

**Continued Progress Is Needed to Improve the
Centralized Offer in Compromise Program**

September 2003

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INSPECTOR GENERAL
for TAX
ADMINISTRATION

September 5, 2003

MEMORANDUM FOR COMMISSIONER, SMALL BUSINESS/SELF-EMPLOYED
DIVISION

Gordon C. Milbourn III

FROM: Gordon C. Milbourn III
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Corporate Programs)

SUBJECT: Final Audit Report - Continued Progress Is Needed to Improve
the Centralized Offer in Compromise Program
(Audit # 200230028)

This report presents the results of our review of the Internal Revenue Service's (IRS) Centralized Offer in Compromise (COIC) Program. The overall objective of this review was to determine if the new COIC Program is processing and resolving offers more quickly and effectively than the old process.

In summary, the IRS initiated the COIC Program in August 2001 as a strategy to process offers more quickly to reduce the growing backlog of offers being received. We concluded that the COIC Program has, in fact, made progress in reducing the backlog of offers in process by more quickly identifying and responding to taxpayers who do not qualify for an offer. After the COIC Program was initiated, the offer inventory decreased 20 percent during Fiscal Year (FY) 2002, and the percentage of offers over 6 months old was reduced from 46 to 37 percent. However, the reduction was primarily due to significantly more offers being returned to taxpayers, and not because more offers were fully evaluated and then accepted or rejected. Taxpayers and their representatives contributed to the increase in returned offers by submitting offers even though they were not eligible for an offer in compromise or because they did not stay current in filing tax returns and making estimated tax payments while their offers were being evaluated. COIC sites also contributed to the higher number of returned offers by inappropriately returning 15 percent of the processable returned offers in our sample.

Our review showed that processability determinations generally complied with policy but were frequently not being done timely. We also found that requests for additional

information from taxpayers occasionally included unnecessary items but, overall, were reasonable and necessary to evaluate the offers.

Analysis of Automated Offer In Compromise (AOIC)¹ system data showed that one COIC site significantly improved the timeliness of offer processing during FY 2002, but the other site had a large inventory of offers awaiting assignment to offer examiners and had a high percentage of over-age offers being closed. Review of correspondence sent to taxpayers showed that, even though one site was several months behind in assigning offers, it continued to send letters to taxpayers telling them they would be contacted within 60 days.

Our review of a sample of closed offers showed that appropriate decisions were generally made in the final dispositions. However, we determined that improvement is needed in the accuracy of the financial analyses to ensure that accurate and consistent conclusions will be made. While the amounts of the errors generally did not change the final decisions in the cases we reviewed, similar errors could affect other cases.

We recommended that the Commissioner, Small Business/Self-Employed (SB/SE) Division, use the AOIC system to periodically track trends in reasons why offers are returned to taxpayers and then modify or highlight forms, instructions, and outreach information for those issues; and develop a method to identify the primary sources of not-processable offers and a strategy to address the issues of not-processable and unrealistic or frivolous offers. We also recommended the Commissioner, SB/SE Division, establish systemic AOIC reports to ensure that processability determinations are being made timely, analyze the staffing mix at both COIC sites in relation to the current volume of offers to be processed, and establish monthly reports to monitor the age of open offers in the various assignments. Finally, we recommended that the Commissioner, SB/SE Division, continually monitor the backlog of cases awaiting assignment to offer examiners and adjust the acknowledgement letter sent to taxpayers to more accurately reflect the estimated time before contact should be expected, and provide additional guidance and training to offer examiners for analysis of taxpayers' earning statements.

Management's Response: The Commissioner, SB/SE Division, agreed with our recommendations and has either implemented them or is in the process of implementing them. The SB/SE Division has reports from the AOIC system that are now categorizing the various reasons why Offers in Compromise (OIC) have been returned. They are analyzing this data to identify trends and incorporating these trends into routine delivery of outreach presentations, and have included the information on the redesigned OIC portion of the IRS web site. They are also using AOIC system data to track trends for the reasons why OICs are returned as not processable and have already incorporated them into their outreach efforts. They have also modified the COIC case processing procedures to quickly address OICs that may be considered unrealistic or frivolous. They are coordinating with the Office of Professional

¹ The AOIC system is a centralized database used to control and track status and activities in offer cases.

Responsibility to develop strategies to identify and address practitioners who appear to routinely submit unrealistic or frivolous offers.

The SB/SE Division is using "My Eureka" software to develop a suite of management information reports for the COIC Program and will include reports to monitor the timeliness of processability determinations and the age of open OICs by the various COIC assignments to help identify potentially misplaced offers or offers with no activity for more than a reasonable number of days. They established a weekly reporting requirement to closely monitor cases awaiting assignment to offer examiners. As a result, they have eliminated the backlog of cases awaiting assignment.

Management conducted an analysis of the staffing mix at both COIC sites and decided to shift resources from the Memphis site to the Brookhaven site and also slightly adjusted the mix between process examiners and offer examiners. They will continually evaluate and adjust the process examiner/offer examiner mix based on workload.

SB/SE Division management is also finalizing a revision of the Internal Revenue Manual that will clearly address the requirements for case actions that must be completed before returning offers. They will reinforce these requirements through operational reviews conducted by SB/SE Division Headquarters during FY 2004. They will also coordinate with the Learning and Education Office to develop enhanced training in the analysis of earnings statements, and will include this training in Continuing Professional Education sessions for COIC employees. Management's complete response to the draft report is included as Appendix VI.

Copies of this report are also being sent to IRS managers who are affected by the report recommendations. Please contact me at (202) 622-6510 if you have questions or Parker Pearson, Director (Compliance), at (410) 962-9637.

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Background

An offer in compromise (OIC) is an agreement between a taxpayer and the Federal Government that settles a tax liability for payment of less than the full amount owed. The Internal Revenue Service (IRS) is authorized to compromise a liability on any one of three grounds:

- Doubt as to collectability, where the taxpayer's assets and income are less than the full amount of the liability.
- Doubt as to liability, where there is a genuine dispute as to the existence or amount of the correct tax liability under the law.
- Effective tax administration, where although collection in full could be achieved, collection of the full liability would cause the taxpayer economic hardship.

Concerns relating to the administration of the OIC Program have existed for some time. The Fiscal Year (FY) 1997 *Taxpayer Advocate's Annual Report to Congress*¹ highlighted the OIC Program as 1 of the 20 most serious problems facing taxpayers, and it has remained on the list every year since then. That report stated that tax practitioners ranked "Offer in Compromise Issues" as the fourth most serious problem facing taxpayers, and IRS management ranked "Delays in OIC Processing" as the fifteenth most serious problem. In the *National Taxpayer Advocate's FY 2002 Annual Report to Congress*, the Taxpayer Advocate ranked offers in compromise as the second most serious problem encountered by taxpayers.

Enactment of the IRS Restructuring and Reform Act of 1998 (RRA 98)² made the OIC Program accessible to more taxpayers by adding "effective tax administration" as a factor in determining whether to accept an offer. The number of offers accepted in FY 2001 was 50 percent

¹ IRS Pub. 2104 (Rev. 1-98).

² 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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higher than the number of offers accepted in FY 1997. However, during the same period there was a 200 percent increase in offer inventory. The year-end inventory increased from approximately 32,000 offers at the end of FY 1997 to approximately 95,000 at the end of FY 2001, and the percentage of inventory older than the IRS' 6-month goal increased from 21 to 46 percent.

As an inventory reduction strategy to process offers more quickly, the IRS initiated the Centralized Offer in Compromise (COIC) Program in August 2001. The concept was to screen and control offers, and gather required documents and information at two centralized sites (Brookhaven, New York, and Memphis, Tennessee). Process examiners do the screening and case building before the offers are assigned for evaluation. The more complex (business) cases are forwarded to experienced revenue officers at field offices. Simpler (wage earner) cases are worked by offer examiners at the centralized sites. All "doubt as to liability" offers are sent to field offices to be worked, while the COIC sites can work offers based on doubt as to collectibility or effective tax administration. See Appendix IV for a basic description of offer processing, some of the changes made in COIC processing, and our analysis of the timeline for processing a sample of offers.

We conducted our review in the Brookhaven and Memphis COIC sites, and the Small Business/Self-Employed (SB/SE) Division Headquarters in New Carrollton, Maryland, between July 2002 and February 2003. The audit was conducted in accordance with *Government Auditing Standards*. Detailed information about our audit objective, scope, and methodology is presented in Appendix I. Major contributors to the report are listed in Appendix II.

