

**The Tax Exempt and Government Entities  
Division Ensures Reject Procedures Are  
Current, but Increased Controls and  
Analysis May Reduce Customer Burden**

**September 2004**

**Reference Number: 2004-10-177**

**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.**



DEPARTMENT OF THE TREASURY

WASHINGTON, D.C. 20220

INSPECTOR GENERAL  
for TAX  
ADMINISTRATION

September 27, 2004

MEMORANDUM FOR COMMISSIONER, TAX EXEMPT AND GOVERNMENT  
ENTITIES DIVISION

*Gordon C. Milbourn III*

FROM: Gordon C. Milbourn III  
Acting Deputy Inspector General for Audit

SUBJECT: Final Audit Report - The Tax Exempt and Government Entities  
Division Ensures Reject Procedures Are Current, but Increased  
Controls and Analysis May Reduce Customer Burden  
(Audit # 200410006)

This report presents the results of our review to determine whether the Tax Exempt and Government Entities (TE/GE) Division was providing the necessary oversight of the processing of the Ogden Submission Processing Site (OSPS) Reject Registers to ensure procedures and programs within the Rejects Unit are current and being followed. In addition, we determined whether there were opportunities for the TE/GE Division to reduce reject conditions and the associated burden on customers.

The TE/GE Division is comprised of the Employee Plans (EP), Exempt Organizations (EO), and Government Entities functions. Many of the customers from these three functions are required to file information and/or tax returns. Small Business/Self-Employed (SB/SE) Division employees located at the OSPS process most of these returns for the TE/GE Division. In Calendar Year (CY) 2003, the OSPS processed more than 1.8 million TE/GE Division returns in addition to the numerous returns filed by businesses.

Returns at the OSPS are routed through a series of processes, collectively known as "the pipeline," that include perfecting return data through a series of validity and consistency checks and correcting errors that are made either by the customer during preparation or by the OSPS during processing. Returns that fail these computer checks are routed to the OSPS Error Resolution Department. Returns that cannot be corrected through the error resolution process are placed in a suspense status and forwarded to the Rejects Unit at the OSPS. During CY 2003, the Rejects Unit at the OSPS processed over 71,000 TE/GE Division returns that needed additional actions to post to

the Master File.<sup>1</sup> For over 33,600 of these rejected TE/GE Division returns, the OSPS sent nearly 51,000 pieces of correspondence to resolve the reject conditions.

The TE/GE Division Customer Account Services (CAS) function is responsible for providing oversight of SB/SE Division processing activities. This includes providing technical instruction and guidance to the OSPS technicians working TE/GE Division returns, as well as monitoring the workload levels for TE/GE Division returns. The oversight provided by TE/GE Division analysts is essential, due to the specialized characteristics of TE/GE Division returns and because SB/SE Division analysts do not provide this type of oversight for TE/GE Division returns.

In summary, our review determined the TE/GE Division CAS function is providing the necessary oversight to ensure OSPS personnel working TE/GE Division customer returns with reject conditions have adequate training materials and the necessary procedures to process and resolve the reject conditions. However, we determined the TE/GE Division CAS function was not effectively monitoring aged cases and has not yet evaluated the types of errors that are causing EP returns to be sent to the Rejects Unit. This results in increased burden to TE/GE Division customers.

We recommended the Director, CAS, TE/GE Division, establish procedures to analyze and document the reasons why EO returns with reject conditions requiring correspondence take more than 120 days to resolve and establish procedures for the SB/SE Division to review EO correspondence cases aged between 45 and 59 days to ensure second correspondence is issued timely. We also recommended the Director, CAS, TE/GE Division, conduct an annual review of EP return filing errors beginning in Fiscal Year 2005 and the Director, EP, TE/GE Division, evaluate the three common errors identified in our review to determine whether any of the errors should be addressed by a redesign of the Return of Excise Taxes Related to Employee Benefit Plans (Form 5330) or through education and outreach efforts.

Management's Response: The Commissioner, TE/GE Division, agreed with the findings and recommendations in the report. The Director, CAS, TE/GE Division, will review and document the reasons why EO returns with reject conditions requiring correspondence are not resolved in 120 days or fewer, coordinate with the SB/SE Division to develop a unique TE/GE Division inventory and aged report that will increase the ability to monitor overage and suspense cases, establish procedures to request that SB/SE Division staff review correspondence cases aged between 45 and 59 days to ensure second correspondence is issued timely, and perform an annual review of EP return filing errors. The TE/GE Division Examination Redesign Study will recommend the IRS Office of Chief Counsel revisit the Incomplete Return Items and the previous General Counsel Memorandum to determine what items are considered critical enough to warrant correspondence. The Director, EP, TE/GE Division, will include articles in the summer edition of *Retirement News for Employers* and the fall edition of *EP News* to remind filers of the most common errors occurring during the processing of

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<sup>1</sup> The IRS database that stores various types of taxpayer account information. This database includes individual, business, and employee plans and exempt organizations data.

