



*Initial Compliance Results Warrant
a More Data-Driven Approach
to Campaign Issue Selection*

September 27, 2019

Reference Number: 2019-30-066

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 = Law Enforcement Techniques/ Procedures and Guidelines for Law Enforcement Investigations or Prosecutions.

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HIGHLIGHTS

INITIAL COMPLIANCE RESULTS WARRANT A MORE DATA-DRIVEN APPROACH TO CAMPAIGN ISSUE SELECTION

Highlights

Final Report issued on September 27, 2019

Highlights of Reference Number: 2019-30-066 to the Commissioner of Internal Revenue.

IMPACT ON TAXPAYERS

The Large Business and International (LB&I) Division traditionally organized itself around business industries, a structure which came about in response to the IRS Restructuring and Reform Act of 1998. Since at least 2010, the LB&I Division's leadership expressed the intent to shift its focus towards examining issues that will have the broadest impact on tax compliance. In 2017, the LB&I Division announced a new approach at addressing specific compliance issues referred to as "campaigns."

WHY TIGTA DID THE AUDIT

Historically, the LB&I Division has used a variety of methods to identify tax returns for audit consideration, and upon selection, the taxpayer's tax return would be subject to audit. However, the new campaign approach involves selecting returns by issue and focusing on that issue in the examination process. TIGTA performed this review to assess the LB&I Division's methodology for the identification and selection of campaigns.

WHAT TIGTA FOUND

In January 2017, the LB&I Division announced the first 13 issue-based compliance campaigns. As of April 2019, a total of 53 campaigns have been announced. The campaign program was a change to the LB&I Division's overall workload selection process and is a new strategy in how it plans to identify, select, and examine strategic compliance issues.

The LB&I Division initially set expectations that campaigns would significantly overtake

traditional inventory selection methods. As of September 2018, only 6 percent of inventory had been generated by campaigns, with this percentage climbing to 15 percent by February 2019.

Initial campaigns were not focused on the most significant compliance issues facing the IRS. Some issues were selected from employee suggestions. Other issues were chosen because there was a compliance plan developed with training already in place or an existing base of institutional knowledge available. TIGTA found that issues for campaigns were not selected or prioritized based on past compliance results or potential impact on compliance. While it is early to assess the overall results of campaigns, the limited results available suggest that the LB&I Division's limited resources would be better utilized working issues selected based on compliance risk.

WHAT TIGTA RECOMMENDED

TIGTA recommended that the Commissioner, LB&I Division: 1) consider a formal process for using past compliance results and potential impact on compliance to strengthen and supplement the process of selecting and prioritizing issues for campaigns, and 2) as recommendations for improvement from the LB&I Division's Campaign Assessment Team are implemented, ensure that actionable metrics and measures, including compliance results and the impact on compliance, are incorporated and timely acted upon to ensure that the most productive inventory is provided to the LB&I Division's resources.

The IRS agreed with our recommendations, stating that it plans to: 1) continue the use of documented processes for utilizing past compliance results and potential impact on compliance in selecting and prioritizing issues for campaigns, and 2) continue to document real-time campaign results and ensure that actionable metrics and measures are incorporated. TIGTA believes the IRS needs to give more consideration to strengthening and supplementing its processes for identifying and prioritizing potential campaign issues before they are routed to the Practice Areas.



TREASURY INSPECTOR GENERAL
FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

September 27, 2019

MEMORANDUM FOR COMMISSIONER OF INTERNAL REVENUE

FROM: Michael E. McKenney
Deputy Inspector General for Audit

SUBJECT: Final Audit Report – Initial Compliance Results Warrant a
More Data-Driven Approach to Campaign Issue Selection
(Audit # 201830014)

This report presents the results of our review to assess the Large Business and International Division's methodology for the identification and selection of campaigns for its Future State Compliance Campaigns strategy. In addition, we evaluated available compliance results for the campaigns. This audit is included in our Fiscal Year 2019 Annual Audit Plan and addresses the major management challenge of the Impact of Global Economy on Tax Administration.

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

If you have any questions, please contact me or Matthew A. Weir, Assistant Inspector General for Audit (Compliance and Enforcement Operations).



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Abbreviations

ADCCI	Assistant Deputy Commissioner Compliance Integration
CIP	Compliance Initiative Project
CONOPS	Concept of Operations
FY	Fiscal Year
I.R.C.	Internal Revenue Code
IRS	Internal Revenue Service
LB&I	Large Business and International



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Background

Since 1998, the Large Business and International (LB&I) Division organized itself around business industries. This structure, which came about in response to the Internal Revenue Service (IRS) Restructuring and Reform Act of 1998, was intended to create more specialization and expertise among IRS employees as well as to better serve taxpayers.¹ Tasked with examining high-wealth individuals and businesses with assets in excess of \$10 million, the LB&I Division divided its business taxpayers into two broad categories: Coordinated Industry Cases and Industry Cases.

Taxpayers meeting Coordinated Industry Case criteria are generally the largest and most complex entities, with examinations conducted by a team of revenue agents and specialists. While taxpayers under the Industry Case program do not meet the criteria to be classified as Coordinated Industry Case taxpayers, the size and complexity of issues are similar between the two programs. Examinations for Industry Case taxpayers are usually conducted by one revenue agent.

The LB&I Division announced, in September 2015, a fundamentally new approach to ensuring compliance, undergirded by four guiding principles, as part of its future state efforts.

Until Fiscal Year (FY) 2016, the LB&I Division was organized along six industries as follows.

- Communications, Technology, and Media.
- Financial Services.
- Heavy Manufacturing and Pharmaceuticals.
- Retailers, Food, Transportation, and Healthcare Industry.
- Natural Resources and Construction.
- Global High Wealth.

In FY 2016, the LB&I Division announced that it was restructuring away from its industry focus model into nine Practice Areas based on either geography or subject matter. As a result of this reorganization, the LB&I Division created four geographically based “Compliance Practice Areas” (Western, Central, Eastern, and Northeastern) and five Practice Areas differentiated by their subject focus: Pass-Through Entities, Enterprise Activities, Cross-Border Activities,

¹ Pub. L. No. 105-206, 112 Stat. 685 (codified as amended in scattered sections of 2 U.S.C., 5 U.S.C. app, 16 U.S.C., 19 U.S.C., 22 U.S.C., 23 U.S.C., 26 U.S.C., 31 U.S.C., 38 U.S.C., and 49 U.S.C.).