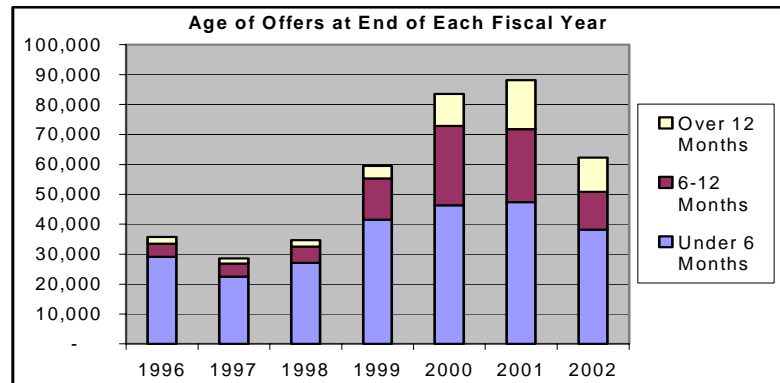
The Program Has Made Progress Toward Its Goals

The COIC Program is making progress toward the IRS goals of reducing the backlog of offers in process and closing more offers within 6 months. The number of offers received continued to increase in FY 2002, as it had in the prior 2 years. The percentage of offers closed within 6 months increased from 32 percent in FY 2001 to 38 percent in FY 2002 and to 53 percent in the first 7 months of FY 2003. In addition, the total number of

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offers closed increased substantially more than the number of new offers received, thereby reducing the inventory of pending offers by about 20,000 (about a 20 percent reduction), and the percentage of offers older than 6 months declined from 46 to 37 percent during FY 2002. Figure 1 shows the overall inventory reduction and the reduction in the number of offers pending for more than 6 months or 12 months.

Figure 1: Age and Volume of Pending Offers

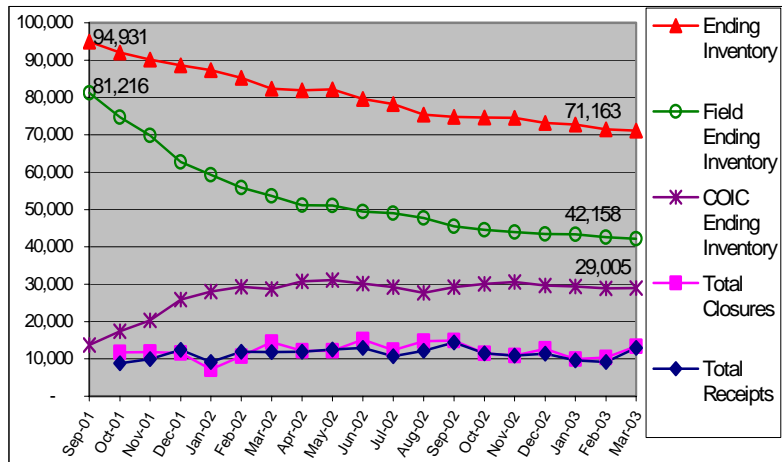


Source: Treasury Inspector General for Tax Administration (TIGTA) analysis of Collection Reports 5000-108 (Monthly Report of Offer in Compromise Activity).

One of the goals of the COIC Program was to reduce the number of field revenue officers working offers so they can be reassigned to work delinquent tax accounts. Figure 2 shows that since the implementation of the COIC Program during FY 2002 and the first half of FY 2003, the field offices have been able to significantly reduce their backlog of open offers and the overall IRS inventory of open offers has steadily decreased. The inventories at the COIC sites grew to about 28,000 to 30,000 and stabilized at that level.

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Figure 2: Change in Offer Inventories in FYs 2002 and 2003



Source: TIGTA analysis of the Automated Offer in Compromise (AOIC)³ system and Reports 5000-108.

Reduction in the number of offers in field offices enabled the IRS to release revenue officers from the offer program and return them to working the inventory of delinquent tax accounts. The number of field office revenue officers dedicated to offers in compromise was reduced from 1,078 in April 2001 to 522 in April 2003.

During the first year and a half the COIC sites were operational, all process examiners and offer examiners (over 600 employees at the time of our visits) were trained in new job skills while work processes were adjusted as needs were identified. Our reviews showed that the employees were adequately performing their duties in the following areas:

- First, a judgmental sample of 49 offers awaiting assignment to offer examiners and 20 offers ready for transfer to field offices showed that process examiners were generally making appropriate designations to field offices or COIC sites depending on the business income reported by the taxpayers. We determined that 42 of the 49 cases in the COIC holding files were appropriately selected to be worked in the COIC sites, while 6 should have been transferred to field units and 1 should have been

³ The AOIC system is a centralized database used to control and track status and activities in offer cases.

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returned to the taxpayer. We also determined that only 1 of the 20 cases being transferred to the field could have been kept in the COIC site, according to the assignment guidelines.

- Second, a judgmental sample of 60 cases from the files pending responses to requests for more information from taxpayers showed that the requests for additional information were generally reasonable and necessary. In 7 of the 60 files reviewed, the requests included an item that was not necessary, had already been provided by the taxpayers, or was for an immaterial amount. However, in each of those cases, the requests included other items that were necessary. Therefore, overall, we believe the requests were reasonable and not overly burdensome.
- Third, a judgmental sample of 60 cases currently assigned to offer examiners showed that additional documentation was requested from taxpayers during initial processing in 42 cases (70 percent). The time awaiting responses from these taxpayers averaged 34 days in 1 site and 45 days in the other.

In addition, we evaluated the accuracy of the Government Performance and Results Act of 1993 (GPRA)⁴ performance measure for the number of “Offers in Compromise Processed.” We compared the IRS Report of Offers in Compromise Activity with an extract from the AOIC system and compared various samples selected throughout the course of our review. We determined that the AOIC system was substantially complete and that cases on the system were supported by case files and case history entries of activity related to the offers. Based on our testing at the COIC sites, analyses of the AOIC system, and discussions with IRS management, we conclude that the performance measure “Offers in Compromise Processed” is substantially reliable.

⁴ Pub. L. No. 103-62, 107 Stat. 285 (codified as amended in scattered sections of 5 U.S.C., 31 U.S.C., and 39 U.S.C.).

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**More Should Be Done to
Reduce the Number of Offers
That Will Not Be Considered**

While the total offer inventory decreased, much of the decrease was because offers were returned to taxpayers who 1) did not meet the preconditions⁵ required to have an offer considered (not-processable), or 2) did not meet other conditions⁶ while the offers were being evaluated (processable returned offer). The IRS has clarified instructions for submitting an offer, but taxpayers and practitioners continue to submit offers even though they are not eligible or the offers are not realistic.

Approximately 58 percent (83,389) of the 143,102 offers closed in FY 2002 were returned to taxpayers either as not-processable or as processable returned offers. Table 1 shows that the number of not-processable offers more than doubled, while the number of processable returned offers increased 82 percent from FY 2001 to FY 2002. During the same period, the number of offers evaluated more thoroughly and closed as accepted, rejected, or withdrawn decreased by 14 percent (from 69,272 to 59,419).

Table 1: Comparison of FYs 2001 and 2002 Closures

FYs 2001 and 2002 Closed Offers					
All Offers – COIC and Field					
	FY 2001		FY 2002		FY 2001 vs. FY 2002
	Number of Offers	% of Total	Number of Offers	% of Total	% Increase (Decrease)
Not processable	16,185	14%	32,897	23%	103%
Returned	27,751	25%	50,492	35%	82%
Accepted	38,643	34%	29,140	20%	(25%)
Rejected	13,976	12%	16,952	12%	21%
Withdrawn or Terminated	16,654	15%	13,621	10%	(18%)
Total	113,209	100%	143,102	100%	26%

Source: TIGTA analysis of Collection Reports 5000-108.

⁵ The preconditions a taxpayer must meet are that they cannot be in bankruptcy and must have filed all required tax returns.

⁶ While an offer is being evaluated, the taxpayer must stay current in filing returns and making estimated tax payments and must supply substantiating documents requested by the IRS.

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The COIC sites closed 96 percent of the not-processable offers and 49 percent of the processable returned offers. See Appendix V for a breakdown of the FY 2002 closures between the COIC sites and the field offices.

