



Treasury Inspector General for Tax Administration Office of Audit

ACTIONS CAN BE TAKEN TO REINFORCE THE IMPORTANCE OF RECOGNIZING AND INVESTIGATING FRAUD INDICATORS DURING FIELD AUDITS

Issued on March 29, 2012

Highlights

Highlights of Report Number: 2012-30-030 to the Internal Revenue Service Commissioner for the Small Business/Self-Employed Division.

IMPACT ON TAXPAYERS

Penalties, such as for civil fraud, are designed to promote voluntary compliance by imposing an economic cost on taxpayers who choose not to comply with the tax law. Because indicators of fraud were not always recognized and properly investigated, the IRS may be missing opportunities to further promote voluntary compliance and enhance revenue for the Department of the Treasury.

WHY TIGTA DID THE AUDIT

This audit was initiated to determine whether fraud is recognized and pursued in accordance with IRS procedures and guidelines during field audits of individual tax returns. The review was part of our planned Fiscal Year 2011 audit coverage and addresses the major management challenge of Tax Compliance Initiatives.

WHAT TIGTA FOUND

TIGTA's review of a statistical sample of 116 field audits closed between July 2009 and June 2010 found 26 audits with fraud indicators that were not recognized and investigated in accordance with some key IRS procedures and guidelines. Each of the field audits involved unreported income and/or overstated expenses that resulted in the taxpayers agreeing they owed additional taxes of at least \$10,000. TIGTA's evaluation indicates that a combination of factors caused the quality problems and that actions can be taken at the examiner and first-line manager levels to better ensure fraud indicators are recognized and properly investigated.

WHAT TIGTA RECOMMENDED

TIGTA recommended that the Director, Exam Policy, Small Business/Self-Employed Division: 1) enhance the job aid examiners are required to maintain in audit files related to documenting and investigating fraud

indicators, and 2) provide specific examples in the Internal Revenue Manual for examiners and first-line managers to use in considering whether it would be beneficial to involve the IRS's technical advisors on fraud in field audits for which there are indications of fraud.

IRS officials did not agree with the first recommendation. They indicated that the job aid (*Fraud Development Lead Sheet*) was significantly enhanced in March 2011. In addition, IRS officials did not agree with the second recommendation, but do plan to take alternative corrective action. IRS officials will issue a memorandum to all Examination employees emphasizing the importance of involving the technical advisors in audits.

As discussed in this report, TIGTA evaluated the enhanced *Fraud Development Lead Sheet* during this review and continues to believe further enhancements would be beneficial. TIGTA also considered the alternative corrective action IRS officials plan to take and concluded that it is responsive to the recommendation. However, TIGTA encourages IRS officials to go beyond merely reiterating existing procedures in their memorandum by providing additional instructions and guidance to clarify when the assistance of a technical advisor should be sought.

Such clarification is important for two reasons. First, there is potential revenue at stake. As noted in their response, IRS officials agreed that the recommendations have the potential to increase revenue by some \$19.7 million over a year (\$98.5 million over five years) from approximately 1,872 field audits. Second, as discussed in the report, Small Business/Self Employed Division Examination personnel and the technical advisors did not always agree with each other over the conclusions reached in our case reviews.

READ THE FULL REPORT

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

<http://www.treas.gov/tigta/auditreports/2012reports/201230030fr.pdf>

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