



*Actions Are Needed to Accurately Reflect
Criminal Investigation's Fraud Referral
Evaluation Period and Improve the
Criminal Fraud Referral Process*

May 24, 2013

Reference Number: 2013-30-051

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.

Redaction Legend:

1 = Tax Return/Return Information
2(e) = Law Enforcement Procedure



HIGHLIGHTS

ACTIONS ARE NEEDED TO ACCURATELY REFLECT CRIMINAL INVESTIGATION'S FRAUD REFERRAL EVALUATION PERIOD AND IMPROVE THE CRIMINAL FRAUD REFERRAL PROCESS

Highlights

Final Report issued on May 24, 2013

Highlights of Reference Number: 2013-30-051 to the Internal Revenue Service Chief, Criminal Investigation.

IMPACT ON TAXPAYERS

Tax fraud is a deliberate and purposeful violation of Internal Revenue laws by those who do not file and properly report their income and expenses. When criminal fraud is not timely pursued, it can undermine the IRS's deterrence efforts. In addition, breakdowns in fraud investigation procedures can result in contact with the taxpayers that may potentially jeopardize Criminal Investigation's (CI) ongoing investigations.

WHY TIGTA DID THE AUDIT

Tax fraud is one of the most egregious forms of noncompliance. The overall objective of this review was to evaluate CI's role in the IRS National Fraud Program's efforts to increase the number of viable fraud referrals. This audit is included in TIGTA's Fiscal Year 2013 Annual Audit Plan and addresses the major management challenge of Tax Compliance Initiatives.

WHAT TIGTA FOUND

Fraud referrals made to CI in Fiscal Year 2012 have increased. This has subsequently resulted in an increase in the number of subject criminal investigations and prosecution recommendations. In addition, CI special agents provided thorough written feedback to the referring operating divisions when they rejected the referrals.

However, the reliability of data CI used to determine the timeliness of evaluating fraud

referrals is questionable. CI management did not have complete or accurate information available to make decisions because CI used incorrect and/or inappropriate data when analyzing its timeliness performance measures. In addition, management did not establish goals for CI's timeliness measures. Furthermore, CI employees did not always ensure that criminal investigations were timely controlled on the Master File.

WHAT TIGTA RECOMMENDED

TIGTA recommended that the IRS 1) stress the importance of capturing correct fraud referral processing data, 2) modify the management information system or develop an alternative method to accurately calculate the fraud referral evaluation period, 3) establish goals for the fraud referral timeliness performance measures, 4) strengthen procedures to ensure that the criminal investigation code is timely input, and 5) issue a reminder to periodically review reports to ensure that the code is input timely.

In its response to the report, IRS management agreed with four of the five recommendations and has taken or plans to take corrective actions. IRS management partially agreed with Recommendation 3. Although IRS management did not agree to set a percentage goal for the performance measure, their commitment to the policy of addressing each fraud referral within the specified time frame is acceptable and will help to ensure that fraud referrals are expeditiously reviewed.



TREASURY INSPECTOR GENERAL
FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

May 24, 2013

MEMORANDUM FOR CHIEF, CRIMINAL INVESTIGATION

A handwritten signature in black ink, appearing to read "Michael E. McKenney".

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

SUBJECT: Final Audit Report – Actions Are Needed to Accurately Reflect
Criminal Investigation’s Fraud Referral Evaluation Period and Improve
the Criminal Fraud Referral Process (Audit # 201130040)

This report presents the results of our review to evaluate Criminal Investigation’s (CI) role in the Internal Revenue Service (IRS) National Fraud Program’s efforts to increase the number of viable fraud referrals. In addition, we determined whether fraud referrals were timely assessed within CI and whether sufficient feedback was provided to the operating divisions on rejected fraud referrals. This review was conducted as part of 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 VI.

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 Augusta R. Cook, Acting Assistant Inspector General for Audit (Compliance and Enforcement Operations).



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*Actions Are Needed to Accurately Reflect
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Abbreviations

CI	Criminal Investigation
CIMIS	Criminal Investigation Management Information System
IRM	Internal Revenue Manual
IRS	Internal Revenue Service
TC	Transaction Code



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Background

Tax fraud is a deliberate and purposeful violation of Internal Revenue laws by those who do not file and properly report their income and expenses. Tax fraud requires both an underpayment and fraudulent intent. It is one of the most egregious forms of noncompliance.

Criminal Investigation's (CI) primary mission is to investigate potential criminal violations of the Internal Revenue Code¹ and related financial crimes in a manner that fosters confidence in the tax system and compliance with the law. The CI Fiscal Year 2012 Annual Business Plan includes a recurring commitment that focuses on the delivery of high-impact, high-quality tax fraud investigations by working closely with the other Internal Revenue Service (IRS) operating divisions. The compliance, business, and communication strategies of CI include maintaining focus on legal source income tax investigations and partnering with the other operating divisions to support a successful Fraud Referral Program.²

The primary objective of the IRS National Fraud Program is to foster voluntary compliance with Federal tax laws through the recommendation of criminal prosecution and/or civil penalties against taxpayers who attempt to evade the assessment and/or payment of taxes due. The IRS National Fraud Program Office provides oversight and direction for fraud referrals throughout the IRS. The Program Office is part of the IRS's Fraud/Bank Secrecy Act Office within the Small Business/Self-Employed Division.

The primary objective of the National Fraud Program is to foster voluntary compliance with Federal tax laws through the recommendation of criminal prosecution and civil penalties against taxpayers who attempt to evade the assessment or payment of taxes due.

Oversight of the fraud program includes providing training to the various operating divisions and assisting in the development of fraud referral leads. The Program Office staff has the primary role of coordinating fraud referrals from the operating divisions to CI, monitoring program accomplishments and trends, resolving IRS-wide fraud issues, and improving policies and procedures related to the detection and deterrence of fraud. National Fraud Program Office Fraud Technical Advisors (hereafter referred to as advisors) are responsible for providing procedural fraud advice to operating division compliance employees, as well as helping to identify and develop potential criminal fraud referrals and civil fraud penalty cases.

¹ See Appendix V for a glossary of terms.

² Legal source investigative cases are part of the core mission of CI and contribute to its efforts to support the IRS's overall compliance goals and enhance voluntary compliance with the tax laws to reduce the Tax Gap. The Fraud Referral Program is a key source of high-income tax fraud investigations and an important source of legal source income tax investigations.