To have an OIC considered, the taxpayer must have filed all required tax returns and cannot currently be in bankruptcy proceedings. Taxpayers who are in business must also have timely filed and paid employment tax returns for the prior two quarters and be current with tax deposits for the quarter in which the offer was submitted. In May 2002, the IRS implemented an additional requirement for processability – the offer must be filed on the current revision of Offer in Compromise (Form 656) with a revision date of May 2001. This revision has more complete instructions for providing documentation to verify amounts reported on the financial statement. This was intended to help the IRS process offers more quickly with less need to correspond with taxpayers for the additional information.

After this change was implemented, the number of not-processable offers increased significantly each month in both sites. This requirement was then rescinded in September 2002 because the IRS Internet site still had the older version that was being used by taxpayers. At that time, the decision was made to process offers submitted on the old form as long as they were complete, all requested supporting documentation was attached, and the taxpayers met all other requirements. (The Internet site has since been updated with the current version of the offer forms.)

We reviewed a judgmental sample of 53 offers closed as not processable during our visits to the 2 COIC sites. We reviewed 30 offers returned by Memphis in August 2002 and 23 offers returned by Brookhaven in September 2002. Overall, the not-processable determinations were in accordance with IRS procedures in all 53 cases. Of the offers we reviewed, the offers were not processable because:

- In 26 instances, the taxpayers had not filed all past due tax returns.
- In 7 instances, the taxpayers were involved in open bankruptcy proceedings.

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- In 25 instances, the taxpayers had not filed the current version of the Form 656 or did not submit the financial form showing assets, income, and expenses.

(Note: These categories total to more than 53 because some offers were returned for more than 1 reason.)

The Offer in Compromise form does not ask or require practitioners to sign offers they prepare, similar to the requirement to sign tax returns. Therefore, it is difficult to determine if offers were prepared by the taxpayers themselves, by independent practitioners, or by any of the firms that actively promote services to file offers for taxpayers. COIC Program personnel advised that many taxpayers or representatives apparently do not understand or take the time to read the instructions regarding filing compliance and bankruptcy or do not realize they will have to provide documentation proving they cannot pay the entire debt. Submission of offers that are not processable increases taxpayer frustration and burden as well as IRS workload. It also degrades service to other taxpayers who submit offers that meet all requirements and more realistically represent their ability to pay.

Recommendations

The Commissioner, SB/SE Division, should:

1. Use the AOIC system to track trends in reasons for not-processable offers or processable returned offers and then modify or highlight forms and instructions for those issues. The trends should be used in news releases, Tax Forums, and other outreach methods to educate practitioners and the public about the basic requirements of an OIC.

Management's Response: SB/SE Division management now has reports from the AOIC system that categorize the various reasons why OICs were returned and are analyzing this data to identify trends. They have incorporated the trends into their outreach presentations and included them on the redesigned OIC portion of the "IRS Digital Daily" web site.

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2. Develop a method to identify the primary sources of not-processable offers so that trends can be tracked and develop a strategy to address the issues of not-processable and unrealistic or frivolous offers submitted by taxpayers and practitioners.

Management's Response: SB/SE Division management is using AOIC data to track trends for the reasons why OICs are returned as not processable and has incorporated the information into outreach efforts and communication strategies with the public. They also modified the COIC case processing procedures to quickly address OICs that may be considered unrealistic or frivolous. SB/SE Division management is coordinating with the Office of Program Evaluation and Risk Analysis on a detailed analysis of OICs returned as not-processable to determine demographic trends regarding the sources of these returns. They are also coordinating with the Office of Professional Responsibility to develop strategies to identify and address practitioners who appear to routinely submit unrealistic and/or frivolous OICs.

Processability Determinations Were Not Timely But Are Improving

When offers are received, procedures require that examiners record basic information on the AOIC system to control the offer and that a processability determination be made within 14 days of receipt. This is to ensure that each offer can be located and that collection activity will be withheld while processable offers are pending.

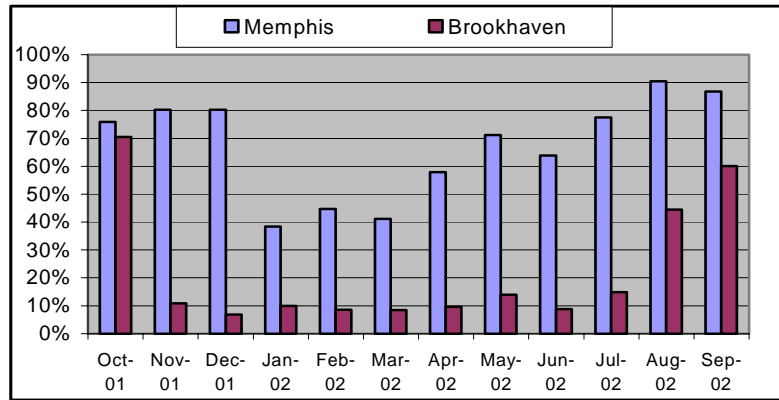
We analyzed the timeliness of processability determinations for 110,299 offers with processability determination dates during FY 2002 at the 2 COIC sites. We calculated the number of days from when the offer was initially received by the COIC site until the date processability was determined. We then calculated the percentage of cases each month that were completed within the 14-day goal and the percentage that took more than 30 days before processability was determined.

As shown in Figures 3 and 4, the Brookhaven site was making processability determinations within 14 days in only about 10 percent of the offers for much of FY 2002 and was exceeding 30 days in 30 to 70 percent of the cases. During this same period, the Memphis site was meeting the 14-day

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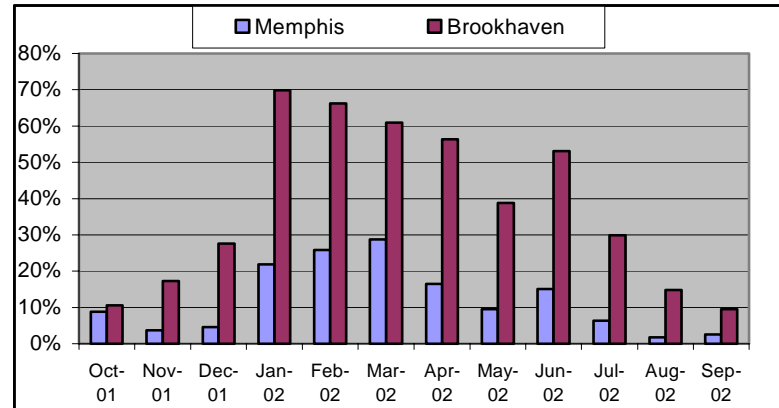
goal in 40 to 80 percent of its cases and exceeding 30 days in less than 30 percent. During the last 2 months of FY 2002, both sites showed significant improvement, with Memphis meeting the 14-day goal in 87 percent of its September cases and exceeding 30 days in only 3 percent. Brookhaven met the 14-day goal in 60 percent and exceeded 30 days in 10 percent of its September 2002 cases.

Figure 3: Percentage of Offers With Processability Determinations Within 14 Days



Source: TIGTA analysis of the AOIC system.

Figure 4: Percentage of Offers With Processability Determinations After 30 Days



Source: TIGTA analysis of the AOIC system.

It is important that processability determinations be timely recorded on the AOIC system so the existence of the offer will be recorded on other IRS systems. Otherwise, collection actions could continue, such as the filing of a levy to collect funds from a taxpayer's wages or bank accounts.

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The RRA 98 requires that levies not be issued while an OIC is pending.⁷

To further evaluate the controls over timeliness of processability determinations, we identified 145 offers assigned to the COIC sites that had been open on the AOIC system for 30 days or more (ranging from 30 to 184 days) with no indication the offers were processable. We requested that the COIC sites review their respective lists and explain the status of the offers (94 in Memphis and 51 in Brookhaven). This showed that:

- Forty-five percent (65 offers) did not have processability determinations completed.
- Twenty-three percent (34 offers) had to be deleted as erroneous records because the offers had been input in error, such as duplicate offers with incorrect Social Security Numbers or names.
- Twenty-one percent (31 offers) had been determined to be not-processable but had not been closed on the AOIC system.
- Three percent (4 offers) had been determined to be processable, but the AOIC system had not been updated.
- Eight percent (11 offers) had processability determinations pending while issues involving the Criminal Investigation Division, Collection Due Process, or Taxpayer Advocate Service were being resolved.

The AOIC system does not have standard reports of cases such as those that have been in the same status for a long time or that have no activity recorded in the history for too long. For example, a report of all cases exceeding the 14-day standard for processability determinations could be a useful management tool. In addition, delays of more than 30 days could be an indication of potentially misplaced offers or erroneous records on the control system. Other

⁷ Collection actions do not have to be suspended if collection is in jeopardy or if the offer was submitted solely to delay collection.

