax returns and requiring large corporations to use the system was a formidable task and a major accomplishment. In the months leading up to the effective date of the corporate *e-file* mandate, the IRS experienced considerable opposition to the mandate and skepticism about the system's ability to overcome the technological challenges needed to effectively process large corporate income tax returns electronically. However, LB&I Division officials reported working closely with tax professionals, software developers, and corporate tax departments and, on May 31, 2006, announced that it had successfully processed the Nation's largest tax return. On paper, the IRS estimated the return would have been some 24,000 pages long and, according to the announcement, the corporation received acknowledgment about its filing in about an hour.<sup>6</sup>

Like the IRS, other tax administrators are similarly taking advantage of electronic processing efficiencies. For example, we found that certain States have a range of *e-filing* options. According to the Federation of Tax Administrators, States in general are currently showing a faster electronic growth than the IRS, but this trend is slowing, which is to be expected given the maturation of their electronic programs. California began accepting electronically filed business returns in Calendar Year 2006 and does not have any mandates for *e-filing*, while New York began in Calendar Year 2007 and implemented a mandate effective for business returns filed on or after January 1, 2009. Both States report a general satisfaction with the level of participation from taxpayers and believe that both the quantity and quality of data are at an appropriate level of satisfaction.

We also looked at the *e-filing* of returns in the Canada Revenue Agency. In Calendar Year 2000, the Canada Revenue Agency redesigned its tax system to electronically capture all taxpayer information received. Specifically, information from paper returns is manually transcribed into the electronic system. The Canada Revenue Agency representatives stated that processing costs have decreased substantially as a result of *e-filing* and felt they had a significant savings due to the estimated decline in data capture costs of more than 80 percent. Approximately 90 percent of all corporate *e-filed* tax returns in the Canada Revenue Agency are filed through the Internet.

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<sup>3</sup> *New Regulations Are Needed to Take Full Advantage of the Opportunities Offered by Filing Large Corporate Income Tax Returns Electronically* (Report Number 2003-30-123, dated May 30, 2003).

<sup>4</sup> Treas. Reg. § 301.9177 (2005).

<sup>5</sup> Treas. Reg. § 301.9363 (2007).

<sup>6</sup> IRS News Release IR-2006-84, *IRS e-file Moves Forward: Successfully Executes Electronic Filing of Nation's Largest Tax Return* (May 31, 2006).



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These corporate tax returns are processed and a notice of assessment is issued to the corporation within 10 business days.

This review was performed at the LB&I Division Headquarters in Washington, D.C., during the period November 2010 through January 2011. Except for not auditing IRS databases to validate the accuracy and reliability of the information, this audit was conducted 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.



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## *Results of Review*

As envisioned in the LB&I Division's business case, meaningful work process improvements have been realized in the years after large corporations were required to *e-file*. Notably, the accomplishments include reducing the costs associated with the inefficiencies of manually processing paper returns, while enhancing customer service and increasing availability of taxpayer information. Corporate taxpayers also report that *e-filing* has reduced the time and expense (burden) they spend filing their tax returns and related forms.

Due to numerous process improvement projects to enhance its audit process for corporations, it is very difficult, if not impossible, to isolate the impact *e-filing* is having on audit productivity. However, when compared to the years before *e-filing* was mandated for large corporations, LB&I Division statistics show that corporate audits are taking less time and generating more additional recommended taxes.

Although *e-filing* was expected to provide the LB&I Division with the capability to eliminate more compliant taxpayers from its audit stream, this key benefit has not been realized. In each of the fiscal years since mandatory *e-filing* was introduced for large corporations, a higher percentage of corporate returns audited in the Industry Case (IC) Program were closed with no adjustment (no-change) when compared to any of the 3 fiscal years preceding its introduction.

Neither the Treasury Inspector General for Tax Administration nor officials in the LB&I Division knows what the no-change rate should be in audits of large corporations. Nevertheless, no-changing roughly one out of every four corporate returns audited in the last several fiscal years indicates there may be room for improvement in how returns are identified for audit and/or how examiners are conducting audits.

### ***The E-File Program Is Providing Meaningful Results to Both Corporations and the Internal Revenue Service***

With the approval of the IRS Oversight Board, the IRS is working towards an overall 80 percent *e-file* participation rate for all individual, major business, and exempt organization tax returns by Calendar Year 2012. The LB&I Division supports the IRS's long range goal through several initiatives and, as indicated in Figure 1, the number of business returns processed electronically for the LB&I Division has increased each year since Calendar Year 2005.



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**Figure 1: Paper Versus E-Filed Corporate Returns  
Processing Years (PY) 2005–2009**

Forms	Number of Paper and E-Filed Returns				
	2005	2006	2007	2008	2009
<b>U.S. Corporation Income Tax Return (Form 1120)</b>					
Paper	44,163	33,757	20,629	17,222	14,662
E-Filed	217	12,764	26,949	32,143	33,965
<b>Form 1120 Totals</b>	<b>44,380</b>	<b>46,521</b>	<b>47,578</b>	<b>49,365</b>	<b>48,627</b>
<b>U.S. Income Tax Return for an S Corporation (Form 1120S)</b>					
Paper	30,938	30,364	20,224	17,202	14,893
E-Filed	984	5,524	19,032	24,097	26,231
<b>Form 1120S Totals</b>	<b>31,922</b>	<b>35,888</b>	<b>39,256</b>	<b>41,299</b>	<b>41,124</b>
<b>U.S. Income Tax Return of a Foreign Corporation (Form 1120F)</b>					
Paper	991	1,109	1,067	1,440	1,447
E-Filed	---	---	---	74	440
<b>Form 1120F Totals</b>	<b>991</b>	<b>1,109</b>	<b>1,067</b>	<b>1,514</b>	<b>1,887</b>
<b>Grand Totals</b>					
Paper	76,092	65,230	41,920	35,864	31,002
E-Filed	1,201	18,288	45,981	56,314	60,636
<b>Grand Totals</b>	<b>77,293</b>	<b>83,518</b>	<b>87,901</b>	<b>92,178</b>	<b>91,638</b>

Source: IRS Processing Year 2009 Business Returns Transaction File.

**Customer and employee satisfaction with the Modernized e-File system**

During our review, we found that the LB&I Division recognizes the importance of providing a high level of service to the taxpayers it serves. In a June 2009, *Form 1120 e-file Customer Satisfaction Study*,<sup>6</sup> it was determined that 92 percent of filers of corporate income tax returns were very satisfied with their Form 1120 *e-filing* experience. This level of satisfaction was the same for both those business taxpayers who were mandated to *e-file* and those that did so voluntarily. Ninety-seven percent of users of Form 1120 *e-file* responded stating that they would recommend *e-filing* to a friend, colleague, or relative, and this percentage was statistically the same among both mandated and nonmandated users. The only exception noted by the nonmandated users in determining their level of satisfaction with *e-filing* was in the use and importance of acknowledgement of receipt and verification of corporate tax returns. Nonmandated users considered the acknowledgment of receipt and verification of corporate tax

<sup>6</sup> The *Form 1120 e-file Customer Satisfaction Study* was conducted by an outside vendor. The contractor was required to determine the business taxpayer's satisfaction, attitudes, and concerns regarding *e-filing*, as well as the concerns and barriers to *e-filing* for nonusers.



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returns slightly more important than mandated users in determining their level of satisfaction with *e-filing*.

When asked whether the *e-file* process could be improved, 22 percent of mandated users and 19 percent of nonmandated users responded stating that there was room for improvement. The areas suggested for improvement related to expanding Form 1120 *e-file*, as well as providing faster feedback and better, clearer, and easier to understand information about rejected returns. Most *e-filed* returns were transmitted via a third-party software vendor for both mandated (85 percent) and nonmandated (91 percent) users. Figure 2 shows some additional responses to the *Form 1120 e-file Customer Satisfaction Study* and indicates that the dominant reason for the overall satisfaction with *e-file* was the ease of use and convenience, which was about the same for both mandated and nonmandated users.