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The Internal Revenue Manual (IRM)³ requires that a fraud referral be developed in the operating division when an advisor determines that a case includes firm indications of fraud and established criminal criteria are met. Although not all inclusive, examples of fraudulent criminal activities committed by individuals, businesses, and/or tax return preparers that are considered violations of the tax law include:

- Deliberately underreporting or omitting income.
- Overstating the amount of deductions.
- Keeping two sets of books.
- Claiming personal expenses as business expenses.
- Claiming false deductions.
- Hiding or transferring assets or income.

The fraud referral is submitted to the respective CI field office using Form 2797, *Referral Report of Potential Criminal Fraud Cases*. CI procedures require that the date the fraud referral is received by the CI field office be noted on the Form 2797 and entered in the initiation date field in the Criminal Investigation Management Information System (CIMIS). The fraud referral is then assigned to a special agent, who should schedule an initial conference with the referring compliance employee and the advisor within 10 workdays to discuss the fraud referral's merits. After this initial meeting and upon further research, CI must then make a decision whether to accept or reject the fraud referral, *i.e.*, the disposition of the referral, within a total of 30 workdays from the fraud referral's receipt.

Sometimes, CI will not pursue a criminal investigation based on the fraud referral. Reasons for rejecting fraud referrals include:

- Insufficient evidence.
- Lack of jury appeal.
- Lack of willful intent by the taxpayer.
- The taxes owed are not cost effective to pursue a criminal investigation.

If the fraud referral is rejected, the date the rejection decision was made is entered in the disposition date field on the Form 2797 and in the closed status date field in the CIMIS. The special agent writes a declination memorandum, which is provided to the referring operating division's advisor and compliance employee, detailing the reasons the fraud referral was

³ IRM 25.1.3.2 (Oct. 30, 2009).



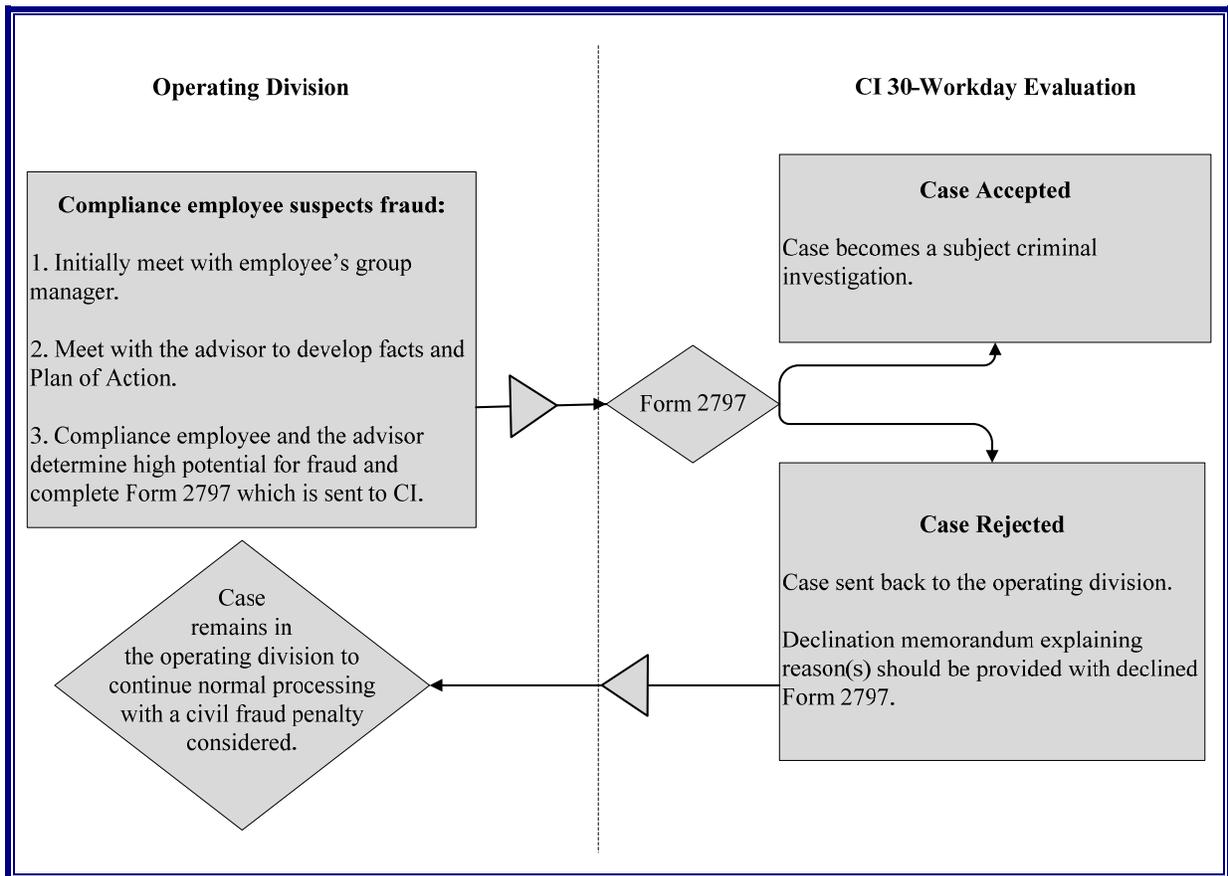
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rejected. Compliance employees in the referring operating division are then to resume normal case processing with consideration given to the application of a civil fraud penalty.

If CI determines that there are sufficient tax issues to accept the fraud referral and upgrade it to a Subject Criminal Investigation, the date this decision is made is to be entered on the Form 2797 in the disposition date field. The CIMIS is then to be updated to reflect the acceptance of the fraud referral and the start of the Subject Criminal Investigation.

Figure 1 provides an overview of the fraud referral process from the identification of fraud indicators by compliance employees in the operating divisions through the evaluation of whether the fraud referral is accepted or declined as an investigative case in CI.

Figure 1: Criminal Fraud Referral Process



Source: Treasury Inspector General for Tax Administration analysis of IRM 25.1.3.