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Collection case control systems include standard reports to alert managers to cases that are over-age or that have had no activity so that some action can be taken. However, these features have not been designed into the AOIC system.

Recommendation

3. The Commissioner, SB/SE Division, should establish systemic AOIC reports for supervisors to identify offers that do not have a processability determination 14 days after creation on the AOIC system. The Commissioner should also consider establishing monthly management reports to show the percentage of processability determinations made within the 14-day standard in each site and department.

Management's Response: SB/SE Division management is using "My Eureka" software to develop a suite of management information reports for the COIC Program that will include reports on the timeliness of processability determinations.

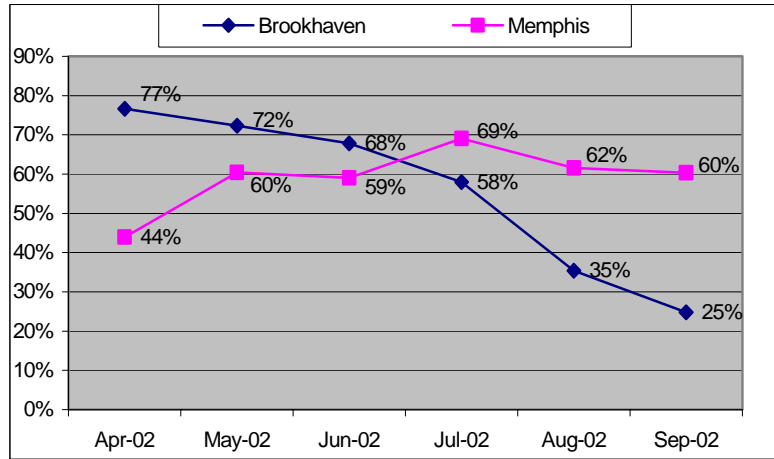
One Site Improved the Timeliness of Case Closings, But the Other Did Not

The IRS goal is to complete offer evaluations within 6 months of receipt (about 180 days). To evaluate whether the sites were meeting this goal, we analyzed the AOIC system for offers that were accepted or rejected by the COIC sites from April to September 2002 (8 or more months after the COIC sites began operations). Both sites accepted or rejected about 2,400 offers during this 6-month period, and both sites closed almost 700 offers in September 2002.

As Figure 5 shows, the Brookhaven site improved in the amount of time taken to close cases. In September 2002, only 25 percent of Brookhaven's closures were more than 6 months old, while the Memphis site had 60 percent of its closures over 6 months old. At the end of September 2002, Memphis had about 2,200 offers over 6 months old in inventory, while Brookhaven had about 600 offers over 6 months old in inventory.

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Figure 5: Percentage of Accepted and Rejected Offers Closed After 180 days



Source: TIGTA analysis of accepted and rejected offers on the AOIC system.

One contributing reason for the variance between the two sites was the significant difference in the numbers and ages of cases awaiting assignment to offer examiners in each site. Table 2 shows the volume of offers, according to the AOIC system, assigned to the holding files as of August 22 and August 23, 2002.

Table 2: Volumes and Ages of Offers Awaiting Assignment to Offer Examiners

Cases Awaiting Assignment to Offer Examiners			
<i>(per the AOIC system on 8/22/02 and 8/23/02)</i>			
Month of Processability Date	Memphis	Brookhaven	Age of Cases
February 2002 or before	30	8	Over 175 days
March 2002	142	0	145-175 days
April 2002	754	5	115-144 days
May 2002	692	4	84-114 days
June 2002	1111	93	54-83 days
July 2002	914	63	23-53 days
August 2002	311	161	0-22 days
Total	3,954	334	

Source: TIGTA query of the AOIC system.

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We attempted to match the AOIC system control records to case files for the oldest cases in each site. The cases awaiting assignment are kept in order by the date the offer was determined to be processable. The Memphis files had only cases with dates after March 1, 2002, and the Brookhaven files had only cases with dates after June 1, 2002 (indicated by bold horizontal lines in the chart above). This showed that Memphis had at least 30 offers and Brookhaven had at least 17 offers that were not in the physical files where the AOIC system indicated they should be. There are no procedures requiring management to use inventory matches or queries similar to the one we used to identify potentially misplaced offers.

Our review of the staffing mix at the two sites in August 2002 showed one factor that contributed to the differences in timeliness between the two sites. While the overall staffing and numbers of offers received were about the same,⁸ the Memphis site allocated about 63 percent of its technical positions to process examiners and 37 percent to offer examiners, while the Brookhaven site had about 53 percent of its positions as process examiners and 47 percent as offer examiners. Thus, Memphis was more able to keep up with the initial offer processing but less able to keep up with the final evaluation of the offers.

The over-age case condition in Memphis also resulted in a problem with acknowledgement letters sent to taxpayers. When taxpayers submit an offer and processability has been determined, a letter is sent acknowledging receipt. The letter requests additional documentation or, if all documentation was provided, advises the taxpayer that an offer examiner will contact him or her within 60 days. However, due to the large backlog of cases awaiting assignment to offer examiners at the time of our visit to the Memphis site, those cases would not be assigned for an estimated 135 to 160 days. Even though local management was aware of the backlog, they did not want to change the letter to tell taxpayers it would be longer than 60 days.

⁸ The Memphis site actually had 5 percent more staff, while the Brookhaven site received 7 percent more offers.

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Therefore, after 60 days, the taxpayers would have to call or write to ask about the status of their offers.

If a taxpayer or representative called, an employee would research the AOIC system to determine the current location of the case and advise the taxpayer it would be a while longer before he or she would be contacted. However, if a taxpayer wrote a letter to the Memphis site, clerical personnel simply put it in the case file without responding to it. We discussed this with local management, and they agreed to have process examiners rather than clerical personnel review incoming correspondence and reply to the taxpayers or representatives.

Recommendations

The Commissioner, SB/SE Division, should:

4. Analyze the staffing mix at both COIC sites in relation to the current volume of offers to be processed and reallocate some positions at the Memphis site from process examiners to offer examiners.

Management's Response: SB/SE Division management has analyzed the staffing mix at both COIC sites and decided to shift some resources from the Memphis site to the Brookhaven site, and has also slightly adjusted the process examiner and offer examiner mix. They will continually evaluate and adjust the mix based on workload and inventory levels.

5. Establish monthly reports to monitor the age of open offers in the various assignments and identify potentially misplaced offers. Reports should include features to identify cases with no activity for more than a reasonable number of days, depending on the current assignment location.

Management's Response: SB/SE Division management is using AOIC reports to monitor the age of open OICs by the various COIC assignments. They are also using "My Eureka" software to develop a suite of management information reports for the COIC program that will allow managers to readily identify and correct problems.

Continued Progress Is Needed to Improve the Centralized Offer in Compromise Program

6. Establish a procedure to continually monitor the backlog of cases awaiting assignment to offer examiners and adjust the acknowledgement letter sent to taxpayers, if necessary, to more accurately reflect the estimated time before contact should be expected.

Management's Response: SB/SE Division management established a weekly reporting requirement for COIC to closely monitor cases awaiting assignment to offer examiners. As a result, the backlog of unassigned cases has been eliminated and the need to adjust the acknowledgement letter no longer exists.

Some Processable Offers Were Unnecessarily Returned to Taxpayers

After offers are determined to be processable, they may still be returned to taxpayers for various reasons, including:

- 1) the taxpayer fails to remain in compliance with the filing of required tax returns while the offer is under investigation,
- 2) the taxpayer fails to make required estimated tax payments for the current year while the offer is under investigation, or
- 3) the taxpayer fails to fulfill a request for information necessary to complete a full investigation.

Additional financial information requested may include bank statements, income verification, verification of expenses or court-ordered payments, home mortgage information, automobile loan information, or a completed Collection Information Statement for Wage Earners and Self-Employed Individuals (Form 433-A).

We reviewed a sample of 33 offers closed as processable returned offers. The sample was randomly selected from a total of 3,502 offers closed in July 2002 as processable returned offers. These were offers returned to taxpayers without consideration of the offer (i.e., a financial analysis was not completed).

In 5 (15 percent) of the 33 cases reviewed, the return of the offer was not in accordance with IRS guidelines or local procedures. The reasons for the inappropriate returns included:

- The information was supplied to the IRS but was not associated with the case file – two instances.

