



*Implementing Better Management Controls  
Would Improve the Exempt Organizations  
Function's Ability to Properly Oversee  
and Timely Process Referrals*

**June 1, 2012**

**Reference Number: 2012-10-058**

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.

---

Phone Number | 202-622-6500

E-mail Address | [TIGTACommunications@tigta.treas.gov](mailto:TIGTACommunications@tigta.treas.gov)

Website | <http://www.tigta.gov>



## HIGHLIGHTS

### **IMPLEMENTING BETTER MANAGEMENT CONTROLS WOULD IMPROVE THE EXEMPT ORGANIZATIONS FUNCTION'S ABILITY TO PROPERLY OVERSEE AND TIMELY PROCESS REFERRALS**

## Highlights

**Final Report issued on June 1, 2012**

Highlights of Reference Number: 2012-10-058 to the Internal Revenue Service Acting Commissioner for the Tax Exempt and Government Entities Division.

### **IMPACT ON TAXPAYERS**

Referrals alert the Exempt Organizations (EO) function to potentially serious violations of Federal tax law. While the EO function has greatly improved its timeliness for acknowledging receipts to submitters, the EO function did not always control referrals or process referrals timely. If referrals are not properly accounted for or worked timely, the EO function may not identify tax-exempt organizations that are potentially in violation of Federal tax law or have referrals ready when new examination cases are needed.

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

This review was requested by the EO function and addresses the Tax Compliance Initiatives major management challenge. The overall objective of this review was to determine whether the EO function is accurately accounting for referrals of alleged violations of Federal tax law, acknowledging receipt to submitters, and tracking and monitoring the time periods for working referrals.

### **WHAT TIGTA FOUND**

The Referral Unit has dramatically improved the timeliness of acknowledgement letters being sent to submitters of referrals; however, the EO function faces significant challenges in managing referrals. Specifically, the EO function could not readily locate referrals it received, ensure all referrals it received were being controlled, or ensure referrals were being

processed timely. For example, TIGTA determined that the Referral Unit 1) could not readily locate 31 of the 120 referrals TIGTA requested and 2) did not control 350 referrals involving partnership returns upon receipt in the Referral Unit. In addition, TIGTA identified some inaccuracies and omissions of key information on the EO Referral Database, which is used to track and control referrals received by the Referral Unit.

Also, Referral Unit management stated that current measures could not be met and needed to be reconsidered. For example, the Internal Revenue Manual states that Referral Unit employees should make a determination as to whether a referral should be examined within 60 calendar days of receipt. However, almost 25 percent of these referrals took more than 120 calendar days to process.

EO function management was aware of deficiencies in the referral process and has been focusing on making improvements. TIGTA believes that implementing better management controls would help improve the EO function's ability to properly oversee referrals.

### **WHAT TIGTA RECOMMENDED**

TIGTA recommended that the Director, EO, Tax Exempt and Government Entities Division, ensure all referrals are properly controlled, guidance is developed and updated, performance goals are developed, and timeliness measures are updated. TIGTA also recommended the IRS evaluate the priority for additional funding for a more robust case management system.

In their response to the report, IRS officials agreed with the recommendations and plan to take appropriate corrective actions.



TREASURY INSPECTOR GENERAL  
FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY

WASHINGTON, D.C. 20220

June 1, 2012

**MEMORANDUM FOR** ACTING COMMISSIONER, TAX EXEMPT AND GOVERNMENT  
ENTITIES DIVISION

**FROM:** (for) Michael R. Phillips  
Deputy Inspector General for Audit

**SUBJECT:** Final Audit Report – Implementing Better Management Controls  
Would Improve the Exempt Organizations Function’s Ability to  
Properly Oversee and Timely Process Referrals (Audit # 201110023)

This report presents the results of our review relating to the Exempt Organizations (EO) function’s referral process. The overall objective of this review was to determine whether the EO function is accurately accounting for referrals of alleged violations of Federal tax law, acknowledging receipt to submitters, and tracking and monitoring the time periods for working referrals. This review was requested by the EO function, is included in our Fiscal Year 2012 Annual Audit Plan, and addresses the Tax Compliance Initiatives major management challenge.

Management’s complete response to the draft report is included as Appendix V.

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 Russell P. Martin, Acting Assistant Inspector General for Audit (Management Services and Exempt Organizations), at (202) 622-8500.



---

*Implementing Better Management Controls Would  
Improve the Exempt Organizations Function's Ability  
to Properly Oversee and Timely Process Referrals*

---

## *Table of Contents*

<b>Background</b> .....	Page 1
<b>Results of Review</b> .....	Page 4
The Referral Unit Dramatically Improved Its Timeliness for Acknowledging Receipts of Referrals.....	Page 5
Referrals Were Not Adequately Controlled.....	Page 5
<u>Recommendation 1</u> :.....	Page 11
<u>Recommendations 2 and 3</u> : .....	Page 12
Performance Goals Were Not Developed and Timeliness Measures Are Not Being Met .....	Page 12
<u>Recommendation 4</u> :.....	Page 14
Referral Processing Would Benefit From Transitioning to a More Robust Case Management System .....	Page 14
<u>Recommendation 5</u> :.....	Page 16
<b>Appendices</b>	
Appendix I – Detailed Objective, Scope, and Methodology .....	Page 17
Appendix II – Major Contributors to This Report .....	Page 19
Appendix III – Report Distribution List .....	Page 20
Appendix IV – Outcome Measures.....	Page 21
Appendix V – Management’s Response to the Draft Report .....	Page 22



*Implementing Better Management Controls Would  
Improve the Exempt Organizations Function's Ability  
to Properly Oversee and Timely Process Referrals*

---

## *Abbreviations*

EO	Exempt Organizations
IRM	Internal Revenue Manual
IRS	Internal Revenue Service
RCCMS	Reporting Compliance Case Management System
TEFRA	Tax Equity and Fiscal Responsibility Act of 1982



*Implementing Better Management Controls Would Improve the Exempt Organizations Function's Ability to Properly Oversee and Timely Process Referrals*

