

**Some Automated Collection System Business
Results Have Recently Improved, but More
Emphasis on Nonfilers Is Needed**

September 2003

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INSPECTOR GENERAL
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ADMINISTRATION

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MEMORANDUM FOR COMMISSIONER, SMALL BUSINESS/SELF-EMPLOYED
DIVISION

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Assistant Inspector General for Audit (Small Business and
Corporate Programs)

SUBJECT: Final Audit Report - Some Automated Collection System
Business Results Have Recently Improved, but More Emphasis
on Nonfilers Is Needed (Audit # 200330005)

This report presents the results of our review of the Small Business/Self-Employed (SB/SE) Division's Automated Collection System (ACS).¹ Our overall objectives were to provide an assessment of the SB/SE Division's ACS function and to ascertain the Division's plans and strategies for improving the delinquent account and delinquent investigation programs in the ACS function.

Several reports by the Treasury Inspector General for Tax Administration (TIGTA) and the General Accounting Office (GAO) have addressed the Internal Revenue Service's (IRS) declining enforcement programs since the mid-1990s. An August 2000 TIGTA report² also noted that the ACS function's business results had significantly decreased from Fiscal Year (FY) 1997 to FY 1999. The Congress, the IRS Oversight Board, the GAO, and professional organizations are concerned about the growing compliance gap and the IRS' inability to keep pace with it.

In summary, while the ACS function is a critical Collection operation, collecting nearly \$1 million per Full-Time Equivalent (FTE)³ in FY 2002, it was far more effective before

¹ The ACS is a computerized system that maintains balance due accounts (called Taxpayer Delinquent Accounts) and return delinquency investigations (called Taxpayer Delinquency Investigations).

² *Management Advisory Report: Actions to Improve the Automated Collection System Should Be Taken Within a Sound Strategic Framework* (Reference Number 2000-30-122, dated August 2000).

³ An FTE is a measure of labor hours. One FTE is equal to 8 hours multiplied by the number of compensable days in a particular fiscal year.

the enactment of the IRS Restructuring and Reform Act of 1998 (RRA 98).⁴ The ACS function collected over \$1.56 million per FTE in FY 1997. In addition, it was much more effective in closing Taxpayer Delinquency Investigations (TDI).⁵ TDI closures have significantly decreased since FY 1997.⁶

After the IRS completed reorganizing into four business operating divisions by the end of FY 2000, the ACS function became a resource shared by both the SB/SE and the Wage and Investment (W&I) Divisions. For the 2 full fiscal years since the SB/SE Division began (FY 2001 and 2002), its ACS function's business results continued to decline. That period showed decreases in closures, fewer dollars collected, a lower rate of fully paid cases, a much higher rate of not collectible closings, and decreased timeliness. According to management officials, the inventory mix in the SB/SE Division's ACS function significantly changed, resulting in fewer dispositions. Additionally, its Level of Service, which is a measure of telephone callers' abilities to connect with a Customer Service Representative, declined during the period.

During the first 7 months of FY 2003, the SB/SE Division's ACS function reversed some of these trends. Most Taxpayer Delinquent Accounts (TDA)⁷ measures have improved, including gains in dollars collected and timeliness and a solid improvement in the productivity rate. Unfortunately, TDI results have not followed the TDA trends. Projected year-end closures for FY 2003 could be nearly 33 percent fewer than in FY 2001. A relatively low priority assigned to TDI cases may have long-term consequences for filing compliance. In addition, the number of TDAs and TDIs in the Queue⁸ continued to grow significantly, as did the number of cases shelved.⁹

The SB/SE Division is taking steps to improve Collection operations. A method to identify probable collectible TDAs and filter out probable uncollectible cases was implemented in January 2003. A team has recommended several approaches for optimizing the ACS function's performance, and several additional projects are expected to improve the ACS function's results, including a filter for TDIs similar to the one for TDAs.

We recommended that the Director, Compliance, SB/SE Division, continue to monitor and evaluate the results of the initiatives and reevaluate resources for the TDI program, to reinforce a balanced program ensuring filing compliance does not erode.

Management's Response: Management agreed with the recommendation. They stated they are addressing filing compliance by developing models, to be fully operational by

⁴ 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.).

⁵ An unfiled tax return for a taxpayer.

⁶ Figures comparing FY 1997 to FY 2002 are IRS-wide, including both the SB/SE and Wage and Investment Divisions.