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- The information request was not mailed to the taxpayer – one instance.
- The taxpayer was incorrectly thought to be noncompliant in filing a tax return – one instance.
- The request for information was not stated clearly and the information was not of a financial nature (requested marital status) – one instance.

These errors occurred because process examiners overlooked key information in the AOIC case history or case file, did not accurately interpret tax account transcripts, or did not clearly state what information was needed from the taxpayer.

Returning offers contrary to IRS guidelines affects taxpayer rights by not allowing their offers to be fully evaluated to determine whether an acceptable offer can be reached. Additionally, returning offers inappropriately may increase both taxpayer burden and IRS workload due to resubmitted offers.

Recommendation

7. The Commissioner, SB/SE Division, should reemphasize that COIC employees should make a thorough analysis of the case files and AOIC history entries before returning offers.

Management's Response: SB/SE Division management is finalizing a revision of the Internal Revenue Manual (IRM) that will clearly address the requirements for case actions that must be completed by COIC employees before returning offers. They will reinforce these requirements through operational reviews conducted by SB/SE Division Headquarters during FY 2004.

Inconsistent Financial Analyses Could Alter Offer Decisions

Our review of a judgmental sample of 87 closed offers (46 accepted, 31 rejected, and 10 withdrawn) showed that, generally, appropriate determinations were made in the final offer dispositions. However, we determined that improvement is needed in the accuracy of the financial analyses to ensure that accurate and consistent conclusions

Continued Progress Is Needed to Improve the Centralized Offer in Compromise Program

will be made. While the amounts of the errors generally did not change the final decisions in the cases we reviewed, similar errors could affect other cases when the income or expense amounts are significantly affected and no special circumstances are identified. This could result in incorrect determinations being made when an offer is accepted or rejected.

In the analysis of offers based on doubt as to collectibility, the offer examiner compares the amount the taxpayer offered with the amount the IRS determines could legally be collected from the taxpayer (known as the reasonable collection potential). In the analysis of offers based on effective tax administration, the offer examiner first determines if the reasonable collection potential is greater than the amount owed before considering the taxpayer's special circumstances. The reasonable collection potential is based on the taxpayer's equity in assets and future income in excess of necessary living expenses. To ensure the integrity of the process, the IRS requires the taxpayer to complete a financial statement⁹ and provide documents to verify the amounts reported on the financial statements.

Of the 87 cases reviewed, 75 had in-depth financial analyses and verifications. In the other 12 cases, the offers were evaluated using the "Full Pay Analysis"¹⁰ (9 cases), or the taxpayers withdrew the offers before financial analyses were conducted (3 cases). We identified errors or a combination of errors in the financial analyses in 22 (29 percent) of the 75 cases. The errors involved:

- Interpreting earning statements to determine monthly income or expense information – 15 instances.

⁹ The financial statement includes a monthly income and expense analysis as well as a listing of all assets and liabilities.

¹⁰ This is done using the financial information provided by the taxpayer with the offer request. If this information shows that the taxpayer has sufficient assets and/or income in excess of expenses to fully pay the liability, the offer is rejected without verifying the amounts.

Continued Progress Is Needed to Improve the Centralized Offer in Compromise Program

- Determining allowable living expenses for taxpayers who share living arrangements with nonliable persons – two instances.
- Recording financial information in the Decision Point¹¹ program – three instances.
- Determining the value of pensions or retirement accounts – two instances.

The majority of errors (15) involved the examiner's analysis of earning statements to determine average monthly income and expenses. IRS procedures require the examiner to estimate the taxpayer's monthly income from current earning statements or from an average of the taxpayer's earnings from the prior years. A taxpayer's earning statements (pay stubs) for the prior 3 months or year-to-date are used when the taxpayer has current employment. An average from the prior years (generally 3) is used when the taxpayer is temporarily unemployed or work is sporadic. In addition to monthly income, the earning statements may also contain information indicating potential assets (bank accounts, investments, and retirement accounts) and allowable necessary living expenses including taxes, health and life insurance, or court-ordered payments such as child support.

In the 15 instances above, we determined that the offer examiner:

- Used individual pay period information rather than year-to-date information in three instances. Consequently, the examiner's calculation of income was overstated due to overtime or bonus pay on the statement used.
- Used an incorrect number of pay periods per year in five instances. For example, the offer examiner incorrectly determined that the earning statement information reflected bi-weekly pay rather than semi-monthly pay or considered an

¹¹ Decision Point is a spreadsheet application developed by the IRS to guide IRS employees through the financial evaluation of offers.

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incorrect number of pay periods reflected by the year-to-date earning statement.

- Used an amount that was not gross pay in two instances.
- Did not accurately calculate the reasonable collection potential in four instances where the taxpayer's earning statement was not reflective of an entire year or the taxpayer was unemployed at the time.
- Did not accurately calculate other allowable expenses (union dues) shown on the earning statements in one instance.

Guidance in the IRM and the offer examiner training materials do not adequately cover many circumstances encountered in evaluating the various types of earning statements. For example, guidelines for estimating future income do not adequately explain:

- When it is preferable to use individual pay period information versus year-to-date information.
- How to identify the applicable pay period and the number of pay periods included in year-to-date earning statements.
- How to consider bonuses or overtime pay.

Recommendation

8. The Commissioner, SB/SE Division, should provide additional IRM guidance and training to offer examiners for analysis of earning statements, including estimating income when overtime or bonuses are included on the earning statement, and determining when and how year-to-date information should be used.

Management's Response: SB/SE Division management will coordinate with the Learning and Education Office to develop enhanced training in the area of analysis of earnings statements, and include this training in Continuing Professional Education sessions for COIC employees.

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Appendix I

Detailed Objective, Scope, and Methodology

The overall objective was to determine whether the new Centralized Offer in Compromise (COIC) Program is processing and resolving offers more quickly and effectively than the old process. To accomplish this objective, we:

- I. Determined the process and assessed the effectiveness with which the Internal Revenue Service (IRS) monitored the COIC Program, measured the Program's success, and implemented corrective actions.
 - A. Interviewed COIC management at the Small Business/Self-Employed Division Headquarters in New Carrollton, Maryland, and the Brookhaven, New York, and Memphis, Tennessee, COIC sites.
 - B. Reviewed written procedures and reports used for monitoring the COIC Program.
- II. Assessed the timeliness and effectiveness of the COIC case processing and determined the cause of delays.
 - A. Evaluated the timeliness and appropriateness of processability determinations and the cause of delays.
 1. Analyzed the Automated Offer in Compromise (AOIC) system¹ and determined whether processability determinations were made within 14 days for all 110,299 offers with processability determination dates in Fiscal Year (FY) 2002 at the 2 COIC sites.
 2. Analyzed a download of the AOIC system on October 18, 2002, and identified 145 offers that had been on the system for 30 days or more but did not show that the offers were processable. We reviewed system data and asked COIC Program management why these cases did not have processability determinations.
 3. Reviewed judgmental samples² of cases to determine whether processability determinations complied with policy for:
 - a) Fifty-three of approximately 800 not-processable offers on hand at the time of our visits in August and September 2002.

¹ The AOIC system is a centralized database used to control and track status and activities in offer cases.

² Judgmental and random samples were used throughout the review because we did not wish to make projections to the population and because the resources involved to select and review statistical samples would have been prohibitive.

