The Use of Return on Investment Information in Managing Tax Enforcement Resources Could Be Improved

September 23, 2013

Reference Number: 2013-10-104

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HIGHLIGHTS

THE USE OF RETURN ON INVESTMENT INFORMATION IN MANAGING TAX ENFORCEMENT RESOURCES COULD BE IMPROVED

Highlights

Final Report issued on September 23, 2013

Highlights of Reference Number: 2013-10-104 to the Internal Revenue Service Deputy Commissioner for Operations Support and the Office of the Deputy Commissioner for Services and Enforcement.

IMPACT ON TAXPAYERS

Return on investment (ROI) information, including both estimated ROI for new enforcement initiatives and cost/benefit calculations based on actual program results and costs, is an important tool available to assist IRS senior executives in managing enforcement resources. IRS budget reductions heighten the importance of having comprehensive and reliable data to help make informed resource allocation decisions to ensure that every tax dollar is spent wisely.

WHY TIGTA DID THE AUDIT

This audit was initiated to review the IRS's use of ROI data in managing its enforcement resources and evaluate the IRS's progress in developing a methodology to measure actual revenue collected from specific new enforcement initiatives included in its annual budget requests.

WHAT TIGTA FOUND

The IRS's use of cost/benefit information in managing its enforcement resources could be significantly improved. Specifically, although cost/benefit information is considered in making resource allocation decisions, the IRS does not document how or to what extent it uses the information and has no policies or procedures to guide this process.

In addition, TIGTA's review of the IRS cost/benefit statistics identified that the calculations provide an incomplete picture and understate the actual results of the enforcement programs analyzed by the IRS.

TIGTA also found that the IRS continues to be unable to measure actual revenue from new enforcement initiatives funded in prior years. TIGTA previously recommended that the IRS develop methods to track actual performance results of initiatives. Although IRS management stated in response to this recommendation that they were working to develop a methodology to determine actual revenue collected from specific enforcement initiatives, TIGTA determined that the IRS has not yet made significant progress in this effort.

WHAT TIGTA RECOMMENDED

TIGTA recommended that the Office of the Deputy Commissioner for Services and Enforcement should develop procedures to assist in guiding the use of enforcement program cost/benefit information in comparing resource allocation options. Also, the Chief Financial Officer should conduct an analysis to determine whether there are potential variations for allocation of enforcement revenue from the current cost/benefit model that would provide beneficial information to the IRS. Finally, the IRS should conduct a feasibility analysis to identify the steps necessary to measure actual revenue for new enforcement initiatives.

In their response to the report, IRS officials substantially agreed with our recommendations. The IRS plans to consider the feasibility of developing procedures to assist in guiding the use of enforcement program cost/benefit information when a longer-term research effort is complete and review the current cost/benefit model with an emphasis on analyzing whether the IRS can update the allocation of enforcement revenue to a specific enforcement program. The IRS also plans to document the current challenges that exist in estimating actual revenue for new enforcement initiatives and conduct an analysis to determine the feasibility of overcoming these challenges within existing legislation, systems, and processes.

TREASURY INSPECTOR GENERAL
FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY

WASHINGTON, D.C. 20220

September 23, 2013

MEMORANDUM FOR DEPUTY COMMISSIONER FOR OPERATIONS SUPPORT
OFFICE OF THE DEPUTY COMMISSIONER FOR SERVICES AND ENFORCEMENT

FROM: Michael E. McKenney
Acting Deputy Inspector General for Audit

SUBJECT: Final Audit Report – The Use of Return on Investment Information in Managing Tax Enforcement Resources Could Be Improved (Audit # 201210035)

This report presents the results of our review of the Internal Revenue Service's (IRS) use of return on investment data in managing its enforcement resources and the IRS's progress in developing a methodology to measure actual revenue collected from specific new enforcement initiatives included in its annual budget requests. This review is included in our Fiscal Year 2013 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 IV.

