

GAO Highlights

Highlights of [GAO-16-103](#), a report to congressional requesters

Why GAO Did This Study

IRS audits small businesses and self-employed individuals to ensure compliance with tax laws. Audits can help improve reporting compliance and reduce the tax gap—the difference between taxes owed and those voluntarily paid on time, which is estimated at \$385 billion annually after late payments and enforcement actions. Therefore, it is important that IRS makes informed decisions about how it selects taxpayers for audit.

GAO was asked to review IRS's processes and controls for selecting SB/SE taxpayers for audit. This report (1) describes these processes and (2) determines how well SB/SE's selection processes and controls support its mission to apply the tax law with integrity and fairness to all.

GAO reviewed IRS criteria, processes, and control procedures for selecting taxpayers for audit; assessed whether IRS control procedures followed *Standards for Internal Control in the Federal Government*; and reviewed nonprobability samples of over 200 audit files. GAO also conducted eight focus groups with SB/SE staff who review or make audit selection decisions and interviewed IRS officials.

What GAO Recommends

GAO recommends that IRS take seven actions to help ensure that the audit selection program meets its mission, such as establishing and communicating program objectives related to audit selection and improving procedures for documenting and monitoring the selection process. In commenting on a draft of this report, IRS agreed with the recommendations.

View [GAO-16-103](#). For more information, contact James R. McTigue, Jr. at (202) 512-9110 or mctiguej@gao.gov

December 2015

IRS RETURN SELECTION

Certain Internal Controls for Audits in the Small Business and Self-Employed Division Should Be Strengthened

What GAO Found

The Small Business/Self-Employed (SB/SE) division of the Internal Revenue Service (IRS) uses over 30 methods, called workstreams, to identify and review tax returns that may merit an audit. These returns were initially identified through seven sources which include referrals; computer programs that run filters, rules, or algorithms to identify potentially noncompliant taxpayers; and related returns that are identified in the course of another audit.

SB/SE's workstreams follow a general, multiphase process for identifying, reviewing (classifying), and selecting returns for audit. Within this general approach, the selection process varies across workstreams. Differences include the number of review steps and manual processes, which are greater for field audits compared to correspondence audits which generally focus on a single compliance issue and are identified using automated processes. For fiscal year 2013, IRS reported that SB/SE's primary workstream for field audits identified about 1.6 million returns as potentially most noncompliant. About 77,500 returns (5 percent) were selected for audit, a much smaller pool of returns than was initially identified.

SB/SE has control procedures for safeguarding data and segregating duties across the overall selection process, among others, but it has not implemented other key internal controls. The lack of strong control procedures increases the risk that the audit program's mission of fair and equitable application of the tax laws will not be achieved. Examples of internal control deficiencies include the following:

Program objectives and key term of fairness are not clearly defined.

Fairness is specified in SB/SE's mission statement and referenced in IRS's procedures for auditors. However, IRS has not defined fairness or program objectives for audit selection that would support its mission of treating taxpayers fairly. GAO heard different interpretations of fairness from focus group participants. Not having a clear definition of fairness can unintentionally lead to inconsistent treatment of taxpayers and create doubts as to how fairly IRS administers the tax law. Further, the lack of clearly articulated objectives undercuts the effectiveness of SB/SE's efforts to assess risks and measure performance toward achieving these objectives.

Procedures for documenting and monitoring selection decisions are not consistent. SB/SE does not always require selection decisions and rationales to be documented. For example, SB/SE requires that some workstreams document survey decisions (when returns are not assigned for audit), rationale, and approval using a form. Other workstreams, such as its primary workstream for field audits, require a group manager stamp but do not require the rationale to be documented. Also, SB/SE does not always require classification decisions (when returns are assessed for audit potential and compliance issues) to be reviewed. Having procedures to ensure that selection decisions and rationale are consistently documented and reviewed can reduce the potential for error and unfairness.