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- b) One hundred and twenty processable offers (60 from approximately 6,500 offers awaiting responses from taxpayers and 60 from approximately 4,400 cases awaiting assignment to offer examiners at the time of our tests in August and September 2002).
 - B. Evaluated the timeliness and appropriateness of offer assignments to the field and COIC units and determined the cause of any delays in assignments.
 - 1. Reviewed a judgmental sample of 60 cases (30 from each site) from approximately 6,500 files pending responses to requests for more information from taxpayers at the time of our tests in August and September 2002 to determine if the requests were reasonable and necessary. [These were the same cases used for test II.A.3.b on the preceding page.]
 - 2. Reviewed a sample of 60 open offers (30 from each site) assigned to offer examiners to determine the number of times information was requested from the taxpayers and to evaluate whether the requests for additional information were reasonable and necessary. The sample cases were randomly selected from approximately 3,600 offers open and assigned to offer examiners on the AOIC system at the time of our test in September 2002 at the Brookhaven site and 4,400 offers open and assigned to offer examiners on the AOIC system at the time of our test in December 2002 at the Memphis site.
 - 3. Reviewed a judgmental sample of 49 offers from approximately 4,400 awaiting assignment to offer examiners and 20 offers ready for transfer to field offices at the time of our visits in August and September 2002 to determine whether cases were appropriately assigned to field offices or COIC units depending on the complexity of the taxpayers' financial information (e.g., wage earner or small business owner, etc.).
- III. Evaluated the timeliness and appropriateness of offers closed in the COIC units and determined the reason for delays in closing offers.
 - A. Reviewed a judgmental sample of 120 cases (46 accepted, 31 rejected, 10 withdrawn, and 33 returned) processed by the COIC units to determine if the case resolutions complied with policy. The sample of rejected, withdrawn, and returned offers was randomly selected from July 2002 closures and included 31 of 351 offers rejected where the taxpayer did not exercise appeal rights, 10 of 224 offers withdrawn, and 33 of 3,502 offers returned during July 2002. Accepted offers are maintained at the IRS campuses responsible for monitoring terms of the offer agreements; therefore, we selected a judgmental sample of 46 of 194 accepted offers awaiting shipment to the designated campuses during our on-site visits in August and October 2002.

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- B. Evaluated the timeliness of closing the 120 offers in step III.A. above, including an evaluation of the time required to process the offers through the various stages of the process.
- IV. Determined the reliability of the Government Performance and Results Act of 1993 (GPRA)³ performance measure “Offers in Compromise Processed.”
- A. Identified the data definition for the measure “Offers in Compromise Processed” and the IRS process for compiling data for the performance measure.
 - B. Determined what verification and validation routines the IRS performs to ensure the accuracy of the performance measure.
 - C. Determined whether the performance data for FY 2002 are accurate and complete by analyzing a download of the AOIC system and by comparing information from samples of 547 case files from tests II and III on the preceding pages to data recorded in the AOIC system.

³ Pub. L. No. 103-62, 107 Stat. 285 (codified as amended in scattered sections of 5 U.S.C., 31 U.S.C., and 39 U.S.C.).

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Appendix II

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Appendix III

Report Distribution List

Commissioner N:C
Deputy Commissioner for Services and Enforcement N:SE
Acting Deputy Commissioner, Small Business/Self-Employed Division S
Director, Compliance, Small Business/Self-Employed Division S:C
Director, Payment Compliance, Small Business/Self-Employed Division S:C:CP:FP
Chief Counsel CC
National Taxpayer Advocate TA
Director, Office of Legislative Affairs CL:LA
Director, Office of Program Evaluation and Risk Analysis N:ADC:R:O
Office of Management Controls N:CFO:AR:M
Audit Liaison: Commissioner, Small Business/Self-Employed Division S

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Appendix IV

Overview and Timeline of Offer Processing

The Centralized Offer in Compromise (COIC) Program essentially consists of the following steps in processing offers:

1. The taxpayer submits an offer to one of the two COIC sites depending on the state in which the taxpayer resides. However, if the taxpayer is already working with an Internal Revenue Service (IRS) field Collection unit at the time of filing the offer, the offer is worked in the IRS field Offer in Compromise (OIC) unit rather than being sent to a COIC site.
2. Once an offer is received at the COIC site, basic information is input to the Automated Offer in Compromise (AOIC)¹ system and an offer number is assigned. The AOIC system is used to document, record, and control the offer throughout the offer process.
3. Process examiners review the offer for processability. This step is to determine whether the offer can be processed and worked or if the offer must be returned to the taxpayer. An offer is considered processable unless the taxpayer has not filed all required tax returns or is currently in bankruptcy proceedings. Offers not processable are returned to the taxpayer with a letter of explanation.
4. Processable offers from corporations and partnerships are forwarded to field office OIC units. All “doubt as to liability” offers are sent to field offices to be worked.
5. Process examiners analyze the processable offers to determine if the taxpayer could fully pay the liability (the “Full Pay Analysis”). This is done using the financial information provided by the taxpayer with the offer request. If this information shows that the taxpayer has sufficient assets and/or income in excess of expenses to fully pay the liability, the offer is rejected without verification of the amounts. The taxpayer is issued a letter of explanation and a proposal to make other payment arrangements such as an installment agreement.
6. Offers that do not meet the fully payable criteria are reviewed by process examiners to determine whether required information and supporting documentation have been provided. If not, a letter requesting the information and supporting documentation is sent to the taxpayer. The taxpayer is given 30 days to respond to the request.
7. If the requested information is not received within 45 days, the offer is returned to the taxpayer with a letter of explanation.

¹ The AOIC system is a centralized database used to control and track status and activities in offer cases.

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8. Process examiners research IRS records and property records through automated systems to obtain complete information for the case file.
9. When the files are complete, the less-complex cases (primarily wage earners) are put in a holding file for assignment to offer examiners at the COIC sites. The more complex cases, such as offers from taxpayers with business income, are sent to field OIC units to be worked by experienced revenue officers.
10. When offer examiners are available to take more cases, the cases are pulled from the holding file in order of date received. The assigned offer examiner evaluates the financial information and supporting documentation to determine if the taxpayer is offering a reasonable collection potential based on his or her assets, income, and expenses. The examiner can contact the taxpayer to ask for additional information or to request that the taxpayer modify the offer. The offer examiner then makes a recommendation to accept or reject the offer.
11. The offer examiner's manager reviews all offers. If the offer is accepted or withdrawn by the taxpayer, a letter is sent advising the taxpayer.
12. All rejected offers are reviewed by an Independent Administrative Reviewer (IAR) prior to closing to ensure that the rejection is the correct action based on information in the file. If the IAR concurs, a rejection letter is sent to the taxpayer giving him or her 30 days to file an appeal. If no appeal is filed, the case is closed.
13. The Collection Quality Measurement System (CQMS) also selects random samples of all closed offers for quality review.

Procedural Changes Were Made to Speed Up Processing

The IRS changed several procedures in attempts to shorten overall processing times. The changes included:

- **Requests for additional information.** Process examiners' requests for information that was not submitted with the offer initially gave taxpayers 14 days to respond. If the information was not received, a second request was made giving another 14 days to respond. This process was changed to allow 1 request for information giving the taxpayer 30 days to respond. In each of these processes, an additional 10 to 20 days was generally allowed for mail and other delays before the next action. (This change was made per an August 28, 2001, memorandum but was not incorporated into the Internal Revenue Manual.)
- **Information requested.** Taxpayers were requested to provide substantial supporting financial information for the offer evaluation process. The IRS issued revised procedures in June 2002 to focus information requests on earnings, assets, and expenses claimed on the Collection Information Statement for Wage Earners and Self-Employed Individuals (Form 433-A).

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- **Rejection process.** Taxpayers were initially sent a letter asking them to increase or withdraw their offer, and giving them 14 days to respond. If there was no response or the response did not change the proposed rejection, the offer was sent to an IAR. When the IAR sustained the decision to reject, the taxpayer was sent a rejection letter. The taxpayer then had 30 days to file a formal appeal. Currently, proposed rejections go directly to an IAR without a letter asking the taxpayer to withdraw. Once the IAR sustains the rejection, the taxpayer is sent the rejection letter and has 30 days in which to file a formal appeal.
- **Full Pay Analysis.** The processing for all offers previously included requesting additional supporting documentation (if not already provided) and other case-building activities before evaluation by an offer examiner. Under the first-in-first-out case assignment practices, it was possible that an offer would not be evaluated for several months, and, once assigned for evaluation, some offers would obviously be rejected based on the financial information submitted with the offer without the need to verify it. In June 2002, the IRS began using a spreadsheet application to quickly analyze the taxpayers' financial information to immediately identify potential fully payable cases (see step 5 above) without the need to gather documentation to verify the amounts.

Overall, these changes should reduce processing times and thereby assist in reducing inventory. However, they may also be viewed by some as being less responsive to taxpayers' needs by not giving taxpayers as many opportunities to work out their offers.

Analysis of Time Taken in Steps to Process Offers

We reviewed the timeliness of processing activities for 87 offers closed as accepted, rejected, or withdrawn to determine where delays occurred. This included 31 of 351 offers rejected where the taxpayers did not exercise appeal rights and 10 of 224 offers withdrawn during July 2002. Accepted offers are maintained at IRS offices responsible for monitoring terms of the offer agreements; therefore, we selected a random sample of 46 of 194 accepted offers awaiting shipment to the designated IRS offices during our visits to the COIC sites in August and October 2002.