Copies of this report are also being sent to the IRS managers affected by the report recommendations. If you have any questions, please contact me or Gregory D. Kutz, Assistant Inspector General for Audit (Management Services and Exempt Organizations).

Table of Contents

Abbreviations

CFO	Chief Financial Officer
FY	Fiscal Year
GAO	Government Accountability Office
IRS	Internal Revenue Service
ROI	Return on Investment
TIGTA	Treasury Inspector General for Tax Administration

Background

The Internal Revenue Service (IRS) is the largest component of the Department of the Treasury and has primary responsibility for administering the Federal tax system. The IRS strives to enforce the tax laws fairly and efficiently while balancing service and education to promote voluntary compliance and reduce taxpayer burden. The IRS's role is unique within the Federal Government in that it collects the revenue that funds the Government.

The IRS has prioritized the focus of its operations under two strategic goals: improving service to make voluntary compliance easier and enforcing the law to ensure that everyone meets their obligations to pay taxes. To assist it in managing its enforcement resources, the Chief Financial Officer (CFO) annually calculates return on investment (ROI) performance measures for seven of the IRS's enforcement program areas. These performance measures are known as cost/benefit calculations and differ significantly from the ROI estimates of enforcement initiatives proposed in the IRS's annual budget submission.[1] The cost/benefit performance measures are defined as the ratio of program revenues to full program costs. Having timely and relevant data for enforcement activities is critical to the IRS's ability to effectively and efficiently manage its enforcement program. In Fiscal Year (FY) 2012, the IRS had funding of $5.3 billion available for enforcement activities, examined 1.7 million tax returns, and closed 7.46 million taxpayer delinquent accounts.

In FY 2012, the IRS had $5.3 billion available for enforcement activities, examined 1.7 million tax returns, and closed 7.46 million taxpayer delinquent accounts.

The IRS's annual Congressional Budget Submission contains the IRS's program and budget decisions including proposals to increase funding for programs or initiatives the IRS believes will improve its ability to address taxpayer noncompliance. To justify these initiatives, the IRS estimates the ROI for each new enforcement initiative included in its annual budget submissions. The ROI is calculated by estimating the marginal revenues the initiatives will produce annually and dividing this amount by the estimated annual incremental cost of the initiatives.

When the IRS prepares its annual budget request, it also includes an overall achieved ROI for the IRS using revenue collected from its enforcement programs and budget data. For example, the IRS reported an overall ROI ratio of $4.2 to $1 in its FY 2014 budget request.

[1] The ROI figures published for proposed enforcement initiatives in the IRS's annual budget are an estimate of the marginal increase in revenue potential of hiring additional employees in the proposed program area. The cost/benefit performance measures take into account the full costs of existing program area resources and are based on actual revenues.

The IRS's use of estimated ROI information to justify its proposed budget increases for enforcement initiatives has been the subject of several Treasury Inspector General for Tax Administration (TIGTA) and Government Accountability Office (GAO) reports in previous years. In September 2005, TIGTA reported that actual revenues attributable to specific increases in IRS resources funded by Congress could not be identified and recommended that the IRS develop a methodology to evaluate the results of increased investments in enforcement activities.[2] In June 2009, the GAO also recommended that the IRS "…take steps to develop ROIs for IRS's enforcement programs using actual revenue and full cost data and compare the actual ROIs to the projected ROIs included in the budget requests."[3]

The CFO is responsible for the management of all IRS financial resources, including administrative and revenue accounting. The Office of Research, Analysis, and Statistics has a primary responsibility to provide data and analyses on estimated enforcement revenue. The CFO is responsible for calculating the estimated ROI for proposed enforcement initiatives.

This review was performed at the offices of the Chief Financial Officer; Large Business and International Division; Research, Analysis, and Statistics; Small Business/Self-Employed Division; and Wage and Investment Division in Washington, D.C., during the period October 2012 through April 2013. 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 objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. Detailed information on our audit objectives, scope, and methodology is presented in Appendix I. Major contributors to the report are listed in Appendix II.