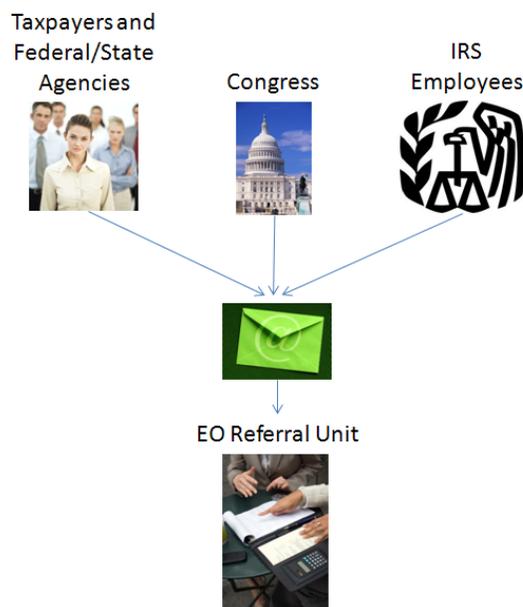
## *Background*

The Internal Revenue Service (IRS) receives thousands of complaints (hereafter referred to as referrals) alleging that tax-exempt organizations are potentially violating Federal tax law. For example, these referrals involve potentially serious allegations of:

- Political intervention by religious or other organizations.
- Community organization decisions benefitting management board members and not the community at large.
- Inappropriate lobbying and fundraising activities.
- Noncompliance related to nonfiling, employment tax, and unrelated business income issues.

The Exempt Organizations (EO) function within the Tax Exempt and Government Entities Division is responsible for assessing referrals from the general public, members of Congress, and Federal and State agencies, as well as other parts of the IRS. As shown in Figure 1, these referrals are centrally processed in the EO Classification Referral function (hereafter referred to as the Referral Unit) in Dallas, Texas.

**Figure 1: EO Referral Process**



*Source: Discussions with EO function officials.*



## *Implementing Better Management Controls Would Improve the Exempt Organizations Function's Ability to Properly Oversee and Timely Process Referrals*

After receipt, the referrals are controlled on the EO Referral Database and the Referral Unit sends an acknowledgement letter to all non-IRS submitters who have provided a complete name and address. The Internal Revenue Code<sup>1</sup> prohibits the IRS from disclosing whether it has initiated an examination or the results of any examination. Therefore, the acknowledgement letter states that the referral has been received, but the IRS cannot communicate any actions it may or may not be taking based on the referral.

Experienced Referral Unit employees review the allegations to evaluate the facts and determine whether the EO function should undertake an examination of the organization. Some referrals require further review and are forwarded to a three-member committee to decide whether to proceed with an examination.<sup>2</sup> Before making a decision to select a referral for examination, Referral Unit employees or committee members must determine that the facts included in the referral create a reasonable belief that the allegations may be true. If the Referral Unit or a committee recommends examining an organization, the referral will be put in "pending" status on the EO Referral Database and the referral and related supporting documentation will be filed. Upon request by a group manager for new cases, referrals in pending status will be forwarded to an agent for examination. The EO function can generally only determine if there were potential violations of Federal tax law through an examination. Therefore, it is important that the EO function evaluate referrals in a timely manner to identify those that should be examined.

The Referral Unit received more than 13,000 referrals alleging potential noncompliance with Federal tax law during the period October 1, 2009, through June 17, 2011. However, the EO function has limited resources to conduct examinations to determine if actual tax law violations of have occurred. As such, the Referral Unit must effectively and efficiently review referrals to provide examiners cases with the best potential. If tax-exempt organizations are not complying with Federal tax law, the impact could be significant. Some tax-exempt organizations receive millions of dollars tax free. If these organizations are determined to have violated Federal tax law, they could be penalized or potentially lose their tax-exempt status, in which case their revenue would become taxable.

***The EO Referral Unit received more than 13,000 referrals alleging tax law violations by tax-exempt organizations between October 1, 2009, and June 17, 2011.***



This review was requested by the EO function. The request for assistance noted that, despite efforts to identify and implement improvements to manual and online referral processes, the

<sup>1</sup> § 6103 (2011).

<sup>2</sup> Committees review referrals containing evidence of allegations involving: 1) political or lobbying activities, 2) financial transactions with known or suspected terrorist connections, 3) churches, 4) high impact issues, and 5) information submitted by elected officials or members of Congress.



*Implementing Better Management Controls Would Improve the Exempt Organizations Function's Ability to Properly Oversee and Timely Process Referrals*

---

EO function continues to discover deficiencies. Our review focused on determining whether the EO function is accurately accounting for referrals of alleged violations of Federal tax law, acknowledging receipt to submitters, and tracking and monitoring the time periods for working referrals. We did not review the quality of the referral decisions to select or not select the referral for examination.

During our review, we raised issues and the EO function took actions to address them. Actions taken by IRS management are noted throughout this report as *Management Actions*. In addition, this audit was conducted while the EO function was making improvements to its referral process. As a result, this report may not reflect the most current status of the EO function's efforts to oversee referrals.

This review was performed at the EO function's Examination Office in Dallas, Texas, during the period June through November 2011. 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.



---

*Implementing Better Management Controls Would Improve the Exempt Organizations Function's Ability to Properly Oversee and Timely Process Referrals*

---

## *Results of Review*

EO function management believes that referrals are a critical source of work, as they alert the EO function to potentially serious violations of Federal tax law by tax-exempt organizations. While the Referral Unit has dramatically improved the timeliness of acknowledgement letters being sent to submitters of referrals, the EO function faces significant challenges in managing referrals. Specifically, we determined that the EO function could not readily locate referrals it received, ensure all referrals it received were controlled, or ensure referrals were being processed timely. If referrals are not properly accounted for or worked timely, the EO function may not identify tax-exempt organizations that are potentially in violation of Federal tax law or take action timely to bring organizations into compliance. As a result, potentially noncompliant organizations could continue to receive the benefits of their tax-exempt status while not complying with Federal tax law.

