



*Improvements Are Needed to Ensure the  
Business Master File Case Creation Nonfiler  
Identification Process Is Working Effectively*

**February 17, 2012**

**Reference Number: 2012-30-020**

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

### **IMPROVEMENTS ARE NEEDED TO ENSURE THE BUSINESS MASTER FILE CASE CREATION NONFILER IDENTIFICATION PROCESS IS WORKING EFFECTIVELY**

## Highlights

**Final Report issued on February 17, 2012**

Highlights of Reference Number: 2012-30-020 to the Internal Revenue Service Commissioner for the Small Business/Self-Employed Division.

### **IMPACT ON TAXPAYERS**

Each year, the IRS identifies more potential business nonfiler cases than it has the capacity to work. Many of the worked cases are closed because the business was not required to file a tax return, which is generally an unproductive use of the IRS's enforcement resources and burdensome to taxpayers. In addition, taxpayers who do not file and pay their taxes create an unfair burden on compliant taxpayers.

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

TIGTA initiated this audit to determine whether the Business Master File Case Creation Nonfiler Identification Process (BMF CCNIP) implementation was effective in targeting business nonfilers who may be delinquent in filing their required tax returns by improving workload selection and casework quality.

### **WHAT TIGTA FOUND**

TIGTA's comparison of the Baseline Business Case goals to Collection Activity Report data for Fiscal Years 2010 and 2011 showed nonliable closures increased rather than decreased as expected. In addition, the number of returns secured increased as expected, but this may have been caused by an increase in the total closed inventory. The percentage of returns secured compared with the entire closed inventory decreased in Fiscal Year 2010, but increased in Fiscal Year 2011.

IRS officials advised us that they believe it is too early to measure BMF CCNIP performance results. However, the Baseline Business Case

established a proactive approach to risk management and very specific goals and target dates after BMF CCNIP implementation. TIGTA does not believe it is proactive to allow additional time to pass when indications suggest an opportunity to make improvements.

TIGTA also determined that many of the BMF CCNIP cases assigned high-priority selection codes also had conflicting, low-priority primary codes (Primary Code B). There is a higher risk that collection actions may be delayed and revenue will remain uncollected on these cases. In addition, some of the BMF CCNIP selection code criteria were inconsistent and not formally documented.

### **WHAT TIGTA RECOMMENDED**

TIGTA recommended that the Director, Enterprise Collection Strategy, Small Business/Self-Employed Division: 1) determine the causes of increases or decreases in closure types and make selection code adjustments; 2) monitor all higher priority selection code cases to ensure they are not also designated as Primary Code B; 3) determine whether cases that have been suspended from further collection activity need further evaluation or collection actions; and 4) formalize clear and consistent selection code criteria.

In their response to the report, IRS officials agreed with Recommendations 1, 2, and 4, and plan to take appropriate corrective and monitoring actions. IRS officials stated they do not agree with Recommendation 3 due to current resource constraints and believe that the resource cost would outweigh the benefits of this recommendation. As resource constraints change, they plan to consider whether actions in this area are appropriate.

TIGTA continues to believe that identification and analysis of the cases suspended from further collection activity is important. Because the BMF CCNIP has already scored these cases as higher priority, there is a greater likelihood of taxpayers filing a return and paying taxes.



TREASURY INSPECTOR GENERAL  
FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY  
WASHINGTON, D.C. 20220

February 17, 2012

**MEMORANDUM FOR** COMMISSIONER, SMALL BUSINESS/SELF-EMPLOYED  
DIVISION

*Michael R. Phillips*

**FROM:**

Michael R. Phillips  
Deputy Inspector General for Audit

**SUBJECT:**

Final Audit Report – Improvements Are Needed to Ensure the Business  
Master File Case Creation Nonfiler Identification Process Is Working  
Effectively (Audit # 201030019)

This report presents the results of our review to determine whether the Business Master File Case Creation Nonfiler Identification Process implementation was effective in targeting business nonfilers who may be delinquent in filing their required tax returns by improving workload selection and casework quality. This audit was conducted as part of our Fiscal Year 2011 Annual Audit Plan and addresses the major management challenge of Tax Compliance Initiatives.

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

Copies of this report are also being sent to the Internal Revenue Service managers affected by the report recommendations. Please contact me at (202) 622-6510 if you have questions or Margaret E. Begg, Assistant Inspector General for Audit (Compliance and Enforcement Operations), at (202) 622-8510.



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## *Abbreviations*

BMF CCNIP	Business Master File Case Creation Nonfiler Identification Process
FY	Fiscal Year
IRS	Internal Revenue Service
PC-B	Primary Code B
TC	Transaction Code



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## *Background*

Nonfilers<sup>1</sup> are individuals and businesses that are legally required to file tax returns but have failed to file the tax returns when they are due. The Internal Revenue Service (IRS) considers nonfiling to be an egregious problem because it creates an unfair burden on compliant taxpayers and can cause them to lose faith in the fairness of the tax system. Taxpayers who timely file and pay their taxes want to be confident that other taxpayers are doing the same.

The IRS defines the gross Tax Gap as the difference between the estimated amount taxpayers owe and the amount they voluntarily and timely pay in a tax year. In February 2006, based upon the best information available, the IRS estimated the gross Tax Gap at \$345 billion for Tax Year 2001. The IRS has also reported that individual nonfilers accounted for an estimated \$30 billion of the total Tax Gap for Tax Year 2001. The IRS does not have an estimate of the business nonfiler Tax Gap. However, each year the IRS identifies more potential business nonfiler cases than it has the capacity to work. Many of these cases will not be resolved, and many cases that are worked will be closed because the business was not required to file a tax return. In general, this situation results in an unproductive use of IRS enforcement resources and is burdensome for taxpayers. As a result, IRS nonfiler strategies have included refining the processes for selection and modeling of nonfiler cases each year through risk-based compliance approaches. The intention is to identify and select the most productive nonfiler inventory and then apply appropriate compliance treatments to high-priority cases.

The Individual Master File Case Creation Nonfiler Identification Program is a tool used to identify individual nonfilers. This Program identifies taxpayers who have filed an individual income tax return in the prior year but failed to file in the current year and for whom the IRS has received third-party reporting information, *e.g.*, wages and other income. Based on characteristics such as reported income and withholding data, this information is then used to assign a selection code to nonfiler cases, which will prioritize inventory and allow selection of the most productive individual nonfiler cases.

In the past, the IRS did not have a similar tool for business taxpayers. Instead, the IRS relied exclusively on the Business Master File to identify business nonfilers solely from missing returns. Filing requirements for business taxpayers include specific conditions or situations, *e.g.*, number of employees; type of organization entity; or amount of wages paid that, when present, requires the submission of a Federal tax return. The only criteria for sending a delinquency notification to a business taxpayer was an open filing requirement and the absence of a filed tax return. The system used no external data, such as third-party reporting information, to identify and create the delinquent return investigation cases that could be potentially worked

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<sup>1</sup> See Appendix V for a glossary of terms.



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by IRS employees. Responses to delinquency notifications sent to taxpayers often revealed that the taxpayers were no longer in business.

In Fiscal Year (FY) 2002, the Treasury Inspector General for Tax Administration recommended the IRS match third-party reporting information with Business Master File information to identify business nonfilers.<sup>2</sup> In April 2009, the IRS implemented a new tool that expanded the use of third-party information and research tools to enhance identification, selection, and resolution of business nonfiler cases. This initiative, aimed at addressing longstanding business nonfiler issues, is referred to as the Business Master File Case Creation Nonfiler Identification Process (BMF CCNIP). Similar to the Individual Master File Case Creation Nonfiler Identification Program for individual nonfilers, the BMF CCNIP uses third-party return information and other IRS account data to select potential business nonfiler cases based on the likelihood of securing returns and revenue. Although the IRS Small Business/Self-Employed Division is the primary stakeholder, the BMF CCNIP also affects Large Business and International Division and Tax Exempt and Government Entities Division taxpayers.