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[2] TIGTA, Ref. No. 2005-10-159, *A Better Model Is Needed to Project the Return on Additional Investments in Tax Enforcement* pp. 11-12 (Sept. 2005).
[3] GAO, GAO-09-754, *Internal Revenue Service: Review of the Fiscal Year 2010 Budget Request* p. 6 (June 2009).

Results of Review

Return on Investment Information Should Be Revised to Better Manage Enforcement Resources

The allocation of enforcement resources represents an increasingly complex challenge for the IRS in light of significant reductions in its budget. In FYs 2011 and 2012, the IRS budgets were approximately $12.1 billion and $11.8 billion, respectively. In FY 2013, the IRS budget was also approximately $11.8 billion. However, mandatory spending reductions, including approximately $618 million in reductions implemented as part of the sequestration and rescission, reduced the IRS's FY 2013 budget to approximately $11.2 billion. Thus, the IRS must continue to look for ways to maximize the use of its resources.

IRS policy states that IRS officials with managerial or executive responsibilities must have useful information to make decisions and plan future programs and activities. The use of cost/benefit information assists senior management in comparing options, ensuring efficiency is considered in the decisionmaking process, and making informed choices. In FY 2012, the IRS had funding of $5.3 billion available for enforcement activities.

We found that the IRS's use of cost/benefit information in managing its enforcement resources could be significantly improved. Specifically, although the IRS informed us that it broadly considers cost/benefit information in its business planning, it does not document how or to what extent it uses cost/benefit information in allocating its resources among its various enforcement programs, what information it uses, or what other factors are considered. The IRS also has not developed any policies or procedures to guide this critical process and has not established any requirement that business plan decisions based on cost/benefit information be fully documented.

The CFO annually prepares cost/benefit calculations for the IRS's seven major enforcement program areas including Field Examination, Field Collection, and Automated Underreporter. However, the IRS was unable to provide any evidence that this information was used by senior executives in allocating resources. Additionally, our review of these calculations found that they provide an incomplete and potentially misleading picture of the actual results of these programs. For example, the process used for calculating Field Examination cost/benefit information does not consider the significant enforcement revenue collected in Field Examination cases requiring subsequent involvement by the Appeals function. In FY 2012, $4.2 billion of all enforcement revenue collected required involvement by the Appeals function. However, none of revenue from this $4.2 billion that was related to the field examination that initiated the assessment was included in the cost/benefit ratio, resulting in an understated ratio for programs such as Field Examination.

We further found that additional work is needed to properly allocate enforcement revenue collected during the balance due notice process. Although the IRS identified that it collected approximately $24.4 billion in enforcement revenue in FY 2012 associated with the issuance to taxpayers of over 50 different types of balance due notices, it did not allocate this revenue to the enforcement program responsible for the assessment resulting in the balance due notice, as applicable. These notices related to corrections of math errors, adjustments to tax credits, audit adjustments, and past-due liabilities. Because the IRS also did not report the amount of revenue applicable to each of these types of notices, we were unable to determine how this revenue relates to enforcement programs such as Field and Correspondence Examination. The CFO determined that in FY 2012, almost 49 percent of all enforcement revenue was collected during the balance due notice process.

In an attempt to better match program costs and results, the CFO attributes revenue collected to a particular enforcement program only if the revenue was collected at the close of the enforcement action being measured. Additionally, business rules developed by the CFO stress the need to avoid double counting of revenue. The IRS also informed us that a separate cost/benefit analysis of the IRS Appeals function was not performed because the Appeals function is tasked with impartially deciding on taxpayer liability, and the performance of a cost/benefit analysis could be viewed as an attempt to reduce the Appeals function's impartiality.