Forms 5330 and will initiate a review of the Form 5330 to determine what changes can be made to improve its design, so filing errors can be minimized. Management's complete response to the draft report is included as Appendix V.

Copies of this report are also being sent to the IRS managers affected by the report recommendations. Please contact me at (202) 622-6510 if you have questions or Daniel R. Devlin, Assistant Inspector General for Audit (Headquarters Operations and Exempt Organizations Programs), at (202) 622-8500.

**The Tax Exempt and Government Entities Division Ensures Reject Procedures Are Current, but Increased Controls and Analysis May Reduce Customer Burden**

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**Table of Contents**

Background ..... Page 1

Customer Account Services Provides the Oversight Necessary to Ensure Procedures for Processing Customer Returns With Reject Conditions Are Current..... Page 4

Increased Controls Over Exempt Organization Returns Suspended for Correspondence Are Needed to Ensure Timely Resolution..... Page 6

Recommendations 1 and 2: .....Page 8

Analyzing the Reasons for Filing Errors in Employee Plans Customer Returns Could Reduce Reject Conditions..... Page 9

Recommendations 3 and 4: .....Page 10

Appendix I – Detailed Objectives, Scope, and Methodology ..... Page 11

Appendix II – Major Contributors to This Report ..... Page 13

Appendix III – Report Distribution List ..... Page 14

Appendix IV – Outcome Measures..... Page 15

Appendix V – Management’s Response to the Draft Report..... Page 16

## The Tax Exempt and Government Entities Division Ensures Reject Procedures Are Current, but Increased Controls and Analysis May Reduce Customer Burden

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### Background

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The Internal Revenue Service (IRS) Tax Exempt and Government Entities (TE/GE) Division serves three distinct customer segments with its Employee Plans (EP), Exempt Organizations (EO), and Government Entities (GE) functions. Many of the customers from each of these functions are required to file information and/or tax returns. Most of these returns<sup>1</sup> are processed by Small Business/Self-Employed (SB/SE) Division employees located at the Ogden Submission Processing Site (OSPS). In Calendar Year (CY) 2003, the OSPS processed more than 1.8 million TE/GE Division returns in addition to the numerous returns filed by businesses.

The goal of processing return information at the OSPS is to post customer return information to each customer's Master File<sup>2</sup> account. To accurately post to the Master File, returns go through a series of processes. Collectively, these processes are called "the pipeline;" they include perfecting return data through a series of validity and consistency checks and correcting errors that are made either by the customer during preparation or by the OSPS during processing.

The Internal Revenue Manual (IRM) outlines business rules, administrative procedures, and guidelines used by the OSPS to conduct business. These rules, guidelines, and procedures assist managers and employees in administering processing activities.

After returns are transcribed, return data must pass a series of computer checks to provide IRS management with reasonable assurance that the correct information is forwarded to the Master File for posting. Returns or source documents that fail any of these computer checks are routed to the OSPS Error Resolution Department for further work. The Error Resolution Department technicians compare the related return to the error report and attempt to correct any errors made by either the taxpayer or the OSPS processing.

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<sup>1</sup> The Annual Return/Report of Employee Benefit Plan (Form 5500) series is processed by a contractor for the Department of Labor.

<sup>2</sup> The IRS database that stores various types of taxpayer account information. This database includes individual, business, employee plans, and exempt organizations data.

## The Tax Exempt and Government Entities Division Ensures Reject Procedures Are Current, but Increased Controls and Analysis May Reduce Customer Burden

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Currently, the majority of TE/GE Division error cases are processed using the Error Resolution System (ERS) computer terminals. The remaining TE/GE Division error cases are processed using the Service Center Replacement System (SCRS) paper registers.

There are three types of general errors that cause a return to be forwarded to the ERS or printed on an SCRS error register:

- Field Validity Error – includes missing information from a required field or inconsistencies between data in two different fields.
- Section Validity Error – includes missing sections, sections that are unnecessarily transcribed, and sections that are formatted incorrectly (e.g., a nonnumeric character in a numeric field).
- Math Error – occurs when the computer's computation differs from the taxpayer's entry or the transcribed amount.

Returns or documents that cannot be corrected through the error resolution process are placed in a suspense status and forwarded to the Rejects Unit at the OSPS. Some of the reasons for sending returns to the Rejects Unit may include:

- Correspondence with the taxpayer is required to obtain missing information, a schedule, or forms.
- The return or document has been numbered incorrectly. For example, a Return of Organization Exempt From Income Tax (Form 990) cannot be processed using a number reserved for a Return of Private Foundation or Section 4947(a)(1) Nonexempt Charitable Trust Treated as a Private Foundation (Form 990-PF).
- The return requires additional research to determine the correct entity, month of the fiscal year, or filing requirements.
- A previous IRS examiner was unable to make the proper correction.