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Withholding and International Individual Compliance, and Treaty and Transfer Pricing Operations.²

A key focus of the LB&I Division's mission is to identify the highest potential compliance risks among taxpayers and to assign resources to address these potential risks. Traditionally, the LB&I Division used a variety of methods, such as computer models and staff review of returns, to identify tax returns for audit consideration. From the returns identified, managers in the LB&I Division's field offices then select the returns to be examined. However, due to an increasingly difficult tax environment in which its budget and resources were shrinking and tax laws were growing more complex, the LB&I Division concluded that its approach to determining which taxpayers to treat and which treatment streams to apply could be improved with a strategic focus upon issues, transactions, and processes. Since at least 2010, the organization's leadership expressed the intent to shift its focus towards examining issues that will have the broadest impact on tax compliance.

Campaigns

In FY 2017, the LB&I Division announced a new approach designed to address specific compliance issues; it refers to the new approach as "campaigns." Although the LB&I Division indicated that other areas of the IRS used this term, no other IRS functional units refer to any issue-based workstreams as "campaigns," and as part of this audit, we asked management for information on the origins of the term. It appears that the origins of the term in the LB&I Division began in FY 2014 when the IRS began working with a contractor to redesign the Concept of Operations (CONOPS) for multiple IRS business units as part of the IRS's future state efforts. The contractor's process included interviewing and consulting with 50 leaders within the LB&I Division and resulted in delivery of a CONOPS document dated December 31, 2014. As a result of the CONOPS process, "campaign" became the term used to describe the LB&I Division's new approach. The CONOPS document appears to be the first time the word "campaign" was used to describe this approach.

The LB&I Division is using this campaign approach to plan for and establish specific objectives intended to improve compliance across the population of taxpayers for whom it is responsible. Specifically:

- Campaigns are intended to allow the LB&I Division to focus its limited resources in the right areas to drive specific compliance objectives. It intends to focus on the right issues, using the right resources, and using the right combination of treatment streams to achieve compliance.

² A Practice Area is a group of employees organized together to focus on one or more areas of expertise. The geographic Compliance Practice Areas' footprints changed on October 1, 2018. The four Compliance Practice Areas were reduced to three, with the abolishment of the Central Compliance Practice Area.

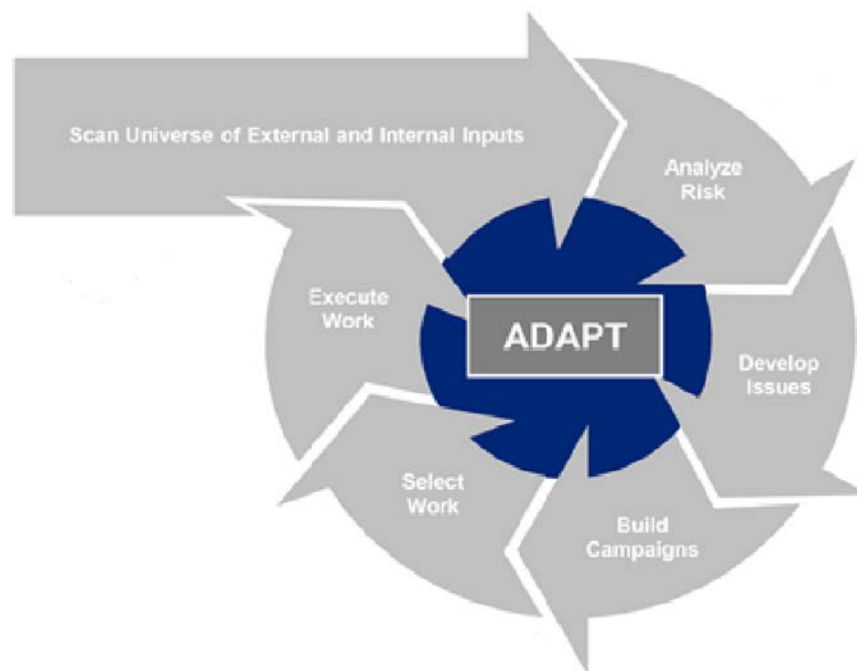


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- Using campaigns to respond to compliance risks is a fundamental change in the way the LB&I Division has been selecting and performing work. Under the campaign process, the division decides which compliance risk will be responded to and how.

The CONOPS document contains the chart in Figure 1, depicting how the LB&I Division will continually gather, assess, and incorporate feedback to enhance operations and improve taxpayer compliance.

Figure 1: The LB&I Division's Agile model



Source: The IRS LB&I Division Concept of Operations December 31, 2014.

The CONOPS emphasizes the role of data analytics to identify the greatest risks to compliance and determine work selected based on that compliance risk. The LB&I Division adopted the CONOPS and announced the identification and selection of the initial 13 issues for campaigns in January 2017, following up with 11 additional campaigns in November 2017. According to the IRS, these campaigns were identified through extensive data analysis, suggestions from IRS compliance employees, and feedback from the tax community.

The Assistant Deputy Commissioner Compliance Integration (ADCCI) is responsible for administering the campaign development process, which consists of six stages: 1) proposal and scoping, 2) framework and approach, 3) approval, 4) execution, 5) monitoring and assessment, and 6) conclusion.

The IRS has stated that campaign development requires strategic planning and deployment of resources, training, and tools as well as metrics and feedback. In addition, the process is



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intended to include robust feedback mechanisms for capturing input on the effectiveness of data analysis, issue identification filters, soft letter processes, training, on-the-job tools, outreach efforts with the tax community, and other matters so that refinements and improvements can be made quickly. The LB&I Division has acknowledged that, in some instances, feedback may indicate a need to move away from a specific campaign altogether. The IRS envisions the successful implementation of campaigns providing improved return selection, identifying issues representing a risk of noncompliance, making the greatest use of limited resources, increasing taxpayer compliance, and enhancing the IRS's tax administration efforts.

In March, 2017, the Government Accountability Office reported that the LB&I Division did not fully meet project planning principles in developing and implementing its campaign process.³ Included in these principles is the development of performance measures, which provide a way to determine what has been accomplished and whether or not an organization is meeting its stated goals and objectives.⁴ The LB&I Division continues to work on developing measurable results that can be evaluated alongside traditional enforcement and examinations. While we include results provided by the LB&I Division in our report, these measures are not dissimilar from those measures traditionally used by IRS examination functions, such as no-change rate or yield. It is too early to tell whether such measures will be effective at determining the success or failure of campaigns.