We believe that the usefulness of the IRS's cost/benefit information for individual enforcement programs could be significantly improved, without compromising the integrity of the data, by allocating enforcement revenue collected after the Appeals process and/or through the balance due notice process to the specific enforcement program which initially produced the assessment, where applicable. To ensure matching of cost and revenues, the cost of the subsequent appeal and/or balance due notice processing should also be allocated.

The IRS further informed us that its enforcement resource allocation process is a highly complex process that considers multiple factors in addition to the cost/benefit information it produces of the enforcement program. For example, when allocating resources to examination programs, the IRS's policy stresses the need to maintain fair and balanced coverage, assuring all taxpayers of equitable consideration as well as making the most efficient use of staffing.

We agree that fairness to all taxpayers is of paramount concern. However, additional emphasis on cost/benefit data could also enhance the efficient use of the IRS's limited resources. The GAO reported that the IRS could significantly increase revenues by better allocating enforcement resources.[4] It also reported that incremental shifts in IRS Examination function resources from lower revenue generating functions to higher revenue generating functions could significantly increase the revenue the IRS collects.

[4] GAO, GAO-13-151, *Tax Gap: IRS Could Significantly Increase Revenues by Better Targeting Enforcement Resources* p. 10 (Dec. 2012).

Improvements in the cost/benefit management information used by the IRS, in conjunction with increased documentation of the factors used in the resource planning decisionmaking process, may lead to additional revenue being collected. Additionally, it would allow the IRS to more clearly explain to stakeholders the factors taken into consideration when prioritizing the use of compliance resources.

Recommendations

Recommendation 1: The Office of the Deputy Commissioner for Services and Enforcement should develop procedures to assist in guiding the use of enforcement program cost/benefit information, along with consideration of other factors such as balanced measures and coverage, in comparing resource allocation options and allocating staff to the IRS's enforcement programs. The procedures should also require the IRS to document the process used in performing this allocation.

> ***Management's Response:*** While IRS management agreed with the need to take cost-effectiveness into account when allocating resources, they stated that cost-effectiveness needs to be evaluated at the margin, instead of on average, and should reflect all benefits and all costs. Estimating all of the necessary elements is complex, but a research effort to do this is underway. The IRS will consider the feasibility of developing procedures in this area when the longer-term research effort is complete.

Recommendation 2: The CFO should conduct an analysis to determine whether there are potential variations for allocation of enforcement revenue from the current cost/benefit model that would provide beneficial information to the IRS. For example, variations could include allocating 1) enforcement revenue collected through the balance due notice process and 2) enforcement revenue collected after the Appeals process to the specific enforcement program which initially produced the assessment, where applicable.

> ***Management's Response:*** The IRS agreed with this recommendation. The CFO will review the current cost/benefit model with an emphasis on analyzing whether the IRS can update the allocation of enforcement revenue to a specific enforcement program.

Additional Efforts Are Still Needed to Measure Actual Revenue for New Enforcement Initiatives

The IRS has made progress in expanding the information it reports to external stakeholders regarding the achieved ROI of its enforcement efforts. For example, the IRS reported in its FY 2014 annual budget request that it achieved a total Service-wide ROI ratio of $4.20 to $1. For the first time, the IRS also reported summary level ROI information for the Examination, Collection, and Automated Underreporter programs in its FY 2014 Budget Request to Congress. The development of additional ROI information related to enforcement program areas should assist the IRS in communicating with external stakeholders. This is especially important in the current economic environment and continued budget constraints.

However, the IRS continues to be unable to measure actual revenue from individual enforcement initiatives. Enforcement initiatives are increases in IRS resources used to focus on specific tax compliance issues such as underreporting of tax associated with international activities or noncompliance among business and high-income taxpayers. In 2011, TIGTA recommended that the IRS develop methods to track actual performance results of initiatives.[5] Although IRS management stated in response to this recommendation that they were working to develop a methodology to determine actual revenue collected from specific enforcement initiatives, we determined that the IRS has not yet made significant progress in this effort.