During CY 2003, the Rejects Unit at the OSPS processed over 71,000 TE/GE Division returns that needed additional

## The Tax Exempt and Government Entities Division Ensures Reject Procedures Are Current, but Increased Controls and Analysis May Reduce Customer Burden

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actions to post to the Master File. For over 33,600 of these rejected TE/GE Division returns, the OSPS sent nearly 51,000 pieces of correspondence to resolve the reject conditions.

**Table 1: Number of Rejects by Type of TE/GE Division Return  
CY 2003<sup>3</sup>**

Program	Rejects
Form 990	25,883
Form 990-EZ <sup>4</sup>	18,234
Form 990-PF and Form 5227 <sup>5</sup>	16,726
Form 990-C and Form 990-T <sup>6</sup>	3,176
EO Function Miscellaneous	2,485
EP Function Miscellaneous (Form 5330) <sup>7</sup>	4,684
Total	71,188

*Source: IRS Program Analysis Report (PCC 6240).*

The TE/GE Division Customer Account Services (CAS) function is responsible for providing oversight of SB/SE Division processing activities. This includes providing technical instruction and guidance to the OSPS technicians working TE/GE Division returns, as well as monitoring the workload levels for TE/GE Division returns. The oversight provided by TE/GE Division analysts is essential, due to the specialized characteristics of TE/GE Division returns and because SB/SE Division analysts do not provide this type of oversight for TE/GE Division returns. As a result, TE/GE Division CAS function analysts are responsible for keeping

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<sup>3</sup> This is not a complete list of TE/GE Division returns with reject conditions processed at the OSPS because some forms are included in other programs (e.g., U.S. Income Tax Returns for Certain Political Organizations (Form 1120-POL) are included with other U.S. Corporation Income Tax Returns (Form 1120)).

<sup>4</sup> Short Form Return of Organization Exempt From Income Tax (Form 990-EZ).

<sup>5</sup> Split-Interest Trust Information Return (Form 5227).

<sup>6</sup> Farmers' Cooperative Association Income Tax Return (Form 990-C) and Exempt Organization Business Income Tax Return (Form 990-T).

<sup>7</sup> Return of Excise Taxes Related to Employee Benefit Plans (Form 5330).



## The Tax Exempt and Government Entities Division Ensures Reject Procedures Are Current, but Increased Controls and Analysis May Reduce Customer Burden

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### Customer Account Services Provides the Oversight Necessary to Ensure Procedures for Processing Customer Returns With Reject Conditions Are Current

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abreast of any changes to TE/GE Division returns and for alerting SB/SE Division analysts to the changes.

This review was performed at the Ogden, Utah, TE/GE Division office and the Rejects Unit of the OSPS during the period January through May 2004. The audit was conducted in accordance with *Government Auditing Standards*. Detailed information on our audit objectives, scope, and methodology is presented in Appendix I. Major contributors to the report are listed in Appendix II.

The TE/GE Division CAS function is providing the necessary oversight to ensure OSPS personnel working the TE/GE Division customer returns with reject conditions have adequate training materials and the necessary procedures to process and resolve the reject conditions. While providing training materials and updating processing procedures is a top priority for the TE/GE Division CAS function at the OSPS, this effort is primarily directed at the initial processing of returns and reject cases. We determined the TE/GE Division CAS function was not effectively monitoring aged cases and has not yet evaluated the types of errors that are causing EP reject returns. As a result, the burden on TE/GE Division customers is increased. We discuss these two issues in more detail later in the report.

The TE/GE Division CAS function is responsible for the analysis and evaluation of programs associated with the processing of TE/GE Division returns in the OSPS. To accomplish effective program management, TE/GE Division CAS function analysts carry out the following necessary tasks related to TE/GE Division returns:

- Proposing IRM revisions and changes to manual or systemic processes.
- Advising OSPS personnel of new or revised program procedures or guidelines.
- Monitoring the progress of work performed at the OSPS to detect trends or problems.
- Preparing or assisting in the preparation of new or existing training materials.

## The Tax Exempt and Government Entities Division Ensures Reject Procedures Are Current, but Increased Controls and Analysis May Reduce Customer Burden

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- Reviewing legislative and program proposals to determine the overall impact on program areas and initiating the appropriate modifications.

SB/SE Division personnel at the OSPS handle the above functions for the business returns and rely on TE/GE Division analysts to initiate the actions for TE/GE Division returns. The TE/GE Division CAS function annually revises the IRM used by OSPS personnel working the TE/GE Division returns with reject conditions. Legislative or form changes may occur during the processing year<sup>8</sup> or after the annual IRM revision has been made. In these instances or when the IRM does not contain procedures for certain processing situations, TE/GE Division CAS function analysts issue Information Alerts (IA) which supplement or change the IRM procedures until the next revisions are made. During the first quarter of CY 2004, TE/GE Division CAS function analysts issued 62 IAs, including 19 related to processing TE/GE Division returns with error or reject conditions. For CY 2003, the analysts issued 145 IAs, including 63 related to processing TE/GE Division returns with error or reject conditions.