We determined that the Referral Unit 1) could not readily locate 31 out of the 120 referrals we requested, 2) did not control 350 internal referrals involving partnership returns on the EO Referral Database upon receipt in the Referral Unit, and 3) had no procedures in place to follow up on the status of referrals sent to committees. In addition, we identified some inaccuracies and omissions of key information on the EO Referral Database, which is used to track and control referrals received by the Referral Unit. As a result, the EO function did not have control over its referral inventory, which could result in referrals being lost, or not being worked timely.

We also determined that adequate performance goals had not been established and measures had not been developed or updated for processing referrals. For example, Referral Unit management stated that current measures could not be met and needed to be reconsidered because the time standards did not take into account unanticipated projects and staffing shortages. Our analyses of the Referral Unit Database determined that timeliness measures were not being met. For example, the Internal Revenue Manual (IRM)<sup>3</sup> states that Referral Unit employees should make a determination as to whether a referral should be examined within 60 calendar days of receipt. However, almost 25 percent of these referrals took more than 120 calendar days to process.

EO function management was aware of deficiencies in the referral process and has been focusing on making improvements. We believe that implementing better controls to track referrals, clarifying internal guidance, and implementing goals and measures would help improve the EO function's ability to properly oversee referrals. Also, we believe transitioning to a more robust system for tracking and evaluating referrals would be beneficial, provided resources become available. If improvements are not made to the referral process, valid referrals of

---

<sup>3</sup> IRM 4.75.5.5(10)c (May 13, 2005).



---

*Implementing Better Management Controls Would Improve the Exempt Organizations Function's Ability to Properly Oversee and Timely Process Referrals*

---

significant noncompliance could be lost or referrals may not be ready when new examination cases are needed.

### ***The Referral Unit Dramatically Improved Its Timeliness for Acknowledging Receipts of Referrals***

IRM guidelines<sup>4</sup> state that referrals received from non-IRS sources should be acknowledged within 21 calendar days of receipt. The intent of this requirement is to assure the sources of these referrals that the IRS is taking taxpayer allegations seriously and is monitoring compliance.

Between October 1, 2009, and June 17, 2011, we determined acknowledgement letters for 2,854 (55 percent) of 5,160 non-IRS referrals were not issued timely. However, we determined the process had greatly improved over time and that 85 percent of the more egregious delays were isolated to a specific three-month period in Fiscal Year 2010. During the period April 1, 2011, through June 17, 2011, the Referral Unit issued 453 (95 percent) of 478 acknowledgement letters timely to non-IRS sources.

***The EO function dramatically improved the timeliness of acknowledgement letters sent to submitters of referrals.***



This improvement is significant because the Treasury Inspector General for Tax Administration has received complaints in the past about the lack of timely acknowledgement. This can be very frustrating to taxpayers, who may perceive that the IRS is not interested in their referrals, or may cause taxpayers to send in duplicate referrals because they are not certain whether the initial referral was received. Sending acknowledgement letters provides the public with knowledge that the IRS has received their referrals and will be taking action to evaluate them.

### ***Referrals Were Not Adequately Controlled***

While the EO function has improved its timelines related to acknowledgement letters, the EO function did not ensure referrals were properly accounted for and controlled on the EO Referral Database. We determined that 1) referrals were missing or could not be readily located, 2) referrals were not properly controlled on the EO Referral Database upon receipt, 3) no follow-up procedures were in place to determine the status of referrals sent to committees, 4) the EO Referral Database contained some inaccuracies and omissions of key data, and 5) written procedures for processing referrals were incomplete or out of date. If the EO function cannot properly account for or control referrals, it cannot ensure all referrals of potential

---

<sup>4</sup> IRM 4.75.5.5(10)a (May 13, 2005).



---

*Implementing Better Management Controls Would Improve the Exempt Organizations Function's Ability to Properly Oversee and Timely Process Referrals*

---

violations by tax-exempt organizations are being evaluated properly and tax-exempt organizations violating the law are identified and brought into compliance.

**The Referral Unit could not readily locate referrals in its inventory**

The Government Accountability Office's *Standards for Internal Control in the Federal Government*<sup>5</sup> states that "...all transactions and other significant events need to be clearly documented, and the documentation should be readily available for examination." Furthermore, "All documentation and records should be properly managed and maintained." However, we determined that the Referral Unit was not properly accounting for all referrals in its inventory. During a site visit, we requested 120 random cases for review from the EO Referral Database. However, Referral Unit officials could not readily locate 31 (26 percent) of the 120 cases.

Seven weeks after we requested the cases, the EO function provided the following explanation for the 31 missing cases:

- **17** case files were not created for various reasons. For example, referrals that were misrouted to the EO function and later forwarded to another IRS function were entered on the EO Referral Database, but no documentation was maintained to explain why case files were not created.
- **12** case files were subsequently located.
- **2** case files were lost.

***The EO Referral Unit could not readily locate some referrals and lost others.***



We believe the EO function had difficulty locating referrals because its current inventory control system is paper driven and labor intensive. Locating referrals is also made more difficult by the fact that the EO Referral Database does not always indicate where referrals are located or to whom they are assigned. This, combined with a large volume of referrals, results in referrals being lost, misfiled, or inaccurately entered on the EO Referral Database.

---

<sup>5</sup> Government Accountability Office, GAO/AIMD-00-21.3.1, *Standards for Internal Control in the Federal Government* (Nov. 1999).



*Implementing Better Management Controls Would Improve the Exempt Organizations Function's Ability to Properly Oversee and Timely Process Referrals*

**The Referral Unit was not tracking all referrals on the EO Referral Database upon receipt**

The Government Accountability Office's *Standards for Internal Control in the Federal Government* states that "transactions should be promptly recorded to maintain their relevance and value to management in controlling operations and making decisions." However, we determined that not all referrals were being entered on the EO Referral Database when they were received. Specifically, 350 referrals involving partnership returns (referred to as Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA)<sup>6</sup> referrals) were not immediately controlled on the EO Referral Database upon receipt in the Referral Unit.<sup>7</sup>

This happened because the Referral Unit did not have enough staff to work TEFRA referrals and the referrals were assigned to be worked by an agent in another location. This agent did not always timely update the EO Referral Database to control new cases or update the status of existing cases. EO function management informed us that the agent deferred establishing the TEFRA cases on the database to complete more critical and productive work. While general referral guidelines require that referrals be established within 21 calendar days of receipt in the Referral Unit, there were no specific procedures identified for working TEFRA referrals. As a result, these cases took longer to process, and management could not effectively oversee progress in evaluating these referrals.