This review was performed at the Examination offices of the LB&I Division in New York, New York; Columbus, Ohio; Independence, Ohio; and Philadelphia, Pennsylvania, with information provided by the LB&I Division's Examination offices in Phoenix, Arizona; Washington, D.C.; Atlanta, Georgia; Chesterfield, Missouri; Raleigh, North Carolina; and Houston, Texas, during the period of December 2017 through June 2019. 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 objective, scope, and methodology is presented in Appendix I. Major contributors to the report are listed in Appendix II.

³ Government Accountability Office, GAO-17-324, *Improved Planning, Internal Controls, and Data Would Enhance Large Business Division Efforts to Implement New Compliance Approach* (Mar. 2017).

⁴ GAO, *Standards for Internal Control in the Federal Government*, GAO-14-704G (Washington, D.C.; Sept. 2014).



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Results of Review

The LB&I Division has worked extensively to develop and implement the new campaign program over the past three years. The LB&I Division's goal to work more efficiently is laudable in light of the IRS's diminished compliance resources. The IRS's examination resources have been reduced over the last five years.⁵ IRS Examination personnel have decreased 38 percent, from 13,138 examiners in FY 2010 to 8,205 examiners in FY 2017. The number of audits has also decreased by 31 percent, from 1.6 million in FY 2013 to 1.1 million in FY 2017. In addition, proposed assessments have declined over the last 10 years, from \$44 billion in FY 2007 to \$29 billion in FY 2017.

Given the diminished examination resources, the IRS should be even more focused on emphasizing areas that have the highest compliance risk. However, the campaign program as a whole has not met initial expectations. In addition, because issues selected to be developed as campaigns were not selected based on past compliance results, some implemented campaigns are not as productive as the LB&I Division's general program examinations.

***The Large Business and International Division Has Initiated
53 Issue-Based Campaigns***

In January 2017, the LB&I Division announced the first 13 issue-based compliance campaigns. These were followed in November 2017 with the announcement of 11 more. As of April 2019, there have been 53 campaigns announced. The campaign program was a change to the LB&I Division's overall workload selection process and is a new strategy in how it plans to identify and select strategic compliance issues and subsequently deliver that work to its diminished resources.

As shown in Figure 2, the decline in revenue agents, by more than 44 percent from FY 2010 to FY 2018, has made it necessary for the LB&I Division to consider alternatives to its traditional methods of workload selection and administering the tax code.

⁵ Treasury Inspector General for Tax Administration, Ref. No. 2018-30-069, *Trends in Compliance Activities Through Fiscal Year 2017* (Sept. 2018).



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Figure 2: Decline in the LB&I Division’s Revenue Agents Since FY 2010

LB&I Nonmanagement Revenue Agent Staffing	FY 2010	FY 2011	FY 2012	FY 2013	FY 2014	FY 2015	FY 2016	FY 2017	FY 2018
Total Revenue Agents	5,224	4,739	4,521	4,069	3,807	3,549	3,309	3,149	2,923
New Hires	375	15	35	7	5	6	0	3	0
Retirements	217	210	142	163	183	191	179	123	112
Attrition ⁶	71	51	26	30	33	18	19	22	15

Source: Our analysis of IRS Table 37 for FYs 2010 through 2018.

In developing the campaign program, the LB&I Division’s goal was “...to improve return selection, identify issues representing a risk of non-compliance, and make the greatest use of limited resources.”⁷ The LB&I Division’s efforts to develop and initiate campaign inventory have been extensive. Developing campaigns that identify, prioritize, and allocate resources to the highest risk compliance issues can be a lengthy process depending on the complexity of the issue, which contributes to the fact that campaigns represent a small percentage of total examination inventory.

Campaigns Are Not Meeting Initial Expectations

As outreach around the new campaigns was ongoing, the LB&I Division set expectations that campaigns would significantly overtake traditional inventory selection methods. Publicly, when asked if all activity will be in the form of campaigns, the lead executive at the time responded that, “We don’t expect that campaign work will ever be 100 percent of our work, but we do expect it to be a majority of our work in the future.”⁸ The executive further stated that, as the campaigns developed, the audits generated through the campaign process would increase as a percentage of the overall number, eventually representing a majority of the LB&I Division’s work. The LB&I Division received 730 campaign submissions by December 2016, prior to any campaign issues being announced publicly. However, the number of campaign submissions received since that time has fallen off precipitously. The LB&I Division received 194 campaign submissions in Calendar Year 2017, 51 in Calendar Year 2018, and two as of February 2019.

⁶ The IRS Table 37 includes attrition separately from retirements. Attrition includes resignations, dismissals, and transfers to another agency.

⁷ Large Business and International Compliance Campaigns at www.irs.gov.

⁸ *Tax Notes Today – March 29, 2017*, and *Compliance Campaign Webinar #1 FAQ’s*, (March 7, 2017).



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Management stated that many of their resources were reassigned to work on tax reform during 2018 and 2019 and that they had anticipated a decline in the number of campaign submissions.

The number of campaign submissions do not reflect the number of campaigns in development. Campaign submissions may be rejected, or multiple submissions may be combined if they consider the same issue. According to the LB&I Division, there are currently 38 submissions in some stage of buildout and 169 submissions under Practice Area review and assessment.

As of September 2018, only 6 percent of the LB&I Division's inventory had been generated by campaigns, with this percentage climbing to 15 percent by February 2019. The remaining 85 percent of inventory continues to be delivered through traditional methods, such as the Compliance Assurance Process, the Coordinated Industry Case program, Discriminant Analysis System scoring, and other workstreams.⁹ Campaigns are one of seven compliance program areas used to identify workload. The inventory delivered by each program in a year is determined during the annual program planning process. Although campaign inventory is increasing, initial expectations appear to have overstated the extent to which campaigns would affect the identification and selection of work delivered to the field, at least in the short term.

The Internal Revenue Service Did Not Select Issues or Prioritize Campaigns Based on Past Compliance Results or Potential Impact on Compliance

The LB&I Division's initial effort to identify specific areas of increased risk on which to focus its limited resources included converting Compliance Initiative Projects (CIPs) and other internal compliance projects to campaigns. More specifically, 23 of the first 54 campaigns developed were previously organized compliance efforts, ongoing projects and CIPs that were incorporated into the campaign program.¹⁰ Twenty-four of the remaining 31 campaigns were issues or innovative approaches to working issues that were derived by soliciting employees for suggestions on the issues that they felt should be developed further into campaigns. The issues to be converted or developed into campaigns were not selected or prioritized based on past compliance results or potential impact on compliance.