**Figure 2: Listing of E-File Benefits Noted Among Corporate Filers**

	Mandated	Nonmandated
<b>Number of Respondents</b>	<b>262</b>	<b>741</b>
	%	%
Being the most convenient way to file	98	98
Being paperless	95	98
Making tax filing easier	98	98
Being easy to use, with little hassle	95	98
Being easy to learn	96	97
Compared to paper filing	97	98
Providing fast acknowledgment of receipt	96	98
Being a more accurate way to file	96	96
Being a private and secure way to file	97	95
Providing easy-to-use signature options	95	95
Being a time-saver for you	95	94
Taking away the worry about the form	95	94
Reducing filing errors	94	94
Allowing schedules & attachments	92	92
Being inexpensive	92	91
Clear/understand process for correcting rejects	81	79
Easy to understand what caused reject	79	77
Paying the balance due electronically	60	50

Source: Findings from the *Form 1120 e-file Customer Satisfaction Study*.

The Modernized e-File system also received high marks from LB&I Division managers. Results from the survey we conducted of mid-level and frontline managers shows that a substantial percentage (45 percent) of the respondents agreed or strongly agreed that the use of *e-filed*



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returns is enhancing their ability to identify strategic compliance issues, as well as trends and problems with auditing taxpayers. Additionally, 79 percent of respondents reported being satisfied with the timeliness of the data received. The survey also indicated that respondents were generally satisfied with the quality and quantity of *e-filed* data received. The complete survey and results are included in Appendix IV.

**Processing error rates for e-filed returns are low and data reliability, as well as IRS communications and assistance, is high**

Ninety-three percent of all *e-filed* returns are accepted on their first transmission. Business taxpayers should receive a return acknowledgement within 24 hours of transmission; however, current acknowledgments are sent out to the taxpayers in less than a minute. When a transmission is rejected, processing stops and return validation cannot begin. Returns often have multiple reject errors and the Modernized e-File system will only check up to 100 errors on the return. If an *e-filed* return has more than 100 errors, then the system will stop processing the return and reject the return with an explanation of the first 100 errors found. The taxpayer (or vendor) transmitting the return receives one business rule acknowledgment file with up to 100 business rules listed per transmission. The taxpayer then has 10 days to correct the error and resubmit the return for processing.

For Fiscal Year (FY) 2009, the Electronic Tax Administration reported a 9 percent processing error rate for *e-filed* returns, while a 21 percent processing error rate was reported for paper returns. Some of the more common examples of errors for the categories are: (1) missing data where there must be a value for all of the items listed on the forms; (2) a missing supporting document that must be present for the return to be accepted for processing; (3) data validation error (for example, the return type indicated in the return header must match the return type established with the IRS for that Employer Identification Number); and (4) an Extensible Markup Language (XML) Schema error, which makes up the greatest number of errors (the structure of an XML document has failed schema or structure validation).

The Modernized e-File system also has a built-in system of integrity. For example, the Modernized e-File system has business rules that reject information and stop a return from processing, and other business rules that reject information (for example, a specific deduction) but allow the return to proceed. However, the taxpayer is always provided with the errors that need to be addressed. To reduce these types of errors in future transmissions of tax returns, the LB&I Division notifies taxpayers of the most common reject codes among business taxpayers through informational briefings at external conferences, notices posted on the IRS's web site and the American Institute of Certified Public Accountants' web site, and newsletter communications. Also, the LB&I Division updates the business rules as needed when schema updates are made.

In addition to providing business taxpayers the reasons for the rejection, the IRS also provides the e-help desk, which assists in providing access to the taxpayer's account through the Return



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Request and Display System. This system allows users to view any changes made to the taxpayer's return, as well as assisting with error correction and any other Modernized e-File system needs.

As mentioned, the largest number of reject errors fall into the XML Schema category, which covers every field on each form available in XML format. The LB&I Division strives to test the most commonly used fields on each return type; however, it is not conceivable to test every condition or tax situation that could occur on every return. The purpose of XML schema validation reject errors is to prevent erroneous or invalid data from acceptance into the Modernized e-File system. It is more effective for the customer and the IRS to reject these returns up front, which prevents further problems during downstream processing.

Since the original LB&I Division survey of Form 1120 users was published in June 2009, the LB&I Division E-File Project Office has presented the top 10 error rejects at software vendor conferences and the American Institute of Certified Public Accountants meetings in December 2009 and February 2010. In addition, the LB&I Division E-File Project Office identified the need to test additional form fields during the software assurance testing. For example, new forms added to the 1120 Form family were included in the current processing year testing scenarios. The E-File Project Office secured the services of subject matter experts to improve the testing scenarios for each form family. The LB&I Division E-File Project Office also hosts individual calls with vendors as necessary to address specific software concerns or issues.

***E-filing enables tax returns to be processed faster***

As Figure 3 shows, more steps are involved in processing a paper-filed return before it is posted to the IRS Master File and is available for audit screening than are involved in processing an *e-filed* return. Error rates are also considerably higher for paper tax returns. In contrast, *e-filed* tax returns are sent through a number of validations, which check for several hundred possible errors before the IRS accepts the tax return.



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**Figure 3: Comparison of Paper Versus E-File Tax Return Processing**

<i>Steps</i>	<i>Paper</i>	<i>E-Filed</i>
<b><i>Return Receipt</i></b>	Returns in sealed envelopes are delivered, opened, counted, and batched by return type. Returns with payments are separated from those without payments, and the payments are deposited.	<i>E-filing</i> saves the costs of manually handling and sorting tax returns delivered by mail. It also has an integrated payment option so electronic funds can be withdrawn from or deposited to a bank.
<b><i>Review and Coding</i></b>	Manually reviewed to ensure all forms are attached, completed, and signed. Returns are coded and edited so they can be manually transcribed into IRS computers.	<i>E-filing</i> saves the costs of manually reviewing tax returns and eliminates the need to transcribe return data for computer processing.
<b><i>Computer Processing</i></b>	A variety of checks are performed to determine if the return data are complete, were transcribed accurately, and are mathematically accurate. Returns that fail these checks are transferred to an error register, where IRS personnel attempt to correct the errors.	Compared to paper filing, <i>e-filing</i> is far less prone to transaction, math, and other errors because many errors are identified and corrected before IRS accepts the returns for processing.
<b><i>Return Numbering</i></b>	The document locator number is a control number assigned to every return and must be manually stamped on every return.	<i>E-filing</i> allows control numbers to be assigned automatically, which eliminates the need to manually stamp a control number on each return.
<b><i>Master File Posting</i></b>	Computer tapes with perfected return data are sent to the IRS's Martinsburg Computing Center in West Virginia where the data are uploaded to the Master File within about 4 weeks after the returns are filed.	Most <i>e-filed</i> returns post directly to the Master File within 1 week, if not sooner, after the returns are filed.
<b><i>Audit Screening</i></b>	Returns are mailed from IRS files to examiners, where they are manually screened to determine which ones warrant an audit and which ones do not. Returns that do not warrant an audit are returned to IRS files.	<i>E-filing</i> facilitates online audit screening and enables returns warranting an audit to be delivered electronically to examiners.
<b><i>Storage and Retention</i></b>	Returns are stored at the Federal Record Center for 75 years, requiring a large amount of space to house returns prior to being allowed to legally dispose of the paper returns.	<i>E-filing</i> saves the costs of storing paper returns in the Federal Record Center. Returns are maintained on an electronic storage media, which reduces the amount of storage space needed.

Source: IRS LB&I Division E-File Project Office.