⁷ A balance due account of a taxpayer.

⁸ The Queue is an automated holding file for unassigned inventory of lower-priority delinquent cases that the Collection function does not have enough resources to immediately assign for contact.

⁹ Shelved accounts are delinquent unpaid accounts, or investigations of unfiled returns, that have been taken out of Collection inventory because they are lower priority.

July 2004, to identify the most productive TDIs to work in ACS and the field, and will monitor and evaluate initiative results. Management's complete response to the draft report is included as Appendix V.

Office of Audit Comment: While management agreed to monitor and evaluate initiative results, they state in the Implementation Date section of their response that corrective action has been completed. Therefore, the response neither identifies a responsible official nor defines a monitoring plan that specifically measures the degree to which the models are successful in improving filing compliance. We believe that, by indicating completed implementation, the IRS is not complying with the Department of the Treasury requirements that final bureau action determinations are made on an audit report only when all necessary corrective actions have actually been taken and validated.¹⁰ In our opinion, an implementation date should be scheduled for some time after the July 2004 date, to ensure that the balanced program concerns are addressed.

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

¹⁰ Treasury Directive 40-03, Treasury Audit Resolution, Follow-up, and Closure, § 5f.

**Some Automated Collection System Business Results Have
Recently Improved, but More Emphasis on Nonfilers Is Needed**

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Background

The Automated Collection System (ACS) is a computerized system that maintains balance due accounts (Taxpayer Delinquent Accounts [TDA]) and return delinquency investigations (Taxpayer Delinquency Investigations [TDI]). A balance due account occurs when the taxpayer has an outstanding liability for taxes, penalties, and/or interest. The return delinquency program identifies taxpayers who have not filed a return by the return due date. When the Internal Revenue Service (IRS) reorganized during Fiscal Year (FY) 2000, the ACS became a resource shared by both the Small Business/Self-Employed (SB/SE) and Wage and Investment (W&I) Divisions.

The ACS function attempts to collect taxes through telephone contact with the taxpayer. It is the second part of the IRS' three-stage Collection enforcement process. In the first stage, a series of notices is sent to the taxpayer from one of the IRS' campuses. In the final stage, the tax delinquencies may be referred to the Collection Field function (CFf) for possible face-to-face contact with the taxpayer.

During FY 2002, the ACS¹ function collected nearly \$2.7 billion and closed over 1.9 million TDAs and over 348,000 TDIs. At the end of FY 2002, nearly 3.2 million TDAs and over 1.3 million TDIs remained in inventory. The ACS function is a critical Collection operation, collecting nearly \$1 million per Full-Time Equivalent (FTE) in FY 2002. An internal SB/SE Division study showed the ACS function's return on investment exceeds that of the CFf.

We conducted this review from January to June 2003 at the SB/SE Division Headquarters Offices in New Carrollton, Maryland, and at the Philadelphia, Pennsylvania, ACS site. The audit was conducted in accordance with *Government Auditing Standards*. Data used in this report came from various IRS reports. We did not conduct tests to verify the accuracy of the data or to evaluate the effectiveness of the actions being taken or planned to improve the ACS

¹ Figures cited here are IRS-wide, including both the SB/SE and W&I Divisions.

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The Automated Collection System's Programs Reflect the Internal Revenue Service's Declining Enforcement Efforts

function's effectiveness. Detailed information on our audit objectives, scope, and methodology is presented in Appendix I. Major contributors to the report are listed in Appendix II. A Glossary of Terms used in this report is included as Appendix IV.

Several reports by the Treasury Inspector General for Tax Administration (TIGTA) and the General Accounting Office (GAO) have addressed the overall decline in the IRS' enforcement programs since the mid-1990s. A recent TIGTA report² cited several factors for the decline including budgetary constraints, the desire to provide increased customer service, and the need to implement and provide additional taxpayer protections and rights mandated by the IRS Restructuring and Reform Act of 1998 (RRA 98).³

An August 2000 TIGTA report⁴ noted that the ACS function's business results had significantly decreased from FY 1997 to FY 1999. Beyond the factors above, the report discussed additional reasons contributing to the diminished performance of the ACS function, including the declining number of FTEs used by the ACS function and the declining use of enforcement tools. The RRA 98 required the IRS to incorporate many new or modified taxpayer rights provisions into its Collection work processes. These included additional notices, new rights for innocent spouses, new administrative review and approval requirements, and new appeal procedures. Additionally, RRA 98 § 1203 provided for the removal of IRS employees who violated certain taxpayer rights. Some employees no longer believed they were protected if they were firm with the deadlines they gave to delinquent taxpayers, causing hesitancy in handling some routine enforcement actions.