During our fieldwork, management indicated that the first 13 campaigns, announced in January 2017, had been developed on a "first in, first out" basis.¹¹ Public statements from

⁹ Workstreams are seven compliance programs that together represent total inventory for the LB&I Division. The Compliance Assurance Process is characterized by an examination team working collaboratively with taxpayers to identify and resolve potential tax issues before the tax return is filed. Discriminant Analysis System scoring is used to rank return filings and establish the order in which returns should be examined.

¹⁰ CIPs are any activities involving contact with specific taxpayers and collection of taxpayer data within a group or segment, using either internal or external data to identify potential areas of noncompliance within the group or segment, for the purpose of correcting the noncompliance.

¹¹ "First in, first out" is an inventory method that assumes the first items produced or acquired are used or disposed of first.



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management also acknowledging that the initial campaigns were not focused on the most significant issues facing the IRS; instead, they reflected those issues that the LB&I Division felt were ready for the campaign approach, for which training had previously been developed or would not be difficult to set up, or for which there was institutional knowledge available. While there are differences in these descriptions, it is apparent that ease of implementation played an important role in early efforts to identify issues for potential development into campaigns and ultimately for attempting to identify better work. However, selecting issues for campaigns, as well as other examination work, based on past compliance results and potential compliance impact could help to ensure that IRS resources are used in the most productive areas.

A key aspect of the LB&I Division's compliance campaign strategy was employee engagement, and a significant part of this engagement centered around the ability of employees to make suggestions on those issues they felt should be campaigns. Compliance issues were proposed by employees through the employee suggestion portal, triaged, and delivered to the LB&I Division Practice Areas for scoping and buildout. We recognize that it is important for employees to have an avenue to make management aware of potential compliance issues; however, employees may not have the same access to information as management as to what the most significant compliance risks are.

The U.S. Government Accountability Office's *Standards for Internal Control in the Federal Government* requires management to track major agency achievements and compare these to established plans, goals, and objectives. Management needs to compare actual performance to planned or expected results throughout the organization and analyze significant differences. When developing an issue-based workload selection plan that it felt would drive the majority of its inventory, rather than selecting those compliance issues that were quickest to launch or those issues that were suggested by employees, the LB&I Division may have been better served to have considered past compliance results, including the productivity of issues, to inform its identification of issues for potential campaign development.

We previously recommended that the LB&I Division consider past compliance results by issue in order to inform its issue-based strategy.¹² In response to that recommendation, management stated that, as part of the campaign development process, they were providing compliance results by issue, from the Issue Based Management Information System, for use by the Practice Areas in development of campaigns after they were selected and prioritized. The LB&I Division did provide a high-level report that identified proposed adjustments in the field (at a given time) using the Uniform Issue List code.¹³

¹² Treasury Inspector General for Tax Administration, Ref. No. 2016-30-089, *The Large Business and International Division's Strategic Shift to Issue-Focused Examinations Would Benefit From Reliable Information on Compliance Results* (Sept. 2016).

¹³ The Uniform Issue List (UIL) is a code-based numerical index used to identify issues arising under the Internal Revenue Code. These codes are a key component for capturing information, by issue, in the Issue Management System.



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In addition, management stated that the Practice Areas had historical knowledge and experience in the issues. However, by initially focusing on current and ongoing CIPs or projects and on issues suggested by employees, the LB&I Division may not have made the best use of readily available data from past compliance issues and results.¹⁴

We did see evidence that staff considered compliance data within the Practice Areas as part of the campaign development process. In addition, we noted multiple instances, supported by meeting minutes, in which compliance data and results were discussed as part of the campaign approval process—notably as part of the campaign information presented by Subject Matter Experts at Compliance Integration Council meetings as well as within the minutes of those meetings. We also noted comments within those minutes which indicated that campaign development forms and, potentially, risk assessment processes were incomplete.

While there is evidence that compliance data were used to scope and evaluate potential campaigns, management explained that prioritization of campaigns (determining which potential compliance issue to scope and propose for approval and implement first) was not performed because the campaign program was under development. In June 2018, after 35 campaigns had already been announced, the LB&I Division began using a prioritization scoring tool to assess the campaigns for the organization as a whole.

The LB&I Division indicated that the prioritization scoring tool was derived from Value Measurement Methodology for Federal business case development. The IRS's scoring framework is developed around three criteria and 13 subcriteria.¹⁵ The Business Value criteria lists various subcriteria, including, but not limited to, strategic campaign importance, prevalence of issue, issue coverage, and the likelihood of significant compliance outcomes. While the scoring tool is intended to help the Practice Areas discern which of the campaigns assigned for development pose the greatest compliance risk, the tool does not utilize specific past compliance data. Since the prioritization scoring tool has been implemented, we noted that, of the 37 approved campaigns, in June 2018, nine of the ten lowest priority campaigns are those that were announced first. IRS management noted that their processes have evolved based on feedback and lessons learned and that they are working more on prioritization of campaigns than they had done initially.

Management stated that the tool is intended to help stratify the campaigns for executive review. However, management also stated that the tool is not used to prioritize the order of how campaigns are presented for approval or the order in which they are implemented. As such, each

¹⁴ Data from the Issue-Based Management Information System, Issue Management System, and Audit Information Management System.

¹⁵ Currently, the scoring tool is used to assess three main criteria: Business Value, Feasibility, and Ease of Implementation. The tool is comprised of a workbook detailing the criteria and subcriteria. Users score each subcriterion as high, medium, or low, after which each criterion is converted to a numerical score of 1 through 3. Criterion-level scores are the average of the underlying subcriteria scores. The program management office then computes one overall campaign score by applying weights to criterion scores and applying a scaling factor.



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campaign's "score" and the overall ranking may carry weight within each particular Practice Area, but there is no evidence that the tool has had any positive impact at an organizational level in ensuring that the LB&I Division is coordinating the delivery of better work to the field from across multiple Practice Areas.

Insufficient planning may have contributed to the lack of consideration the LB&I Division gave to its initial campaign inventory. IRS management stated during interviews that, in general, there is no set time frame to the campaign process. However, after publicly and internally establishing expectations around the new campaign process, the LB&I Division moved (before prioritization criteria had been finalized) to announce and deliver initial campaign inventory. Throughout the campaign development process, we found that initial campaign submissions were not consistently prioritized following any common criteria, matrix, or preestablished guidelines and that the order in which campaign submissions were processed was not systematic.