The CFO prepared an internal analysis of the cumulative revenue generated from new enforcement initiatives included in the FYs 2009 and 2010 budget submissions. This analysis estimated the effects of enforcement initiatives introduced in FYs 2009 and 2010 on revenue collected by the IRS during FY 2011. For example, the IRS estimated that its FYs 2009 and 2010 new enforcement initiatives would collectively generate an increase in revenue collected during FY 2011 of $2.9 billion. The IRS collected $48.9 billion in enforcement revenue during FY 2009 and $55.2 billion during FY 2011, for an increase of approximately $6.3 billion, far surpassing the expected increase in collections of $2.9 billion. However, this calculation is not refined enough to measure the revenue generated from individual enforcement initiatives, and as the IRS itself notes, it does not have the ability to separate the revenue effect of initiative hiring from macroeconomic factors such as the economy or implementation of legislative proposals.

The IRS last received additional funding for new enforcement initiatives in its FY 2010 budget request. For the largest of these initiatives, the IRS received approximately $128 million to hire 784 employees to address the underreporting of tax associated with international transactions as well as domestic taxpayers involved with offshore activities. However, IRS officials responsible for these resources stated they have not implemented any process to track actual revenues generated by this hiring initiative. The officials informed us that a barrier in measuring actual revenues from hiring initiatives is the difficulty in tracking and allocating revenues generated from a case which is worked on by multiple employees.

In addition, these officials cited barriers to tracking the revenue produced by each initiative. For example, IRS management stated that new employees hired under a new enforcement initiative may not immediately work on cases relating to that initiative due to the need to fully train the new employees and the potential complexity of the tax cases focused on through the new initiative.

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[5] TIGTA, Ref. No. 2011-30-039, *Challenges Remain to Balance Revenue Officer Staffing With Attrition and Workload Demands* pp. 7-9 (May 2011).

The IRS also cited potential legislative prohibitions surrounding the use of enforcement data in measuring employee performance. Despite these barriers, the IRS informed us that measuring revenue from specific enforcement initiatives remains a goal towards which they believe they are making progress. However, the IRS could not provide us with documentation that a formal analysis had been performed to research the steps necessary to directly measure actual revenue for new enforcement initiatives or that an estimation methodology, such as statistical sampling, was considered. Statistical sampling uses random samples to make a statement about the population from which the sample was selected.

Recommendation

Recommendation 3: The IRS should perform a feasibility analysis to identify the steps necessary to measure actual revenue for new enforcement initiatives. As part of this analysis, the IRS should evaluate both directly measuring actual revenue for new enforcement initiatives and utilizing an estimation methodology, such as statistical sampling, to determine this revenue. This analysis should be documented, and for any viable options that can be implemented, the IRS should identify interim and long-term steps, including a timeline for completion of these steps.

> ***Management's Response:*** The IRS agreed with this recommendation. The Research, Analysis, and Statistics organization, in coordination with the CFO, will document the current challenges that exist in estimating actual revenue for new enforcement initiatives. An analysis will be conducted to determine the feasibility of overcoming these challenges within existing legislation, systems, and processes. The IRS will then evaluate whether the viable options can be implemented with a minimal additional cost and within existing budget resources. For options that can be implemented, the IRS will identify interim and long-term steps, including a timeline.

Appendix I

Detailed Objectives, Scope, and Methodology

Our overall objectives were to review the IRS's use of ROI data in managing its enforcement resources and the IRS's progress in developing a methodology to measure actual revenue collected from specific new enforcement initiatives included in its annual budget requests. To accomplish our objectives, we:

I. Determined how ROI data are used by the IRS to allocate its enforcement resources among various activities.

   A. Interviewed key CFO and enforcement management personnel to determine how ROI data are used in determining the allocation of resources to its various enforcement programs.

   B. Reviewed any procedures the IRS had developed to guide the use of ROI data in the allocation of enforcement resources.

   C. Determined the methodology used for calculating ROI among various enforcement programs.

   D. Reviewed the FY 2012 ROI calculations for IRS enforcement program areas to determine how the estimates were calculated.