² *Trends in Compliance Activities Through Fiscal Year 2002* (Reference Number 2003-30-078, dated March 2003).

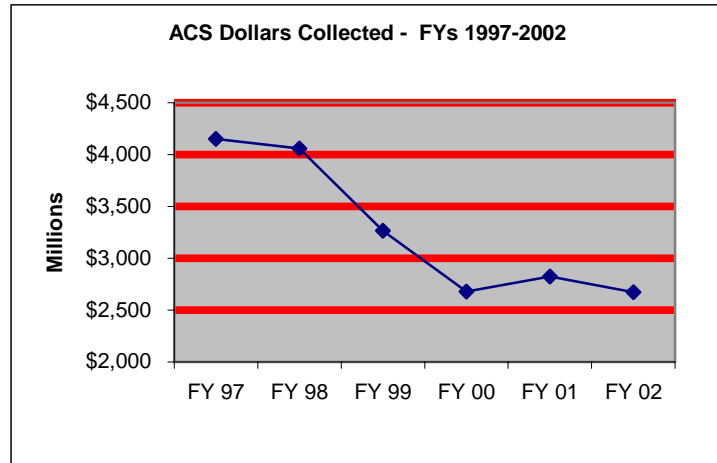
³ Pub. L. No. 105-206, 112 Stat. 685 (codified as amended in scattered sections of 2 U.S.C., 5 U.S.C. app., 16 U.S.C., 19 U.S.C., 22 U.S.C., 23 U.S.C., 26 U.S.C., 31 U.S.C., 38 U.S.C., and 49 U.S.C.).

⁴ *Management Advisory Report: Actions to Improve the Automated Collection System Should Be Taken Within a Sound Strategic Framework* (Reference Number 2000-30-122, dated August 2000).

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Similar to the IRS' overall decline in compliance indicators, Figure 1 shows that, after the enactment of the RRA 98, the ACS function's collections declined, then improved in FY 2001 and declined again in FY 2002. The \$2.6 billion collected in FY 2002 is significantly lower than the pre-RRA 98 total of \$4.1 billion.⁵

Figure 1 - Dollars Collected



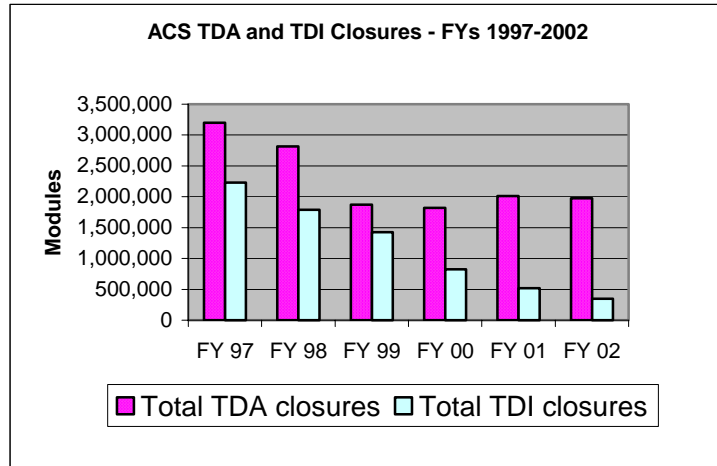
Source: IRS Collection 5000-2, 5000-6, and 5000-139 Reports.

The decline in TDA closures was similar to that for dollars collected. Figure 2 shows FY 2002 closures were only 62 percent of the 3.2 million modules closed in FY 1997. TDI closures continued their steep decline, falling from a high of 2.2 million in FY 1997 to 348,000 in FY 2002, only 16 percent of the pre-RRA 98 level.

⁵ Figures cited in this section of the report are IRS-wide, including both the SB/SE and W&I Divisions.