Since LB&I Division officials had not performed any analyses to determine if *e-filed* returns are processed faster than paper returns, we worked with officials in analyzing a small sample of



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paper returns (15 returns for each year from PYs 2007 through 2009) and the population of *e-filed* returns. Our results show that *e-filed* returns are processed<sup>7</sup> and ready for audit classification in a much shorter time frame than paper returns. For instance, we found that 13 percent of PY 2009 paper returns were processed and available for audit classification within a week. Comparatively, our results indicate that 72 percent of the *e-filed* returns for PY 2009 were processed and available for audit classification within a week, as shown in Figure 4.

**Figure 4: Comparison of Paper Versus E-Filed Processing Times**

<i>Processing Time (in weeks)</i>	<i>2007 Paper</i>	<i>2007 E-Filed</i>	<i>2008 Paper</i>	<i>2008 E-Filed</i>	<i>2009 Paper</i>	<i>2009 E-Filed</i>
	<i>% Processed</i>		<i>% Processed</i>		<i>% Processed</i>	
1	0	66	0	49	13	72
2	7	18	13	22	27	11
3	7	5	13	10	33	5
4	20	2	27	7	7	3
5	7	1	0	3	7	2
6	7	1	0	2	0	1
7	20	1	7	2	0	1
8	13	1	7	1	7	1
9	20	1	0	1	7	1
10	0	1	0	1	0	1
11	0	1	7	1	0	1
12	0	1	0	0	0	1
13	0	1	7	0	0	1
14	0	0	0	0	0	0
15	0	0	0	0	0	0
16 and longer	0	1	21	1	0	0

*Source: IRS LB&I Division Research and Workload Identification function.*

However, according to the LB&I Division, the reduction in processing time cannot be solely attributed to the fact that more returns are *e-filed*. Instead, the LB&I Division stated that the implementation of the LB&I Imaging Network (LIN) during Tax Year 2004 is the major reason for the decrease in processing time. The LIN is the primary method of LB&I Division audit workload delivery and provides an electronic format of corporate and partnership returns to the field. This system provides the return image to users for viewing and downloading through a secure intranet-based system.

<sup>7</sup> The amount of time it takes from the date the return is received to when a return has completed processing, i.e., received date to Master File posting date.



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The LIN system existed prior to *e-filing* and consisted of scanning paper returns and delivering an electronic copy of the return to the field in a totally paperless process. In 2004, when the LIN was implemented, only a portion of the LB&I Division population of Form 1120 and Form 1120S returns were scanned (a total volume of about 25,000 returns).

In January 2005, the Department of the Treasury issued temporary regulations that required corporations with assets of \$50 million or more and that file 250 or more returns per year (including income tax, excise, employment tax, and information returns) to *e-file* their corporate income tax return. This requirement presented new challenges to the LIN team, both in return processing and return delivery. There was no system in place to create a transportable *e-file* return for delivery to the field. When returns began to arrive electronically, a second process was implemented to create a facsimile return as a Portable Document File (PDF). The IRS's Statistics of Income Division offered to use the *e-file* data to create a PDF of the returns and make them available for LIN delivery.

The Modernized e-File system had limitations that resulted in the need for large corporate taxpayers to file part of their returns electronically and part as paper documents. This was known as the hybrid process. During this time, the IRS's Statistics of Income Division was able to piece the *e-filed* and paper returns together to create a complete return for LIN delivery to the field.

In 2007, the LIN began delivering the XML data file for *e-filed* returns in addition to the PDF. The XML data file can be used in several applications developed by LB&I Division Computer Audit Specialists to provide the *e-file* data to the field for use in examinations of tax returns. In PY 2009, about 45 percent of LB&I Division returns were *e-filed*, and about 1.2 million returns consisting of 107 million pages have been scanned for the LIN.

The front end cycle time, defined as the time between a return posting to its selection for examination (Status 08 in the IRS's Audit Information Management System) has been significantly reduced over the past several years. Specifically, as shown in Figure 5, the processing time for both electronically and paper-filed returns has been reduced from 410 days in September 2002 to 24 days in December 2009, a decrease of nearly 95 percent.



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**Figure 5: Average Days Between Return Posting and Selection for Examination**

	<i>September</i>	<i>December</i>						
<b>LB&amp;I Division Form 1120 Returns Only</b>	<b>2002</b>	<b>2003</b>	<b>2004</b>	<b>2005</b>	<b>2006</b>	<b>2007</b>	<b>2008</b>	<b>2009</b>
Paper & e-filed returns <sup>8</sup>	410	173	70	80	79	48	21	24
Paper returns only <sup>9</sup>					42	41	26	28
E-filed returns only <sup>10</sup>					180	55	19	23

Source: IRS LB&I Division E-File Project Office.

**The LB&I Division is realizing cost savings from e-filing**

During our review, we found that the LB&I Division had not completed any studies to determine whether the *e-filing* of returns has resulted in cost savings. However, based on data we received from the IRS’s Wage and Investment Division Submission Processing function, we calculated the LB&I Division’s storage costs from FY 2006 to FY 2009, as shown in Figure 6. Our calculations indicate storage costs have decreased 46 percent since FY 2006, which is the first year business taxpayers were mandated to *e-file*. When you consider that some business tax returns are subject to a 75 year retention rate, the decrease in the estimated storage cost savings is even more substantial.

**Figure 6: Forms 1120 Storage Costs<sup>11</sup>**

<i>Fiscal Year</i>	<i>Volume in Cubic Feet</i>	<i>Monthly Storage Costs</i>	<i>Yearly Storage Costs</i>	<i>Increase/Decrease in Yearly Storage Costs</i>	<i>Storage Costs Over a 75 Year Period</i>
2006	70,739	\$14,855	\$178,262	-	\$13,369,671
2007	64,561	\$13,559	\$162,694	9% Decrease	\$12,202,029
2008	66,546	\$13,975	\$167,696	3% Increase	\$12,577,194
2009	37,932	\$7,966	\$95,589	43% Decrease	\$7,169,148
<b>Total</b>	<b>239,778</b>	<b>\$50,355</b>	<b>\$604,241</b>	<b>46% Decrease<sup>12</sup></b>	<b>\$45,318,042</b>

Source: IRS Wage and Investment Division, Submission Processing function, Post Processing unit.

<sup>8</sup> For PY 2006, the first year of the LB&I Division *e-file* mandate, the overall average days is a weighted average of paper-filed and *e-filed* returns as applicable. Prior to PY 2006, *e-filing* was not in effect and only paper returns were received and accounted for in this calculation. The remaining columns are left blank prior to PY 2006 because there is no information applicable.

<sup>9</sup> Paper-filed returns only – Average days from return posting to Audit Information Management System Status 08.

<sup>10</sup> E-filed returns only – Average days from return posting to Audit Information Management System Status 08.

<sup>11</sup> All costs have been rounded to the nearest dollar.

<sup>12</sup> The 46 percent decrease under “Total” represents the time period FYs 2006 through 2009.



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Additionally, we calculated the processing costs for paper and *e-filed* Forms 1120 based on data we received from the IRS Business Returns Transaction File. Our calculations estimated that *e-filing* has reduced Form 1120 processing costs by \$279,478 (see Figure 7). We based our calculations on the estimated costs for processing of paper and *e-filed* returns included in the FY 2008 Cost Estimate Guide.<sup>13</sup> Additionally, we included costs related to overhead and employee benefits. We determined the estimated cost savings by taking the difference between (1) the estimated cost if the *e-filed* returns would have been filed as paper returns and (2) the estimated cost for the *e-filed* returns. We did not include any costs associated with nonpipeline processing, which would have increased the cost savings from *e-filing*.

**Figure 7: Form 1120 Processing Costs**

<i>Forms 1120</i>	<i>PY 2005</i>	<i>PY 2006</i>	<i>PY 2007</i>	<i>PY 2008</i>	<i>PY 2009</i>
Paper Cost	\$585	\$34,400	\$72,630	\$86,629	\$91,539
E-File Cost	\$13	\$759	\$1,602	\$1,911	\$2,020
Savings by Year	\$572	\$33,641	\$71,028	\$84,718	\$89,519
<b>Total Estimated Savings From 2005 Through 2009</b>					\$279,478

Source: Our analyses of the FY 2008 Cost Estimate Guide and the Business Returns Transaction File.