This review was performed at CI Headquarters in Washington, D.C., and the Small Business/Self-Employed Division National Fraud Program Office in New York, New York, during the period December 2011 through September 2012. We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that



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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

Criminal Investigations Initiated From Fraud Referrals Have Increased Over the Past Year

Fraud referrals made to CI in Fiscal Year 2012 resulted in notable contributions to tax administration. With continuing emphasis on the Fraud Referral Program as one of the key sources of high-impact tax fraud cases, the number of fraud referrals increased more than 7 percent from Fiscal Years 2011 to 2012, and the number of accepted referrals increased by nearly 5 percent. Other notable results included:

- Subject Criminal Investigations increased by 7.1 percent.
- Prosecution recommendations increased by 3.9 percent.
- Convictions increased by 11.8 percent.
- The average number of months to serve per conviction increased by 16.7 percent.

CI's Fiscal Year 2012 Annual Business Plan continued to stress the importance of delivering high-impact investigations by working closely with the other IRS operating divisions to address significant cases of tax fraud abuse. Figure 2 shows CI's Business Performance Review data for the fraud referral inventory and results for Fiscal Years 2011 and 2012.



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Figure 2: IRS-Wide Fraud Referrals to Criminal Investigation

Comparisons Fiscal Year End	Fiscal Year 2011	Fiscal Year 2012	% Change Fiscal Year 2011 to 2012
Fraud Referrals Received During Fiscal Year	549	589	7.3%
Fraud Referrals Pending Evaluation	96	100	4.2%
Accepted (1st Subject Criminal Investigation Numbered)	381	399	4.7%
Rejected (Closed With No Subject Criminal Investigation)	177	199	12.4%
Acceptance Rate⁴ (Accepted/[Accepted + Rejected])	68.3%	66.7%	-1.6%
Performance Results From Fraud Referrals			
Subject Criminal Investigation Initiated	452	484	7.1%
Prosecution Recommendations	256	266	3.9%
Prosecution Rate ⁴	58.1%	60.7%	2.6%
Department of Justice Acceptance Rate ⁴	92.6%	91.6%	-1.0%
United States Attorney Acceptance Rate ⁴	84.9%	90.7%	5.8%
Convictions	211	236	11.8%
Sentenced	222	222	0.0%
Incarceration Rate ⁴	83.3%	81.1%	-2.2%
Average Number of Months to Serve Per Conviction	24	28	16.7%

Source: IRS CI Business Performance Reviews dated September 30, 2012.

CI management attributed the increase in the number of fraud referrals received to CI's outreach efforts with other IRS operating divisions, biannual compliance council meetings, and assistance in advisor training development and delivery. For example, CI field office special agents provide outreach presentations to groups within a geographic Territory. In general, these presentations consist of general information about the indicators of fraud and CI's role in the fraud referral process. Additionally, CI management stated that CI partners with the local operating divisions by holding Compliance Counsel Meetings at least semiannually to obtain input on the training and presentations that the operating divisions would like CI to provide.

⁴ For this item, the percentage figures shown in the "percentage change" column are the difference in the percentage from one year to the next, not the percentage change from one year to the next.



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The National Fraud Program Office has approximately 80 advisors who also provide fraud awareness presentations to IRS compliance employees in the various operating divisions. The presentations include topics such as interviewing skills and various techniques to examine tax returns and identify possible indicators of fraud. The Program Office provided fraud outreach presentations and training to more than 17,000 compliance employees in Fiscal Year 2011 and to almost 16,000 compliance employees in Fiscal Year 2012.

To determine the types of fraud issues that were referred to CI, we selected and reviewed a stratified random sample of 127 (86 accepted and 41⁵ rejected fraud referrals) of the 1,583 fraud referrals made during Fiscal Years 2009 through 2011. Our analysis showed that the Small Business/Self-Employed Division initiated the vast majority of fraud referrals to CI and that most were related to individual tax returns, which indicates that these taxpayers are either fully or partially self-employed or small business owners. The fraud referrals in our sample generally included multiple suspected fraudulent issues, most commonly involving: 1) omitted income, 2) failure to file or pay tax, or 3) evasion of payment.

When fraud referrals were not accepted, CI provided thorough feedback

While a majority of fraud referrals were accepted and worked, CI did not pursue all fraud referrals with a criminal investigation. When CI did not accept a fraud referral for criminal investigation, CI special agents provided thorough feedback to the operating divisions to support why the fraud referrals were not accepted.

The IRM⁶ requires that CI issue a declination memorandum to the referring operating division's advisor explaining the reason(s) why a fraud referral was rejected. To determine whether CI was providing the required feedback to the referring operating division's advisor regarding rejected referrals, we reviewed the declination memorandums for the rejected fraud referrals in our sample. In all instances, CI special agents provided thorough feedback to the operating divisions to support why the fraud referrals were not accepted. Some examples of the specific feedback given to the operating divisions included:

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⁵ One fraud referral was incorrectly coded as rejected when it was actually accepted. Following recognized statistical practices, the one incorrectly coded fraud referral was left in the strata where it was originally placed, which increased the rejected fraud referrals to 41.

⁶ IRM 25.1.3.5 (Oct. 30, 2009).



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In addition, in 28 of the 41 declination memorandums in our sample, CI specifically stated or indicated that civil actions could be considered. For example, several declination memorandums contained the specific wording “nothing was discovered during our review which would preclude the assertion of civil fraud penalties.” Providing the referring compliance employees with adequate feedback will help foster continual improvement in the quality and sustainability of the fraud referral process.

Data Reliability and System Limitations Restrict Criminal Investigation's Ability to Accurately Measure Fraud Referral Evaluation Timeliness

The reliability of data CI used to determine the timeliness of evaluating fraud referrals is questionable. CI management did not have complete or accurate information available to make decisions because it used incorrect and/or inappropriate data when analyzing its timeliness performance measures. In addition, management did not establish goals for its timeliness measures. Furthermore, CI employees did not always ensure that a criminal investigation code was timely entered on the account of taxpayers under criminal investigation. Such delays or omissions of the criminal investigation code could lead to improper contact by other IRS employees and ultimately compromise CI's investigations.

It is important that a fraud referral be timely evaluated so that either a criminal investigation can be initiated or the suspected fraudulent issue can be pursued through the normal examination or collection process before the statute of limitations expires. Using data in the CIMIS, CI tracks two fraud referral timeliness performance measures.