A primary objective of the BMF CCNIP is to prioritize business nonfiler cases by using third-party and other account data to help identify indications of recent business activity. Indications of recent business activity allow the IRS to identify potential business nonfiler cases that are most likely to be active businesses. Based on analysis of these data, the BMF CCNIP assigns the case a selection code (ranging from 01 to 99) which helps quantify its priority for assignment. Cases assigned lower numbered selection codes have a higher priority. For example, the three highest priority selection codes are as follows:

- 01 – High Dollar Credits – Cases with credit balances greater than or equal to \$100,000.
- 02 – Large Dollar Credits – Cases with credit balances between \$50,000 and \$100,000.
- 03 – Medium-Large Dollar Credits – Cases with credit balances between \$10,000 and \$50,000.

The selection codes assigned to potential business nonfiler cases are updated automatically every week as new taxpayer information is received.

In a recent review of the IRS's business nonfiler program, the Government Accountability Office reported<sup>3</sup> that, while the IRS has made good progress in implementing the BMF CCNIP, it has not calculated the BMF CCNIP's performance measures or planned the evaluations it would need to assess success. The IRS responded that a planned report will show information on resolution type for each case, selection code, and return type; whether the return was secured;

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<sup>2</sup> Treasury Inspector General for Tax Administration, Ref. No. 2002-30-185, *The Internal Revenue Service Should Evaluate the Feasibility of Using Available Documents to Verify Information Reported on Business Tax Returns* (Sept. 2002).

<sup>3</sup> Government Accountability Office, GAO-10-950, *TAX GAP: IRS Has Modernized Its Business Nonfiler Program but Could Benefit from More Evaluation and Use of Third-Party Data* (August 31, 2010).



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and revenue collected with the return. The IRS plans to use this report to assess the effectiveness of the selection codes and track the volume of cases closed as not liable to file a return. IRS officials did not know when the report would be available.

This review was performed at the IRS Small Business/Self-Employed Division Headquarters in New Carrollton, Maryland, and the Philadelphia Campus in Philadelphia, Pennsylvania, during the period July 2010 through July 2011. Our review was delayed because the IRS was unable to timely provide us with the necessary data to conduct our testing of the BMF CCNIP selection code assignments. 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.



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## *Results of Review*

### ***The Business Master File Case Creation Nonfiler Identification Process Is Providing a More Balanced Workload***

One of the goals of the BMF CCNIP is to enable more efficient targeting of business nonfilers who may be delinquent in filing their required tax returns. Additionally, IRS officials informed us that an objective of the BMF CCNIP was to identify and select more productive cases to work and to improve workload management by improving workload selection.

According to IRS officials, before the BMF CCNIP was implemented, there was no way to control inventory workload or perform inventory analysis. The IRS would generally select potential nonfiler cases to be worked by the type of return, *e.g.*, corporate returns, employment tax returns, or partnership returns. This approach was not very effective at controlling the volume of cases selected. For example, when a specific type of return was selected from nonfiler inventory, all taxpayers with returns of that type would then be sent a delinquency notification. The number of returns of a specific type could be large or small. As a result, the number of delinquency notices generated and assigned to be worked varied widely from week to week.

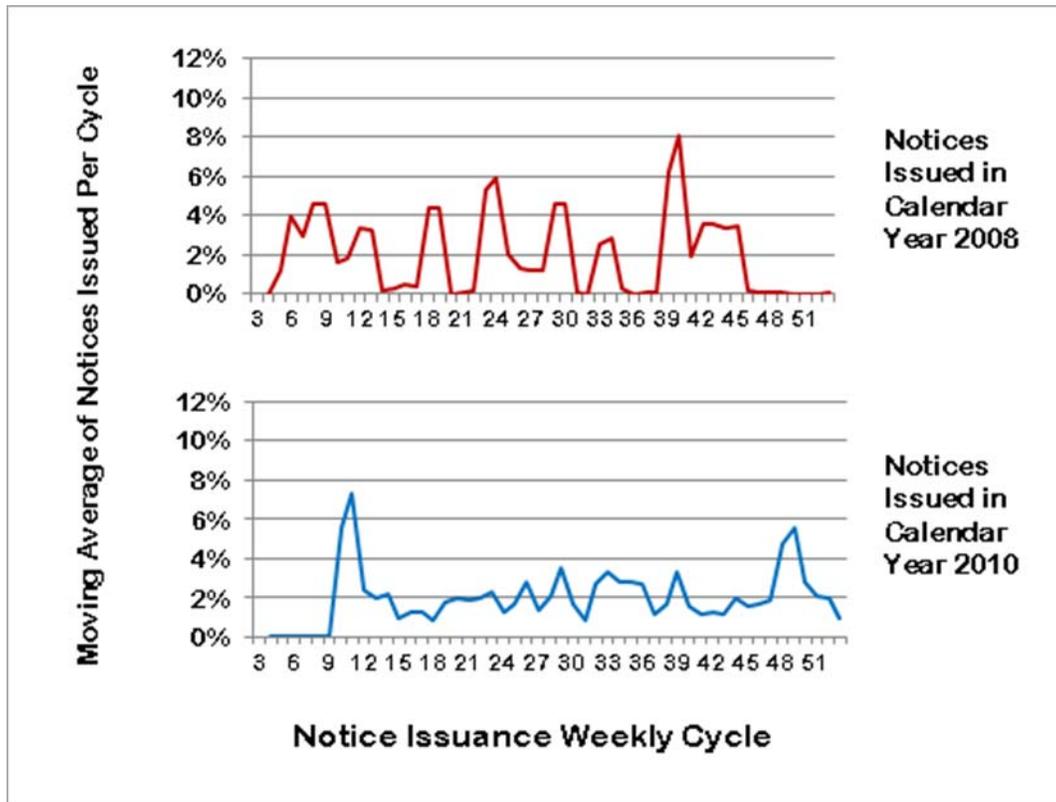
The BMF CCNIP prioritizes nonfiler inventory with the introduction and use of selection codes. In addition to type of return, the selection codes further categorize nonfiler cases by type of third-party reporting information and various other account data. This process results in the creation of more manageable groups of inventory and assigns each group a workload priority. Consequently, there is better control and more consistency in the number of weekly delinquency notices assigned to be worked by IRS employees. Business nonfiler cases are now moved into the collection stream in a more consistent, balanced manner.

Figure 1 compares the moving average of the inventory (delinquency notifications) assigned during each weekly cycle before and after implementation of the BMF CCNIP.



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**Figure 1: Moving Average of Delinquency Notices Issued Per Weekly Cycle**



Source: Computer Paragraph 25<sup>4</sup> Notice data obtained from the IRS Servicewide Notice Information Program.

In Calendar Year 2008, before implementation of the BMF CCNIP, the number of delinquency cases assigned to work varied considerably, as evidenced by the repeated spikes in the graph in Figure 1. The variance in the moving average of weekly notices issued in Calendar Year 2010 (after implementation of the BMF CCNIP) shows less fluctuation and greater consistency, which is an indication of a more balanced workload.

### **Initial Results Did Not Meet All Baseline Business Case Goals**

The Government Performance and Results Act of 1993<sup>5</sup> establishes that Federal Government agencies are expected to identify performance measures and have clear time periods and targets.

<sup>4</sup> Master File generated first Taxpayer Delinquent Investigation Notice for delinquent business tax returns.