Minutes of the LB&I Division Compliance Integration Council's meetings indicate that the LB&I Division was conscious of the need to prioritize campaigns. However, as the program was standing up and the initial campaigns were being approved and announced, there were no standard risk, scoping criteria, or thresholds established by the LB&I Division that would have ensured that staff within the different Practice Areas were developing campaigns in support of the LB&I Division's strategic goals/objectives. Management stated that their guidance and procedures were still "evolving" even as the campaign program was already underway and after many of the campaigns were approved by the Compliance Integration Council.

The importance of prioritizing and allocating resources in compliance programs is evident. To ensure that the best work was being delivered to revenue agents, LB&I Division management should have given more consideration to the compliance risk and potential productivity associated with the work and issues they intended to deliver through campaigns. A preliminary assessment of potential enforcement results compared to the investment in developing the potential campaign inventory would have allowed the LB&I Division to compare the return on investment of multiple potential issues prior to selection.

This type of analysis could have been conducted on not only potential issues and original campaign submissions but also on prior CIPs or projects. Although not all CIPs were converted to campaigns, many were. Developing, approving, and moving less-than-productive issues to campaigns may have wasted time and resources that could have been better expended.

LB&I Division management needs to use the controls that they have developed and the data available, such as prior compliance results, to ensure that this new workload selection process delivers the most productive inventory to the field. While it is early to assess the overall results of these campaigns, those limited results that are available bring into question the decision to convert many of these projects and CIPs to campaigns.

Results from 18 of the initial 24 campaigns are shown in Figure 3.



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**Figure 3: Cumulative Performance Results of the
Initial 24 Announced Campaigns Through September 2018**¹⁶

Campaigns	Returns Closed	Agreed %	Unagreed %	No Change %	Recommended Dollars	Hours per Return	Yield
I.R.C. § 48C Energy Credit	**2**	**2**	**2**	**2**	**2**	**2**	**2**
OVDP Declines – Withdrawals	**2**	**2**	**2**	**2**	**2**	**2**	**2**
DPAD, MVPD, and TV Broadcasters	**2**	**2**	**2**	**2**	**2**	**2**	**2**
Micro-Captive Insurance	**2**	**2**	**2**	**2**	**2**	**2**	**2**
Related-Party Transactions	**2**	**2**	**2**	**2**	**2**	**2**	**2**
Basket Transactions	**2**	**2**	**2**	**2**	**2**	**2**	**2**
Land Developers – CCM	**2**	**2**	**2**	**2**	**2**	**2**	**2**
S-Corp Losses Claimed in Excess of Basis	**2**	**2**	**2**	**2**	**2**	**2**	**2**
Repatriation	**2**	**2**	**2**	**2**	**2**	**2**	**2**
Form 1120-F Nonfiler	**1**	**1**	**1**	**1**	**1**	**1**	**1**
Inbound Distributor	**2**	**2**	**2**	**2**	**2**	**2**	**2**
Agricultural Chemicals Security Credit	**2**	**2**	**2**	**2**	**2**	**2**	**2**
Deferral of Cancellation of Indebtedness Income	**1**	**1**	**1**	**1**	**1**	**1**	**1**
Economic Development Incentives	**1**	**1**	**1**	**1**	**1**	**1**	**1**
Form 1120-F Chapter 3 and Chapter 4 Withholding	**2**	**2**	**2**	**2**	**2**	**2**	**2**
Individual Foreign Tax Credit (Form 1116)	**2**	**2**	**2**	**2**	**2**	**2**	**2**
Swiss Bank Program	**2**	**2**	**2**	**2**	**2**	**2**	**2**
Verification of Form 1042-S Credit Claimed on Form 1040NR	**2**	**2**	**2**	**2**	**2**	**2**	**2**

Source: Our analysis of the LB&I Division’s campaign results. CCM = Completed Contract Method. DPAD = Domestic Production Activities Deduction. Form 1040NR = U.S. Nonresident Alien Income Tax Return. Form 1042-S = Foreign Person’s U.S. Source Income Subject to Withholding. Form 1116 = Foreign Tax Credit (Individual, Estate, or Trust). Form 1120-F = U.S. Income Tax Return of a Foreign Corporation. I.R.C. = Internal Revenue Code. MVPD = Multichannel Video Programing Distributors. OVDP = Offshore Voluntary Disclosure Program. TV = Television.

¹⁶ See Appendix IV for a description of each campaign listed in Figure 3. Campaigns announced as part of the first 24 campaigns but not included above: Deferred Variable Annuity and Life Insurance Reserves Industry Issue Resolution as well as Tax Equity and Fiscal Responsibility Tax Act of 1982 Linkage Plan Strategy were intended to improve procedural guidance, and no enforcement results were available; *****2*****
*****2*****
*****2*****



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The measures above reflect the cumulative results for each campaign since the campaign was announced. However, these results may also include results of work performed while a particular campaign was previously a compliance project or CIP. For example, the Micro-Captive Insurance Campaign was previously a promoter examination and was converted to a campaign in September 2017.

The campaign program may incorporate multiple treatment streams in addition to issue-based examinations. These can include administrative guidance, outreach, new legislation, published guidance, soft-letters/notices, and tax forms or publications. The results above are related to issue-based examinations which are the result of the IRS's identification, selection, and development of these issues into campaigns.

Examination results from the LB&I Division's ADCCI organization show ****2****
*****2*****
*****2*****
*****2*****17 *****
*****2*****
*****2*****
*****2*****
*****2*****
*****2*****
*****2*****
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*****2*****

In addition, for the Inbound Distributor Campaign (which was also a prior project), ****2****
*****2*****
*****2*****18
*****2*****
*****2*****
*****2*****

The I.R.C. Section (§) 48C Campaign and the 1120-F Non-Filer Campaign were also CIPs.
*****2*****
*****2*****
****2****

*****2*****
*****2*****

17 *****2*****
*****2*****
18 *****2*****
*****2*****



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*****19 *****2*****
*****2*****
*****2*****
*****2*****

Results above may not support that the LB&I Division has delivered better work through campaigns. However, these results do support what the LB&I Division has openly stated in the past, that many of the initial campaigns were not those that were of the highest compliance risk:

...although the issues selected weren't the biggest ones — the most far-reaching or widespread — the idea was to pick issues that were ready for the campaign approach. That sometimes meant picking issues for which training was already developed, or wouldn't be difficult to set up, or for which foundational knowledge was already available...