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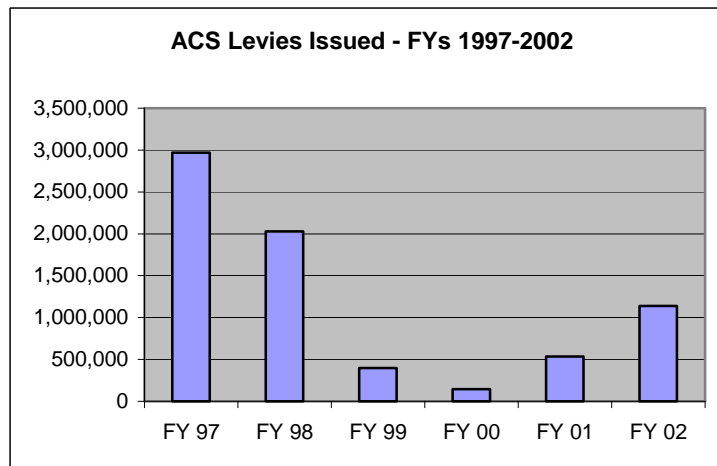
Figure 2 - Delinquent Account and Investigation Closures



Source: IRS Collection 5000-2 and 5000-4 Reports.

The ACS function can file levies against taxpayers’ wages and bank accounts to collect taxes owed. The number of levies issued reflects the dramatic effect the provisions of the RRA 98 had on enforcement activities. Figure 3 shows the number increased from the FY 2000 low of 145,000 levies issued; however, the number in FY 2002 was only about 39 percent of the nearly 3 million issued in FY 1997.

Figure 3 - Levies Issued



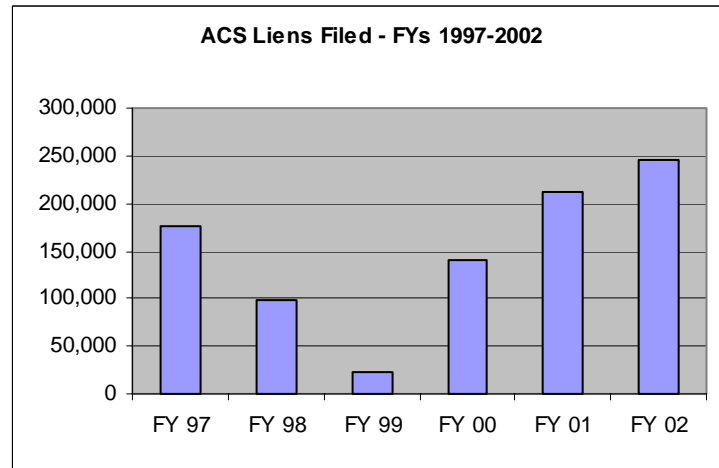
Source: IRS Collection 5000-C23 Reports, IRS Automated Lien System, and ACS Customer Service Activity Reports.

The ACS function can also file Federal Tax Liens against taxpayers’ assets, such as property, to collect taxes owed.

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Like levies, the number of liens filed dropped sharply after the enactment of the RRA 98 and then increased after FY 1999. At nearly 250,000, liens filed have climbed to a figure that is almost 40 percent higher than that in FY 1997.

Figure 4 - Liens Filed

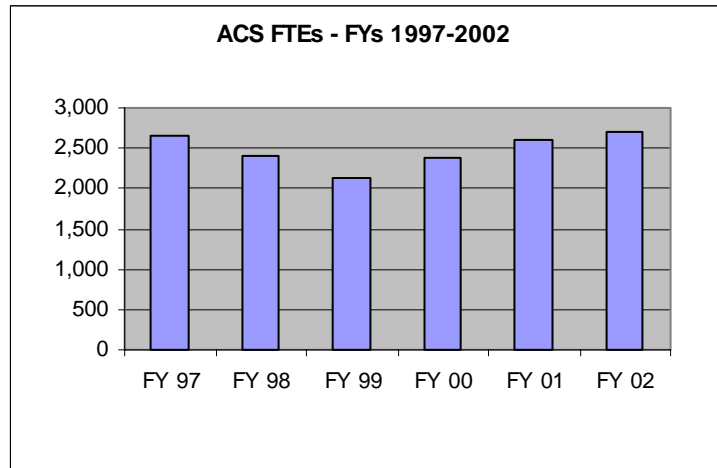


Source: IRS Collection 5000-C23 Reports, IRS Automated Lien System, and ACS Customer Service Activity Reports.

After a decline of resources following the enactment of the RRA 98, staffing has also steadily increased since FY 1999. Figure 5 shows the 2,696 FTEs realized in FY 2002 were just slightly higher than the 2,661 FTEs realized in FY 1997. This likely helped the ACS function achieve the gains it has posted in rebounding from the declines immediately following the enactment of the RRA 98.