**Overall, productivity indicators are trending favorably for audits of corporate returns**

To determine whether large corporations comply with tax laws, the LB&I Division audits their tax returns under two programs. In general, the largest and most complex corporate returns are continuously audited by a team of examiners under the Coordinated Industry Case Program, while the vast majority of other large corporations may be selected for audit under the IC Program. Unlike the team approach used to audit returns in the Coordinated Industry Case Program, corporate returns in the IC Program are typically assigned to one examiner, although other specialists may be called upon to provide assistance in auditing some complex tax issues, such as those involving international taxation.

One measure of audit productivity in both Programs is the amount of additional taxes recommended for each return audited and another is the amount of additional taxes recommended for each hour examiners apply to an audit. Overall, we found that the amount of additional taxes recommended on both a return and hourly basis in both Programs is trending favorably since mandatory *e-filing* was introduced for large corporations in FY 2005. As Figure 8 shows, the recommended additional taxes on a return basis in the IC Program increased

<sup>13</sup> Document 6746 (Catalog Number 62707C, Rev. 7-2009).



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almost 113 percent from a low of \$254,638 in FY 2002 to \$542,006 in FY 2010, which was the latest full year of audit productivity data available during our review.

**Figure 8: Coordinated Industry Case and Industry Case  
Recommended Additional Taxes, No-Change Rates, and Cycle Times  
From Corporate Audits for FYs 2002 Through 2010**

FY	Coordinated Industry Cases					Industry Cases				
	Total Cycle Time <sup>14</sup>	Audit Cycle Time <sup>15</sup>	Dollars per Return	Dollars per Hour	No-Change Rate	Total Cycle Time	Audit Cycle Time	Dollars per Return	Dollars per Hour	No-Change Rate
2002	64	38	\$4,978,642	\$3,282	7%	38	18	\$254,638	\$1,230	22%
2003	62	38	\$5,212,924	\$3,461	7%	42	19	\$246,107	\$1,043	21%
2004	62	36	\$5,152,384	\$4,202	8%	39	16	\$401,840	\$1,773	22%
2005	62	37	\$9,488,680	\$7,277	6%	40	16	\$507,131	\$2,306	24%
2006	63	39	\$10,156,293	\$6,810	4%	33	14	\$711,709	\$3,422	30%
2007	61	38	\$13,144,049	\$8,533	7%	28	13	\$511,812	\$2,199	28%
2008	49	32	\$14,196,631	\$9,658	5%	29	14	\$552,755	\$2,185	27%
2009	47	30	\$18,055,362	\$11,731	6%	29	14	\$659,599	\$2,594	25%
2010	44	28	\$16,137,186	\$10,016	8%	28	13	\$542,006	\$2,398	28%

Source: Our analysis of FYs 2002 through 2010 audited corporate returns as reflected in the Audit Information Management System.

Figure 8 also shows corporate audits in the Coordinated Industry Case Program result in substantially more additional recommended taxes per return than those conducted in the IC Program. There are several factors that can contribute to this difference. For example, the corporations in the Coordinated Industry Case Program are generally much larger and have higher taxable incomes than those in the IC Program. Consequently, a tax increase to a corporation with high taxable income will result in higher additional recommended taxes than the same change would for a corporation with less taxable income. While the favorable trend in the amount of recommended additional taxes is noteworthy, the number of corporate audits that are closed without a tax change (no-change) in the IC Program is an area that could be improved.

<sup>14</sup> The total cycle time is calculated from the date the return is filed to the date the audit is completed.

<sup>15</sup> The audit cycle time is calculated from the date the return is selected for audit to the date the audit is completed.



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***Despite the Overall Favorable Trend of Audit Productivity Indicators, the No-Change Percentage of Corporate Audits Is a Concern***

Because *e-filing* gives the IRS all of the return information in its computers, compared to the 151 items it previously transcribed from paper returns, the Modernized e-File system was expected to provide the LB&I Division with the capability to eliminate more compliant taxpayers from its audit stream. However, statistics from closed audits of corporate returns in the IC Program suggest the additional return information has not resulted in realizing this key benefit.

In each of the FYs (2005 through 2010) since mandatory *e-filing* was introduced for large corporations, a higher percentage of corporate returns audited in the IC Program were closed as a no-change when compared to any of the 3 fiscal years preceding its introduction. As the IRS reported to Congress in 2003,<sup>16</sup> a high no-change rate means a significant amount of resources are being devoted to unproductive audits and compliant corporations are being unnecessarily burdened by audits. Neither the Treasury Inspector General for Tax Administration nor LB&I Division officials know what the no-change rate should be in audits of large corporations. Nevertheless, no-changing roughly one out of every four corporate returns audited in FYs 2005 through 2010, as shown in Figure 8, indicates there is room for enhancing the use of *e-file* data in deciding which returns to audit and/or how audits are conducted.

***Enhancing the Use of E-File Data in Deciding Which Returns to Audit***

The LB&I Division should be commended for consistently investing considerable efforts in process improvement projects to enhance how it identifies and selects corporate returns for audit, as well as how returns are audited. For example, LB&I Division officials coordinated with IRS researchers about 10 years ago in developing and testing the Discriminate Analysis System, which is currently in use helping select IC corporate returns for audit. The Discriminate Analysis System uses tax return data, mathematical models, and statistical formulas to automatically assign a compliance risk score to IC corporate returns. In general, the higher the score, the more compliance risk the return poses and the greater probability a tax change will result if the return is audited.

Currently, the LB&I Division is involved in numerous projects that are relying on *e-file* data and the efficiencies it provides to make work process improvements. One such project is called the Compliance Management Operations pilot. The Compliance Management Operations pilot is a multiyear project that was initiated in February 2010 to test if a more comprehensive approach

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<sup>16</sup> *Report to Congress: IRS Tax Compliance Activities*, Department of the Treasury and Internal Revenue Service, July 15, 2003.



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for identifying and selecting returns for audit can outperform the Discriminate Analysis System and other existing techniques.

Although we did not conduct an in-depth review of the Compliance Management Operations pilot, we did learn through discussions with LB&I Division officials that a detailed evaluation plan for the pilot has yet to be completed and documented even though the pilot began over a year ago. According to published Government Accountability Office guidance,<sup>17</sup> a sound evaluation plan needs to be developed early and include such details as: (1) clear and measurable objectives, (2) standards for determining the pilot's performance and measuring its success against stated objectives, and (3) details about the type and amount of data needed to evaluate the pilot as well as how the data will be collected.

The LB&I Division has two stated goals for the Compliance Management Operations pilot, which is to test whether the approach can drive taxpayer compliance as early and efficiently as possible and by getting productive returns into the audit stream that would not have otherwise been selected. It has also outlined key objectives in briefing documents by indicating that the Compliance Management Operations approach is designed to improve the LB&I Division's workload selection capabilities, increase compliance coverage of taxpayers, shorten the length of audits, promote voluntary compliance, and identify emerging compliance risks sooner.

However, not all of the objectives are clear. For example, "increase compliance coverage of taxpayers" does not explain the type of taxpayers that will be covered or what is meant by compliance coverage. The LB&I Division covers several segments of the taxpayer population. These segments include high-wealth individuals, multinational corporations and large partnerships, and subchapter S corporations. Moreover, compliance coverage can include a variety of activities, such as conducting correspondence, office, and field audits; reaching out to taxpayer groups for educational purposes; securing agreements with State or local business licensing authorities to address certain tax issues; and sending notices to taxpayers that encourage self-correction of potential tax return errors. In addition to better defining objectives, not all of the objectives can be easily measured. For instance, the statement "improve LB&I Division's workload selection capabilities" does not indicate how much of an improvement in workload selection capabilities is expected. The statement also does not specify what would indicate success, such as identifying a certain anticipated percentage drop in no-change audits.