- **Average Elapsed Days Acted Upon.** This is the average length of time it takes CI to make the determination to either accept the fraud referral for criminal investigation or return it back to the originating operating division to resume processing.
- **Percentage Acted Upon in 45 Days or Less.** This is the percentage of CI's fraud referral evaluations that meet the timeliness criteria.⁷

Figure 3 shows that the “Total Number of Fraud Referrals Reviewed” and the “Number of Fraud Referrals Reviewed Within 45 Days or Less” have increased over the last several years. However, the “Average Elapsed Days Acted Upon” increased by 1.3 percent in Fiscal Year 2012, and the “Percentage Acted Upon in 45 Days or Less” decreased by 0.3 percentage points when compared to Fiscal Year 2011.

⁷ IRM 25.1.3.3 (2) (Oct. 30, 2009) states that a determination of whether to accept or reject a fraud referral should be completed within 30 workdays. A CI representative stated that 30 workdays roughly equates to 45 calendar days, which is how CI has titled the timeliness performance measure.



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**Figure 3: CI Fraud Referral Workload Inventory
and Timeliness Performance Measures**

Measure	Fiscal Year 2008	Fiscal Year 2009	Fiscal Year 2010	Fiscal Year 2011	Fiscal Year 2012	Changes From Fiscal Year 2011 to 2012
Workload Inventory Measures						
Total Number of Fraud Referrals Reviewed	625	500	525	558	598	7.2%
Number of Fraud Referrals Reviewed Within 45 Days or Less	294	212	221	231	246	6.5%
Timeliness Performance Measures						
Percentage Acted Upon Within 45 Days or Less ⁸	47.0%	42.4%	42.1%	41.4%	41.1%	-0.3%
Average Elapsed Days Acted Upon	68	72	72	75	76	1.3%

Source: IRS CI Business Performance Reviews dated September 30, 2010, and September 30, 2012, and CI provided data on the number of fraud referrals reviewed.

The reliability of data used to determine the timeliness of evaluating fraud referrals is questionable

To determine if CI procedures for monitoring the timeliness of its fraud referral evaluation period were operating effectively, we reviewed the initiation date and closing date information for a sample of 127 fraud referrals. Analysis showed that the data entered in the CIMIS did not always match the field offices' source documentation, for example:⁹

- The initiation dates did not agree¹⁰ in 78 (61 percent) of 127 sampled cases. These discrepancies ranged from an actual of 49 fewer calendar days than reported to 73 more calendar days than reported. When the sample results are projected over the population of 1,583 fraud referrals, we estimate that mismatches in the initiation date of greater than five calendar days occur in 972 fraud referrals.¹¹ We are 95 percent confident that the

⁸ For this item, the percentage figures shown in the "percentage change" column is the difference in the percentage from one year to the next, not the percentage change from one year to the next.

⁹ We used either the Form 2797 or, if a date was missing from the Form 2797, we referred to the field office's monitoring log and used that date, if present. If there were no dates on the Form 2797 or the field office's monitoring log, we accepted the dates in the CIMIS as correct.

¹⁰ We allowed five calendar days for the time to route and assign the referral to a special agent in the field.

¹¹ To project the results of our statistical sample, we used a 95 percent confidence level, a 61.4 percent error rate, and an 8.18 percent precision factor.



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number of fraud referrals with errors in the initiation date field of greater than five calendar days ranges between 843 and 1,102.

- The closed status date or the Subject Criminal Investigation date in the CIMIS did not agree with the source documents disposition date in 97 (76 percent) of 127 sampled cases. These discrepancies ranged from an actual of 27 fewer calendar days than reported to 504 more calendar days than reported. When the sample results are projected over the population of 1,583 fraud referrals, we estimate that mismatches occur in these sources of data in 1,208 fraud referrals.¹² We are 95 percent confident that the number of fraud referrals with errors in the closing date field ranges between 1,095 and 1,321.

The discrepancies between the source documentation and CIMIS information occurred because there are no controls to ensure that the dates are properly recorded on the Forms 2797 and there is no reconciliation of the dates on the Forms 2797 to the dates input into the CIMIS. According to the IRM,¹³ “Balanced performance measures and corresponding underlying metrics can be used to identify and understand changes in performance and identify improvement options.... In general, it is best to ensure the validity and integrity of all measures to ensure decision making is based on accurate, reliable data.” Office of Management and Budget Circular A-11¹⁴ further emphasizes the importance of accurate measures and states, “In order to assess the progress towards achievement of performance goals, the performance data must be appropriately accurate and reliable for the intended use...significant data limitations can lead to bad decisions resulting in lower performance or inaccurate performance assessments.”

The CIMIS does not contain a data field to accurately capture the end date of the evaluation period for accepted fraud referrals

Instead, the Subject Criminal Investigation date serves as both the end of the referral evaluation period and the start of the Subject Criminal Investigation.¹⁵ Our analysis of the discrepancies in the fraud referral disposition dates and the Subject Criminal Investigation dates showed that the start of the criminal investigation (Subject Criminal Investigation date in the CIMIS) was not always near the date the decision was made to accept the fraud referral (disposition date).

Using the Subject Criminal Investigation date in the timeliness measure can add considerable time to the evaluation period. As a result of these inaccuracies and system limitations, CI management does not have complete or accurate information available to make decisions affecting the timeliness of the Fraud Referral Program.

¹² To project the results of our statistical sample, we used a 95 percent confidence level, a 76.33 percent error rate, and a 7.13 percent precision factor.

¹³ IRM 1.5.1.12 (1) and IRM 1.5.1.15 (3) (Nov. 1, 2011).

¹⁴ Office of Management and Budget, OMB Circular No. A-11 (Revised), *Preparation, Submission, and Execution of the Budget*, Section 260-3 (Aug. 2012).

¹⁵ When a fraud referral is initially received in CI, a primary investigation is started. If the fraud referral is accepted, it transitions from a primary investigation to a Subject Criminal Investigation.



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CI management did not establish goals for its fraud referral evaluation timeliness measures

CI management stated that a specific goal for the “Percentage Acted Upon in 45 Days or Less” performance measure has not been set, but CI strives to evaluate each fraud referral within that time frame as prescribed in the IRM.¹⁶ Management added that the goal for the “Average Elapsed Days Acted Upon” should be close to the 45-day requirement established in the IRM. CI also obtains periodic timeliness reports by field office to determine which field offices are not meeting the time frame and to identify the cause(s).

Management also stated that the two timeliness performance measures are used internally for case inventory planning, but they are not used for budget or resource allocation purposes. Nevertheless, the results of these two timeliness performance measures are shared with the IRS Oversight Board.