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Figure 5 - FTEs Realized



Source: IRS ACS officials.

Although it collected nearly \$1 million per FTE in FY 2002, the ACS function was far more effective before the enactment of the RRA 98, collecting over \$1.56 million per FTE in FY 1997. In addition, it was much more effective in closing TDI cases. TDI closures have significantly decreased since FY 1997 (see Figure 2).

Many observers, including the Congress, the IRS Oversight Board, the GAO, and professional organizations, have discussed concerns about the growing compliance gap and the IRS' inability to keep pace with it. The GAO testified in June 2003 about its concern over the IRS' deferred collection actions, designating the collection of unpaid taxes as a high-risk area. In his report to the Oversight Board during September 2002, the former IRS Commissioner stated that productivity gains and an annual 2 percent staffing increase would be needed to help reverse the trends and reduce the nearly 60 percent gap between the Collection function's workload and completed work. In endorsing the proposed budget, the Oversight Board echoed the call for increased staffing.

To help ease this dilemma, the IRS requested budget resources to allow Private Collection Agencies (PCA) to collect some of the delinquent taxes. These PCAs would employ telephone collection techniques similar to those used in the ACS function. However, the IRS would expend

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The Small Business/Self-Employed Division's Automated Collection System Showed Declining Trends in Business Measures

resources for a support unit and an oversight team to train, work with, monitor, and evaluate each PCA.

FY 2001 was the first year that business results data were available for the new business operating divisions. A comparison of the results in the SB/SE Division's ACS function during the first 2 years (FYs 2001 and 2002) showed declining trends in business measures. Several key indicators for the TDA and TDI programs are presented in Figures 6 and 7 (adverse trends are shaded). The Glossary in Appendix IV explains terms used in these tables.

Areas of particular concern are declines in dollars collected, the lower rate of fully paid cases, the much higher rate of Currently Not Collectible (CNC) closings, and decreased timeliness. The productivity decline, a measure of dispositions per staff year, is also significant. Absent any staffing increases or systemic improvements, additional collections and closures depend on improving this factor.

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Figure 6 - Key SB/SE Division ACS FYs 2001-2002 TDA Statistics

TDA MEASURES	FY 2001	FY 2002	% CHANGE FYs 2001-2002
Cycle Timeliness (weeks)	30	37	23.33%
Percent Overage	16.59%	17.19%	3.62%
Closures	1,004,817	949,868	-5.47%
Inventory	1,150,080	1,216,412	5.77%
Productivity	1,286	1,143	-11.12%
Receipts	1,820,930	1,714,636	-5.84%
Dollars Collected	\$ 2,045,354,645	\$ 1,896,065,353	-7.30%
Fully Paid Rate	42.54%	36.51%	-14.17%
CNC Rate	13.33%	20.18%	51.39%
Installment Agreement Rate	28.84%	28.42%	-1.46%
Levies	197,564	455,850	130.74%
Liens	114,475	109,669	-4.20%

Source: IRS Collection 5000-2, 5000-6, 5000-139 and 5000-C23 Reports, IRS Automated Lien System, and ACS Customer Service Activity Reports.

Management officials advised that one explanation for the declines is the change to the inventory mix in the SB/SE Division's ACS function brought about by Collection reengineering recommendations. Under this initiative, in October 2001 most trust fund⁶ TDAs began to bypass the ACS function, going directly to the Queue for assignment to the CFf. These cases had relatively short turnover times and were replaced by cases taking longer to resolve, resulting in fewer dispositions. We did not conduct tests to validate this explanation. However, trust fund module inventory dropped nearly 19 percent, and dollars in that inventory dropped over 32 percent, from the end of FY 2001 to the end of FY 2002.

Most of the key TDI statistics were also down significantly in FY 2002, although the number of returns secured actually increased slightly. With its limited resources, the ACS

⁶ Trust fund taxes are income, Social Security, and Medicare taxes that must be withheld from employees.