Besides clear and measurable objectives, sound evaluation plans include details about the type and amount of data that will be needed to evaluate the pilot's performance and specify the criteria or standards for objectively measuring performance. Assessing data needs early, as well as how the data will be gathered, helps ensure they will be available and collected once testing

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<sup>17</sup> Government Accountability Office published guidance includes, among others, the *Business Process Reengineering Assessment Guide* (GAO/AIMD-10.1.15, dated May 1997) and *Tax Administration: Planning for IRS's Enforcement Process Changes Included Many Key Steps but Can Be Improved* (GAO-04-287, dated January 2004).



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begins. Measuring performance objectively is important for making effective business decisions by determining whether desired results are being obtained and whether further improvements may be needed. Such determinations can also increase the likelihood the project will successfully target and address the intended problem area while enhancing the credibility of the results and helping avoid any perception bias in the outcomes.

### **Enhancing the use of e-file data in conducting audits**

Establishing a framework for identifying, developing, and sharing best practices is widely recognized both in the government and private industry as a cost-effective and efficient way to draw on expertise and experience of others in using new technologies and techniques to improve performance. It is also in line with the *Standards for Internal Control in the Federal Government*,<sup>18</sup> which indicates such a process can be a powerful training tool for ensuring all personnel possess and maintain a level of competence that allows them to accomplish their assigned duties.

Although we did not evaluate case files to assess whether some examiners, or specific groups of examiners, may be struggling with *e-file* data issues in isolation, we did review examiner training records and found that a limited number of examiners (195 of the approximate 7,000 LB&I Division examiners) participated in a July 2010 web-based training session on accessing and using available tools for analyzing *e-file* data. While the session received favorable feedback from participants, it is no longer available online to examiners, nor have similar training sessions been provided subsequently.

In addition, our survey of LB&I Division Territory and Group Managers found evidence indicating that there is room for improving how examiners work with *e-file* data. Approximately 66 percent of the respondents disagreed or expressed no opinion that they were satisfied with the training they have been provided in accessing and using *e-filed* returns for audits. Several respondents commented that they did not fully understand how to use the systems available and to manipulate the data in order to take full advantage of the available information. Respondents also believed that some of their coworkers had more knowledge on how to manipulate the data and wanted to obtain the same level of competency in working with the data.

### **Recommendations**

The Commissioner, LB&I Division, should:

**Recommendation 1:** Ensure the Compliance Management Operations pilot project team and other teams involved in process improvement projects develop, document, and carry out evaluation plans to assess project results. The plans should include such key evaluation items as clear and measurable objectives, criteria for determining the project performance and measuring

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<sup>18</sup> *Standards for Internal Control in the Federal Government*, (GAO/AIMD-00.21.1.3, dated November 1999).



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its success against stated objectives, and details about the type and amount of data needed to evaluate the project, as well as how the data will be collected.

**Management's Response:** IRS management agreed with this recommendation. The Commissioner, LB&I Division, will ensure that the Compliance Management Operations pilot project team will develop, document, and carry out evaluation plans to assess project results. The assessment for the first year of the Compliance Management Operations pilot has been completed and the report is being finalized. After reviewing the report, the IRS will refine performance measurements for the Compliance Management Operations. A project management function with responsibility for overseeing, evaluating, and assessing how the Compliance Management Operations process is working on an ongoing basis is being implemented. A similar approach will be deployed to other workload selection processes in a manner appropriate to the individual project.

**Recommendation 2:** Assess the relative effectiveness of the LB&I Division's current methods of promoting and sharing best practices for working with *e-file* data by using existing tools, such as including appropriate questions in periodic employee surveys. This assessment should include the observations made in this report and be subsequently used to adjust current methods, as needed, to better meet examiner needs.

**Management's Response:** IRS management agreed with this recommendation. The Commissioner, LB&I Division, will assess the relative effectiveness of the LB&I Division's current methods of promoting and sharing best practices for working with *e-file* data. In addition, the LB&I Division will record an improved Web-based CENTRA training session for employee use. The LB&I Division is also working on enhancements to improve the field's ability to use *e-file* data by making the returns easier to navigate, search, analyze, etc. The LB&I Division will obtain feedback from employees periodically via surveys and other means to identify additional ways to make working with electronic data easier and more effective.



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## Appendix I

### *Detailed Objective, Scope, and Methodology*

Our overall objective was to evaluate the progress the LB&I Division is making to take advantage of the opportunities offered by *e-filing*. To accomplish our objective, we:

- I. Assessed whether the Modernized e-File system achieved (or planned actions exist to realize) benefits such as improved cost savings; reduction in taxpayer burden; increased employee satisfaction; and improved identification of issues, trends, and problems with noncompliant taxpayers by:
  - A. Analyzing and comparing the processing procedures for U.S. Corporation Income Tax Returns (Form 1120) for paper versus *e-filed* tax returns.
  - B. Obtaining and analyzing the *Form 1120 e-file Customer Satisfaction Study* (June 2009) from the IRS LB&I Division E-File Project Office.
  - C. Obtaining and analyzing the PYs 2005 through 2009 Business Returns Transaction File.<sup>1</sup>
  - D. Interviewing IRS LB&I Division personnel to obtain error processing rates and types of errors made for PY 2009 *e-filed* tax returns.
  - E. Analyzing and comparing the time periods for processing Forms 1120 paper versus *e-filed* tax returns for Tax Years 2007 through 2009.
  - F. Obtaining (from the IRS LB&I Division E-File Project Office) the September 2002 through December 2009 average days between return posting and selection for examination of Forms 1120 and compared the difference between paper and *e-filed* tax returns.
  - G. Analyzing the results of a judgmental sample selected by the LB&I Division's Research and Workload Identification function to compare the processing times of paper and *e-filed* tax returns.
  - H. Obtaining and comparing storage cost data for both paper and *e-filed* Forms 1120 for the time period FYs 2006 through 2009 from the Wage and Investment Division Submission Processing function to determine which process provided the most cost savings.

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<sup>1</sup> See Appendix V for a Glossary of Terms.



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- I. Analyzing data from the Automated Information Management System to determine the impact *e-filed* data has had on the productivity of large corporate examinations.
- II. Conducted an onsite visitation to the King of Prussia, Pennsylvania, office to interview and observe how *e-filed* returns were being utilized during the examination process.
- III. Obtained 289 surveys from LB&I Division Territory and Group Managers to determine how the Modernized e-File system has improved work processes and satisfaction with the existing system, and suggestions for improvement.
- IV. Identified the best practices, policies, and procedures being used by the States and other governments in the processing of *e-filed* business tax returns by:
  - A. Contacting the Federation of Tax Administrators to obtain information on States' usage of *e-filing*.
  - B. Judgmentally selecting two States (California and New York) and conducting interviews with and obtaining appropriate support information from those State tax officials using a standardized questionnaire.
  - C. Conducting interviews with Canadian tax officials (Canada Revenue Agency) about the benefits they have experienced with *e-filing*.

**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: 1) the controls in place to ensure the IRS's ability to identify compliant taxpayers and eliminate them from the audit stream and 2) the controls in place to ensure better identification of issues, trends, and problems of noncompliant taxpayers. We evaluated these controls by reviewing source materials and interviewing management.