A Request for Information Services (RIS) is prepared when changes to automated systems are needed for processing TE/GE Division returns. The RIS report dated October 2003 contained 9 requests submitted because of legislative changes and 64 requests submitted by TE/GE Division CAS function analysts for TE/GE Division returns with reject conditions. TE/GE Division CAS function analysts also reviewed the training materials developed for OSPS Rejects Unit personnel and provided guidance to course instructors.

Our analysis of the IRM, IAs, and RISs issued during the period CY 2001 through March 2004 for the OSPS Rejects Unit determined the procedures were timely updated and reflected the latest legislative and form changes. TE/GE Division CAS function analysts also followed the applicable procedures for preparing and approving this guidance. As a result, TE/GE Division CAS function analysts demonstrated the necessary oversight to ensure the procedures and

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<sup>8</sup> The calendar year in which the return or record was processed.

## The Tax Exempt and Government Entities Division Ensures Reject Procedures Are Current, but Increased Controls and Analysis May Reduce Customer Burden

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### Increased Controls Over Exempt Organization Returns Suspended for Correspondence Are Needed to Ensure Timely Resolution

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training materials used by SB/SE Division personnel working TE/GE Division returns with reject conditions were accurate and reflected the latest legislative and form changes.

TE/GE Division CAS function analysts have not established effective controls or procedures to monitor whether EO returns suspended for correspondence were resolved within 120 days or whether the second correspondence was issued timely. A second correspondence is issued if the IRS has not received a reply to the first correspondence. This situation is unique for EO returns<sup>9</sup> because the IRS does not generally send a second correspondence for other (EP or GE) returns.

The IRM requires reject correspondence cases to be maintained for 45 calendar days or at least 10 days after the period provided for the taxpayer to respond. TE/GE Division reject correspondence generally gives the taxpayer 30 days to respond. The IRM also requires a follow-up review of any correspondence returns over 60 days old in the Rejects Unit and gives a final deadline of 120 days to resolve all records in the Rejects Unit.

While the ERS and the SCRS cases forwarded to the Rejects Unit appear on an aged listing at 45 days, IRM procedures do not require employees in the Rejects Unit to monitor or take any actions to resolve cases that are aged for 45 to 59 days. Our review of aged reports was limited to the ERS because the OSPS is not required to maintain SCRS reports after they are worked.

The OSPS ERS Unworkable Suspense Aged Reports for CY 2003 showed that approximately 30 percent (20,176 of 67,611) of the total business and TE/GE Division returns open in the Rejects Unit for at least 45 days and suspended for correspondence were EO returns. In addition, 92 percent (285 of 310) of the suspended returns that were not resolved within 120 days were EO returns. The disproportionate

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<sup>9</sup> In 1984, the IRS implemented an Incomplete Returns Program for certain EO returns to increase assurances that information required by law was being provided. This Program requires that second correspondence be sent if an incomplete return item is not secured with the first correspondence.

## **The Tax Exempt and Government Entities Division Ensures Reject Procedures Are Current, but Increased Controls and Analysis May Reduce Customer Burden**

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share of EO returns that were open over 120 days indicates that systemic or procedural problems requiring action by TE/GE Division CAS function analysts may exist. TE/GE Division CAS function analysts should review some of the cases to determine the causes of the delays in closing the cases.

An analyst for the TE/GE Division CAS function advised us there are very few SCRS cases that meet the 120-day criteria and, generally, they are aged because the document cannot be located and needs to be renumbered or reinput. We acknowledge that it is difficult for TE/GE Division management to monitor the weekly aged case listing because the listing does not break out TE/GE Division returns separately from the business returns. On average, TE/GE Division returns make up approximately 32 percent of the returns included on the listing.

We analyzed the ERS aged case listings for the period January 3 through December 24, 2003, and determined that 85 percent (243 of 285) of these returns were suspended for correspondence for the entire time (indicating that they were locatable) and 48 percent (136 of 285) were listed on 2 or more reports after reaching 120 days (indicating that SB/SE Division examiners were not meeting the IRM time standard to close all Rejects Unit cases within 120 days). TE/GE Division analysts have not established specific procedures to follow up with the SB/SE Division on EO returns that are suspended for correspondence and remain unresolved for 120 days. Establishing procedures to analyze and document these cases may identify systemic or procedural problems that are causing the delays, which increase TE/GE Division customers' burden.

In addition, for EO returns requiring a second correspondence, we determined that, in 80 percent (37 of 46) of our judgmental sample, the second correspondence was not issued within 45 days. The average number of days from the first correspondence to the second correspondence was 57 days for the 46 cases. In 15 instances, the second correspondence was issued more than 70 days after the initial correspondence.