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function focuses more attention on TDAs, where it has more enforcement avenues in the form of levies and liens. Unless a TDI is associated with a related TDA, it has a relatively low priority in the ACS function's inventory assignments. Additionally, management advised that TDI closures were affected because a programming problem suspended the Automated 6020(b) Program.⁷

Figure 7 - Key SB/SE Division ACS FYs 2001-2002 TDI Statistics

TDI MEASURES	FY 2001	FY 2002	% CHANGE FYs 2001-2002
Cycle Timeliness (weeks)	21	31	47.62%
Percent Overage	9.61%	10.70%	11.34%
Closures	339,564	211,792	-37.63%
Inventory	656,491	708,741	7.96%
Productivity	1,889	1,171	-38.01%
Receipts	1,276,289	661,373	-48.18%
Returns Secured	433,471	448,505	3.47%

Source: IRS Collection 5000-4 Reports.

Some Automated Collection System Business Results Have Begun to Improve in Fiscal Year 2003

Compared to the first 7 months of last year, measures for the SB/SE Division's ACS function through April 2003 have shown some improvement. This is particularly true for TDAs.

Figure 8 shows most of the key TDA measures have improved, including a reduction in overage cases; gains in dollars collected, timeliness, closures, and installment agreement cases; and a solid improvement in the productivity rate. The CNC closing rate decreased somewhat, although it is still significantly higher than the 13 percent rate of FY 2001. Additionally, the rate of fully paid cases continued to decline. The IRS is anticipating these rates, as well as other key statistics, will improve when case-screening initiatives discussed in the last section of this report take full effect.

⁷ 26 U.S.C. § 6020(b) (2002) authorizes the IRS to prepare, based upon filing requirements, and to process certain business returns for nonfiling taxpayers.

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Figure 8 - Key SB/SE Division ACS FY 2003 TDA Statistics

TDA MEASURES	Through April FY 2002	Through April FY 2003	% CHANGE FYs 2002-2003
Cycle Timeliness (weeks)	36	33	-8.30%
Percent Overage	22.36%	17.04%	-23.79%
Closures	505,986	609,938	20.54%
Inventory	1,189,114	1,362,703	14.60%
Productivity	1,105	1,249	13.03%
Receipts	937,836	1,183,486	26.19%
Dollars Collected	\$ 1,066,796,460	\$ 1,146,184,677	7.44%
Fully Paid Rate	36.59%	33.57%	-8.25%
CNC Rate	21.27%	20.84%	-2.02%
Installment Agreement Rate	27.20%	31.06%	14.19%

Source: IRS Collection 5000-2, 5000-6, and 5000-139 Reports.

In evaluating these numbers, however, one must recognize they do not represent an entire year, as did the figures in the previous tables. For example, averaging the 7-month figures through April 2003 over a full year would result in a more modest 4 percent closure increase, and the dollars collected would actually decline nearly 4 percent from FY 2002. Nevertheless, comparing results at one point in a year to the same point in the previous year can indicate trends in performance, and most of the TDA trends are encouraging.

Despite significantly improved TDA closure numbers, the inventory continued to rise (14 percent) as the Division experienced an even larger increase in receipts. Along with the increase in the active ACS function inventory, the number of cases in the SB/SE Division's Queue also continued to grow significantly. Figure 9 shows how these numbers increased between the end of FY 2001 and April 2003. Additionally, during the same period, more than 1.6 million modules, with a total balance due of over \$6.5 billion, were removed from the SB/SE Division's inventory through shelving procedures. Most shelved cases

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probably will never be worked, and those in the Queue may or may not be worked in the future.

Figure 9 - Increases in TDA Queue Inventory

TDA's in Queue	FY 2001	FY 2002	FY 2003 Through April	% CHANGE FYs 2001-2003
Number of Taxpayers	370,161	402,694	451,963	22.10%
Number of Modules	1,175,483	1,343,050	1,523,831	29.63%
Balance Due (Billions)	\$10.12	\$13.76	\$16.57	63.74%

Source: IRS Collection 5000-2 Reports.

Figure 10 shows most TDI results continued the downward trend seen in FY 2002, except for the productivity improvement. The TDI inventory has escalated sharply, and the number of returns secured, which gained slightly from FY 2001 to FY 2002, has noticeably decreased. Timeliness has substantially declined. If the closure rate continues, projected year-end closures of 229,000 for FY 2003 could be nearly 33 percent fewer than the approximately 339,000 achieved in FY 2001 (see Figure 7).