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## **Appendix II**

### *Major Contributors to This Report*

Margaret E. Begg, Assistant Inspector General for Audit (Compliance and Enforcement Operations)  
Frank Dunleavy, Director  
Michelle Philpott, Audit Manager  
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## **Appendix III**

### *Report Distribution List*

Commissioner C  
Office of the Commissioner – Attn: Chief of Staff C  
Deputy Commissioner for Services and Enforcement SE  
Deputy Commissioner, Large Business and International Division SE:LB  
Director, Business Systems Planning, Large Business and International Division SE:LB:BSP  
Director, Planning, Analysis, Inventory and Research, Large Business and International Division  
SE:LB:PAIR  
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 Liaison: Commissioner, Large Business and International Division SE:LB



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## **Appendix IV**

### *Treasury Inspector General for Tax Administration Survey for Large Business and International Division Territory and Group Managers*

The following questions were included in an online survey conducted by the Treasury Inspector General for Tax Administration (TIGTA). Notification about the online survey was emailed to 712 managers listed under the Discovery Directory under the LB&I Division management category. The email notification was sent on January 29, 2010, and a reminder was sent on February 8, 2010. Online surveys were completed by February 12, 2010. A total of 289 LB&I Division managers participated in the survey. The percentages reflected in the survey responses may not always equal 100 percent due to rounding.

#### **Email Notification**

The TIGTA, Office of Audit, is conducting an evaluation of the LB&I Division's efforts to take advantage of the opportunities offered by the increase in *e-filing* of business returns. As part of the evaluation, the TIGTA is conducting a survey of all Territory Managers and Group Managers in the LB&I Division.

TIGTA and LB&I Division executives appreciate your participation in the survey. As individuals who work directly with *e-filed* business returns, we value your opinions on the current *e-filing* process. Your input will help to identify areas in which there may be barriers hampering your ability to take full advantage of using *e-file* returns in the day-to-day, case-related activities of your examinations.

The TIGTA estimates that the survey will take about 20 minutes to complete. The survey is confidential. Your responses will be combined with those of other respondents and will be reported only in summary form. The TIGTA will not identify the specific respondents who participated in the survey either in its report or to other IRS officials.

Thank you!



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### **Survey Questions**

The TIGTA appreciates your participation in this survey because it will help identify current practices and procedures in the *e-filing* community.

Your responses will be combined with those of other respondents and will be reported only in summary form. The TIGTA will not identify specific respondents who participated in the survey in our report or to other IRS officials.

Thank you for your participation!

#### **1. Check the box that best describes your position.**

<u>29</u>	Territory Manager	(10.03%)
<u>189</u>	Team Manager	(65.40%)
<u>21</u>	IE Manager <sup>1</sup>	( 7.27%)
<u>2</u>	Economist Manager	( 0.69%)
<u>9</u>	CAS Manager <sup>2</sup>	( 3.11%)
<u>12</u>	Engineer Manager	( 4.15%)
<u>11</u>	Financial Products Manager	( 3.81%)
<u>16</u>	Other	( 5.54%)

#### **2. How long have you been in your current position?**

<u>68</u>	Zero to one year	(23.53%)
<u>104</u>	One year to five years	(35.99%)
<u>117</u>	Over five years	(40.48%)

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<sup>1</sup> IE = International Examiner.

<sup>2</sup> CAS = Computer Audit Specialist.



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**3. I find that the use of *e-filed* business returns is enhancing our ability to identify strategic compliance issues, trends, and problems without examining taxpayers.**

<u>35</u>	Strongly Agree	(12.11%)
<u>96</u>	Agree	(33.22%)
<u>84</u>	Neither Agree nor Disagree	(29.07%)
<u>47</u>	Disagree	(16.26%)
<u>14</u>	Strongly Disagree	( 4.84%)
<u>11</u>	Not Applicable	( 3.81%)
<u>2</u>	No response provided	( 0.69%)

**4. I believe the use of *e-filed* business returns has reduced the amount of time between when a return is filed and the examination of a business taxpayer is complete.**

<u>81</u>	Strongly Agree	(28.03%)
<u>125</u>	Agree	(43.25%)
<u>41</u>	Neither Agree nor Disagree	(14.19%)
<u>21</u>	Disagree	( 7.27%)
<u>9</u>	Strongly Disagree	( 3.11%)
<u>10</u>	Not Applicable	( 3.46%)
<u>2</u>	No response provided	( 0.69%)

**5. I find the use of *e-filed* business returns is making the audit process more focused on noncompliance by providing increased data for trend issue analysis.**

<u>30</u>	Strongly Agree	(10.38%)
<u>102</u>	Agree	(35.29%)
<u>80</u>	Neither Agree nor Disagree	(27.68%)
<u>54</u>	Disagree	(18.69%)
<u>12</u>	Strongly Disagree	( 4.15%)
<u>9</u>	Not Applicable	( 3.11%)
<u>2</u>	No response provided	( 0.69%)



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**6. I am satisfied with the quality of data provided by *e-filed* business returns, including the data delivered via the LIN.**

<u>23</u>	Strongly Agree	( 7.96%)
<u>126</u>	Agree	(43.60%)
<u>46</u>	Neither Agree nor Disagree	(15.92%)
<u>54</u>	Disagree	(18.69%)
<u>29</u>	Strongly Disagree	(10.03%)
<u>10</u>	Not Applicable	( 3.46%)
<u>1</u>	No response provided	( 0.35%)

**7. I am satisfied with the quality of data provided by *e-filed* business returns, including the data provided via the XML applications.**

<u>25</u>	Strongly Agree	( 8.65%)
<u>103</u>	Agree	(35.64%)
<u>83</u>	Neither Agree nor Disagree	(28.72%)
<u>31</u>	Disagree	(10.73%)
<u>20</u>	Strongly Disagree	( 6.92%)
<u>26</u>	Not Applicable	( 9.00%)
<u>1</u>	No response provided	( 0.35%)

**8. I am satisfied with the quantity of data provided by the *e-filed* business returns, including the data delivered via the LIN.**

<u>23</u>	Strongly Agree	( 7.96%)
<u>119</u>	Agree	(41.18%)
<u>63</u>	Neither Agree nor Disagree	(21.80%)
<u>47</u>	Disagree	(16.26%)
<u>23</u>	Strongly Disagree	( 7.96%)
<u>12</u>	Not Applicable	( 4.15%)
<u>2</u>	No response provided	( 0.69%)



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**9. I am satisfied with the quantity of data provided by the *e-filed* business returns, including the data delivered via the XML applications.**

<u>25</u>	Strongly Agree	( 8.65%)
<u>95</u>	Agree	(32.87%)
<u>87</u>	Neither Agree nor Disagree	(30.10%)
<u>33</u>	Disagree	(11.42%)
<u>17</u>	Strongly Disagree	( 5.88%)
<u>25</u>	Not Applicable	( 8.65%)
<u>7</u>	No response provided	( 2.42%)

**10. I am satisfied with the timeliness of data provided by *e-filed* business returns, including the data provided via the LIN.**

<u>60</u>	Strongly Agree	(20.76%)
<u>168</u>	Agree	(58.13%)
<u>23</u>	Neither Agree nor Disagree	( 7.96%)
<u>15</u>	Disagree	( 5.19%)
<u>7</u>	Strongly Disagree	( 2.42%)
<u>13</u>	Not Applicable	( 4.50%)
<u>3</u>	No response provided	( 1.04%)

**11. I am satisfied with the timeliness of data provided by *e-filed* business returns, including the data provided via the XML applications.**

<u>0</u>	Strongly Agree	( 0.00%)
<u>135</u>	Agree	(46.71%)
<u>72</u>	Neither Agree nor Disagree	(24.91%)
<u>15</u>	Disagree	( 5.19%)
<u>6</u>	Strongly Disagree	( 2.08%)
<u>25</u>	Not Applicable	( 8.65%)
<u>36</u>	No response provided	(12.46%)



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**12. I find that *e-filed* business returns are providing revenue agents and others involved in the examination process with better information and tools to make their examination efforts more productive than working with paper-filed business returns.**

<u>30</u>	Strongly Agree	(10.38%)
<u>113</u>	Agree	(39.10%)
<u>63</u>	Neither Agree nor Disagree	(21.80%)
<u>49</u>	Disagree	(16.96%)
<u>21</u>	Strongly Disagree	( 7.27%)
<u>9</u>	Not Applicable	( 3.11%)
<u>4</u>	No response provided	( 1.38%)

