

Advisory Committee on Tax Exempt and Government Entities  
(ACT)

**TE/GE Audit Processes**

**Interim Report**

Terry Burke  
Craig Hoffman  
John Schroeder  
Donald Segal

Perry Israel (adjunct)  
Beth Nunnally (adjunct)

May 20, 2003

## Interim Report

The group project to analyze the audit processes of all areas of the Tax Exempt and Government Entities (TE/GE) Division is extensive. After detailed research and analysis of the current audit processes in Employee Plans, Exempt Organizations, Tax Exempt Bonds, and Federal, State and Local Governments, the group determined that properly addressing this project and providing a report with the recommendations of the entire ACT would require additional work on the part of the project team.

Accordingly, we submit this interim report and a recommendation that the project continue, with additional meetings, interviews, and research to take place over the next year, and that a report in final form be presented at the next public meeting of the ACT.

### Purposes of an Audit

As related to the TE/GE Mission, an effective audit program serves several purposes:

- **Visible enforcement** – To encourage self-compliance by others
- **Correction** – To ensure that past improper practices are corrected retroactively
- **Compliance** – To ensure that the customer operates in compliance going forward and that current rules can be complied with (demonstrate that the rules work)
- **Education** – To collect information to shape audit and self-corrections processes

Self-compliance is the cornerstone of U.S. tax compliance. An effective audit program can encourage higher compliance by ensuring that non-compliers are targeted for audit, and that entities that are abusing the tax process experience heavy penalties relative to those who are merely negligent or who do not profit from their non-compliance. Accordingly, we believe that audit processes should be shaped to target abusive practices and be more tolerant of those who do not profit from their noncompliance.

Audits should determine whether required tests and activities are being undertaken, and should test the honesty and integrity of the information being provided to the Service. Missed processes and inaccurate information should be corrected retroactively, and the Service should be prepared to help those audited identify how to correct their processes and information going forward.

An effective audit program should start with communication to the customer about the purpose of the audit, the process to be followed, and the rights of the customer. It should also produce informational feedback elements to help the Service in its other missions. Results of audits should be used to help identify issues about which taxpayers need greater education, practices that should be reviewed as part of future audits, and areas where self-corrections processes could be expanded. Analysis of audit results should be used by the Service to develop measurement tools to more

effectively select audit targets. Audits can also be the means by which the Service gains greater understanding of industry compliance in particular market segments, as with the Service's 2003 audits of single-family housing bond issues and the market segmentation approach of the Exempt Organizations Division.