Goals or targets are essential to performance measures because they:

- Provide direction to program management and employees about where and how the IRS desires to improve in an area.
- Allow meaningful evaluation of progress because it is immediately clear whether the targets have been met or little progress has been made.
- Facilitate accountability for the level of results achieved.

However, because these performance measures are reported externally, we believe that the IRS should establish specific goals to improve the timeliness of the fraud referral evaluation process. Specifically, the IRS should compare actual results with quantitative, *e.g.*, numeric, targets to report agency progress in delivering tax administration responsibilities. Establishing goals is particularly important to both the IRS and its stakeholders. Without these targets, the two timeliness performance measures do not provide perspective about progress and improvements in the program. In addition, such information assists IRS management and stakeholders in making important program decisions.

Recommendations

The Chief, CI, should:

Recommendation 1: Stress the importance of capturing the correct dates on the Forms 2797 and in the system used to track fraud referrals. In addition, the IRM or policy guidance should include a requirement to reconcile the data on a periodic basis.

¹⁶ IRM 9.4.1.5.1.3.3 (Mar. 30, 2012).



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Management's Response: IRS management agreed with this recommendation. On July 31, 2012, an updated Form 2797 was released and new policy guidance was implemented regarding the reconciliation of fraud referral data. The relevant dates are reviewed periodically by various headquarters and field review processes, and each field office has appointed a coordinator who is responsible for tracking the fraud referral from receipt until final disposition.

Recommendation 2: Modify the CIMIS or develop an alternative method to capture all relevant dates of the fraud referral evaluation period in order to calculate an accurate timeliness measure of the fraud referral acceptance process.

Management's Response: IRS management agreed with this recommendation. A request will be made to modify the CIMIS to capture two dates from the Form 2797: the date the referral was received by the field office and the date the referral was accepted or declined by the field office. In the interim, CI will issue a memorandum reminding all personnel of the CIMIS five-day timeliness guidelines with respect to fraud referrals.

Recommendation 3: Establish quantifiable numeric goals for the "Average Elapsed Days Acted Upon" and the "Percentage Acted Upon in 45 Days or Less" performance measures.

Management's Response: IRS management partially agreed with this recommendation. IRS management agreed with the "Average Elapsed Days" portion of the recommendation and has quantified these numeric goals in IRM Section 9.4.1.5.1.3.3. The field office has 30 business days (45 calendar days) to accept or decline each fraud referral. Additionally, a special agent can request an extension(s) to complete the evaluation of the fraud referral when appropriate. Written extension requests are noted in the CIMIS by the field offices.

IRS management disagreed with the "Percentage Acted Upon" portion of the recommendation. CI's policy is to address each fraud referral in the 30-business-day (45-calendar-day) time frame, excluding extensions. Setting a percentage acted upon goal could give the field offices the impression that it is acceptable for a certain percentage of fraud referrals to be evaluated in longer time frames, which is not the case.

Office of Audit Comment: Although IRS management did not agree to set a percentage goal for the "Percentage Acted Upon" performance measure, their commitment to the policy of addressing each fraud referral within the 30-business-day (45-calendar-day) time frame is acceptable and will help to ensure that fraud referrals are expeditiously reviewed.



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For the seven taxpayer tax accounts with no **2(e)**, we requested that CI verify whether the special agent requested that **2(e)**. For all but one taxpayer, the special agent had requested the **2(e)**; however, CI could not determine why the requests were not completed by the **2(e)**. After our inquiry to CI, the **2(e)** was added to the one taxpayer's tax account that was not initially requested and to three of the other taxpayers' tax accounts. However, as of the end of our review, a **2(e)** had still not been entered on one taxpayer's tax account, and the remaining two other taxpayers' tax accounts no longer needed a **2(e)**.

We also reviewed the tax account histories of these seven taxpayers and found that in six of the seven taxpayers' tax accounts, there was account activity between the dates when the Subject Criminal Investigation was initiated and when the **2(e)** was eventually added to the tax accounts. For example, some taxpayers' tax accounts had activities such as lien or levy actions, notices sent to the taxpayer, or refundable credits and/or refunds generated. Although we were unable to determine if the account activity might have jeopardized CI's investigation, the possibility existed because of the lack of the **2(e)**.

We analyzed the number of days it took to enter the **2(e)** onto the taxpayers' tax accounts for our sample. Because there is no timeliness criterion in the IRM for entering the **2(e)**, we judgmentally considered 30 calendar days as a reasonable time frame for this analysis. Using the field office disposition date for comparison purposes, we determined that it took more than 30 calendar days to enter the **2(e)** on 26 (30 percent) of the 86 taxpayers' tax accounts in our sample. When the sample results are projected to the population of 1,084 accepted fraud referrals, we estimate that a **2(e)** was not entered within 30 calendar days on 328 taxpayers' tax accounts.²¹ We are 95 percent confident that the number of taxpayers' tax accounts on which a **2(e)** was not entered within 30 calendar days ranges between 242 and 413.

Although special agents who are assigned fraud referral cases are not the same employees who enter the **2(e)** on the taxpayers' tax accounts, **2(e)** showing the input of the **2(e)**. Results of our analysis indicate that some special agents are not thoroughly reviewing these reports to verify that a **2(e)** was timely entered onto taxpayers' tax accounts in their assigned inventory. Delays in entering, or the omission of, the **2(e)** on the taxpayers' tax accounts could result in other IRS operating divisions contacting the taxpayers and potentially jeopardizing CI's ongoing investigations.

²¹ To project the results of our statistical sample, we used a 95 percent confidence level, a 30.23 percent error rate, and a 7.86 percent precision factor.



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Recommendations

The Chief, CI, should:

Recommendation 4: Revise the IRM or policy guidance to establish a time criterion to ensure that a **2(e)** is requested on a subject of an investigation's tax account(s) within a reasonable number of calendar days after the decision to accept a fraud referral for an investigation, *i.e.*, the disposition date.

Management's Response: IRS management agreed with this recommendation. On August 16, 2012, CI implemented additional control measures that require submission of **2(e)** requests to the assigned **2(e)** via an electronic mailbox. The Scheme Development Center's standard operating procedures require **2(e)** requests to be processed within **2(e)** of an electronic submission into the mailbox. Confirmation of the **2(e)** postings is forwarded back to the field office, noting that the account controls are in place. **2(e)**
2(e)
2(e)
2(e).

Recommendation 5: Issue a reminder to all CI personnel of the requirement to review the **2(e)** the timely input of the **2(e)** to every taxpayer's tax account in assigned inventory, as necessary.