<sup>5</sup> Pub. L. No. 103-62, 107 Stat. 285 (codified as amended in scattered sections of 5 U.S.C., 31 U.S.C., and 39 U.S.C.).



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In their Baseline Business Case, which introduced the benefits of implementing the BMF CCNIP, IRS officials included goals for reducing the number of nonliable (Transaction Codes (TC) 590–591)<sup>6</sup> closures and increasing the number of returns secured (TC 599). Figure 2 shows the stated performance measures and target dates as shown in the Baseline Business Case.

**Figure 2: Baseline Business Case Current and Future Strategic and Operational Performance Measures**

Performance Measures	Current Value	Future Value	Target Date
Number of Nonliable Closures	815,073	407,537	1 <sup>st</sup> Quarter, FY 09
Number of Returns Secured	1,461,021	1,583,282	1 <sup>st</sup> Quarter, FY 09
Net Taxpayer Delinquent Investigation Dollars Assessed	\$10,352,341,889	\$11,218,657,100	1 <sup>st</sup> Quarter, FY 09
Taxpayer Delinquent Investigation Dollars Collected	\$2,637,142,905	\$2,710,703,243	1 <sup>st</sup> Quarter, FY 09

Source: BMF CCNIP Baseline Business Case Table 3.

The goals were based on FY 2005 Collection Activity Report case closure results (shown as “Current Value” in Figure 2). According to the Baseline Business Case, “there [was to] be one release in April 2009 that will include [all] capability.” However, the target date set to achieve the goals was the first quarter of FY 2009, which was prior to implementation of the BMF CCNIP. In addition, the expected annual goal for nonliable closures and returns secured for FYs 2008 through 2016 was not clearly explained. Figure 3 shows the specific performance goals that were included in Table 9 of the IRS’s Baseline Business Case.

**Figure 3: Baseline Business Case Nonmonetary Quantitative Benefits/Strategic and Operational Performance Measures**

Performance Measures	FY 08	FY 09	FY 10	FY 11	FYs 12–16
Reduction in Nonliable Closures	407,537	407,537	407,537	407,537	2,037,685
Higher Number of Returns Secured	1,583,282	1,583,282	1,583,282	1,583,282	7,916,410

Source: BMF CCNIP Baseline Business Case Table 9.

Figure 3 shows that in each year between FY 2008 and FY 2016, the number of nonliable closures was expected to be reduced by 407,537. However, this chart is confusing because it does not reference the baseline from which the reduction will be realized. It is likely the reduction was based on the number of nonliable closures in the baseline year (FY 2005) and not

<sup>6</sup> See Appendix IV for a complete list of return delinquency transaction codes.



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intended to mean that each year would have 407,537 fewer nonliable closures than the prior year (which would eventually be zero).

IRS management could not provide us with clarification about the anticipated benefits. Instead, management advised us that it would take years before any benefits could be measured. Despite management's position, we believe accountability is important, and IRS management established these goals and benefits when justifying the resources needed to implement the BMF CCNIP. Further, the BMF CCNIP Baseline Business Case included a proactive risk mitigation strategy:

*Risk management for the BMF CCNIP project is an iterative process, performed continuously over the project lifecycle. The process includes activities to identify, quantify, respond to, and control project risks. This process minimizes problems by anticipating rather than reacting to events.*

As noted earlier, the Government Accountability Office reported that the IRS did not establish performance measures or a tracking system that would allow it to determine if the BMF CCNIP was realizing the expected benefits identified in the Baseline Business Case. As a result, the IRS did not have information available to determine the effectiveness of the BMF CCNIP. However, we attempted to identify trends to assist research efforts and make potential improvements. We recognize these trends could be influenced by factors outside the control of the BMF CCNIP, but we do not believe it is proactive to ignore or dismiss either favorable trends or potential early warning signs. Such indicators could provide information to help the IRS make changes that will improve the effectiveness of the BMF CCNIP without waiting through years of potentially weak performance.

We compared<sup>7</sup> the actual number of nonliable closures and returns secured that were reported by the IRS in its Collection Activity Reports for FY 2010 and FY 2011 to the Baseline Business Case goals. Figure 4 shows that instead of reducing the number of nonliable closures to 407,537 closures (which is 50 percent of the FY 2005 nonliable closures) as expected, the number of nonliable closures actually *increased* to 1,421,169 (174 percent of FY 2005 nonliable closures) in FY 2010 and 1,451,942 (178 percent of FY 2005 nonliable closures) in FY 2011.

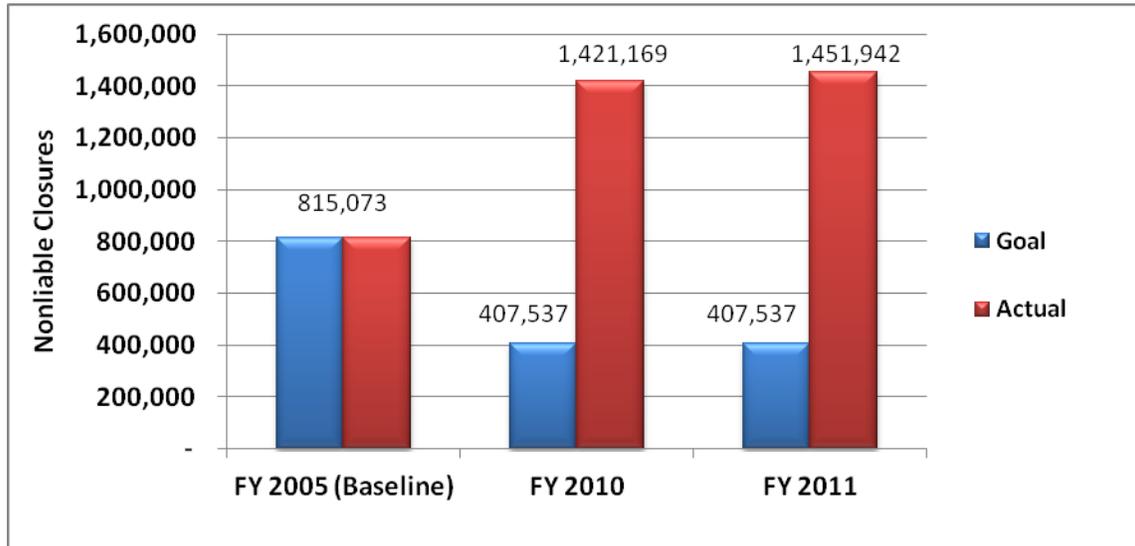
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<sup>7</sup> For these comparisons, we assumed the goals were intended to be the difference between the current year and the baseline year of FY 2005, and not expected to decrease/increase relative to the preceding year. For example, we assumed FY 2010 goal of 407,537 fewer nonliable closures was based on the 815,073 nonliable closures reported in FY 2005, not 407,537 fewer closures than FY 2009.