**13. I am satisfied with the information generated from *e-filed* business returns.**

<u>15</u>	Strongly Agree	( 5.19%)
<u>117</u>	Agree	(40.48%)
<u>64</u>	Neither Agree nor Disagree	(22.15%)
<u>61</u>	Disagree	(21.11%)
<u>22</u>	Strongly Disagree	( 7.61%)
<u>10</u>	Not Applicable	( 3.46%)

**14. I was satisfied with the training that has been provided for accessing and using *e-filed* business returns for examinations.**

<u>11</u>	Strongly Agree	( 3.81%)
<u>64</u>	Agree	(22.15%)
<u>78</u>	Neither Agree nor Disagree	(26.99%)
<u>80</u>	Disagree	(27.68%)
<u>32</u>	Strongly Disagree	(11.07%)
<u>22</u>	Not Applicable	( 7.61%)
<u>2</u>	No response provided	( 0.69%)



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- 15. I feel that *e-filing* of business returns has increased job satisfaction among employees.**
- |            |                            |          |
|------------|----------------------------|----------|
| <u>  9</u> | Strongly Agree             | ( 3.11%) |
| <u> 81</u> | Agree                      | (28.03%) |
| <u>118</u> | Neither Agree nor Disagree | (40.83%) |
| <u> 50</u> | Disagree                   | (17.30%) |
| <u> 22</u> | Strongly Disagree          | ( 7.61%) |
| <u>  9</u> | Not Applicable             | ( 3.11%) |
- 16. I think the use of *e-filing* of business returns helps the Division to attract and maintain a highly skilled and satisfied workforce.**
- |            |                            |          |
|------------|----------------------------|----------|
| <u>  4</u> | Strongly Agree             | ( 1.38%) |
| <u> 53</u> | Agree                      | (18.34%) |
| <u>148</u> | Neither Agree nor Disagree | (51.21%) |
| <u> 52</u> | Disagree                   | (17.99%) |
| <u> 17</u> | Strongly Disagree          | ( 5.88%) |
| <u> 14</u> | Not Applicable             | ( 4.84%) |
| <u>  1</u> | No response provided       | ( 0.35%) |
- 17. Overall, I am satisfied with the electronic filing process for business returns.**
- |            |                            |          |
|------------|----------------------------|----------|
| <u> 22</u> | Strongly Agree             | ( 7.61%) |
| <u>147</u> | Agree                      | (50.87%) |
| <u> 58</u> | Neither Agree nor Disagree | (20.07%) |
| <u> 38</u> | Disagree                   | (13.15%) |
| <u> 16</u> | Strongly Disagree          | ( 5.54%) |
| <u>  8</u> | Not Applicable             | ( 2.77%) |



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**18. When conducting examinations, what benefits do you find working with returns using the LIN and/or XML applications?**

- Ability to look at comparative data over several years using XML applications.
- Able to get returns more quickly in the field.
- Able to review prior and subsequent years online.
- Able to share returns more easily with team members.
- Can see trends, possible errors, or omissions.
- Can view tax return prior to making an assignment.
- Faster pre-audit analysis of returns.
- LIN allows review of return without travel to the audit site.
- LIN provides a complete, transportable return.
- XML file can be manipulated by the CAS to provide meaningful reports for the agents.
- Timeliness is the primary benefit.
- Trend analysis comparisons.

**19. When conducting examinations what barriers do you find working with returns using the LIN and/or XML applications?**

- LIN returns are not indexed.
- Not all pages of returns are available via LIN.
- Supporting schedules are poorly formatted.
- Additional training needed for XML application.
- Large returns are cumbersome to work through and find needed information.
- Lack of training on the use of and the ability to manipulate data on LIN system and XML application.
- Horrible organization of return information.
- Agents need hard copies, returns need to be printed.
- LIN returns are in a PDF format, which is difficult to work with or scroll through returns.



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- LIN lacks capacity to search the return, and returns lack schedules.
- LIN forces the classification process (issue selection) onto the manager.
- Information on LIN is too cumbersome to use. Easier to view a paper copy of return.
- Return information is not displayed in a tax return format and not complete.
- Not all information is transcribed to allow accurate classification.
- We need to be able to manipulate data more efficiently.
- Difficult to navigate, frequently need to print.
- Difficult to review returns with multiple subsidiaries.
- Difficult to classify large electronic returns.
- Have found errors on *e-filed* returns, believe this occurs if the taxpayer transmits more than one return due to an error notice.
- There is no application for classifiers and reviewers to fully access and navigate through an *e-filed* return, and thus to properly exploit the potential of XML data.
- The system is workable as is but could definitely be improved.
- The ability to search all *e-filed* returns was limited, making efforts to filter select returns ineffective.

**20. Do you have any suggestions to improve upon the accessing and use of *e-filed* returns?**

74 Yes (If yes, please describe) (25.61%)

193 No (66.78%)

22 No response provided ( 7.61%)

- Lengthen the life of the LIN password.
- A tool or software that allows agents to review a return without having to use three different applications.
- Set up system where a table of contents can be hyperlinked to the appropriate tax return schedule or form.
- Ensure signature page is available for computation of statute date.
- Eliminate stacked returns and replace with consolidated schedules.



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- Enhance LIN system so that superseded and amended returns that are *e-filed* are available to examination.
- Have most recently filed returns get to the field more quickly. Often takes months to receive return on LIN and LB&I Division can no longer ask for return from taxpayer.
- Improve ability to navigate to selected pages/areas of return.
- Improve printing options for selected pages.
- Make LIN file searchable.
- More training on how to use the XML data.
- Develop automatic systems to take the data on these returns from multiple years and generate reports that can be understood by agents and that will identify issues.
- Make certain all schedules, forms, and elections are included with the LIN return.
- More training so employees know the benefits and the limitations of *e-filed* returns.
- Need additional data analysis functionality and sufficient training to use it.
- Organize/print forms as they would appear if they were filed on hard copy.
- Stop automatic sending of LIN links for subsequent year returns.
- Provide better training.
- Somehow bookmark the attached forms.
- The fact that the electronic returns must be treated the same as the paper-filed returns limits the effective use of filters.
- LIN was designed as a temporary system and needs to be updated, making it viable.
- Need a better report generator so printed returns have all the information and are in a usable format.
- Need the search function to work on PDFs for greater efficiency.
- Easier way to download returns – large return has multiple downloads and then you must determine way to merge them.
- Need summary amounts for detailed information.



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**21. Is there anything else that you would like to add?**

  31   Yes (If yes, please describe) (10.73%)

 238  No (82.35%)

  20  No response provided ( 6.92%)

- LIN system and End User Portal could be more user friendly.
- Create additional training via ELMS<sup>3</sup> or CENTRA sessions on the use of the LIN and XML process.
- *E-FILE* converter for International examiners in BETA testing should be released to the field and, once released, additional training should be provided.
- We imposed the *e-file* requirement without having a plan for what we would do with the returns.
- If the use of electronic returns is to be successful in conducting examinations, then the LIN returns must be complete with all attachments and schedules.
- IRS was totally unprepared to deliver returns to the field. *E-filed* consolidated corporate tax returns are organized in a completely different format than paper-filed returns.
- No adequate training has ever been provided.
- LIN and *e-file* are wonderful. Just need better data format.
- Need to make full use of available products.
- LB&I Division's capability to use *e-file* data has been a complete failure, in terms of delivering returns with good potential and identifiable, high risk issues to the field examiners.
- Need consolidated statements – universal complaint from agents.
- *E-filed* returns do not include the consolidated return schedules that are helpful.
- Require all LB&I Division taxpayers to *e-file* and level the playing field.
- Return preparers who are not United States citizens are prevented from *e-filing*.
- E-FILE and LIN are excellent tools for the field.

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<sup>3</sup> ELMS = Enterprise Learning Management System.