Figure 10 - Key SB/SE Division ACS FY 2003 TDI Statistics

TDI MEASURES	Through April FY 2002	Through April FY 2003	% CHANGE FYs 2002-2003
Cycle Timeliness (weeks)	27	41	51.85%
Percent Overage	17.94%	8.45%	-52.90%
Closures	138,912	133,586	-3.83%
Inventory	459,951	634,887	38.03%
Productivity	1,282	1,339	4.45%
Receipts	359,890	422,625	17.43%
Returns Secured	267,868	237,817	-11.22%

Source: IRS Collection 5000-4 Reports.

Although the overage rate decreased significantly, it corresponds with a substantial rise in the number of cases shelved. Like TDAs, the Division's TDI Queue inventory has increased. From FY 2001 through April 2003, the

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number of TDI modules in the Queue increased by nearly 12 percent, despite the shelving of over 7.6 million modules.

We recognize that the ACS function's resources are limited and the collection of TDAs is important; however, the negative trends in the TDI program over the past few years and the resulting program imbalance are significant. The Collection mission⁸ includes collecting promptly the proper amount of Federal tax from all persons who have not filed returns. The low priority assigned to delinquent return cases may have long-term consequences for filing compliance. If taxpayers who are compliant in filing but delinquent in paying perceive that the IRS cannot pursue nonfilers, some of those delinquent payers could become nonfilers, increasing the IRS' dilemma and making it much more difficult to achieve compliance.

The Automated Collection System's Level of Service Continues to Decline

The ACS function's measures include Level of Service (LOS), which is a measure of callers' abilities to connect with a Customer Service Representative (CSR). This measure is important because it directly affects the business results presented above. The CSR LOS in the SB/SE Division's ACS function dropped from over 79 percent in FY 2001 to 72 percent in FY 2002. At the mid-point in FY 2003, it had fallen to just under 68 percent.

This steady decline prompted the National Taxpayer Advocate, in her FY 2002 Annual Report to Congress, to include access to the ACS function as one of the most serious problems encountered by taxpayers.⁹ Given the possibility of enforced Collection actions that might be taken by the ACS function, the National Taxpayer Advocate stated "it is critical that taxpayers be able to contact the ACS." It is equally crucial for the ACS function to complete the contacts so it can resolve the delinquencies.

The ACS function has not been able to handle the calls generated by its increased workload. Projecting from FY 2003 mid-year numbers, we believe the SB/SE

⁸ The Collection mission is defined in IRS Publication 3560 (01-2000), *IRS Balanced Measurement System*.

⁹ The report discusses IRS-wide ACS numbers, including both the SB/SE and W&I Divisions.

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Division's ACS function will have answered over 18 percent more calls than in FY 2001, but the number of calls received will have grown by over 48 percent. The IRS attributes this largely to additional notices issued in the Federal Payment and State Income Tax Levy Programs. The Advocate's Report criticizes the almost 4 percent LOS goal reduction from FY 2001. Along with a 2 percent projected staffing decrease and a 27 percent closure goal increase for FY 2003, the Report concludes that achieving the goals "would require remarkable program efficiency."

In their response, IRS management cited several factors that affected the LOS, such as the introduction of new work, workload changes requiring hiring and training of new CSRs, a new call routing and workforce management system, and handling a large percentage of calls on non-ACS function cases. The response pointed out a number of initiatives to enhance operations, including analyzing case flow to improve processes, making available new workload planning and enhanced workload management tools, providing new guidelines and training, and establishing an "inventory day" to address priority inventories. Additionally, each call site is required to provide a specified number of CSRs to take telephone calls. Even with the improvements that these actions promise, it will be difficult to keep up with the number of calls, should it continue to increase.

Initiatives to Improve Collection Results Have Been Implemented or Planned

The SB/SE Division has taken action and continues to implement initiatives to improve Collection operations. The recommendations of two teams are particularly relevant. The SB/SE Division's Collection Strategy Team was chartered with achieving short-term collection improvements in both the ACS function and the Cff. The ACS Operating Model Team was chartered to clearly define the priorities of the ACS function and identify the best approach for optimizing performance.

Collection Strategy Team

A major initiative of this team was the development of a strategic approach to filter out probable CNC modules for alternative handling and identify probable fully paid modules for priority handling. A CNC filter would first

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identify accounts likely to be uncollectible. Those cases would then be shelved or worked later. Next, a fully paid filter would identify accounts likely to result in full payment. Those cases would then be routed to either the ACS function or the CFF, based on established criteria.