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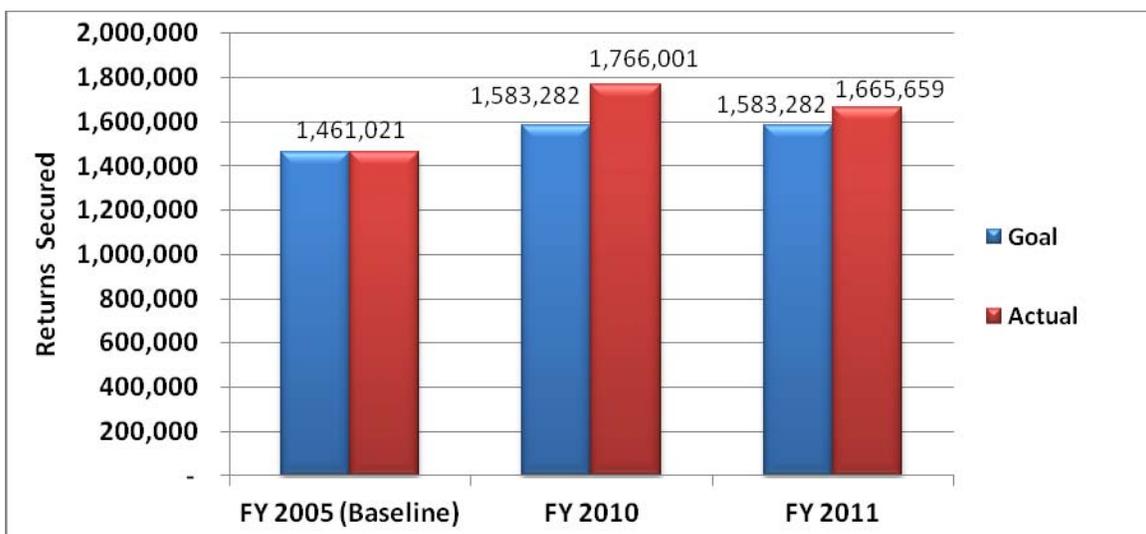
**Figure 4: Comparison of Baseline Business Case Nonliable Closure Goals With Collection Activity Reports for FYs 2010 and 2011**



Source: Our analysis of Collection Activity Reports and BMF CCNIP Baseline Business Case goals.

However, Figure 5 shows that the number of returns secured exceeded the goal of 1,583,282 for both FYs 2010 and 2011. Specifically, returns secured increased to 1,766,001 in FY 2010 and 1,665,659 in FY 2011.

**Figure 5: Comparison of Baseline Business Case Returns Secured Goals With Collection Activity Reports for FYs 2010 and 2011**



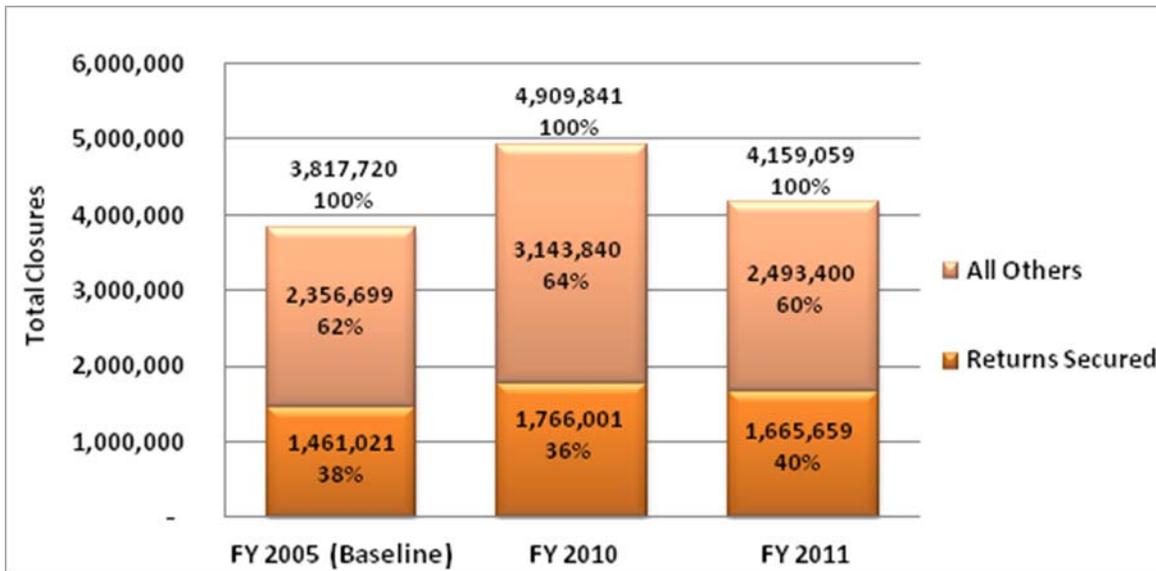
Source: Our analysis of Collection Activity Reports and BMF CCNIP Baseline Business Case goals.



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However, the Baseline Business Case goals were numeric, which did not consider the impact of increases or decreases in the total closed inventory. For example, if the total closed inventory increased significantly, it would be more difficult for the IRS to decrease the total number of nonliable closures because there are more cases that are worked. Similarly, a larger inventory may have contributed to the increase in the number of returns secured. Therefore, we compared the percentage of nonliable closures and returns secured with the total population of closed cases. Figure 6 shows that, while the number of returns secured increased, the percentage of cases closed as return secured actually decreased in FY 2010.

**Figure 6: Percentage of Returns Secured for FYs 2010 and 2011**



Source: Our analysis of Collection Activity Reports and BMF CCNIP Baseline Business Case goals.

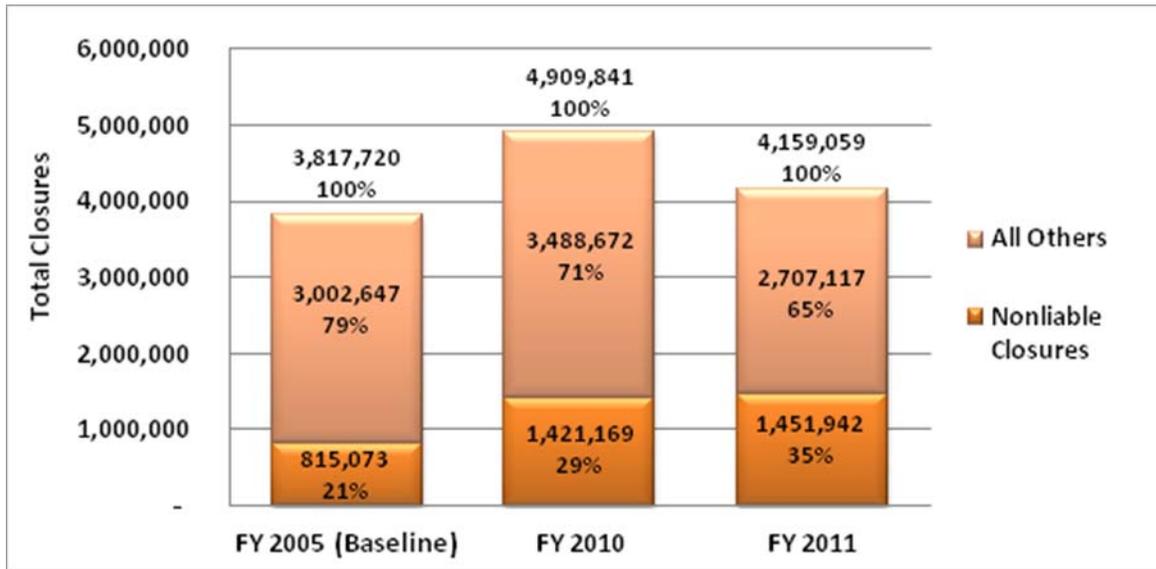
The decrease in the percentage of returns secured suggests the increase in the number of returns secured (Figure 5) was influenced by the increase in the total inventory of closed cases. The number of total closures was much higher in FY 2010 (4,909,841) compared with FY 2005 (3,817,720). However, the percentage of cases closed as return secured did increase in FY 2011.

Figure 7 shows that the percentage of nonliable closures increased in both FY 2010 and FY 2011 from FY 2005, which is consistent with the increases in the number of nonliable closures shown in Figure 4 and contrary to the expected benefits that were cited in the BMF CCNIP Baseline Business Case.



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**Figure 7: Percentage of Nonliable Closures for FY 2010 and FY 2011**



Source: Our analysis of Collection Activity Reports and BMF CCNIP Baseline Business Case goals.