Generally, campaigns are intended to involve a more thorough analysis of data to support the identification and evaluation of a compliance issue; a more deliberate consideration of potential treatment streams; decisions about the resources to be deployed; and identification of training, mentoring, networking, and tools needed as well as a robust feedback mechanism to ensure that all elements of a campaign are continuously improved. While each campaign is unique in its development based on issue complexity, filter development, and other factors, more needs to be done to ensure that the issues selected and the work delivered through campaigns is the most productive and makes the best use of limited resources.

Approximately two years into the implementation of the Campaign Program, the LB&I Division evaluated the campaign processes. In September 2018, the LB&I Division's internal Campaign Program Assessment Team issued its report. Among other issues, the team noted significant weaknesses around campaign metrics, goals, and assessing that information to support an exit strategy for each campaign. The team acknowledged that the LB&I Division was working to create standard metrics and provide a dashboard for all campaigns. The dashboard's draft user guide indicates that the dashboard is intended to support the LB&I Division's Portfolio Management initiative and allow leadership to monitor the progress of campaigns.²⁰

As previously stated, the Government Accountability Office noted that the IRS had not fully met the identified five key principles for effectively planning new projects and initiatives like campaigns. While the LB&I Division has made progress in mitigating the weaknesses that had been identified, proper planning and more consideration of past performance and use of available

¹⁹ Those seven campaigns from Figure 3 that were not prior initiatives or projects are: OVDP Declines – Withdrawals; DPAD, MVPD, and TV Broadcasters; Related-Party Transactions; Repatriation; Agricultural Chemicals Security Credit; Deferral of Cancellation of Indebtedness Income; and Verification of Form 1042-S Credit Claimed on Form 1040NR.

²⁰ Portfolio management is a framework the LB&I Division's leadership plans to use in order to prioritize programs and allocate resources. The goals of portfolio management include maximizing taxpayer compliance, balancing employee resources, and establishing standard processes and metrics across programs.



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compliance data may have allowed the LB&I Division to focus its resources on more productive issues.

Recommendations

The Commissioner, LB&I Division, should:

Recommendation 1: Consider a formal process for using past compliance results and potential impact on compliance to strengthen and supplement the process of selecting and prioritizing issues for campaigns.

Management's Response: IRS management agreed with our recommendation and stated that several of their existing compliance programs are focused on addressing the areas of highest compliance risk. However, they do not intend to limit the purview of Campaigns to focusing solely on the highest compliance risk because they believe it is important to broadly allocate compliance resources to have a positive impact across all areas of noncompliance and to tailor resource allocations to the level of compliance risk present. IRS management also stated that the data in Figure 3 is incomplete as it includes those returns closed first, and should not be used to make a conclusion about the campaigns. They will continue to use their documented processes for utilizing past compliance results and potential impact on compliance in selecting and prioritizing issues for campaigns.

Office of Audit Comment: We agree that it is important for the IRS's resources to have an impact across various areas of noncompliance, however, as we noted in this report, past compliance results were not being used to select and prioritize issues for campaigns. Compliance issues were proposed by employees through the employee suggestion portal, triaged, and delivered to the LB&I Division Practice Areas for scoping and buildout. We found evidence that compliance data were used to scope and evaluate potential campaigns and that the data were discussed as part of the campaign approval process, but the data were not used for selection and prioritization.

The IRS feels that the campaign results as shown in Figure 3 are incomplete as they reflect those returns which were closed first. We agree that these results, also described by IRS management as lackluster, should not be used to assess the success or failure of the program as a whole. However, these results include the results of work performed for some campaigns that were previously compliance projects or CIPs. Given that 23 of the first 54 campaigns developed were previously organized compliance efforts, these results are not incomplete, they simply bring into question the decision to convert many compliance projects and CIPs to campaigns. Which, in light of their scarce resources, further supports the need for the IRS to give more consideration to strengthening and supplementing its processes for identifying and prioritizing potential campaign issues, to ensure that productive inventory is delivered to employees.



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Recommendation 2: As recommendations for improvement from the LB&I Division's Campaign Assessment Team are implemented, ensure that actionable metrics and measures, including compliance results and the impact on compliance, are incorporated and timely acted upon to ensure that the most productive inventory is provided to the LB&I Division's resources.

Management's Response: IRS management agreed with our recommendation and stated that they will continue to use documented real-time campaign examination results and ensure that actionable metrics and measures, including compliance results and the impact on compliance, are incorporated and timely acted upon as they assess issues and continually evaluate whether campaigns are providing the most productive work to field personnel. In December 2018, the Compliance Integration Council approved enhanced metrics that are categorized by Resources, Duration, and Compliance. These new metrics will enable the IRS to standardize reporting across campaigns on costs, duration, and intended compliance outcomes. As part of their annual portfolio planning for FY 2020, IRS management created an initial set of outcome-oriented metrics that support data-driven decision-making for their compliance programs, including campaigns. The FY 2020 portfolio goals and metrics emphasize compliance due to the composition of the current portfolio (compliance programs). The portfolio goals and metrics will be implemented during the first quarter of FY 2020.



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Appendix I

Detailed Objective, Scope, and Methodology

Our overall objective was to assess the LB&I Division's methodology for the identification and selection of campaigns for its Future State Compliance Campaigns strategy. In addition, we evaluated available compliance results for the campaigns. To accomplish our objective, we:

- I. Reviewed documentation, records, or other guidance and interviewed key management personnel.
 - A. Identified and documented the LB&I Division's campaign development strategy.
 - B. Developed an understanding of and assessed the LB&I Division's campaign submission process.
 - C. Developed an understanding of and assessed the LB&I Division's campaign submission triage process.
 - D. Developed an understanding of and assessed the LB&I Division's campaign selection process.
 - E. Developed an understanding of and assessed the LB&I Division's campaign approval process.
 - F. Determined the current process for the LB&I Division's campaign-originated workflow, *e.g.*, from filtering to return selection and workload delivery to the field.
- II. Requested and reviewed campaign performance measures/metrics as well as related documentation or guidance. We evaluated and assessed the results and compared them to other audit areas in the LB&I Division.
- III. Obtained and evaluated business performance reviews (quality, timeliness, and customer satisfaction) or other related reports.
- IV. For any exceptions or issues noted as a result of our testing, we determined if taxpayer rights had been violated.
- V. Evaluated the risk for fraud, waste, and abuse to obtain reasonable assurance that widespread improprieties do not exist in the LB&I Division's campaign submission, approval, and implementation process.