II. Determined the progress made by the IRS in calculating and reporting the actual ROI provided by its funded enforcement initiatives.

   A. Interviewed key management personnel to determine what actions have been taken that would allow the IRS to track and report actual ROI data from enforcement initiatives.

   B. Interviewed CFO management to determine whether they had implemented or planned to implement upgrades to necessary systems to perform the more detailed accounting processes required to supply actual ROI information.

   C. Reviewed whether the IRS had developed performance goals, interim milestones, completion dates, expectations for system updates, or other plans to allow it to report on actual ROI associated with enforcement initiatives requested in budget submissions.

   D. Assessed the status of the IRS's efforts in developing actual ROI data that could be used to report to stakeholders, such as plans to include in its FY 2014 budget report actual ROI data achieved from prior enforcement initiatives funded by past budget requests.

E. Judgmentally[1] selected the largest single initiative from the IRS's FY 2010 budget request and interviewed applicable IRS management to determine any steps taken to calculate revenues based on the initiative. We selected the largest initiative among four total initiatives in the FY 2010 budget request to maximize our use of available audit resources.

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 objectives: the IRS's plans and actions taken to measure actual revenues related to individual enforcement initiatives and the use of ROI statistics in annual resource allocation planning. We evaluated these controls by interviewing management, assessing IRS policy documents, and reviewing IRS calculations of ROI for enforcement programs.

Data reliability

We evaluated the reliability of the IRS's FY 2012 ROI statistics by reviewing the mathematical accuracy of the calculations and comparing reported enforcement revenue to the annual enforcement service results publicly reported by the IRS. We did not identify any significant inconsistencies that would affect the substance of our findings and, as such, consider the data sufficiently reliable for the purposes of this report. However, as discussed in the report, the individual FY 2012 cost/benefit calculations provide an incomplete picture of the actual results of these programs which adversely impacts the usefulness of this data to end users. For example, the process for developing these cost/benefit calculations does not consider enforcement revenue collected in instances where the assessment was collected during the balance due notice or Appeals process.

[1] A judgmental sample is a nonstatistical sample, the results of which cannot be used to project to the population.

Appendix II

Major Contributors to This Report

Gregory D. Kutz, Assistant Inspector General for Audit (Management Services and Exempt Organizations)
Jeffrey M. Jones, Director
Jonathan Meyer, Director
Anthony J. Choma, Audit Manager
Seth A. Siegel, Lead Auditor
James S. Mills, Jr., Senior Auditor
Michele Strong, Senior Auditor

Appendix III

Report Distribution List

Acting Commissioner
Office of the Commissioner – Attn: Chief of Staff C
Chief Financial Officer OS:CFO
Commissioner, Large Business and International Division SE:LB
Commissioner, Small Business/Self-Employed Division SE:S
Commissioner, Wage and Investment Division SE:W
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- Commissioner, Large Business and International Division SE:LB
- Commissioner, Small Business/Self-Employed Division SE:S
- Commissioner, Wage and Investment Division SE:W
- Director, Office of Research, Analysis, and Statistics RAS

Appendix IV

Management's Response to the Draft Report

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

CHIEF FINANCIAL OFFICER

September 12, 2013

MEMORANDUM FOR MICHAEL E. MCKENNEY
ACTING DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: Pamela J. LaRue
Chief Financial Officer

SUBJECT: Draft Audit Report – Review of the Internal Revenue Service's Use of Return on Investment for Managing Enforcement Resources (Audit #201210035)

The IRS appreciates the opportunity to review and respond to the draft report titled, "The Use of Return on Investment in Managing Tax Enforcement Resources Could Be Improved" (Audit #201210035).

The IRS understands and recognizes the importance of having timely and relevant cost and revenue data for enforcement activities. This information assists IRS in understanding the effectiveness of its enforcement programs.