Because ERS reject cases suspended for correspondence are not followed up on until after 60 days, there is a risk that the

## The Tax Exempt and Government Entities Division Ensures Reject Procedures Are Current, but Increased Controls and Analysis May Reduce Customer Burden

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second correspondence will not be issued in 45 days as required by the IRM. Also, because the ERS Unworkable Suspense Aged Report does not distinguish between first and second correspondence, the ability of TE/GE Division CAS function analysts to monitor these cases for timeliness of actions is significantly reduced. Improved monitoring controls would enable TE/GE Division CAS function analysts to provide the necessary oversight on the timeliness of actions within the OSPS Rejects Unit for EO returns that are suspended for correspondence. Also, improved controls would reduce customer burden since some customer account information is not available until the reject is resolved and the return is posted to its respective Master File.

### Recommendations

1. The Director, CAS, TE/GE Division, should establish procedures to analyze and document the reasons EO returns with reject conditions requiring correspondence take more than 120 days to resolve.

Management's Response: The Director, CAS, TE/GE Division, will review, analyze, and document the reasons why EO returns with reject conditions requiring correspondence are not resolved in 120 days or fewer. The TE/GE Division Examination Redesign Study will recommend the IRS Office of Chief Counsel revisit the Incomplete Return Items and the previous General Counsel Memorandum to determine what items are considered critical enough to warrant correspondence.

2. The Director, CAS, TE/GE Division, should establish procedures for the SB/SE Division to review EO correspondence cases aged between 45 and 59 days to ensure second correspondence is issued timely.

Management's Response: The Director, CAS, TE/GE Division, will coordinate with the SB/SE Division to develop a unique TE/GE Division inventory and aged report which will increase the ability to monitor overage and suspense cases and will establish procedures to request that SB/SE Division staff review correspondence cases aged between 45 and 59 days to ensure second correspondence is issued timely.

## The Tax Exempt and Government Entities Division Ensures Reject Procedures Are Current, but Increased Controls and Analysis May Reduce Customer Burden

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### Analyzing the Reasons for Filing Errors in Employee Plans Customer Returns Could Reduce Reject Conditions

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We identified an opportunity for the TE/GE Division to reduce taxpayer burden by identifying common filing errors for EP returns and addressing them in education and outreach efforts. This type of review is currently being done on an annual basis for EO returns. The results from these reviews are used by the EO Customer Education and Outreach function to develop filing tips that are published on the IRS.gov web site, in tax forum sessions on completing Form 990, and in instructions for completing Form 990 returns. This information helps EO customers better understand how to correctly prepare EO returns and should lead to reduced errors and reject conditions. However, similar reviews are not performed for EP returns processed at the OSPS.

From our judgmental sample of Forms 5330 suspended for correspondence, we identified 3 areas that accounted for 90 percent (18 of 20 cases) of the errors:

- Ten filing errors were the result of the relationship between Parts VII and IX of the Form 5330, which may be confusing to some filers.
- Five filing errors occurred because the Forms 5330 were not signed.
- Three filing errors were from line 26 of Form 5330, which requests information on prohibited transactions.

An integral part of the TE/GE Division mission is to help customers understand and comply with applicable tax laws. Analyzing the types of filing errors for EP returns could identify areas where customers are having difficulties understanding and complying with the tax laws. TE/GE Division management could then develop methods to increase awareness, thereby reducing the number of EP returns with reject conditions.

TE/GE Division management advised us that they currently do not conduct such a review of EP returns due to processing changes and corrections that required the attention of the TE/GE Division CAS function analysts. However, if resources are available during Fiscal Year (FY) 2005, they plan to implement a review of EP return filing errors. While this review must be done manually by

## The Tax Exempt and Government Entities Division Ensures Reject Procedures Are Current, but Increased Controls and Analysis May Reduce Customer Burden

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reviewing current cases suspended in the Rejects Unit (the types of errors are not tracked on the ERS reports), we believe implementing such a review would require only a limited amount of resources because the number of EP reject cases is relatively small. For example, for the 2003 processing year, there were almost 4,700 EP reject cases versus approximately 71,000 total TE/GE Division reject cases. In addition, only 607 of the EP reject cases required correspondence. If trends are identified in the types of filing errors and included in future education and outreach activities, it could result in a reduction in the resources needed for correcting filing errors in the future, which may offset the resources used in conducting the review. Moreover, fewer filing errors would reduce the burden on EP customers.

### Recommendations

3. The Director, CAS, TE/GE Division, should conduct an annual review of EP return filing errors beginning in FY 2005, even if the reviews are limited due to the resources available.

Management's Response: The Director, CAS, TE/GE Division, will perform an annual review of EP return filing errors and submit a report to the Director, EP, TE/GE Division.