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Internal controls methodology

Internal controls relate to management’s plans, methods, and procedures used to meet their mission, goals, and objectives. Internal controls include the processes and procedures for planning, organizing, directing, and controlling program operations. They include the systems for measuring, reporting, and monitoring program performance. We determined that the following internal controls were relevant to our audit objective: IRS policies, procedures, and practices for submitting, triaging, developing, approving, executing, monitoring, and concluding campaigns. We evaluated these controls and procedures by reviewing source materials, interviewing IRS management and field employees, and evaluating the campaign development process and performance measures.



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Appendix II

Major Contributors to This Report

Matthew A. Weir, Assistant Inspector General for Audit (Compliance and Enforcement Operations)
Glen Rhoades, Director
Curtis Kirschner, Audit Manager
Nancy Van Houten, Senior Audit Evaluator



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Appendix III

Report Distribution List

Deputy Commissioner for Services and Enforcement
Commissioner, Large Business and International Division
Deputy Commissioner, Large Business and International Division
Assistant Deputy Commissioner Compliance Integration, Large Business and International
Division
Director, Enterprise Audit Management



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Appendix IV

Campaign Descriptions

Campaign	Description
I.R.C. 48C Energy Credit	I.R.C. § 48C was enacted as part of the American Recovery and Reinvestment Act of 2009 and established a tax credit for business that establish, expand, or reequip a manufacturing facility for certain qualifying energy projects, given varying criteria. The campaign is intended to ensure that only those taxpayers whose advanced energy projects were approved by the Department of Energy, and who have been allocated a credit by the IRS, are claiming the credit.
OVDP Declines – Withdrawals	The Offshore Voluntary Disclosure Program (OVDP) allows U.S. taxpayers to voluntarily resolve past noncompliance related to unreported offshore income and failure to file foreign information returns. The campaign is intended to addresses OVDP applicants who applied for preclearance into the program but were either denied access to the OVDP or withdrew from the program of their own accord.
DPAD, MVPD, and TV Broadcasters	Multichannel Video Programing Distributors (MVPDs) and TV Broadcasters often claim that “groups” of channels or programs are a qualified film eligible for the I.R.C. § 199 Domestic Production Activities Deduction (DPAD). The campaign is intended to identify taxpayers affected by these issues and develop training to aid revenue agents in examining them.
Micro-Captive Insurance	The campaign is intended to address transactions described in Transactions of Interest Notice 2016-66, in which a taxpayer attempts to reduce aggregate taxable income using contracts treated as insurance contracts and a related company that the parties treat as a captive insurance company.
Related-Party Transactions	The campaign is intended to focus on transactions between commonly controlled entities that provide taxpayers a means to transfer funds from the corporation to related pass-through entities or shareholders.
Basket Transactions	This campaign is intended to address structured financial transactions described in Notices 2015-73 and 74, in which a taxpayer attempts to defer and treat ordinary income and short-term capital gains as long-term capital gains.



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Campaign	Description
Land Developers – CCM	Large land developers that construct in residential communities may be improperly using the Completed Contract Method (CCM) of accounting. The campaign is intended to provide training for revenue agents assigned to work this issue.
S-Corp Losses Claimed in Excess of Basis	S corporation shareholders report income, losses, and other items passed through from their corporation. The law limits losses and deductions to their basis in the corporation. However, shareholders may claim losses and deductions to which they are not entitled because they do not have sufficient stock or debt basis to absorb these items. The campaign is intended to provide support to revenue agents examining the issue and encourage self-correction through taxpayer outreach.
Repatriation	When repatriating earnings from foreign subsidiaries, taxpayers may not be reporting repatriations as taxable events. The campaign is intended to identify high-risk repatriation issues for examination.
Form 1120-F Non-Filer	Foreign companies doing business in the United States are often required to file Form 1120-F, <i>U.S. Income Tax Return of a Foreign Corporation</i> . The campaign is intended to identify foreign companies not meeting their filing requirement and encourage them to file their required returns.
Inbound Distributor	U.S. distributors of goods sourced from foreign-related parties have incurred losses or small profits on U.S. returns that are not commensurate with the functions performed and risks assumed. In many cases, the U.S. taxpayer may be entitled to higher returns in arms-length transactions. The campaign is intended to provide support to revenue agents examining the issue.
Agricultural Chemicals Security Credit	This nonrefundable credit is claimed under I.R.C. § 45O and allows a 30 percent credit to any eligible agricultural business that paid or incurred security costs to safeguard agricultural chemicals, given certain limitations. The campaign is intended to ensure that only qualified expenses by eligible taxpayers are considered and that taxpayers are properly defining facilities when computing the credit.
Deferral of Cancellation of Indebtedness Income	During Tax Years 2009 and 2010, taxpayers who incurred cancellation of indebtedness income from the reacquisition of debt instruments at an issue price less than the adjusted issue price of the original instrument may have elected to defer the cancellation of indebtedness income. The campaign is intended to ensure that taxpayers who properly deferred cancellation of indebtedness income in Tax Years 2009 and 2010 properly report it in subsequent years.



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Campaign	Description
Economic Development Incentives	Taxpayers may improperly treat government incentives as nonshareholder capital contributions, exclude them from gross income, and claim a tax deduction without offsetting it by the tax credit received. The campaign is intended to promote taxpayer compliance through examinations of this issue.
Form 1120-F Chapter 3 and Chapter 4 Withholding	To make a claim for refund or credit to estimated tax with respect to any U.S. source income withheld under chapters 3 or 4, a foreign entity must file a Form 1120-F. The campaign is intended to verify withholding at source for Forms 1120-F claiming refunds.
Individual Foreign Tax Credit (Form 1116)	Individuals file Form 1116, <i>Foreign Tax Credit (Individual, Estate, or Trust)</i> , to claim a credit that reduces their U.S. income tax liability for the amount of foreign taxes paid on foreign source income. The campaign is intended to address taxpayer compliance with the computation of the foreign tax credit limitation.
Swiss Bank Program	Banks that are participating in the Swiss Bank Program provide information on the U.S. persons with beneficial ownership of foreign financial accounts. The campaign is intended to address noncompliance involving taxpayers who are or may be beneficial owners of these accounts.
Verification of Form 1042-S Credit Claimed on Form 1040NR	The campaign is intended to ensure that the amount of withholding credits or refund/credit elects claimed on Forms 1040NR, <i>U.S. Nonresident Alien Tax Return</i> , is verified and that the taxpayer has properly reported the income reflected on Form 1042-S, <i>Foreign Person's U.S. Source Income Subject to Withholding</i> .