In summary, FYs 2010 and 2011 Baseline Business Case goals were not met for nonliable closures, either as a numeric goal or as a percentage of the total inventory. For returns secured, the numeric goals were met in both FYs 2010 and 2011. However, the results in FY 2010 may have been assisted by a significant increase in the total available inventory.

There were some limitations in these comparisons. IRS officials informed us that there were various changes to the way delinquency notices were sent and how cases were worked during these periods. For example, in FY 2008, the IRS changed the type of first delinquency notice used for Business Master File taxpayers. The IRS began sending delinquency notices to new associated delinquencies, which is when a taxpayer already had a delinquent return in Taxpayer Delinquent Investigation or Taxpayer Delinquent Account status. Prior to this change, delinquency notices were not sent on new delinquencies with existing associated delinquencies.

In addition, after BMF CCNIP was implemented, Collection employees were required to consider all potential delinquent returns when working on taxpayers' responses to delinquency notices. Prior to the implementation, employees were required to consider only the specific delinquent returns based on the taxpayer's response. These changes may have caused an increase in the number of nonliable closures and account for some of the increases shown in our comparisons. However, the BMF CCNIP goals were not changed, even though the IRS planned future iterations of the Baseline Business Case.

Finally, IRS officials informed us that BMF CCNIP cases closed within the first few years after implementation were likely to be simpler cases or those closed as nonliable, and more complicated cases would take much longer to close. However, this risk would have been known



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at the time the Baseline Business Case goals were established, but it was not reflected in the expected benefits. Instead, the nonliable closures goal was the same in each year after implementation.

As an interim BMF CCNIP performance measure, IRS officials use the delinquency notice response rate, which measures taxpayers' responses to IRS delinquency notifications. IRS management advised us that the response rate to notices had doubled since the start of the BMF CCNIP, increasing from about 15 percent to nearly 30 percent, but added it was too early to identify any trends. In response to the 2010 Government Accountability Office report, the IRS indicated that many delinquencies must flow through the entire compliance stream before there is resolution and, therefore, data that measure the BMF CCNIP selection code effectiveness should not be studied until they are complete and available. Management also informed us that information management reports and data necessary to assess the BMF CCNIP performance, which was expected to be available at the end of FY 2011, will not be available until the end of FY 2012. In addition, further delays are possible if needed funding for the completion of the project is not provided. Given these delays and uncertainties, we believe it would be prudent for the IRS to evaluate and determine the causes of these early trends. This assessment will allow the IRS to make more timely adjustments and improvements to the BMF CCNIP selection codes, if needed.

## ***Recommendation***

**Recommendation 1:** The Director, Enterprise Collection Strategy, Small Business/Self-Employed Division, should conduct an evaluation to determine the causes of increases or decreases in closure types since implementation of the BMF CCNIP. The results should be used to make appropriate adjustments to the BMF CCNIP selection codes and performance measures, if needed.

**Management's Response:** IRS officials agreed with this recommendation. Delinquent return cases are selected through schedules developed by analysts. The IRS will perform an analysis of the schedules and output pre- and post-BMF CCNIP implementation to determine how the selection of Master File Tax Account code, selection code, and primary code influenced results. Also, the IRS will perform an analysis to determine if the linked rule is unduly affecting results. The analysis will look for improvements in selection and primary code assignment. If improvements to selection and primary coding are needed, coordination with the Modernization and Information Technology Services organization will be initiated and a Unified Work Request will be submitted.



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## **Conflicting Primary Codes May Delay Collection Actions**

Although the number of potential business nonfiler cases available to be assigned and worked is increasing, many will remain unassigned due to IRS resource constraints. The IRS estimates as much as 50 percent of the available inventory will not be worked. IRS officials informed us they select about 120,000 cases each week to be assigned to be worked, which is approximately six million per year. This contrasts with more than 98 million potential business nonfiler cases that were available to be assigned (as of August 2011). Generally, cases available to be assigned will remain in business nonfiler inventory for six years. It is clear that identifying potential high-priority business nonfiler inventory is very important.

In addition to selection codes, cases are also assigned a primary code. Primary codes existed prior to the implementation of the BMF CCNIP and were the only way a potential return delinquency case was categorized by the Business Master File. Primary codes are used to determine the number of delinquency notices the case receives, what happens after notifications are sent, and which function is assigned to work the case. Business nonfiler cases generally receive a primary code A, B, or X designation. Primary code B (PC-B) cases are considered the lowest priority cases and receive only one IRS delinquency notification letter. Business nonfiler cases without the PC-B designation may receive up to two delinquent return notifications. For example, if the taxpayer does not respond to the first notification, a second delinquent return notification will be sent. Although the BMF CCNIP now includes third-party information to prioritize cases and assign selection codes, IRS management in the Automated Collection System and Collection Field functions elected to keep using primary codes to assign their own inventories. In addition, these functions chose not to program the Automated Collection System and Integrated Collection System to populate the selection codes from the BMF CCNIP. IRS management stated this decision was due to additional programming costs necessary for adding the selection codes to those systems. In addition, employees were already using primary codes and were familiar with them.

Our analysis shows that higher priority selection code cases can, and often do, carry the lower priority PC-B designation. These two designations contradict each other and are, therefore, counterproductive. Figure 9 shows more than one-half of all cases with PC-B designations that were processed through the BMF CCNIP between May 2009 and November 2010 also carried a high-priority selection code (selection codes 01 through 10). Specifically, there were 1,123,877 cases with the 10 highest priority selection codes also designated as PC-B cases, indicating the lowest priority.



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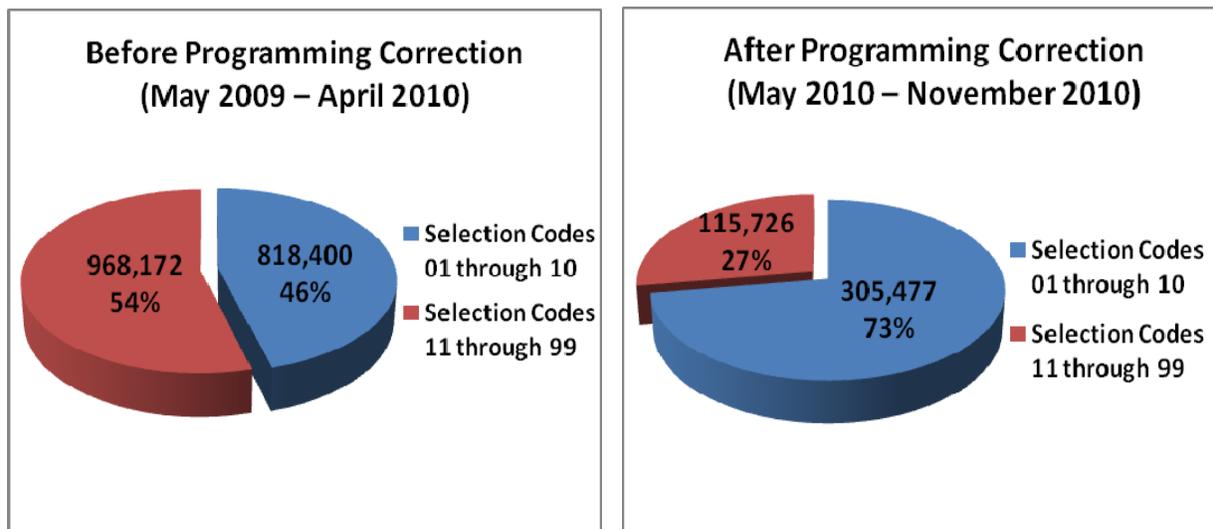
**Figure 9: Selection Codes With a PC-B Designation**

Selection Code	PC-B Cases	Percentage
01 through 10	1,123,877	51%
11 through 99	1,083,898	49%
Total	2,207,775	100%

Source: Our analysis of the BMF CCNIP closed case results.