In 58 (67 percent) of the 87 cases, the offer evaluations were closed more than 6 months after receipt of the offers at the COIC sites. These 87 cases took an average of 220 days (about 7.5 months) from IRS receipt to closure on the AOIC system. In analyzing the average processing times for each activity, we found that:

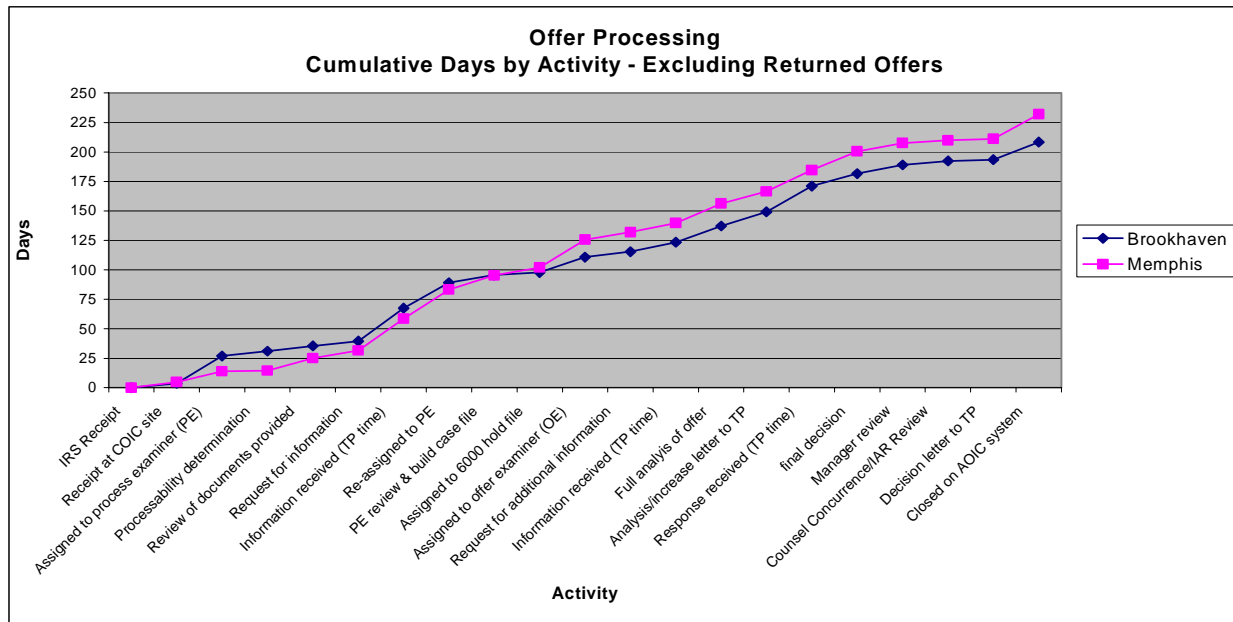
- Approximately 1 month was attributable to the process examiners for determining processability and for gathering information for a complete case file to make the offer evaluation.
- Approximately 2 months were attributable to the IRS waiting for responses to requests for information from taxpayers.

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- Approximately 2 months were spent in 1 of the COIC site holding files awaiting assignment to an available process examiner or offer examiner for the next step.
- Approximately 1.5 months were spent by offer examiners evaluating the financial and related offer information.
- Approximately 1 month was a combination of transfer time from a field office to the COIC site, managerial or other reviewer time, and time for administrative closure.

See Figure IV-1 and Table IV-1 for a comparison of the average timeline in case processing steps for the two COIC sites. This analysis shows that, up to the point of assignment to code 6000 (the holding file for cases ready for offer examiners), the two sites took about the same time. Since Memphis took longer to get the offers assigned to an offer examiner, the timeline from that point on was parallel but stayed about 15 to 20 days longer than for Brookhaven cases.

Figure IV-1: Chart of Cumulative Days to Evaluate Offers at COIC Sites



Source: Treasury Inspector General for Tax Administration (TIGTA) analysis of 87 sampled offers. See Table IV-1 for more details and an explanation of abbreviations in this chart.

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Table IV-1: Listing of Cumulative Days to Evaluate Offers at COIC Sites

Offer Step	Brookhaven		Memphis	
	<u>Average Days</u>	<u>Cumulative Days</u>	<u>Average Days</u>	<u>Cumulative Days</u>
IRS receipt				
Receipt at the COIC site	3.8	3.8	4.8	4.8
Assigned to process examiner (PE)	23.3	27	9.1	13.9
Processability determination	4.1	31.1	0.5	14.5
Review of documentation provided	4.3	35.4	10.7	25.1
Request for additional information	4.2	39.6	6.6	31.7
Information received from taxpayer	27.8	67.4	26.8	58.5
Re-assigned to PE	21.7	89.1	24.8	83.3
PE review and build case file	6.4	95.5	12	95.4
Assigned to “6000” holding file	2.2	97.7	6.6	102
Assigned to offer examiner (OE)	13	110.8	23.6	125.6
Request for additional information	4.6	115.4	6.4	132
Information received from taxpayer	8	123.4	7.8	139.8
Full analysis of offer	13.8	137.1	16.4	156.3
Analysis and increase letter to taxpayer	12.1	149.3	10.3	166.6
Response received from taxpayer	21.8	171.1	17.9	184.5
Final decision by OE	10.5	181.5	16	200.6
Manager review	7.5	189	7.1	207.7
Counsel Concurrence or IAR Review	3.5	192.4	2.1	209.8
Decision letter mailed to taxpayer	1.1	193.5	1.4	211.2
Closed on AOIC system	14.8	208.3	20.7	231.9
Total Average days	208		232	

Source: TIGTA analysis of 87 sampled offers.

Note: Some rows may not add exactly due to rounding.

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Appendix V

**Breakdown of Field and Centralized Offer in Compromise
Closures in Fiscal Year 2002**

Since most new offers are sent directly to the Centralized Offer in Compromise (COIC) sites, most “not-processable” closures are made in the COIC sites. Because COIC sites do the initial case file analyses for completeness for most offers before sending them to the field offices, they will have a large share of the “returned” closures. Field offices will still return offers if taxpayers do not reply to their requests for additional information or stay current with filing returns and estimated tax payments while the offer is being processed. Since Fiscal Year (FY) 2002 was the first year of operation for the COIC sites, the number of offers they were able to start and work completely through to closure as accepted, rejected, or withdrawn is substantially smaller than the number the field offices completed.

Table V-1: Number of FY 2002 Closures by COIC and Field Offices

Closure Type\Location	COIC	Field	Total
Not-Processable	31,701	1,196	32,897
Returned	24,527	25,965	50,492
Accepted	2,739	26,401	29,140
Rejected	2,518	14,434	16,952
Withdrawn or Terminated	2,671	10,950	13,621
Total	64,156	78,946	143,102

*Source: Treasury Inspector General for Tax Administration analysis of
Collection Reports 5000-108.*

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Appendix VI

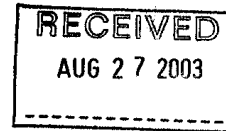
Management's Response to the Draft Report



COMMISSIONER
SMALL BUSINESS/SELF-EMPLOYED DIVISION

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

AUG 25 2003



MEMORANDUM FOR TREASURY INSPECTOR GENERAL FOR TAX
ADMINISTRATION

FROM:

Dale F. Hart 
Commissioner, Small Business/Self-Employed Division

SUBJECT:

Draft Audit Report – Continued Progress Is Needed to Improve
the Centralized Offer in Compromise Program
(Audit # 200230028)

I have reviewed your report and appreciate the recognition of the improvements we have made in the Centralized Offer in Compromise (COIC) Program. The COIC Program has been an important component of our effort to provide timely service and appropriate case decisions to taxpayers attempting to resolve their tax delinquencies through the OIC process. As you noted in your report, we have significantly reduced inventory backlogs, improved the timeliness of our responses to OIC requests, and generally made the appropriate decisions in the final disposition of COIC cases. We have continued to review and revise our COIC processes to improve the efficiency of the OIC program, as well as the accuracy and timeliness of our responses to the public. We have streamlined COIC work processes, reduced the documentation burden on taxpayers, and made significant investments in our outreach efforts to improve the quality of OIC applications.

As the COIC Program has only been in operation since August 2001, we recognize that continuous improvement is an ongoing objective. In fact, during much of the time this audit was in process, most COIC employees were in various training classes, and we were revising many COIC operating procedures. We agree with the recommendations you made in this report, and we have either implemented them or are in the process of implementing them.