4. The Director, EP, TE/GE Division, should evaluate the three common errors identified in our review to determine whether any of the errors should be addressed by a redesign of the Form 5330 or through education and outreach efforts.

Management's Response: The Director, EP, TE/GE Division, will include articles in the summer edition of *Retirement News for Employers* and the fall edition of *EP News* to remind filers of the most common errors occurring during the processing of Forms 5330 and will initiate a review of the Form 5330 to determine what changes can be made to improve its design, so filing errors can be minimized.

### **Detailed Objectives, Scope, and Methodology**

The objectives of this audit were to determine whether the Tax Exempt and Government Entities (TE/GE) Division was providing the necessary oversight of the processing of the Ogden Submission Processing Site (OSPS) Reject Registers to ensure procedures and programs within the Rejects Unit are current and being followed. In addition, we determined whether there were opportunities for the TE/GE Division to reduce reject conditions and the associated burden on customers. To achieve these objectives, we:

- I. Determined whether the TE/GE Division Customer Account Services function was providing the necessary oversight to ensure Small Business/Self-Employed Division employees working TE/GE Division returns in the Rejects Unit have accurate procedures and training materials and the procedures reflect the latest legislative and form changes.
  - A. Interviewed TE/GE Division analysts and reviewed applicable documents to determine whether policy and procedures were established to ensure procedures, programs, and training materials within the Rejects Unit were current and reflected the latest legislative and form changes.
  - B. Interviewed OSPS Rejects Unit personnel working TE/GE Division returns and reviewed applicable documents to determine whether procedures, programs, and training materials were current and reflected the latest legislative and form changes.
  - C. Reviewed Requests for Information Services<sup>1</sup> to determine whether changes to procedures were submitted to reflect the latest legislative and form changes.
- II. Determined whether the TE/GE Division implemented effective controls to monitor the processing of reject conditions in the Rejects Unit and initiated changes that will correct processing problems.
  - A. Determined the number of rejects, the correspondence volume, and the number of replies to correspondence for processing year<sup>2</sup> 2003 TE/GE Division returns.
  - B. Reviewed monthly operational reports prepared by TE/GE Division analysts to determine whether reject rates were tracked, processing concerns were identified, and actions were taken to resolve issues associated with reject returns.
  - C. Reviewed the weekly aged listing of reject inventories to determine whether inventory levels were manageable as defined by the Internal Revenue Manual.

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<sup>1</sup> A Request for Information Services is prepared when changes to automated systems are needed for processing TE/GE Division returns.

<sup>2</sup> The calendar year in which the return or record was processed.



## **The Tax Exempt and Government Entities Division Ensures Reject Procedures Are Current, but Increased Controls and Analysis May Reduce Customer Burden**

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- D. Reviewed a judgmental sample<sup>3</sup> of TE/GE Division returns forwarded to the OSPS Rejects Unit and assessed the reason for the reject condition and whether the reject condition was adequately and timely resolved.
- III. Determined whether the TE/GE Division established policies and procedures to analyze the causes of errors and implemented actions to reduce future errors and the burden on customers.
- A. Interviewed TE/GE Division analysts and reviewed applicable documentation to determine whether policies and procedures have been established to analyze the causes of errors and implement actions to reduce future errors and the burden on customers.
  - B. Interviewed TE/GE Division Customer Education and Outreach function staffs and reviewed applicable documentation to determine what actions have been implemented to reduce errors.
  - C. Determined whether any of the reasons for reject conditions on TE/GE Division returns identified in the judgmental sample taken in Step II.D. could be addressed by TE/GE Division management to prevent or reduce the number of reject cases.

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<sup>3</sup> A judgmental sample of TE/GE Division rejected returns that required correspondence was used because the population could not be determined. Some of the TE/GE Division rejected returns are processed using paper registers that are not maintained by the OSPS Rejects Unit. The sample of 100 TE/GE Division rejected returns was selected on February 3 and 4, 2004, from the OSPS Rejects Unit Correspondence Suspense File. The sample included 80 Exempt Organizations (EO) returns, which consisted of 46 EO returns that required second correspondence and 34 EO returns that did not require second correspondence, and 20 Employee Plans (EP) returns [Return of Excise Taxes Related to Employee Benefit Plans (Forms 5330)]. Second correspondence is not sent for EP returns.