***Three hundred and fifty referrals were not being tracked as part of inventory.***



Delays in establishing these TEFRA referrals on the EO Referral Database increase the risk that these referrals will be lost, not reviewed, or not timely reviewed. Additionally, without an adequate inventory control system, EO function management cannot properly monitor its referral process, particularly when the database does not always track who specifically is working the referral at any point in time.

***Management Actions:*** During the audit, we determined that some TEFRA referrals were not on the EO Referral Database. After discussing this with Referral Unit management, 350 TEFRA referrals were added to the EO Referral Database and another agent was trained to evaluate TEFRA referrals. Subsequently, all TEFRA referrals were transferred to the Referral Unit in Dallas, Texas, to be reviewed and all future TEFRA referrals will be processed in the Dallas Referral Unit.

<sup>6</sup> Pub. L. No. 97-248, 96 Stat. 324 (codified in scattered sections of 26 U.S.C.).

<sup>7</sup> See Appendix IV for details.



---

*Implementing Better Management Controls Would Improve the Exempt Organizations Function's Ability to Properly Oversee and Timely Process Referrals*

---

**Procedures were not in place to determine the status of referrals sent to committees**

*Standards for Internal Control in the Federal Government* states that managers "...need to compare actual performance to planned or expected results." However, we determined the Referral Unit did not have any follow-up procedures for determining the status of referrals sent to the committees for further review. This control was not in place because the EO Referral Database was not set up to track time spent on cases to make it easy to follow up on cases that may have been outstanding for some time in committees.

*Management Actions:* During our review, Referral Unit management assigned a reviewer to send periodic e-mails to committee members to monitor the status of referrals sent to the committees. In addition, a Referral Unit reviewer developed a spreadsheet to track cases sent to two of the three committees.

**The EO Referral Database contained some inaccuracies and omissions of key information**

The EO Referral Database is used to track and monitor the inventory of referrals received by the Referral Unit. However, we found inaccuracies and omissions of key data in the database that makes it difficult to use for tracking referrals. Based on our sample of 89 referral cases,<sup>8</sup> we identified inaccuracies and omissions of key information on the EO Referral Database involving 48 (54 percent) of the 89 referral cases.<sup>9</sup> Figure 2 provides a list of inaccurate and missing information we found in our review of the EO Referral Database.

***The EO Referral Database included inaccurate or missing information in more than half of the cases we reviewed.***



---

<sup>8</sup> Our sample initially included 120 cases; however, only 89 cases could be located timely for review.

<sup>9</sup> See Appendix IV for additional details.



*Implementing Better Management Controls Would Improve the Exempt Organizations Function's Ability to Properly Oversee and Timely Process Referrals*

**Figure 2: Inaccurate and Missing Information on the EO Referral Database**

Invalid Data	Consequence of Invalid Data	Number of Database Entries With Invalid Data <sup>10</sup>
Inaccurate or Missing Source Code	Without valid source codes, the EO function will be unable to link its examinations with the source of referrals and, subsequently, will be unable to track the more productive sources of referrals.	42
Inaccurate Received Date	Without valid received dates, the IRS cannot accurately determine when the submitter originally sent the referral, how long it has been evaluating a referral, and if actions are being completed timely.	12
Missing Name and Address of Person Submitting the Referral	If a valid name and address is not entered on the EO Referral Database, an acknowledgement letter will not be sent and the taxpayer who sent the referral will not know whether the referral is being evaluated by the IRS. As a result, the taxpayer may become frustrated and send in a duplicate referral.	1
Acknowledgement Letter Not Recorded on the Database	If the EO Referral Database does not show the IRS acknowledged receipt, multiple copies of the acknowledgement letter may be sent to the submitter.	1

*Source: Our review of 89 case files and associated records on the EO Referral Database.*

We attributed these inaccuracies to transcription errors and employee oversight. However, we also noted controls were not in place to prevent or detect these errors. The EO Referral Database was created without validity checks to ensure that certain key fields are entered or entered values are reasonable. In addition, no procedures exist to quality review the data in the database periodically, such as a manager spot checking the accuracy of data input to the database.

<sup>10</sup> *Entries* refer to *data fields* on the EO Referral Database that have inaccurate or missing data. This column will not add up to 48 because some records had more than one data field with inaccurate data.



## *Implementing Better Management Controls Would Improve the Exempt Organizations Function's Ability to Properly Oversee and Timely Process Referrals*

***Management Actions:*** During our review, Referral Unit management stated that the Referral Unit planned to develop procedures that will include a goal to review three open and/or closed cases per employee per month.

We also found the referral inventory was overstated when a referral record was established on the EO Referral Database with the wrong Employer Identification Number. This occurred because referrals were sometimes established with an incorrect Employer Identification Number when the referral lacked specificity regarding the tax-exempt organization potentially violating Federal tax law. Once the correct Employer Identification Number was identified as a result of additional research, a new case was established with the correct Employer Identification Number. However, the record with the wrong Employer Identification Number was not deleted on the EO Referral Database. EO function management indicated there were no procedures in place to address this problem and no specific category on the database to show that the referral needs to be “closed due to input error.” Overstating the number of referrals may hinder EO function management’s ability to manage resources effectively.

In addition to inaccurate information input on the EO Referral Database, we determined that controls related to the receipt of referrals need to be improved. Specifically, we were unable to validate the accuracy of the date the referral was received in the Referral Unit for 17 (19 percent) of the 89 referrals reviewed. These referrals did not have a received date stamp indicating when they came into the Referral Unit. Many of the referrals were immediately shipped to another office without a date stamp. We could not determine why the remaining referrals had no date stamp. Without the proper date stamps on the referral, the EO function cannot ensure the accuracy of its database or properly monitor the status of referrals in the Unit.

### **Written procedures for working referrals were inadequate**

Internal controls should be designed to ensure management’s directives are carried out. While the EO function had developed multiple desk procedures and an IRM<sup>11</sup> section for working referrals, these procedures were not complete or consistent, and information appeared to be out of date.