Our comments on the recommendations are as follows:

RECOMMENDATION 1

Use the Automated Offer in Compromise (AOIC) system to track trends in reasons for not-processable offers, or processable returned offers, and then modify or highlight forms and instructions for those issues. The trends should be used in news releases,

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Tax Forums, and other outreach methods to educate practitioners and the public about the basic requirements of an offer in compromise.

CORRECTIVE ACTION

We have reports from the AOIC system that categorize the various reasons why Offer in Compromises (OICs) have been returned. We are analyzing this data to identify trends. As you recommended, we have incorporated these trends into our "key messages" that we routinely deliver in outreach presentations, such as the Tax Forums, and we have also included them in our recently redesigned OIC portion of the "IRS Digital Daily" web site.

IMPLEMENTATION DATE

Analysis and communication efforts are ongoing; the corrective actions are completed.

RESPONSIBLE OFFICIAL(S)

Director, Payment Compliance, Small Business/Self-Employed Division

CORRECTIVE ACTION MONITORING PLAN

N/A

RECOMMENDATION 2

Develop a method to identify the primary sources of not-processable offers so that trends can be tracked, and develop a strategy to address the issues of not-processable and unrealistic or frivolous offers submitted by taxpayers and practitioners.

CORRECTIVE ACTION

We are using AOIC data to track trends for the reasons why OICs are returned as not processable. We are also coordinating with the Office of Program Evaluation and Risk Analysis (OPERA) on a detailed analysis of OICs returned as not processable, to determine demographic trends regarding the sources of these returns. As mentioned in Recommendation 1, we are already using this information in our outreach efforts and communication strategies with the public to increase the awareness of reasons why certain OICs are returned as not processable.

We are addressing the issues of unrealistic or frivolous offers through improvements in the COIC operating procedures. Generally, these OICs will result in the OICs being returned due to lack of financial verification, or they will be quickly rejected as a result of streamlined financial analysis. Additionally, we are coordinating with the Office of Professional Responsibility to develop strategies to identify and address practitioners who appear to routinely submit unrealistic and/or frivolous OICs.

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The recommended analysis of the reasons behind unprocessable returns has been completed, and we have already incorporated much of this information into our outreach efforts. We have also modified our COIC case processing procedures to quickly address OICs that may be considered unrealistic or frivolous. We plan to implement a strategy to address "abusive practitioners" by January 15, 2004.

IMPLEMENTATION DATE

January 15, 2004

RESPONSIBLE OFFICIAL(S)

Director, Payment Compliance, Small Business/Self-Employed Division

CORRECTIVE ACTION MONITORING PLAN

The Project Director, Offer in Compromise Program, will advise the Director, Payment Compliance of any corrective action delays.

RECOMMENDATION 3

The Commissioner, SB/SE Division, should establish systemic AOIC reports for supervisors to identify offers that do not have a processability determination 14 days after creation on the AOIC system. The Commissioner should also consider establishing monthly management reports to show the percentage of processability determinations made within the 14-day standard in each site and department.

CORRECTIVE ACTION

We have AOIC reports that provide this data, however; they are not "user-friendly" management tools. We are using "My Eureka" software to develop a suite of management information reports for the COIC Program. We will include reports on the timeliness of processability determinations in these management information reports.

IMPLEMENTATION DATE

January 15, 2004

RESPONSIBLE OFFICIAL(S)

Director, Payment Compliance, Small Business/Self-Employed Division

CORRECTIVE ACTION MONITORING PLAN

The Project Director, Offer in Compromise Program, will advise the Director, Payment Compliance of any corrective action delays.

Continued Progress Is Needed to Improve the Centralized Offer in Compromise Program

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RECOMMENDATION 4

Analyze the staffing mix at both COIC sites in relation to the current volume of offers to be processed and reallocate some positions at the Memphis site from process examiners to offer examiners.

CORRECTIVE ACTION

We have conducted the recommended analysis at both COIC sites. Based on this analysis, we decided to shift some resources from the Memphis site to Brookhaven, and we have also slightly adjusted the process examiners (P/E) and offer examiners (O/E) mix. However, the mix between P/E and O/E requires continual evaluation and adjustments, based on workload. For example, the pending implementation of the OIC application fee will increase the P/E workload, and we do not feel that significant adjustments to the staffing mix would be prudent at this time. We will continue to monitor this situation to ensure that both P/E and O/E inventories are worked timely and accurately.

IMPLEMENTATION DATE

The recommended analysis has been completed, and we have adjusted COIC staffing accordingly.

RESPONSIBLE OFFICIAL(S)

Director, Payment Compliance, Small Business/Self-Employed Division

CORRECTIVE ACTION MONITORING PLAN

N/A

RECOMMENDATION 5

Establish monthly reports to monitor the age of open offers in the various assignments and identify potentially misplaced offers. Reports should include features to identify cases with no activity for more than a reasonable number of days, depending on the current assignment location.

CORRECTIVE ACTION

We are already using AOIC reports to monitor the age of open OICs by the various COIC assignments. Additionally, we are using "My Eureka" software to develop a suite of management information reports for the COIC program that will allow COIC managers to readily identify and correct problems in this area.

IMPLEMENTATION DATE

January 15, 2004

RESPONSIBLE OFFICIAL(S)

Director, Payment Compliance, Small Business/Self-Employed Division

Continued Progress Is Needed to Improve the Centralized Offer in Compromise Program

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CORRECTIVE ACTION MONITORING PLAN

The Project Director, Offer in Compromise Program will advise the Director, Payment Compliance of any corrective action delays.

RECOMMENDATION 6

Establish a procedure to continually monitor the backlog of cases awaiting assignment to offer examiners and adjust the acknowledgement letter sent to taxpayers, if necessary; to more accurately reflect the estimated time before contact should be expected.

CORRECTIVE ACTION

In October 2002, we established a weekly reporting requirement for COIC to closely monitor cases awaiting assignment to offer examiners. As a result, the backlog of cases has been eliminated. Currently, a minimal number of cases are awaiting assignment to O/Es in both locations, and the need to adjust the acknowledgement letters, as you recommended, no longer exists.

IMPLEMENTATION DATE

Completed

RESPONSIBLE OFFICIAL(S)

Director, Payment Compliance, Small Business/Self-Employed Division

CORRECTIVE ACTION MONITORING PLAN

N/A

RECOMMENDATION 7

The Commissioner, SB/SE Division, should reemphasize that COIC employees should make a thorough analysis of the case files and AOIC history entries before returning offers.

CORRECTIVE ACTION

We recognize that the quality and consistency of our return determinations is a critical component of the COIC Program. We are finalizing a revision of the Internal Revenue Manual (IRM) that will clearly address the requirements for case actions that must be completed by COIC employees before returning offers. We will reinforce these requirements through operational reviews conducted by SB/SE Headquarters during Fiscal Year 2004.

IMPLEMENTATION DATE

April 15, 2004

Continued Progress Is Needed to Improve the Centralized Offer in Compromise Program

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RESPONSIBLE OFFICIAL(S)

Director, Payment Compliance, Small Business/Self-Employed Division

CORRECTIVE ACTION MONITORING PLAN

The Project Director, Offer in Compromise Program, will advise the Director, Payment Compliance of any corrective action delays.

RECOMMENDATION 8

The Commissioner, SB/SE Division, should provide additional IRM guidance and training to offer examiners for analysis of earning statements, including estimating income when overtime or bonuses are included on the earning statement, and determining when and how year-to-date information should be used.

CORRECTIVE ACTION

Although we have delivered financial analysis training for COIC offer examiners, we recognize we have opportunities for improvement in this area. We will coordinate with the Learning and Education Office to develop enhanced training in this area, including the specific items you mentioned in this recommendation, and include this training in Continuing Professional Education (CPE) sessions for COIC employees.

IMPLEMENTATION DATE

April 15, 2004

RESPONSIBLE OFFICIAL(S)

Director, Payment Compliance, Small Business/Self-Employed Division

CORRECTIVE ACTION MONITORING PLAN

The Project Director, Offer in Compromise Program, will advise the Director, Payment Compliance of any corrective action delays.

If you have any questions, please call me at (202) 622-0600 or Joseph R. Brimacombe, Deputy Director, Compliance Policy, Small Business/Self-Employed Division, at (202) 283-2200.