**The Tax Exempt and Government Entities Division Ensures Reject Procedures Are Current, but Increased Controls and Analysis May Reduce Customer Burden**

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**Appendix II**

**Major Contributors to This Report**

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James V. Westcott, Audit Manager

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Marcus Sloan, Auditor

**The Tax Exempt and Government Entities Division Ensures Reject Procedures Are Current, but Increased Controls and Analysis May Reduce Customer Burden**

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**Appendix III**

**Report Distribution List**

Commissioner C  
Office of the Commissioner – Attn: Chief of Staff C  
Deputy Commissioner for Services and Enforcement SE  
Deputy Commissioner, Tax Exempt and Government Entities Division SE:T  
Director, Customer Account Services, Tax Exempt and Government Entities Division  
SE:T:CAS  
Director, Employee Plans, Tax Exempt and Government Entities Division SE:T:EP  
Director, Exempt Organizations, Tax Exempt and Government Entities Division SE:T:EO  
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 Management Controls OS:CFO:AR:M  
Audit Liaison: Director, Communications and Liaison, Tax Exempt and Government Entities  
Division SE:T:CL

### **Outcome Measures**

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

Type and Value of Outcome Measure:

- Taxpayer Burden – Potential; 13 Employee Plans returns with reject conditions (see page 9).

Methodology Used to Measure the Reported Benefit:

An integral part of the Tax Exempt and Government Entities (TE/GE) Division mission is to help customers understand and comply with applicable tax laws. In our limited judgmental sample of 20 Return of Excise Taxes Related to Employee Benefit Plans (Form 5330) in the Rejects Unit on February 4, 2004, we identified 10 filing errors that were the result of the relationship between Parts VII and IX of the Form 5330, which may be confusing to some filers. In addition, three filing errors were from line 26 of Form 5330, which requests information on prohibited transactions.

By addressing these two types of filing errors through a redesign of the Form 5330 or education and outreach efforts, the TE/GE Division may be able to reduce the number of Employee Plans returns with reject conditions, thus reducing the burden on customers who file a Form 5330.

The Tax Exempt and Government Entities Division Ensures Reject Procedures Are Current, but Increased Controls and Analysis May Reduce Customer Burden

Appendix V

Management's Response to the Draft Report



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

RECEIVED  
SEP 15 2004

SEP 08 2004

MEMORANDUM FOR ACTING DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: Steven T. Miller, Commissioner *STM / Sarah Halloran*  
Tax Exempt and Government Entities

SUBJECT: The Tax Exempt and Government Entities Division Ensures  
Reject Procedures Are Current, but Increased Controls and  
Analysis May Reduce Customer Burden (Audit # 200410006)

I was pleased to see that your review shows that TE/GE Customer Account Services provides adequate oversight to ensure that the Small Business/Self-Employed (SB/SE) Division effectively processes TE/GE returns and resolves errors associated with those returns without unnecessarily burdening our customers. As always, our primary mission is to provide accurate and timely responses to our customers' submissions, continue to stress customer service, improve employee satisfaction and improve business results as we enhance our operation.

We agree that more can be done to improve the monitoring of aged cases and to determine the types of errors that cause EP reject returns.

**RECOMMENDATION 1:** The Director, Customer Account Services (CAS), TE/GE Division, should establish procedures to analyze and document the causes why EO returns with reject conditions requiring correspondence take more than 120 days to resolve.

**CORRECTIVE ACTION 1 (A):** We will review, analyze, and document the reasons why EO returns with reject conditions requiring correspondence are not resolved in 120 days or less. To accomplish this, we will coordinate with SB/SE to develop a report that will meet the needs of both operating divisions. If necessary, we will prepare a Request for Information Services with an implementation date of January 2006.

**IMPLEMENTATION DATE 1(A):** January 2, 2006

**RESPONSIBLE OFFICIALS 1(A):** Director, Customer Account Services SE:T:CAS

## The Tax Exempt and Government Entities Division Ensures Reject Procedures Are Current, but Increased Controls and Analysis May Reduce Customer Burden

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2

**CORRECTIVE ACTION MONITORING PLAN 1 (A)**: We will monitor this corrective action through the Business Performance Review (BPR) process of the Commissioner of the Internal Revenue Service, and the Inventory Tracking and Closure (ITC) system of the Treasury Department.

We previously performed a review to determine if we could reduce the amount of correspondence. We issued a memorandum to the Director, Exempt Organizations, recommending the elimination of correspondence for certain incomplete return items.

**CORRECTIVE ACTION 1 (B)**: The TE/GE Examination Redesign Study will recommend that IRS Counsel revisit the Incomplete Return Items (IRI) and the previous General Counsel Memorandum (GCM) to determine what items are considered critical enough to warrant correspondence.

**IMPLEMENTATION DATE 1 (B)**: January 2, 2005

**RESPONSIBLE OFFICIALS 1 (B)**: Director, Exempt Organization SE:T:EO

**CORRECTIVE ACTION MONITORING PLAN 1(B)**: We will monitor this corrective action through the Business Performance Review (BPR) process of the Commissioner of the Internal Revenue Service, and the Inventory Tracking and Closure (ITC) system of the Treasury Department.

**RECOMMENDATION 2**: The Director, CAS, TE/GE Division, should establish procedures for the SB/SE Division to review EO correspondence cases aged between 45 and 59 days to ensure second correspondence is timely issued.