For example:

- Approximately 800 TEFRA cases were on the EO Referral Database; however, desk procedures did not include guidance for working TEFRA cases, similar to other types of cases.

***Guidelines for working referrals were incomplete and were not up to date.***



<sup>11</sup> IRM 4.75.5 (May 13, 2005).



---

## *Implementing Better Management Controls Would Improve the Exempt Organizations Function's Ability to Properly Oversee and Timely Process Referrals*

---

- The IRM states that committee members should use the “reasonable belief standard”<sup>12</sup> when determining whether referrals should result in an examination. However, none of the desk procedures we reviewed stated that this standard should be used, and neither the IRM nor the desk procedures state that agents evaluating referrals in the Referral Unit should also be using this standard.
- From discussions with personnel in the Referral Unit, we determined the actions they take to process referrals. However, these actions do not always align with the procedures set forth in the IRM because the IRM has not been updated since May 2005.<sup>13</sup> For example, the IRM states that the EO function will retain all referrals and source documents regardless of whether the referral results in an examination, but Referral Unit employees were not always establishing misroutes on the EO Referral Database, creating files, or retaining any copies. In addition, the Referral Unit has more up-to-date desk procedures that state misroutes should be established on the database but that no files need to be created and no copies made. However, these desk procedures also do not always align with the actions that are actually being taken to evaluate referrals.

EO function officials stated that management turnover had prevented the EO function from reviewing and updating its procedures. However, EO function officials have stated that they are committed to making improvements to the referral process, and we observed changes being made. It will be important for EO function management to codify improvements made to processes. If improvements are not documented, new employees and managers that are assigned to work and oversee referrals may not be aware of the correct procedures and may begin working referrals incorrectly or using a process that no longer is the most effective or efficient.

### ***Recommendations***

To provide better inventory controls and management oversight of the referral process, the Director, EO, Tax Exempt and Government Entities Division, should:

**Recommendation 1:** Ensure all referrals are properly controlled by timely establishing referrals on the EO Referral Database, timely updating the EO Referral Database to show to whom referrals are assigned, and date stamping referrals upon receipt in the Referral Unit.

**Management's Response:** IRS management agreed with our recommendation and has implemented inventory control procedures to ensure referrals are timely established on the EO Database, are timely updated on this database to show to whom they are assigned, and are date stamped upon receipt in the Referral Unit.

---

<sup>12</sup> IRM 4.75.5.7 (May 13, 2005) states that the referral “when considered fairly and in light of other reliable information, if available, demonstrates that a violation of the Federal tax law occurred or appears likely to lead to the discovery of a violation upon examination.”

<sup>13</sup> During our audit work, the EO function was in the process of revising the IRM 4.75.5 (May 13, 2005).



---

*Implementing Better Management Controls Would Improve the Exempt Organizations Function's Ability to Properly Oversee and Timely Process Referrals*

---

**Recommendation 2:** Develop procedures and update guidance to ensure 1) all types of referrals are addressed and 2) quality review of the EO Referral Database is performed, such as the manager periodically spot checking the accuracy of the data input to the database.

**Management's Response:** IRS management agreed with our recommendation and informed us that the EO function is currently performing quality reviews of referral case records and is in the process of developing procedures and updating guidance to ensure 1) all types of referrals are addressed and 2) quality review of the EO Referral Database is performed.

**Recommendation 3:** Update the EO Referral Database with validity checks to ensure required information is input in the source code field and reasonable information is input in the received date field.

**Management's Response:** IRS management agreed with our recommendation and is incorporating enhancements into the EO Referral Database that will run validity checks to ensure that required information is input in the source code field and that reasonable information is input in the received date field.

### ***Performance Goals Were Not Developed and Timeliness Measures Are Not Being Met***

*Standards for Internal Control in the Federal Government* states that managers "...need to compare actual performance to planned or expected results ... and analyze significant differences." However, EO function management had not established performance goals for the referral process. We believe this occurred due to management turnover in the Referral Unit. Without performance goals, the IRS will have difficulty assessing its success in processing referrals as well as knowing whether or not sufficient resources are being applied to the area.

In addition to overall performance goals, the EO function could benefit from developing or updating timeliness measures (metrics) for completing key steps in the referral process. The May 2005 IRM<sup>14</sup> provided an overall timeliness measure and measures for completing specific steps when Referral Unit employees evaluate referrals, but did not include this information for referrals evaluated by committees. During our audit, the EO function began updating its IRM and considered eliminating most timeliness measures. According to Referral Unit management, the draft IRM generally did not include measures because the Referral Unit could not meet the measures that were established in the May 2005 IRM due to staffing issues.

---

<sup>14</sup> IRM 4.75.5.5(10) (May 13, 2005).



*Implementing Better Management Controls Would Improve the Exempt Organizations Function's Ability to Properly Oversee and Timely Process Referrals*

We analyzed the EO Referral Database and determined that timeliness measures were not being met. For example, the May 2005 IRM states that Referral Unit employees should make a determination as to whether a referral should be examined within 60 calendar days of receipt. However, it took an average 91 calendar days to determine whether or not an examination was warranted and almost 25 percent of these referrals took more than 120 calendar days to process.

While the IRM did not have a clear overall timeliness measure for committees evaluating referrals, the Manual stated that committees should decide whether referrals warrant examinations monthly. However, complex or sensitive referrals evaluated by a three-member committee averaged 196 calendar days to process. In addition, about 35 percent of committee referrals took more than 240 calendar days, which is excessive compared to the IRM requirement for committees to make decisions monthly. Some of the delays in processing committee cases were due to one committee that did not meet for a four-to-five month period due to staffing issues.

Without specific or reasonable measures, EO function management cannot tell whether referrals are being evaluated timely and whether any adjustments are needed for specific steps in the referral process. If referrals are not being evaluated in a timely manner, referrals of tax-exempt organizations that potentially have violated Federal tax law will not be ready when new examination cases are needed.