Management's Response: IRS management agreed with this recommendation. A reminder will be sent to the field offices to remind them of the importance of timely submission of **2(e)** requests and the necessity to proactively ensure that the **2(e)** control was actually posted.



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Appendix I

Detailed Objective, Scope, and Methodology

The overall objective of this review was to evaluate CI's role in the IRS National Fraud Program's¹ efforts to increase the number of viable fraud referrals. In addition, we determined whether fraud referrals were timely assessed within CI and whether sufficient feedback on rejected fraud referrals was provided to the IRS operating divisions. To accomplish this objective, we:

- I. Evaluated CI and National Fraud Program efforts to increase the number of viable fraud referrals received from the operating divisions.
 - A. Reviewed applicable fraud referral guidance in the IRM, standard operating procedures, and the IRS's fraud intranet website.
 - B. Interviewed the CI Acting Director, Global Financial Crimes, and the Fraud Referral Analyst to determine what actions were taken to emphasize the importance of fraud referrals to CI personnel.
 - C. Interviewed the Small Business/Self-Employed Division's National Fraud Program Office Chief, Fraud Policy and Operations, and staff to determine what guidance and training was available to increase or improve the quality of fraud referrals forwarded to CI. We interviewed Large Business and International Division, Tax Exempt and Government Entities Division, and Wage and Investment Division fraud liaison personnel to determine the process for developing fraud referrals.
 - D. Reviewed performance management literature and CI and National Fraud Program performance goals.
- II. Determined whether CI has instituted procedures to monitor the effectiveness and timeliness of its fraud referral review process.
 - A. Reviewed available CI guidance and documentation for monitoring fraud referrals received from the operating divisions.
 - B. Obtained an extract from the CIMIS of 1,583 fraud referrals that were either accepted or rejected by CI during Fiscal Years 2009 through 2011. We consulted with a contracted statistician who assisted with the sampling plan and the projections. From the CIMIS extract, we selected a stratified random sample with two strata consisting of 86 accepted fraud referrals and 41 rejected fraud referrals totaling 127 fraud

¹ See Appendix V for glossary of terms.



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referrals that were accepted or rejected by CI during Fiscal Years 2009 through 2011.² We used a 10 percent expected error rate, a 95 percent confidence level, and a ± 5 percent precision level. A stratified random sample was taken because we wanted to estimate the total number of accepted and rejected fraud referrals that were not timely processed from the population of 1,583 fraud referrals that were either accepted or rejected by CI during Fiscal Years 2009 through 2011.

1. Reviewed the fraud referrals that were rejected by CI and were returned to the originating operating division to determine if the declination memorandum was completed and provided sufficient information on why the referral was rejected.
2. Analyzed the fraud referral documentation to determine the types of tax returns and suspected fraudulent issues that comprised the fraud referrals.
3. Validated the accuracy of the CIMIS data by comparing Form 2797, *Referral Report of Potential Criminal Fraud Cases*, fraud referral information input to the CIMIS to data on the Integrated Data Retrieval System.
4. Analyzed the fraud referral documentation to determine if the decision to accept/reject the fraud referral occurred within 30 workdays of receipt by CI.
5. Analyzed fraud referrals that were accepted by CI to determine the amount of time that elapsed between the fraud referral acceptance date and when the Subject Criminal Investigation was initiated. In addition, we analyzed taxpayer's tax account records to determine the amount of time that elapsed between the fraud referral acceptance date and the date the **2(e)** was input on the taxpayer's tax account.

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 determining whether fraud referrals are timely processed and monitored. We evaluated these controls by reviewing source materials, interviewing management, and reviewing a stratified statistically valid random sample of 127 fraud referrals that were either accepted or rejected by CI during Fiscal Years 2009 through 2011.

² The 127 fraud referrals consisted of 86 accepted fraud referrals, 40 rejected fraud referrals, and one fraud referral which was incorrectly coded as rejected when it was actually accepted. Following recognized statistical practices, the one incorrectly coded fraud referral was left in the strata where it was originally placed, which increased the rejected fraud referrals to 41.



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Appendix II

Major Contributors to This Report

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

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Appendix III

Report Distribution List

Acting Commissioner C
Office of the Commissioner – Attn: Chief of Staff C
Deputy Commissioner for Services and Enforcement SE
Deputy Chief, Criminal Investigation SE:CI
Deputy Commissioner, Small Business/Self-Employed Division SE:S
Director, Fraud/Bank Secrecy Act, Small Business/Self-Employed Division SE:S:F/BSA
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 Liaisons:
 Chief, Criminal Investigation SE:CI
 Commissioner, Small Business/Self-Employed Division SE:S



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Appendix IV

Outcome Measures

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

Type and Value of Outcome Measure:

- Reliability of Information – Potential; 1,620 fraud referrals for which CI data sources contained discrepancies in the initiation date (see page 8).

Methodology Used to Measure the Reported Benefit:

We selected and reviewed a stratified random sample with two strata totaling 127 fraud referrals made during Fiscal Years 2009 through 2011.¹ Our analysis showed discrepancies of more than five calendar days in the initiation date recorded in the CIMIS and the received date annotated on the field office source documentation in 78 (61.4 percent)² of the 127 fraud referrals in our sample. To calculate the processing timelines of those fraud referrals, CI management relied on the CIMIS data. However, we found that the supporting field office source documentation contained inconsistencies for the initiation date. The following factors were used in calculating the number of fraud referrals estimated.³

- Multiplied the 1,583 fraud referrals in our population by 61.4 percent = 972 fraud referrals (324 annually (972/3)) for Fiscal Years 2009 through 2011.
- Projected over five years the number of discrepancies in the fraud referral initiation date (324 x 5 = 1,620).

¹ See Appendix V for glossary of terms.

² In discussions with a CI representative, we were told that when the fraud referrals are forwarded to the CI field office, oftentimes these cases are not immediately assigned to a special agent due to delays (*e.g.*, someone on leave, in training, in court) during the routing process. Therefore, there is generally a short lapse before the fraud referrals are entered into the CIMIS. Our analysis takes into account a five-calendar-day delay for fraud referral initiation data to be entered into the CIMIS.

³ The calculation for the number of discrepancies in fraud referral closing dates will not equal due to rounding.



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Type and Value of Outcome Measure:

- Reliability of Information – Potential; 2,015 fraud referrals for which CI data sources contained discrepancies in the closing date of fraud referrals (see page 8).