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Appendix V

Management's Response to the Draft Report



DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, DC 20224

September 18, 2019

MEMORANDUM FOR MICHAEL E. MCKENNEY
DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: Douglas W. O'Donnell *Douglas W. O'Donnell*
Commissioner, Large Business and International Division

SUBJECT: Draft Audit Report # 2018-30-014, Initial Compliance Results
Warrant a More Data-Driven Approach to Campaign Issue
Selection

Thank you for the opportunity to respond to the above referenced draft audit report. The Large Business and International (LB&I) portfolio is comprised of several different compliance programs (e.g., Large Corporate Compliance Program, Compliance Assurance Process, etc.) that address our filing population. In 2017, we established the Campaign Program that employs an issue focused, strategic approach to address potential non-compliance. Unlike traditional examinations of a taxpayer's entire return, campaigns are generally focused on addressing a specific issue and employ a variety of treatment streams, including issue-based examinations, published guidance, education and outreach, and industry issue resolutions, to name a few.

To date, we have initiated over 50 campaigns, and approximately 12 percent of our direct examination time this fiscal year is applied to campaigns. The Campaign Program is still relatively new, and refinements will continue to be made based on lessons learned, results of campaigns, and feedback from our employees and our external stakeholders. Recently, we formed a team of employees and managers to review the campaign program and identify opportunities for improvements. The team made several recommendations that we are working to implement – including improving the campaign development process, implementing additional data analytics tools, enhancing quality review, and soliciting feedback, including an external customer survey.

Your report notes that we should emphasize the areas that have the highest compliance risk. Several of our existing compliance programs are focused on addressing the areas of highest compliance risk. However, we do not intend to limit the purview of Campaigns to focusing solely on the highest compliance risk because it is important for us to broadly allocate our compliance resources to have a positive impact across all areas of non-compliance and to tailor resource allocations to the level of compliance risk present. For example, campaigns involving Industry Issue Resolutions (IIR) may not rise



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to the level of “highest compliance risk” but are nonetheless important issues to many taxpayers and as such warrant our attention. An IIR helps provide remedies to reduce taxpayer burden, promote consistency, and decrease examination time to more efficiently use IRS resources. Campaigns may also involve education efforts to help increase awareness and compliance with the law or soft letters to encourage taxpayer voluntary compliance and/or self-correction via amended returns, which should in turn reduce the need for LB&I examination resources.

We fully agree with the importance of a data-driven approach, and one of LB&I’s current strategic goals is to use data to drive compliance decisions. We continually seek improvements in this area, both in terms of improving accuracy of the data on taxpayer filings and the analytics applied to the data received. Of course, these data analytics tools cannot replace the risk analysis performed by our experienced workforce. Indeed, the first campaign listed in the “performance results” chart in Figure 3 was partly borne out of risks that the TIGTA identified. The IRS was addressing these risks via an active compliance initiative project which was converted to a campaign to complete. During the campaign, we determined it did not present the identified risks and found limited, if any, non-compliance; and, as such, we retired that campaign. In this instance, the campaign helped solidify potential risk, improve our future risking, and refine our selection and deselection tools, and saved additional audit resources from being spent, which results in a significant service to compliant taxpayers and better focuses our resource deployment. Also, as we shared with you, the data in Figure 3 is incomplete in that it focuses only on the returns closed to date, and historically the returns that close first are those that do not present noncompliance and as such, no adjustments are made to the return. No conclusion should be made on the basis of this incomplete data as to the totality of the returns under exam for each of these issues and the adjustments that result from these exams.

Finally, while we agree that there are always improvements to be made, we disagree with some of the conclusions reflected in the report. As we shared with you during your audit, past compliance results and potential impact are assessed during development and real-time results and feedback are used to inform the decision to retire, continue or modify a specific campaign.

If you have any questions, please contact me, or a member of your staff may contact Donald J. Sniezek, Acting Assistant Deputy Commission Compliance Integration, at 847-737-6437.

Attachment



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Attachment

RECOMMENDATION 1:

The Commissioner, Large Business and International Division, should consider a formal process for using past compliance results and potential impact on compliance to strengthen and supplement the process of selecting and prioritizing issues for campaigns.

CORRECTIVE ACTION(S):

We will continue to use our documented processes for utilizing past compliance results and potential impact on compliance in selecting and prioritizing issues for campaigns.

IMPLEMENTATION DATE:

Implemented

RESPONSIBLE OFFICIAL:

Assistant Deputy Commissioner Compliance Integration

CORRECTIVE ACTION(S) MONITORING PLAN:

N/A

RECOMMENDATION 2:

The Commissioner, Large Business and International Division should, as recommendations for improvement from the LB&I Division's Campaign Assessment Team are implemented, ensure that actionable metrics and measures, including compliance results and the impact on compliance, are incorporated and timely acted upon to ensure that the most productive inventory is provided to the LB&I Division's resources.

CORRECTIVE ACTION(S):

We will keep using our documented real-time campaign examination results and ensure that actionable metrics and measures, including compliance results and the impact on compliance, are incorporated and timely acted upon as we assess issues and continually evaluate whether campaigns are providing the most productive work to our field personnel. We implemented an initial set of metrics for each campaign treatment stream in March 2018. In December 2018, the Compliance Integration Council approved enhanced metrics that are categorized by Resources, Duration & Compliance. These new metrics will enable us to standardize reporting across campaigns on costs, duration, and intended compliance outcomes. An Executive Dashboard has also been



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developed that furthers our ability to assess the results of campaigns. We recognize that metrics are vital for determining the success of our portfolio goals. As part of our annual portfolio planning for FY 2020, we reviewed the FY 2019 IRS and LB&I Strategic goals and objectives and created an initial set of outcome-oriented metrics that support data-driven decision-making for our compliance programs, including campaigns. The FY 2020 portfolio goals and metrics emphasize compliance due to the composition of the current portfolio (compliance programs). Future planning years will include goals related to strategic or support functions. The portfolio goals and metrics will be implemented during the first quarter of FY 2020.

IMPLEMENTATION DATE:

Implemented

RESPONSIBLE OFFICIAL:

Assistant Deputy Commissioner Compliance Integration

CORRECTIVE ACTION(S) MONITORING PLAN:

N/A