We also determined the Referral Unit was not consistently using reports to effectively monitor the age of referrals or easily identify over-age referrals. Instead, Referral Unit management produces a report weekly with a tally of all the referrals received for the week, the number of acknowledgement letters sent, the number of referrals evaluated, the number of referrals awaiting evaluation, and the total number of referrals where an examination was recommended but an examination has not been initiated. In addition, the Referral Unit manager uses a listing of all referrals sorted by receipt date to monitor the inventory.

***While procedures stated that referrals worked in the Referral Unit should be evaluated within 60 calendar days of receipt, we determined almost 25 percent were taking more than 120 calendar days.***



While this is important information, it does not provide the range of capabilities needed to fully oversee EO function referrals. EO function management stated that the EO Referral Database does not contain these capabilities because it was developed as an interim tool for controlling referral inventory while awaiting the development of a Tax Exempt and Government Entities Division-wide case management system. The EO function is still using the EO Referral Database because the Division-wide system did not include all the capabilities that would be needed to process EO function referrals. However, without using more detailed aging and tracking reports, the Referral Unit cannot easily identify referrals that



---

*Implementing Better Management Controls Would Improve the Exempt Organizations Function's Ability to Properly Oversee and Timely Process Referrals*

---

are lost, follow up on specific referrals that have been outstanding for a long time, or identify referrals that have not been assigned for evaluation. As a result, some tax-exempt organizations in violation of the law may continue to receive the benefits of their tax-exempt status without having a timely examination to determine if they are in compliance with Federal tax law.

Management Actions: The EO function decided not to publish the revised IRM that eliminated many of the measures. In addition, EO function management stated they planned to determine the feasibility of developing more advanced aging and tracking reports.

### **Recommendation**

Recommendation 4: The Director, EO, Tax Exempt and Government Entities Division, should provide better controls and monitoring of the referral process by 1) developing and implementing performance goals to measure the accomplishments of the referral program, 2) developing and updating timeliness measures for referrals evaluated in the Referral Unit and referrals evaluated by committees, and 3) enhancing existing management reporting to more effectively monitor the age of referrals in the EO Referral Database inventory and systemically identify over-age referrals.

Management's Response: IRS management agreed with our recommendation and as of April 30, 2012, had developed and updated timeliness standards for referrals evaluated in the Referral Unit, as well as referrals evaluated by the Referral committee. Additionally, management agreed to implement these standards after training is delivered. IRS management is developing and will implement performance goals to measure the accomplishments of the referral program. IRS management also agreed to our monitoring recommendation, immediately following implementation of the performance goals and time standards.

### **Referral Processing Would Benefit From Transitioning to a More Robust Case Management System**

According to EO function officials, the EO Referral Database was developed as a stopgap measure until the Tax Exempt and Government Entities Division could develop a Division-wide case management system known as the Tax Exempt and Government Entities Reporting and Electronic Examination System. This system (now known as the Reporting Compliance Case Management System (RCCMS)) was developed and is being used by the EO function; however, many planned capabilities were not delivered because of budget cutbacks. As a result, the stand-alone EO Referral Database is still in use but does not provide the full range of controls needed to oversee EO function referrals.



---

*Implementing Better Management Controls Would Improve the Exempt Organizations Function's Ability to Properly Oversee and Timely Process Referrals*

---

Not only would transitioning referral processing to the RCCMS potentially correct some of the issues presented in this report and provide much needed inventory and case management support to the Referral Unit, it would also:

- **Alleviate Security Concerns** – EO function officials noted that the EO Referral Database may not be compliant with the Federal Information Security Management Act.<sup>15</sup> Therefore, the EO function limits assignments of referral reviews to agents within the Dallas, Texas, post-of-duty because it is concerned about an unsecure database being accessed from remote posts-of-duty and delays when the system locks up.<sup>16</sup> In Fiscal Year 2010, the EO function sent agents to Dallas, Texas, to work on backlogs of referrals. The RCCMS can be accessed nationwide by EO function agents. Therefore, transitioning referrals to the RCCMS would provide flexibility in assigning personnel to work referrals.
- **Eliminate Reliance on Independent Databases** – As noted in a previous audit,<sup>17</sup> the Tax Exempt and Government Entities Division relies on at least 15 independent databases (in addition to the RCCMS) to track issues or results related to referrals, examination results, and quality review data. Eliminating stand-alone databases, such as the EO Referral Database, would minimize duplication of effort and inefficient use of limited resources.
- **Eliminate the Current Paper-Driven Process** – Currently, referrals are processed using a labor-intensive, paper-driven process. Thousands of referrals are filed in storage cabinets and some have been lost. Until recently, whenever referral documentation was needed by a committee in another part of the country, it was shipped. Referral Unit management advised us that the Unit now scans committee referral documentation onto the Unit's shared drive which eliminates paper and mailing costs. However, the Referral Unit needs a high-speed scanner to control its entire large inventory of referrals. With the addition of a high-speed scanner in the Referral Unit, all referrals could be controlled electronically, which would significantly decrease the risk of losing referral documentation and would allow documentation to be accessed around the country easily and at less cost.

---

<sup>15</sup> Pub. L. No. 107-347, 116 Stat. 2899 (2002) (codified as amended in 44 U.S.C. §§ 3541-3549).

<sup>16</sup> The scope of our review did not include reviewing the security aspects of the EO Referral Database.

<sup>17</sup> Treasury Inspector General for Tax Administration, Ref. No. 2010-10-020, *Additional Actions Are Needed to Realize Benefits of the Tax Exempt and Government Entities Reporting and Electronic Examination System* (Jan. 2010).



---

*Implementing Better Management Controls Would Improve the Exempt Organizations Function's Ability to Properly Oversee and Timely Process Referrals*

---

EO function officials agreed that transitioning from the EO Referral Database to the RCCMS would provide a more efficient referral process that ensures properly accounting for, acknowledging receipt of, and tracking and monitoring of EO function referrals. However, there are some obstacles to transitioning referrals to the RCCMS in the near future. For example, although other Tax Exempt and Government Entities Division functions are using the RCCMS to control their referral inventory, the RCCMS lacks the functionality needed for the EO function to properly manage its large inventory of referrals. Specifically, EO function management stated that the RCCMS would need to provide 1) case management and accomplishment reports to effectively manage the EO referral inventory and 2) a quality review process to effectively monitor, measure, and improve the quality of the referral review process. Therefore, resources would be needed to upgrade the RCCMS with the features the EO function needs to adequately track its referrals. In the current budget environment, any upgrade to the RCCMS will have to compete with other projects for limited funds. As a result, Tax Exempt and Government Entities Division management did not know when or if this upgrade would occur.