Methodology Used to Measure the Reported Benefit:

We selected and reviewed a stratified random sample with two strata totaling 127 fraud referrals made during Fiscal Years 2009 through 2011. To calculate the processing timelines of the fraud referrals, CI management relied on the CIMIS data even though some of the supporting field office source documentation contained inconsistent closing dates. Our analysis showed discrepancies in the closing dates recorded in the CIMIS and the disposition date from the field office source documents in 97 (76 percent) of the 127 fraud referrals in our sample. The following factors were used in calculating the number of fraud referral cases with discrepancies between the closing dates recorded in the CIMIS and the disposition dates from the field office source documents.

- The total number of fraud referrals with discrepancies in the overall population was calculated by determining the population for each stratum then multiplying the stratum population by its unique error rate and adding the results together.
 - The total population of fraud referrals made during Fiscal Years 2009 through 2011 was 1,583. This was comprised of the accepted stratum of 1,084 accepted fraud referrals and the rejected stratum of 499 rejected fraud referrals.
 - Multiplied the accepted stratum population by its error rate (1,084 x .744), which resulted in 806 accepted fraud referrals with discrepancies between the closing dates recorded in the CIMIS and the disposition dates from the field office source documents.
 - Multiplied the rejected stratum population by its error rate (499 x .805), which resulted in 402 rejected fraud referrals with discrepancies between the closing dates recorded in the CIMIS and the disposition dates from the field office source documents.
- Added the accepted stratum results to the rejected stratum results (806 + 402), which totaled 1,208 fraud referrals with discrepancies between the closing dates recorded in the CIMIS and the disposition dates from the field office source documents. We divided this total by three to get the average number of discrepancies per year for the three years (Fiscal Years 2009 through 2011) (1,208 / 3 = 403).
- Projected over five years the number of fraud referrals with inconsistent closing dates (403 x 5 = 2,015).



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Type and Value of Outcome Measure:

- Reliability of Information – Potential; 145 ****2(e)**** not entered on taxpayers' tax accounts (see page 13).

Methodology Used to Measure the Reported Benefit:

We selected and reviewed a stratified random sample with two strata totaling 127 fraud referrals made during Fiscal Years 2009 through 2011 (86 accepted fraud referrals and 41 rejected fraud referrals). Our analysis of the 86 accepted fraud referrals in our sample showed that seven taxpayers (8.1 percent) did not have a ****2(e)**** properly entered onto their tax accounts.⁴ The following factors were used in calculating the number of fraud referrals estimated.

- Multiplied the 1,084 accepted fraud referrals in our population by its error rate of 8.14 percent = 88 fraud referrals (29 annually (88/3)) for Fiscal Years 2009 through 2011.
- Projected over five years the number of fraud referrals with no ****2(e)**** (29 x 5 = 145).

⁴ Only 82 of the 86 accepted fraud referrals in our sample included tax-related cases for which a ****2(e)**** was applicable. In our analysis, we followed recognized statistical practices and treated the four nontax cases as correct; therefore, those four cases are not factored into the seven exceptions for which no ****2(e)**** was entered.



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Appendix V

Glossary of Terms

Term	Definition
Business Performance Review	A quarterly review by an IRS operating division to report on its performance measures, business results, employee and customer satisfaction, and other items of importance.
Compliance Employee	The staff in the IRS's Collection and Examination functions whose mission is to ensure taxpayer compliance through collecting delinquent taxes and auditing tax returns to determine correct tax liabilities.
Criminal Investigation Management Information System	A database that tracks the status and progress of criminal investigations and the time expended by special agents.
Disposition Date	The date CI makes the decision to accept or reject a fraud referral. This date should generally be within 30 workdays from receipt of the fraud referral; however, extensions can be granted.
Fiscal Year	A 12-consecutive-month period ending on the last day of any month. The Federal Government's fiscal year begins on October 1 and ends on September 30.
Fraud Referral Program	A program designed as a partnership between CI and the IRS operating divisions to promote fraud awareness and facilitate fraud training.
Fraud Technical Advisor	A Fraud Technical Advisor serves as a resource person and liaison to compliance employees in all operating divisions. The advisor plays a vital role in the development of a potential fraud case. The advisor is consulted in all cases involving potential criminal fraud, as well as those cases that have potential for a civil fraud penalty. The advisor is available to assist in fraud investigations and offer advice on matters concerning tax fraud to all operating divisions.
Integrated Data Retrieval System	IRS computer system capable of retrieving or updating stored information. It works in conjunction with a taxpayer's account records.



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Term	Definition
Internal Revenue Code	The codified collection of United States laws on income, estate and gift, employment, and excise taxes, plus administrative and procedural provisions.
Legal Source Income Tax Investigation	Investigation of crimes involving legal industries and occupations and legally earned income.
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.
National Fraud Program	Small Business/Self-Employed Division function that provides oversight and direction for fraud policy and fraud operations throughout the IRS.
Primary Investigation	An evaluation of an allegation that an individual or entity is in noncompliance with the Internal Revenue laws and related financial crimes.
****2(e)*****	CI function that identifies and develops **2(e)** for the purpose of referring and supporting high-impact criminal tax and related financial investigations. Among other responsibilities, the ****2(e)***** are to maintain controls on all taxpayer accounts under criminal investigation.
Special Agent	CI law enforcement employee who investigates potential criminal violations of the Internal Revenue laws and related financial crimes.
Statute of Limitations	A type of Federal or State law that restricts the time within which legal proceedings may be brought.
Strata	The division of a population into two or more nonoverlapping subgroups. Each of the subgroups is called a stratum, and two or more subgroups are called strata.
Subject Criminal Investigation	An investigation of an individual or entity alleged to be in noncompliance with the laws enforced by the IRS and having criminal prosecution potential.
Tax Gap	The estimated difference between the amount of tax that taxpayers should pay and the amount that is paid voluntarily and on time.



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Appendix VI

Management's Response to the Draft Report



Criminal Investigation

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

April 26, 2013

MEMORANDUM FOR DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: Richard Weber  for
Chief, Criminal Investigation (SE:CI)

SUBJECT: Response To Draft Audit Report—Actions Are Needed to
Improve the National Fraud Program and Accurately Reflect
Criminal Investigation's Fraud Referral Assessment Period
(Audit #201130040)

Thank you for the opportunity to respond to the above referenced draft report. Criminal Investigation (CI) believes that the Fraud Referral Program plays a vital role in ensuring tax compliance. We continue to stress the need for our special agents to efficiently and effectively address fraud referrals and to provide relevant and detailed feedback when a fraud referral is rejected. We also continue to focus on improved outreach and partnerships with our civil counterparts. These efforts are validated by your audit findings.