The 2,207,775 PC-B designated cases represent approximately 69 percent of the overall closed BMF CCNIP cases during this period. IRS officials informed us that the BMF CCNIP should not be assigning most of the higher priority selection codes with a PC-B designation and that a programming error was a possible cause. This condition had been occurring since implementation of the BMF CCNIP in April 2009 but was not discovered and corrected until April 2010. We believe this condition supports our position that waiting years to analyze the data is not proactive. Further, the correction does not appear to have fixed the problem. Figure 10 shows our analysis of higher priority selection codes before the programming error was corrected compared with after the correction was made.

**Figure 10: Selection Codes With PC-B Designation  
Before and After Programming Correction**



Source: Our analysis of the BMF CCNIP closed case results.

Before the programming correction, 46 percent of the higher priority selection codes (selection codes 01 through 10) also carried a PC-B designation. However, after the correction, 73 percent of the higher priority selection codes had a PC-B designation.



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Because primary codes are used to determine the number of return delinquency notifications to send to taxpayers, it is possible that cases with a high-priority selection code, but also a low-priority PC-B designation, would not receive additional collection actions beyond the first delinquency notification. For example, PC-B designation cases would:

- Not be sent a second delinquency notification (follow-up notice).
- Not be elevated to Status 03 (Taxpayer Delinquent Account status) where active collection would continue, meaning they may not be assigned to alternative collection treatment streams such as the Automated Collection System or the Collection Field function.
- Be suspended from further collection activity (suppressed) if there was no response or resolution by the taxpayer after 10 weeks.
- Be closed as “no longer liable for tax” if the suspended cases had no further activity after 24 months. However, before the case is closed, a final review is completed to check for any outstanding conditions such as credit balances or returns previously filed. In addition, if at any time during this period there is continued noncompliance by the taxpayer, it would cause the case to be accelerated to the Collection Field function to be worked.

As a result, there is a higher risk that collection actions may be delayed and revenue will remain uncollected on delinquent return cases with high-priority selection codes that carry PC-B designations.

## ***Recommendations***

The Director, Enterprise Collection Strategy, Small Business/Self-Employed Division, should:

**Recommendation 2:** Monitor all higher priority selection code cases to ensure they are not also assigned a PC-B designation.

**Management's Response:** IRS management agreed with this recommendation. They will monitor the assignment of both selection and primary codes by reviewing delinquencies through the BMF CCNIP Quality Assurance screens. The Quality Assurance screen allows analysts to select segments of delinquent return cases for review post-creation. Any identified systemic issues with regard to business rules will be coordinated with the Modernization and Information Technology Services organization.

**Recommendation 3:** Determine whether cases that have been suspended from further collection activity (suppressed) and have both high selection codes and PC-B designations need further evaluation or require additional collection actions.



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**Management's Response:** IRS management did not agree with this recommendation due to current resource constraints. Identification and the re-creation of suppressed delinquencies would require coordination with the Modernization and Information Technology Services organization and the expenditure of significant Small Business/Self-Employed Division campus resources. Given the large volume of available current inventory, the IRS believes that the resource cost would outweigh the benefits of this recommendation. As resource constraints change, it will consider whether actions in this area are appropriate.

**Office of Audit Comment:** The Treasury Inspector General for Tax Administration continues to believe that identification and analysis of the cases suspended from further collection activity is important. Because the BMF CCNIP has already scored these cases as higher priority, there is a greater likelihood of taxpayers filing a return and paying taxes.

### ***Selection Code Criteria Was Inconsistent and Not Formally Documented***

Sound management principles support that organizational rules, policies, and procedures be clear, consistent, and updated in writing. Such consistent, written documentation provides clear guidance and identifies specific steps to follow when carrying out organizational tasks and responsibilities. It also provides reference points for employee responsibilities and troubleshooting and serves as a current standard or benchmark when updating adjustments or making changes.

The BMF CCNIP has numerous selection codes that include the Last Return Amount as a component in the criteria. This designation helps prioritize business nonfiler inventory by identifying tax liabilities of recently filed returns from taxpayers who may be noncompliant. We reviewed 210 judgmentally selected BMF CCNIP cases and identified eight (4 percent) cases that were assigned incorrect selection codes due to the inconsistent application of the Last Return Amount criteria. Three of the eight cases were assigned selection code "07" and five were assigned selection code "08." According to IRS officials, these codes require a search for filed tax returns having tax liabilities within certain dollar ranges. These tax returns are further identified by searching for any tax periods within the same tax year of the potential return delinquency as well as *prior* tax periods. However, some of the cases we reviewed identified tax periods within the same tax year and *subsequent* tax periods in an attempt to satisfy this condition. As a result, these eight cases did not identify the correct tax periods, which resulted in an incorrect selection code.

We attempted to identify the criteria for BMF CCNIP selection codes using Document 6209, *IRS Processing Codes and Information (2011 edition)*, which lists the Business Master File criteria for selection codes. However, this document does not specifically define all the terms



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used in the criteria or identify how or when the criteria are to be applied. IRS officials provided us with interpretations of the criteria through a series of discussions and e-mails and advised us that the *BMF CCNIP Selection Code Rules Document* (October 2009) included the relevant information. It was also noted that this documentation was jointly developed by Small Business/Self-Employed Division officials and IRS computer programmers. However, these documents and the information provided were not only confusing but contained conflicting and incomplete information. IRS officials later advised us that the *BMF CCNIP Selection Code Rules Document* had not been updated properly and the problem occurred due to a programming error. However, the unclear and inconsistent documentation of selection code criteria and terms may have contributed to the conflicting application of some of the BMF CCNIP criteria, such as the Last Return Amount.

The incorrect use of selection codes can result in the assignment of cases that do not meet the criteria for assignment to employees and a failure to assign cases with a higher likelihood of collecting a liability.

## ***Recommendation***

***Recommendation 4:*** The Director, Enterprise Collection Strategy, Small Business/Self-Employed Division, should develop clear and consistent documentation for BMF CCNIP business rules (criteria) and formalize the standard.

***Management's Response:*** IRS management agreed with this recommendation. BMF CCNIP documentation exists and is stored on DocIT.<sup>8</sup> All documentation will be reviewed and updated to ensure consistency with regard to business rules and programming implementation. This will be a joint effort between the Enterprise Collection Strategy function and the Modernization and Information Technology Services organization Application Development for BMF CCNIP function.

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<sup>8</sup> DocIT is a web-based electronic document management system powered by the enterprise standard tool Documentum. Documentum provides documentation control for information technology projects. DocIT manages more than half a million internal project documents within the IRS for more than 3,000 internal users.



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## **Appendix I**

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

Our overall objective was to determine whether the BMF CCNIP implementation was effective in targeting business nonfilers<sup>1</sup> who may be delinquent in filing their required tax returns by improving workload selection and casework quality. To accomplish this objective, we:

- I. Determined whether business nonfiler cases were properly selected and prioritized for inclusion in potential case workload inventory.
  - A. Interviewed Headquarters analysts to determine how the overall selection process works, their role in the process, and when/where the BMF CCNIP is used.
  - B. Determined the methods and appropriateness for categorizing and prioritizing cases, *e.g.*, Inventory Delivery System and Consolidated Decision Analytics, and when this occurs.
  - C. Identified the selection codes and the selection code criteria.
  - D. Determined the appropriateness of the criteria applied in the selection process and the process used to select case inventory when requested by the campuses for collection work.
  - E. Conducted a case review of a judgmental sample of 210 cases from the BMF CCNIP available inventory database and evaluated whether they met the selection code criteria. A judgmental sample was used because the population was unknown. The available inventory is updated and changes on a weekly basis in the BMF CCNIP database.
    1. Completed a Unified Work Request and submitted it to the IRS Small Business/Self-Employed Division for approval and submission to the IRS Modernization and Information Technology Services organization to obtain the data. We requested the first 10 cases from each available BMF CCNIP selection code. We reviewed the first three cases of each of 44 different selection codes and, if we found errors in any one of those cases, we reviewed the remaining seven cases.
    2. Established the reliability of these data by verifying various data fields to the Integrated Data Retrieval System for the 210 cases.