***Moving to a more robust case management system would reduce inefficiencies caused by working and storing paper referrals.***



We understand that referrals have not been transitioned to the RCCMS due to budget issues. Therefore, in the interim, the EO function will have to continue to make changes to its labor-intensive, paper-driven process until funding becomes available.

### ***Recommendation***

***Recommendation 5:*** The Tax Exempt and Government Entities Division Executive Steering Committee should evaluate the need to upgrade the RCCMS to support EO function referral processing to determine whether it should receive priority for additional funding.

***Management's Response:*** IRS management agreed with our recommendation and the Tax Exempt and Government Entities Executive Steering Committee will evaluate the need to upgrade the RCCMS to support EO function referral processing to determine whether it should receive priority for additional funding. In conducting this evaluation, the Executive Steering Committee necessarily will take into account available resources and IRS information technology priorities.



---

*Implementing Better Management Controls Would  
Improve the Exempt Organizations Function's Ability  
to Properly Oversee and Timely Process Referrals*

---

## **Appendix I**

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

Our overall objective was to determine whether the EO function is accurately accounting for referrals of alleged violations of Federal tax law, acknowledging receipt to submitters, and tracking and monitoring the time periods for working referrals. To accomplish the objective, we:

- I. Evaluated whether existing processes and procedures provide sufficient guidance related to accounting for referrals, acknowledging receipt to the submitter, and tracking and monitoring the time periods for working referrals.
  - A. Interviewed management and staff responsible for receiving and working referrals to obtain an overall understanding of the referral process and how referrals are accounted for, acknowledged, tracked, and monitored to ensure actions taken to analyze referrals and reach determinations are timely.
  - B. Interviewed available (current and prior) committee members to obtain an overview of the referral process from the committee perspective.
  - C. Interviewed management to obtain their assessments of the key components of the referral process that affect tax administration and customer service.
  - D. Identified and obtained existing IRM and desk procedures and any planned revisions related to the receipt, acknowledgement, tracking, and monitoring of referrals.
  - E. Identified the types of reports that the EO Referral Database generates and determined how Referral Unit management uses these reports.
  - F. Assessed whether existing processes and procedures provide sufficient detail to account for, acknowledge receipt of, track, and monitor the timeliness of referral work.
  - G. Determined whether the Referral Unit has implemented any performance goals to measure the progress of referrals worked in the Unit.
- II. Determined whether the EO function properly accounts for referrals, acknowledges receipt to the submitter, and tracks and monitors the time periods for working referrals.
  - A. Obtained a copy of the EO Referral Database that includes referrals received during the period October 1, 2009, through June 17, 2011.
    1. Determined the population of referral cases received from October 1, 2009, through June 17, 2011.



---

*Implementing Better Management Controls Would Improve the Exempt Organizations Function's Ability to Properly Oversee and Timely Process Referrals*

---

2. Reviewed the Database to ensure that all required fields were present and whether key field values were reasonable.
  - B. Selected a random sample of 120 referrals on the EO Referral Database from a universe of 13,770 referrals received in the Referral Unit from October 1, 2009, through June 17, 2011, to determine whether referrals were properly accounted for and acknowledgement letters were sent to submitters.<sup>1</sup> We used a random sample due to time constraints and because we did not plan to project our results.
  - C. Identified the key steps in the referral process and identified the established criteria the Referral Unit had implemented to process the referral from each stage of the process.
  - D. Analyzed the referral records from the download of the EO Referral database we had obtained (see Step II.A.) to identify the time periods for completing the key steps in the referral process.
  - E. Obtained the case files for the 89 referrals in Step II.B. and determined if the EO Referral Database accurately reflects the 1) dates the referral was received by the IRS and the Referral Unit, 2) date the acknowledgement letter was sent, 3) submitter's name and address, 4) source code, and 5) current location of the referral.

**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: policies and procedures for overseeing and controlling the EO function referral inventory, performance goals and timeliness measures for assessing the progress of referrals worked by the Referral Unit, and reports regarding referral inventory. We evaluated these controls by interviewing EO function management and other employees in the Referral Unit involved in the EO function referral process, evaluating information on the EO Referral Database, and reviewing a sample of referrals.

---

<sup>1</sup> Our initial sample included 120 cases; however only 89 cases could be located timely for review. We reviewed 89 referrals to determine if acknowledgments were sent to non-IRS submitters.



*Implementing Better Management Controls Would  
Improve the Exempt Organizations Function's Ability  
to Properly Oversee and Timely Process Referrals*

---

## **Appendix II**

### *Major Contributors to This Report*

Nancy A. Nakamura, Assistant Inspector General for Audit (Management Services and Exempt Organizations)  
Russell P. Martin, Acting Assistant Inspector General for Audit (Management Services and Exempt Organizations)  
Troy D. Paterson, Director  
Thomas F. Seidell, Audit Manager  
Theresa M. Berube, Lead Auditor  
Donald J. Martineau, Auditor  
Michael A. McGovern, Auditor  
Carol A. Rowland, Auditor



---

*Implementing Better Management Controls Would  
Improve the Exempt Organizations Function's Ability  
to Properly Oversee and Timely Process Referrals*

---

**Appendix III**

*Report Distribution List*

Commissioner C  
Office of the Commissioner – Attn: Chief of Staff C  
Deputy Commissioner for Services and Enforcement SE  
Acting Deputy Commissioner, Tax Exempt and Government Entities Division SE:T  
Director, Exempt Organizations, Tax Exempt and Government Entities Division SE:T:EO  
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: Director, Communications and Liaison, Tax Exempt and Government Entities  
Division SE:T:CL



---

*Implementing Better Management Controls Would Improve the Exempt Organizations Function's Ability to Properly Oversee and Timely Process Referrals*

---

## Appendix IV

### *Outcome Measures*

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

#### **Type and Value of Outcome Measure:**

- Reliability of Information – Actual; 350 TEFRA<sup>1</sup> referrals were not controlled or established on the EO Referral Database when received in the Referral Unit (see page 5).