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- Training on EUP,<sup>4</sup> E-FILE, and XML should be given to agents.
- We need to maximize our use of electronic data.
- When LIN is sent to agent, beneficial to send account transcript and audit history simultaneously.
- IRS has not been able to exploit the use of *e-file* data because all taxpayers are not required to *e-file* and has not put in place applications to enable reviewers and auditors to efficiently read and analyze returns properly.
- Password issues with LIN.

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<sup>4</sup> EUP = Employee User Portal.



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## Appendix V

### *Glossary of Terms*

<b>Term</b>	<b>Definition</b>
Audit Information Management System	A system that the IRS Examination function uses to control returns, input assessments and adjustments to the Master File, and provide management reports.
Business Case	A document that summarizes numerous technical and business work products, analyses, and studies that provide the basis for making investment funding decisions and for monitoring and evaluating performance.
Business Returns Transaction File	A computer file of transcribed line items from all business returns and the accompanying forms and schedules.
Business Rules	The policies and procedures that describe the operation of a business in achieving its goals. These rules are used to detect potential noncompliance of taxpayers and to rank or prioritize the issues based on potential noncompliance.
Canada Revenue Agency	The tax agency in Canada that collects Federal income taxes imposed upon both individuals and corporations.
CENTRA	A web-based, virtual, e-Learning collaboration software that runs on the Intranet to deliver lecture and content. It allows individuals from many different locations to attend events, communicate and learn from their workstations.
Comprehensive Issue Management Strategy	A comprehensive approach to making business decisions based on examination issues.
Coordinated Industry Case Program	One of the two categories of taxpayers in the LB&I Division, generally involving the Nation's largest taxpayers and usually examined by teams of IRS examiners.
Extensible Markup Language	A standardized way of storing, identifying, and transmitting data through the Internet.
Federation of Tax Administrators	An organization to improve the quality of State tax administration by providing services to State tax authorities and administrators.
Industry Case Program	One of the two categories of taxpayers in the LB&I Division, consisting of all LB&I Division taxpayers not classified as Coordinated Industry Cases and generally assigned to one IRS examiner.



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<b>Term</b>	<b>Definition</b>
Large Business and International Imaging Network	The workload delivery system that captures scanned images of currently filed U.S. Returns of Partnership Income (Form 1065) and U.S. Corporation Income Tax Returns (Form 1120) and delivers them to examiners in an electronic format. It also delivers <i>e-filed</i> returns to the field.
Master File	The IRS database that stores various types of taxpayer account information. It includes individual, business, and employee plans and exempt organization data.
Modernized e-File System	A replacement of the Internal Revenue Service tax return filing technology with a modernized, Internet-based electronic filing platform. This system also serves to streamline filing processes and reduce the costs associated with paper tax returns.
No-Change	Indicates that the tax return was examined but there was not a change in the tax liability or any adjustments.
Processing Year	The calendar year in which the tax return or document is processed by the IRS.
Return Request and Display System	Provides field agents with access to <i>e-filed</i> returns prior to them being available on the Large Business and International Image Network.
Schema	The organization of data in a database; i.e., a blueprint of how a database will be constructed.



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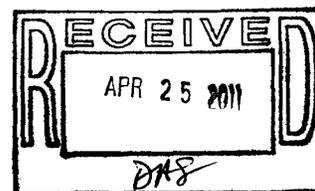
**Appendix VI**

*Management's Response to the Draft Report*

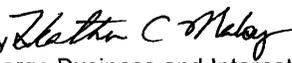


DEPARTMENT OF THE TREASURY  
INTERNAL REVENUE SERVICE  
WASHINGTON, DC 20224

APR 15 2011



MEMORANDUM FOR ASSISTANT INSPECTOR GENERAL FOR AUDIT

FROM: Heather C. Maloy   
Commissioner, Large Business and International Division

SUBJECT: Response to Draft Audit Report – Successfully Processing Large  
Corporate Tax Returns Electronically Was a Major  
Accomplishment, but Eliminating More Compliant Returns from  
the Audit Stream Is a Work in Progress (Audit #201030004)

Thank you for sharing the subject draft report for our review and comments. We agree with your report findings and recommendations, and are pleased with your acknowledgement of the significant IRS accomplishments associated with the implementation of the electronic filing of corporate tax returns and our use of the LB&I Imaging Network, our primary method for return workload delivery.

As your report indicates, the IRS is consistently investing considerable efforts in process improvement initiatives to enhance how we identify and select corporate returns for audit as well as how we audit returns. The Compliance Management Operations (CMO) pilot was implemented to help test new methods for identifying returns for examination with the highest compliance risk. Once implemented, it is anticipated that the CMO will be a key component in our overall efforts to improve workload selection capabilities, increase compliance coverage, shorten the length of audits, identify emerging compliance risks, and promote voluntary compliance. We will develop an evaluation plan to assess the results of this pilot project and share best practices for working with electronic filing data.

Attached is a detailed response outlining the corrective actions that the Large Business and International Division will take to address the two audit recommendations.

If you have any questions, please contact me, or a member of your staff may contact Thomas Brandt, Director, Planning, Analysis, Inventory, and Research (PAIR), at (202) 283-4580.

Attachment



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Attachment

**RECOMMENDATION 1:**

The Commissioner, LB&I Division should ensure the Compliance Management Operations (CMO) Pilot Project Team, as well as other teams involved in process improvement projects, develop, document, and carryout evaluation plans to assess project results. The plans should include such key evaluation items as clear and measurable objectives, criteria for determining the project performance and measuring its success against stated objectives, and details about the type and amount of data needed to evaluate the project as well as how the data will be collected.

**CORRECTIVE ACTIONS:**

The Commissioner, LB&I Division will ensure that the CMO Pilot Project Team will develop, document, and carryout evaluation plans to assess project results. The assessment for the first year of the CMO Pilot has been completed and the report is being finalized. After reviewing the report, we will refine performance measurements for the CMO. A project management function with responsibility for overseeing, evaluating, and assessing how the CMO process is working on an ongoing basis is being implemented.

A similar approach will be deployed to other workload selection processes in a manner appropriate to the individual project.

**IMPLEMENTATION DATE:**

The one-year assessment of the CMO Pilot Operations will be completed by June 30, 2011.

**RESPONSIBLE OFFICIAL(S):**

Director, Planning, Analysis, Inventory, and Research (PAIR), LB&I Division

**CORRECTIVE ACTION(S) MONITORING PLAN:**

The LB&I Internal Control Coordinator will track the implementation date for this corrective action through the Joint Audit Management Enterprise System that tracks implementation of corrective actions addressing audit recommendations.

**RECOMMENDATION 2:**

The Commissioner, LB&I Division should assess the relative effectiveness of the Division's current methods of promoting and sharing best practices for working with E-File data by using existing tools, such as including appropriate questions in periodic



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employee surveys. This assessment should include the observations made in this report and be subsequently used to adjust current methods, as needed, to better meet examiner needs.

**CORRECTIVE ACTIONS:**

The Commissioner, LB&I Division will assess the relative effectiveness of the LB&I Division's current methods of promoting and sharing best practices for working with E-File data. In addition, LB&I will record an improved Web-based CENTRA training session for employee use.

LB&I is also working on enhancements to improve the field's ability to use E-File data by making the returns easier to navigate, search, analyze, etc. LB&I will obtain feedback from employees periodically via surveys and other means to identify additional ways to make working with electronic data easier and more effective.

**IMPLEMENTATION DATE:**

The LB&I will reschedule the CENTRA Session, LB&I Research Tools Overview, by September 30, 2011.

**RESPONSIBLE OFFICIAL(S):**

Director, Planning, Analysis, Inventory, and Research (PAIR), LB&I Division

**CORRECTIVE ACTION(S) MONITORING PLAN:**

The LB&I Internal Control Coordinator will track the implementation date for the LB&I use of methods for promoting and sharing best practices through the Joint Audit Management Enterprise System that tracks implementation of corrective actions addressing audit recommendations.