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<sup>1</sup> See Appendix V for a glossary of terms.



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3. Reviewed the cases by verifying the selection codes assigned with the appropriate selection code criteria.
- II. Determined the overall performance results of the BMF CCNIP.
- A. Determined whether the BMF CCNIP has specific application goals and objectives.
  - B. Determined how the IRS is assessing the performance of the BMF CCNIP in attaining its goals and objectives as identified in Step II.A.
    1. Obtained performance results documentation.
    2. Determined whether the BMF CCNIP is achieving its goals and objectives.
  - C. Determined the BMF CCNIP performance results.
    1. Obtained the open and closed delinquent return investigation cases on the Business Master File that had been through the BMF CCNIP process from May 2009 through November 2010.
      - a. Established the reliability of these data by verifying various data fields to the Integrated Data Retrieval System. We also obtained the data sets and job logs for both open and closed cases.
      - b. Identified the population of open and closed cases by eliminating the records that did not meet our criteria.
    2. Determined the number of nonliable closures (TC 590 and TC 591) and returns secured (TC 599) from the IRS's Collection Activity Reports for the *prior* 19-month period (October 2007–April 2009) before the BMF CCNIP was implemented and compared it to the data for the 19-month period *after* the implementation of the BMF CCNIP (May 2009–November 2010).
    3. Compared FY 2005 data (obtained from the BMF CCNIP Baseline Business Case) against FYs 2010 and 2011 data (obtained from the Collection Activity Reports) to determine whether there was a decrease in nonliable closures and an increase in returns secured.
    4. Interviewed employees within the Collection Field function, Campus Compliance Service Operations, and Automated Collection System, at the Philadelphia Campus to determine if workload inventory and casework quality had improved.



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**Internal controls methodology**

Internal controls relate to management's plans, methods, and procedures used to meet their mission, goals, and objectives. Internal controls include the processes and procedures for planning, organizing, directing, and controlling program operations. They include the systems for measuring, reporting, and monitoring program performance. We determined the following internal controls were relevant to our audit objective: IRS policies, procedures, and practices for prioritizing and selecting business nonfilers as well as measuring the overall performance of the BMF CENIP. We evaluated these controls by reviewing source materials, interviewing management, reviewing delinquent return case files, and researching taxpayer accounts.



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**Appendix II**

*Major Contributors to This Report*

Margaret E. Begg, Assistant Inspector General for Audit (Compliance and Enforcement Operations)

Carl L. Aley, Director

Phyllis Heald London, Audit Manager

Julian E. O'Neal, Lead Auditor

Richard J. Viscusi, Senior Auditor

Rebecca A. Arendosh, Auditor



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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, Small Business/Self-Employed Division SE:S  
Director, Campus Compliance Services, Small Business/Self-Employed Division SE:S:CCS  
Director, Communications, Liaison, and Disclosure, Small Business/Self-Employed Division  
SE:S:CLD  
Director, Enterprise Collection Strategy, Small Business/Self-Employed Division SE:S:ESC  
Director, Research, Small Business/Self-Employed Division SE:S:R  
Director, Collection Policy, Small Business/Self-Employed Division SE:S:ESC:CP  
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, Small Business/Self-Employed Division SE:COM



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**Appendix IV**

*Return Delinquency Transaction Codes<sup>1</sup>*

<b>Transaction Code</b>	<b>Definition</b>
TC 590	Not liable this tax period. Satisfies this module only.
TC 591	No longer liable for tax. Satisfies this module and all subsequent modules for same Master File Tax Account Codes if not already delinquent.
TC 593	Unable to locate taxpayer. Satisfies this module and all subsequent modules for same Master File Tax Account.
TC 594	Return previously filed. Satisfies this module only.
TC 595	Referred to Examination. Satisfies this module and all subsequent modules for same Master File Tax Account.
TC 596	Referred to Criminal Investigation. Satisfies this module and all subsequent modules for same Master File Tax Account.
TC 597	Surveyed. Satisfies this module only.
TC 598	Shelved. Satisfies this module only.
TC 599	Return secured. Satisfies this module only.

*Source: Document 6209, IRS Processing Codes and Information, Chapter 11.8.3.*

<sup>1</sup> See Appendix V for a glossary of terms.



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**Appendix V**

*Glossary of Terms*

<b>Term</b>	<b>Definition</b>
Automated Collection System	A telephone contact system through which telephone assistors collect unpaid taxes and secure tax returns from delinquent taxpayers who have not complied with previous notices.
Baseline Business Case	Presents an analysis of the qualitative and quantitative benefits expected to accrue from the BMF CCNIP.
Business Master File	The IRS database that consists of Federal tax-related transactions and accounts for businesses, including employment taxes, income taxes on businesses, and excise taxes.
Calendar Year	A 12-consecutive-month period beginning on the first day of January and ending on the last day of December.
Campus	The data processing arm of the IRS. The campuses process paper and electronic submissions, correct errors, and forward data to the Computing Centers for analysis and posting to taxpayer accounts.
Collection Activity Report	A report that provides Collection function activity information from the beginning of the fiscal year through the end of the current reporting month.
Collection Field Function	The unit in the Area Offices consisting of revenue officers who handle personal contacts with taxpayers to collect delinquent accounts or secure unfiled returns.
Consolidated Decision Analytics	Decision analytics uses advanced modeling techniques that identify and prioritize the most productive cases for IRS employees to work.
Credit Balance	Occurs on a taxpayer's delinquent return when tax payments have been made prior to the return being filed.



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<b>Term</b>	<b>Definition</b>
Cycle	The year and week in which the IRS posts account transactions or notices are issued to taxpayers.
Fiscal Year	A 12-consecutive-month period ending on the last day of any month, except December. The Federal Government's fiscal year begins on October 1 and ends on September 30.
Government Accountability Office	The investigative arm of Congress charged with examining matters relating to the receipt and payment of public funds.
Integrated Collection System	An information management system designed to improve revenue collections by providing revenue officers in the field access to the most current taxpayer information using laptop computers for quicker case resolution and improved customer service.
Integrated Data Retrieval System	An IRS computer system capable of retrieving or updating stored information. It works in conjunction with a taxpayer's account records.
Inventory Delivery System	The inventory delivery system for collection cases that uses decision analytics, risk-based collection criteria, and established business rules to route cases to the Automated Collection System, the Queue, or directly to field assignment.
Large Business and International Division	The IRS organization that serves corporations, subchapter S corporations, and partnerships with assets greater than \$10 million.
Master File	The IRS database that stores various types of taxpayer account information. This database includes individual, business, and employee plans and exempt organizations data.
Master File Tax Account Codes	The two-digit number codes that identify the type of return filed by the taxpayer.
Modernization and Information Technology Services	The IRS organization designed to deliver information technology services and solutions that drive tax administration to help ensure public confidence.