Criminal Investigation's legal source investigative inventory has been strengthened as a direct result of increasing numbers of fraud referrals. There is closer cooperation between CI, the National Fraud Program (NFP), and field compliance councils. There has also been increased NFP outreach including: presentations and training to more than 17,000 compliance employees in Fiscal Year 2011 and to nearly 16,000 compliance employees in Fiscal Year 2012. These efforts have resulted in improved quality of referrals and their subsequent criminal investigations, as demonstrated by increases in the number of prosecution recommendations, the overall United States Attorney Acceptance Rate, and the average months to serve on imposed sentences.

The Fraud Referral Program remains one of CI's Operational Priorities in FY 2013 and we will continue to work closely with our IRS counterparts in Small Business and Self Employed (SBSE), Large Business & International (LB/I), Tax Exempt/Government Entities (TEGE), and Wage & Investment (W&I) to strengthen the Fraud Referral Program and promote fraud awareness. Our ongoing emphasis will ensure timely evaluation of fraud referrals.

Criminal Investigation has no objection to the overall method of computation used by TIGTA to determine the various "measurable impacts" on tax administration. Generally, we are in agreement that additional data on processing dates would help provide a more accurate accounting of elapsed time. As such, pending available



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funding, CI will seek changes to the Criminal Investigation Management Information System (CIMIS) to accomplish this. However, we do not believe the projected discrepancies in fraud referral initiation and closing dates actually correspond to measurable tax administration benefits. These dates are used by CI management only as estimates of processing timeliness and not as definitive signs of success or failure.

If you have any questions, please contact me or Deputy Chief, Patricia Haynes at (202) 622-3200.



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Attachment

The Chief, CI should:

RECOMMENDATION #1

Stress the importance of capturing the correct dates on the Forms 2797 and in the system used to track fraud referrals. In addition, the IRM or policy guidance should include a requirement to reconcile the data on a periodic basis.

CORRECTIVE ACTION (S)

We agree with this recommendation. On July 31, 2012, an updated Form 2797, *Referral Report of Potential Criminal Fraud Cases*, was released and new policy guidance was implemented regarding the reconciliation of fraud referral data. The relevant dates are reviewed through periodic reviews by various headquarters (HQ) and field review processes and each field office has appointed a coordinator who is responsible for tracking the fraud referral from receipt until final disposition.

IMPLEMENTATION DATE

July 31, 2012

RESPONSIBLE OFFICIAL(S)

Not applicable.

CORRECTIVE ACTION (S) MONITORING PLAN

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

RECOMMENDATION #2

Modify the CIMIS or develop an alternative method to capture all relevant dates of the fraud referral evaluation period in order to calculate an accurate timeliness measure of the fraud referral acceptance process.

CORRECTIVE ACTION (S)

We agree with this recommendation. A request will be made to modify CIMIS to capture two dates from Form 2797: Number 9, the date the referral was received by the field office, and Number 11c, the date the referral was accepted/declined by the field office. In the interim, CI will issue a memorandum reminding all personnel of the CIMIS 5-day timeliness guidelines with respect to fraud referrals.

IMPLEMENTATION DATE

September 15, 2016

RESPONSIBLE OFFICIAL (S)

Director, Operations, Policy & Support



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CORRECTIVE ACTION (S) MONITORING PLAN

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

RECOMMENDATION #3

Establish quantifiable numeric goals for the "Average Elapsed Days Acted Upon" and the "Percentage Acted Upon in 45 Days or Less" performance measures.

CORRECTIVE ACTION (S)

We agree with the average elapsed days recommendation and have quantified these numeric goals in IRM Section 9.4.1.5.1.3.3. The field office has 30 business days/45 calendar days to accept or decline each fraud referral. Additionally, a Special Agent can request extension(s) to complete the evaluation of the fraud referral when appropriate. Written extension requests are noted in CIMIS by the field offices.

We disagree with the percentage acted upon recommendation. Criminal Investigation's policy is to address each fraud referral in the 30 business/45 calendar day timeframe, excluding extensions. Setting a percentage acted upon goal could give the field offices the impression that it is acceptable for a certain percentage of fraud referrals to be evaluated in longer time frames, which is not the case.

IMPLEMENTATION DATE

March 20, 2012

RESPONSIBLE OFFICIAL (S)

No applicable.

CORRECTIVE ACTION (S) MONITORING PLAN

Not applicable.

RECOMMENDATION #4

Revise the IRM or policy guidance to establish a time criterion to ensure that a ***2(e)**** is requested on a subject of an investigation's tax account(s) within a reasonable number of calendar days after the decision to accept a fraud referral for an investigation, i.e., the disposition date.

CORRECTIVE ACTION (S)

We agree with this recommendation. On August 16, 2012, CI implemented additional control measures that require submission of ***2(e)*** requests to the assigned *****2(e)***** via an electronic mailbox. The **2(e)** standard operating procedures require **2(e)** requests to be processed within **2(e)** of an electronic submission into the mailbox. Confirmation, of the **2(e)** , postings are forwarded back to the field office, noting that the account controls are in place. *****2(e)*****
*****2(e)*****
*****2(e)*****

IMPLEMENTATION DATE

August 16, 2012



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RESPONSIBLE OFFICIAL (S)

Not applicable.

CORRECTIVE ACTION (S) MONITORING PLAN

Not applicable.

RECOMMENDATION #5

Issue a reminder to all CI personnel of the requirement to review the *****2(e)*****
*****2(e)***** the timely input of the **2(e)** to every taxpayer's tax account in assigned
inventory, as necessary.

CORRECTIVE ACTION (S)

We agree with this recommendation. A reminder will be sent out to the field offices to remind them of the
importance of timely submission of **2(e)** requests and the necessity to proactively ensure the **2(e)** control
was actually posted.

IMPLEMENTATION DATE

July 15, 2013

RESPONSIBLE OFFICIAL (S)

Director, Operations, Policy & Support

CORRECTIVE ACTION (S) MONITORING PLAN

The IRS will continue to monitor this action as part of our current review process.