#### **Methodology Used to Measure the Reported Benefit:**

During the audit, we determined that some referrals involving partnership returns (referred to as TEFRA referrals) were not on the EO Referral Database. After discussing this with Referral Unit management, 350 TEFRA referrals were added to the EO Referral Database.

#### **Type and Value of Outcome Measure:**

- Reliability of Information – Actual; 48 out of 89 referrals reviewed had inaccurate information recorded on the EO Referral Database (see page 5).

#### **Methodology Used to Measure the Reported Benefit:**

Based on our sample of 89 referral cases,<sup>2</sup> we identified inaccuracies and omissions of key information on the EO Referral Database involving 48 (56 percent) of the 89 referral cases.<sup>3</sup>

---

<sup>1</sup> Pub. L. No. 97-248, 96 Stat. 324 (codified in scattered sections of 26 U.S.C.).

<sup>2</sup> Our sample initially included 120 cases; however, only 89 cases could be located timely for review.

<sup>3</sup> Some of the referrals had multiple issues identified.



*Implementing Better Management Controls Would Improve the Exempt Organizations Function's Ability to Properly Oversee and Timely Process Referrals*

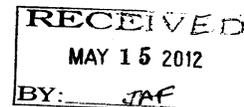
**Appendix V**

*Management's Response to the Draft Report*



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

May 14, 2012



MEMORANDUM FOR DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: *Joseph H. Grant*  
Joseph H. Grant, Acting Commissioner,  
Tax Exempt and Government Entities

SUBJECT: "Implementing Better Management Controls Would Improve the Exempt Organizations Function's Ability to Properly Oversee and Timely Process Referrals" (Audit # 201110023)

We asked you to conduct a review of our referral process and to suggest ways we could improve it. We thank you for agreeing to carry out this review, and appreciate your detailed observations and recommendations. Your report acknowledges the progress we have made in improving the referral process, and notes a number of areas in which we should make additional improvements. We accept your recommendations and have begun to implement them.

Our response to your recommendations is found in the attachment.

We concur with your description of the measurable benefits on tax administration.

If you have any questions about this response, please contact Lois Lerner, Director, Exempt Organizations, at (202) 283-2300.

Attachment



---

*Implementing Better Management Controls Would  
Improve the Exempt Organizations Function's Ability  
to Properly Oversee and Timely Process Referrals*

---

Attachment

**Recommendation 1**

Ensure all referrals are properly controlled by timely establishing referrals on the EO Referral Database, timely updating the EO Referral Database to show to whom referrals are assigned, and date stamping referrals upon receipt in the Referral Unit.

**Corrective Action**

We have implemented inventory control procedures to ensure referrals are timely established on the EO Database, are timely updated on this database to show to whom they are assigned, and are date stamped upon receipt in the Referral Unit.

**Implementation Date**

Completed March 31, 2012

**Responsible Official**

Director, Exempt Organizations Examinations



---

*Implementing Better Management Controls Would Improve the Exempt Organizations Function's Ability to Properly Oversee and Timely Process Referrals*

---

**Recommendation 2**

Develop procedures and update guidance to ensure 1) all types of referrals are addressed and 2) quality review of the EO Referral Database is performed, such as the manager periodically spot checking the accuracy of data input to the database.

**Corrective Action**

We currently perform quality reviews of referral case records, and are in the process of developing procedures and updating guidance to ensure 1) all types of referrals are addressed and 2) quality review of the EO Referral Database is performed.

**Implementation Date**

July 31, 2012

**Responsible Official**

Director, Exempt Organizations Examinations



---

*Implementing Better Management Controls Would Improve the Exempt Organizations Function's Ability to Properly Oversee and Timely Process Referrals*

---

**Recommendation 3**

Update the EO Referral Database with validity checks to ensure required information is input in the source code field and reasonable information is input in the received date field.

**Corrective Action**

We are incorporating enhancements into the EO Referral Database that will run validity checks to ensure that required information is input in the source code field and that reasonable information is input in the received date field.

**Implementation Date**

July 31, 2012

**Responsible Official**

Director, Exempt Organizations Examinations



---

*Implementing Better Management Controls Would Improve the Exempt Organizations Function's Ability to Properly Oversee and Timely Process Referrals*

---

**Recommendation 4**

The Director, EO, Tax Exempt and Government Entities Division, should provide better controls and monitoring of the referral process by 1) developing and implementing performance goals to measure the accomplishments of the referral program, 2) developing and updating timeliness measures for referrals evaluated in the Referral Unit and referrals evaluated by committee, and 3) enhancing existing management reporting to more effectively monitor the age of referrals in the EO Referral Database inventory and systemically identify over-age referrals.

**Corrective Action**

As of April 30, 2012, we have developed and updated timeliness standards for referrals evaluated in the Referral Unit, as well as referrals evaluated by the Referral committee. We are developing and will implement performance goals to measure the accomplishments of the referral program. We will implement these standards after training is delivered. Monitoring, as recommended by TIGTA, will immediately follow implementation.

**Implementation Date**

October 31, 2012

**Responsible Official**

Director, Exempt Organizations Examinations



---

*Implementing Better Management Controls Would Improve the Exempt Organizations Function's Ability to Properly Oversee and Timely Process Referrals*

---

**Recommendation 5**

The Tax Exempt and Government Entities Division Executive Steering Committee should evaluate the need to upgrade the RCCMS to support EO function referral processing to determine whether it should receive priority for additional funding.

**Corrective Action**

The TE/GE Executive Steering Committee will evaluate the need to upgrade the RCCMS to support EO function referral processing to determine whether it should receive priority for additional funding. In conducting this evaluation, the ESC necessarily will take into account available resources and IRS IT priorities.

**Implementation Date**

November 30, 2012

**Responsible Official**

Tax Exempt and Government Entities Division Executive Steering Committee.