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<b>Term</b>	<b>Definition</b>
Moving Average	An average of data points for a certain number of time periods used to indicate trends.
Nonfilers	Individual and business taxpayers who have been identified as liable to file a tax return but have not filed a tax return by the return due date or extended due date.
Queue	An automated holding file for unassigned inventory of delinquent cases for which the Collection function does not have enough resources to immediately assign for contact.
Return Delinquency	An IRS program designed to work responses to notices issued to taxpayers identified as liable to file a tax return but have not filed.
Servicewide Notice Information Program	A program that allows IRS employees to report possible erroneous taxpayer correspondence to the Notice Gatekeeper; view examples of IRS notices; link to Servicewide Notice Information Program Alerts, Internal Revenue Manual references, and other technical reference information pertaining to each notice; and determine the number of notices issued in a particular cycle.
Small Business/Self-Employed Division	The IRS organization that services self-employed taxpayers and small businesses by educating and informing them of their tax obligations, developing educational products and services, and helping them understand and comply with applicable tax laws.
Tax Exempt and Government Entities Division	The IRS organization established to improve the IRS's ability to meet the special needs of pension plans, exempt organizations, and government entities in complying with the tax laws.



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<b>Term</b>	<b>Definition</b>
Tax Year	The 12-month period for which tax is calculated. For most individual taxpayers, the tax year is synonymous with the calendar year.
Taxpayer Delinquent Investigation	An unfiled tax return for a taxpayer. One Taxpayer Delinquent Investigation exists for all tax periods.
Unified Work Request	Gives the detailed business requirements for data requests so that the IRS can properly review, assign, analyze, and respond (approve/deny) to the request and can also cost and schedule the request for the implementation and delivery of any agreed upon information technology products or services.



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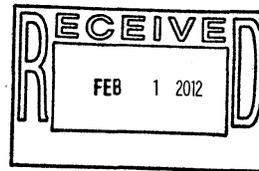
**Appendix VI**

*Management's Response to the Draft Report*



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

FEB 01 2012



MEMORANDUM FOR MICHAEL R. PHILLIPS  
DEPUTY INSPECTOR GENERAL FOR AUDIT

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

SUBJECT: Draft Audit Report – Improvements Are Needed to Ensure the  
Business Master File Case Creation Nonfiler Identification  
Process Is Working Effectively (Audit # 201030019)

Thank you for the opportunity to review your draft report, "Improvements Are Needed to Ensure the Business Master File Case Creation Nonfiler Identification Process Is Working Effectively." Through the successful implementation of the Business Master File Case Creation Nonfiler Identification Process (BMF CCNIP), the IRS can now select delinquent taxpayer accounts for the Collection work stream based on the existence of third-party information. Third-party information is known to indicate a high likelihood a return is due. However, we continue to address the challenge of reengineering business processes and practices within existing legacy systems and processes and agree that review and analysis is required in order to realize fully the benefits of BMF CCNIP.

We agree identification of the causes of increases or decreases in non-liaible closures and secured returns is essential to measure the effectiveness of BMF CCNIP. However, while assignment of selection and primary codes is systemic, manual analysis of the actual accounts selected is necessary to properly determine the impact of the systemic codes on case selection. For instance, created delinquency inventory is worked within various collection functions and systems. The rules that govern which collection treatment stream is utilized needs to be considered when BMF CCNIP selections are made to fully understand the impact of selections on closure type and volumes.

Selection codes are a new prioritization process that did not exist prior to BMF CCNIP implementation. Primary codes are an existing business process used to determine collection treatment. Although BMF CCNIP did not initially allow for selection by primary codes, it was upgraded in December 2010 to allow for selection by Master File Tax



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(MFT) code, selection code, and primary code. That upgrade enhanced the ability to target the most productive delinquencies; although, we recognize the need for further analysis to determine the effectiveness of selection codes with specific primary codes and whether rules for primary code assignment need to be updated.

Attached is a detailed response outlining our corrective actions. If you have any questions, please contact me, or a member of your staff may contact Michael Julianelle, Director, Enterprise Collection Strategy, Small Business/Self-Employed Division at (202) 622-3480.

Attachment



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Attachment

**RECOMMENDATION 1:**

The Director, Enterprise Collection Strategy, Small Business/Self-Employed Division, should conduct an evaluation to determine the causes of increases or decreases in closure types since implementation of the BMF CCNIP. The results should be used to make appropriate adjustments to the BMF CCNIP selection codes and performance measures, if needed.

**CORRECTIVE ACTION:**

Created delinquencies are selected through schedules developed by analysts. We will perform an analysis of schedules and output pre and post-BMF CCNIP implementation to determine how the selection of MFT code, selection code, and primary code influenced results. Also, we will perform an analysis to determine if the linked rule is unduly impacting results. The linked rule was implemented based on a recommendation in a previous TIGTA audit that employment delinquencies should be entity and not module based and created at the same time. The analysis will also look for improvements in selection and primary code assignment. If improvements to selection and primary coding are needed, coordination with MITS will be initiated and a Unified Work Request will be submitted.

**IMPLEMENTATION DATE:**

April 15, 2013

**RESPONSIBLE OFFICIAL(S):**

The Director, Enterprise Collection Strategy, Small Business/Self-Employed Division (SB/SE)

**CORRECTIVE ACTION MONITORING PLAN:**

IRS will monitor this corrective action as part of our internal management system of controls.

**RECOMMENDATION 2:**

The Director, Enterprise Collection Strategy, Small Business/Self-Employed Division, should monitor all higher priority selection code cases to ensure they are not also assigned a PC-B designation.

**CORRECTIVE ACTION:**

We will monitor the assignment of both selection and primary codes by reviewing delinquencies through the BMF CCNIP Quality Assurance (QA) screens. The QA screen allows analysts to select segments of created delinquencies for review post-creation. Any identified systemic issues with regard to business rules will be coordinated with the Modernization and Information Technology Services (MITS) function.



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**IMPLEMENTATION DATE:**

February 15, 2013

**RESPONSIBLE OFFICIAL:**

The Director, Enterprise Collection Strategy, Small Business/Self-Employed Division

**CORRECTIVE ACTION MONITORING PLAN:**

IRS will monitor this corrective action as part of our internal management system of controls.

**RECOMMENDATION 3:**

The Director, Enterprise Collection Strategy, Small Business/Self-Employed should determine whether cases that have been suspended from further collection activity (suppressed) and have both high selection codes and PC-B designations need further evaluation or require additional collection actions.

**CORRECTIVE ACTION:**

Given current resource constraints, we do not agree with this recommendation. Identification and the re-creation of suppressed delinquencies would require coordination with MITS and the expenditure of significant SB/SE campus resources. Given the large volume of available current inventory (as pointed out in the TIGTA report), we believe that the resource cost would outweigh the benefits of this recommendation. As resource constraints change, we will consider whether actions in this area are appropriate.

**IMPLEMENTATION DATE:**

N/A

**RESPONSIBLE OFFICIAL(S):**

N/A

**CORRECTIVE ACTION MONITORING PLAN:**

N/A

**RECOMMENDATION 4:**

The Director, Enterprise Collection Strategy, Small Business/Self-Employed Division, should develop clear and consistent documentation for BMF CCNIP business rules (criteria) and formalize the standard.



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**CORRECTIVE ACTION:**

BMF CCNIP documentation exists and is stored on DOCIT. All documentation will be reviewed and updated to ensure consistency with regard to business rules and programming implementation. This will be a joint effort between the Enterprise Collection Strategy and MITS Application Development for BMF CCNIP functions.

**IMPLEMENTATION DATE:**

February 15, 2013

**RESPONSIBLE OFFICIAL(S):**

The Director, Enterprise Collection Strategy, Small Business/Self-Employed Division

**CORRECTIVE ACTION MONITORING PLAN:**

IRS will monitor this corrective action as part of our internal management system of controls.