We agree that cost/benefit information is one of several factors relevant to making resource allocation decisions. Other relevant factors include balanced measures and coverage. However, when considering cost/benefit information, it is important to reiterate that "(1) overall net revenue is maximized by equalizing the *marginal* (rather than average) ratio of revenue to cost across all relevant activities; and (2) the revenue reflected in those ratios must also include the *indirect* impact of our activities on the voluntary compliance of the taxpayers we contact as well as among others in the general population."[1]

The IRS further agrees that exploring ways to improve the estimates of revenue produced by new enforcement initiatives is worthwhile. However, determining the impact of an initiative will always rely on estimates, as the results of an initiative are the difference between actual results and what would have occurred in the absence of the initiative, which cannot be measured.

[1] See IRS Response to GAO-13-151 (December 2012), *IRS Could Significantly Increase Revenues by Better Targeting Enforcement Resources.*

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If you have any questions, please contact me, or a member of your staff may contact Adina Leach, Associate Chief Financial Officer for Corporate Budget, at (202) 622-8770.

Attachment

Attachment

RECOMMENDATION 1
The Deputy Commissioner for Services and Enforcement should develop procedures to assist in guiding the use of enforcement program cost/benefit information, along with consideration of other factors such as balanced measures and coverage, in comparing resource allocation options and allocating staff to the IRS's enforcement programs. The procedures should also require the IRS to document the process used in performing this allocation.

CORRECTIVE ACTION
While the IRS agrees with the need to take cost-effectiveness into account when allocating resources, cost-effectiveness needs to be evaluated at the margin, instead of on average, and should reflect all benefits and all costs. Estimating all of the necessary elements is complex, but a research effort to do this is underway. The first step in this effort is to estimate marginal direct revenue-to-cost ratios for correspondence audits, due December 31, 2013.[1] The IRS will consider the feasibility of developing procedures in this area when the longer-term research effort is complete.

RESPONSIBLE OFFICIAL
Deputy Commissioner for Services and Enforcement
Research, Analysis and Statistics (RAS)

IMPLEMENTATION DATE
December 31, 2013

RECOMMENDATION 2
The CFO should conduct an analysis to determine whether there are potential variations for allocation of enforcement revenue from the current cost/benefit model that would provide beneficial information to the IRS. For example, variations could include allocating 1) enforcement revenue collected through the balance due notice process and 2) enforcement revenue collected after the Appeals process to the specific enforcement program which initially produced the assessment, where applicable.

CORRECTIVE ACTION
The IRS agrees with this recommendation. The Chief Financial Officer (CFO) will review the current cost/benefit model with an emphasis on analyzing whether the IRS can update the allocation of enforcement revenue to a specific enforcement program.

RESPONSIBLE OFFICIAL
Chief Financial Officer

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[1] This action is planned in response to GAO's December 2012 report *IRS Could Significantly Increase Revenues by Better Targeting Enforcement Resources* (GAO-13-151).

IMPLEMENTATION DATE
May 31, 2014

The IRS should perform a feasibility analysis to identify the steps necessary to measure actual revenue for new enforcement initiatives. As part of this analysis the IRS should evaluate both directly measuring actual revenue for new enforcement initiatives and utilizing an estimation methodology, such as statistical sampling, to determine this revenue. This analysis should be documented, and for any viable options that can be implemented, the IRS should identify interim and long-term steps, including a timeline for completion of these steps.

CORRECTIVE ACTION
The IRS agrees with this recommendation. The RAS organization, in coordination with the CFO, will document the current challenges that exist in estimating actual revenue for new enforcement initiatives. An analysis will be conducted to determine the feasibility of overcoming these challenges within existing legislation, systems, and processes. The IRS will then evaluate whether the viable options can be implemented with a minimal additional cost and within existing budget resources. For options that can be implemented, the IRS will identify interim and long-term steps, including a timeline.

RESPONSIBLE OFFICIAL
Research, Analysis and Statistics (RAS)

IMPLEMENTATION DATE
December 31, 2014