**CORRECTIVE ACTION 2 (A)**: The implementation of our recommendations in our memorandum to EO referenced under Corrective Action 1 and Counsel's review of the IRI and GCM will improve the timeliness of second correspondence. However, we will coordinate with SB/SE to develop a unique TE/GE inventory and aged report which will increase our ability to monitor overage and suspense cases.

**IMPLEMENTATION DATE 2 (A)**: January 2, 2005

**RESPONSIBLE OFFICIALS 2 (A)**: Director, Customer Account Services SE:T:CAS

**CORRECTIVE ACTION MONITORING PLAN 2 (A)**: We will monitor this corrective action through the Business Performance Review (BPR) process of the Commissioner of the Internal Revenue Service, and the Inventory Tracking and Closure (ITC) system of the Treasury Department.

## The Tax Exempt and Government Entities Division Ensures Reject Procedures Are Current, but Increased Controls and Analysis May Reduce Customer Burden

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3

**CORRECTIVE ACTION 2 (B):** We will establish procedures to IRM 3.12.38 to request that SB/SE review correspondence cases between 45 and 59 days to ensure second correspondence is timely issued.

**IMPLEMENTATION DATE 2 (B):** January 2, 2005

**RESPONSIBLE OFFICIALS 2 (B):** Director, Customer Account Services SE:T:CAS

**CORRECTIVE ACTION MONITORING PLAN 2 (B):** We will monitor this corrective action through the Business Performance Review (BPR) process of the Commissioner of the Internal Revenue Service, and the Inventory Tracking and Closure (ITC) system of the Treasury Department.

**RECOMMENDATION 3:** The Director, CAS, TE/GE Division, should conduct an annual review of EP filing errors beginning in FY 2005, even if the reviews are limited due to the resources available.

**CORRECTIVE ACTION 3 (A):** As TIGTA noted in the report, we were unable to perform such reviews in the past due to higher priority processing changes that required the attention of CAS analysts. However, we will perform an annual review of EP filing errors by the end of June 2005 and submit a report to the Director, Employee Plans, by the end of July 2005.

**IMPLEMENTATION DATE 3 (A):** July 29, 2005

**RESPONSIBLE OFFICIALS 3 (A):** Director, Customer Account Services SE:T:CAS

**CORRECTIVE ACTION MONITORING PLAN 3 (A):** We will monitor this corrective action through the Business Performance Review (BPR) process of the Commissioner of the Internal Revenue Service, and the Inventory Tracking and Closure (ITC) system of the Treasury Department.

**RECOMMENDATION 4:** The Director, Employee Plans (EP), TE/GE Division, should evaluate the three common errors identified in our review to determine whether any of the errors should be addressed by redesign of the Form 5330 or through education and outreach efforts.

**CORRECTIVE ACTION 4 (A):** We included an article in the summer edition of *Retirement News for Employers* (a newsletter for business owners with retirement plans) and will include an article in the Fall edition of *EP News*, a newsletter subscribed

## The Tax Exempt and Government Entities Division Ensures Reject Procedures Are Current, but Increased Controls and Analysis May Reduce Customer Burden

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4

by nearly 24,000 pension practitioners, to remind filers of the most common errors occurring during the processing of Form 5330.

**IMPLEMENTATION DATE 4 (A):** October 31, 2004

**RESPONSIBLE OFFICIALS 4 (A):** Director, Employee Plans SE:T:EP

**CORRECTIVE ACTION MONITORING PLAN 4 (A):** We will monitor this corrective action through the Business Performance Review (BPR) process of the Commissioner of the Internal Revenue Service, and the Inventory Tracking and Closure (ITC) system of the Treasury Department.

**CORRECTIVE ACTION 4 (B):** We will initiate a review of the Form 5330 to determine what changes can be made to improve its design so that filing errors can be minimized. This review will begin in FY 05 with an expected completion date of September 2005.

**IMPLEMENTATION DATE 4 (B):** September 30, 2005

**RESPONSIBLE OFFICIALS 4 (B):** Director, Employee Plans SE:T:EP

**CORRECTIVE ACTION MONITORING PLAN 4 (B):** We will monitor this corrective action through the Business Performance Review (BPR) process of the Commissioner of the Internal Revenue Service, and the Inventory Tracking and Closure (ITC) system of the Treasury Department.

Please call Janna Skufca at (513) 263-3705 if you have any questions about the actions to Recommendations 1(A) to 3. Questions concerning Corrective Actions 1 (B) and Recommendation 4 should be directed to Sandy Ayers, (202) 283-8846, and Richard Westley, at (202) 283-9513, respectively.

cc: Director, Exempt Organizations SE:T:EO  
Director, Employee Plans SE:T:EP  
Director, Research and Analysis SE:T:RA  
Director, Customer Account Services SE:T:CAS  
Director, Customer Account Services SE:S:CAS