The team anticipated the initiative would yield a 4 percent increase in fully paid dispositions and a 7 percent decrease in CNC dispositions, equating to an increase of \$1.8 billion collected relative to current SB/SE Division revenues. The initiative was implemented in January 2003 and testing is underway to evaluate its validity and effectiveness.

Operating Model Team

This team's analysis led to four proposals directing the ACS function to an optimal operating model. Under the proposals:

1. ACS function employees would no longer manually perform locator research; rather, automated systems would complete the research. This should allow the employees to better use their skills by working and closing cases that are fit for use (i.e., cases with good telephone numbers, addresses, or levy sources).
2. Cases would be worked based on the ACS function's capacity and priorities. Recommendations would reduce the number of inbound calls by managing the number of letters issued to taxpayers on ACS cases.
3. The first method of contact would be an outbound call through a predictive dialer,¹⁰ followed by a letter if the call did not establish contact. If contact attempts do not resolve the account, then enforcement methods will be

¹⁰ A predictive dialer is a telephone control system that automatically calls a list of telephone numbers in sequence and screens out no-answers, busy signals, answering machines, and disconnected numbers while predicting at what point a CSR will be able to handle the next call. Predictive dialers are commonly used for telemarketing, surveys, appointment confirmation, payment collection, and service follow-ups.

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used as appropriate. A separate TIGTA report¹¹ evaluated the predictive dialer program.

4. Cases would be closed within the ACS function, decreasing the need for transferring unresolved cases. Liens would be used after contact and levy attempts have not resolved the case. This would protect the public interest and avoid transfer of cases to the Queue.

The team proposed changes to policy guidelines for more appropriate and controlled issuance of letters, which they believe will accelerate case processing and reduce the costs of unnecessary letters. A new inventory control process should better manage letters and other actions that result in taxpayer calls, enabling the ACS function to proactively balance the number of incoming calls against staff available to answer them.

Other initiatives

Several additional projects are expected to improve the ACS function's operations. These range from studies on particular types of cases to more general operational recommendations. They include:

- Proposed recommendations on reducing the number of defaulted installment agreements, which cause inefficient processing in the ACS function because they involve considerable rework. The recommendations include educating taxpayers about the costs and benefits of alternative payment options and the financial repercussions of defaulting, encouraging high-risk taxpayers (those having multiple modules) to set up direct deposit installment agreements, and applying lien and levy treatment to those taxpayers at the termination of the agreements. Changes are expected to yield \$147 million in increased revenue and operational savings.

¹¹ *Budget Issues Are Delaying the Expanded Use of Predictive Dialer Systems for Contacting Delinquent Taxpayers* (Reference Number 2003-30-132, dated June 2003).

Some Automated Collection System Business Results Have Recently Improved, but More Emphasis on Nonfilers Is Needed

- Development of a TDI model to identify potentially productive nonfiler cases, similar to the TDA CNC/Fully Paid filter previously discussed.
- A design to allow taxpayers to use self-service, automated applications to resolve their tax issues, thus providing them additional service channels and freeing assistors for more complex calls.
- An analysis to decrease overall call volume by reducing the taxpayers' need to call back.
- Improvements to the ACS function's measures at the local levels to give the ACS sites more ownership and understanding of their contribution to corporate goals.

Recommendation

1. The Director, Compliance, SB/SE Division, should continue to monitor and evaluate the results of the various initiatives. Resources for the TDI program need to be reevaluated to reinforce a balanced program that continues to not only encourage payment compliance but also ensure that filing compliance does not erode.

Management's response: Management agreed with the recommendation. They stated they are addressing filing compliance by developing models, to be fully operational by July 2004, to identify the most productive TDIs to work in ACS and the field, and will monitor and evaluate initiative results.

Office of Audit Comment: While management agreed to monitor and evaluate initiative results, they state in the Implementation Date section of their response that corrective action has been completed. Therefore, the response does not identify a responsible official or define a monitoring plan that specifically measures the degree to which the models are successful in improving filing compliance. We believe that, by indicating completed implementation, the IRS is not complying with the Department of the Treasury requirements that final bureau action determinations are made on an audit report only when

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all necessary corrective actions have actually been taken and validated.¹² In our opinion, an implementation date should be scheduled for some time after the July 2004 date, to ensure that the balanced program concerns are addressed.

¹² Treasury Directive 40-03, Treasury Audit Resolution, Follow-up, and Closure, § 5f.

Detailed Objectives, Scope, and Methodology

The overall objectives of the review were to provide an assessment of the Small Business/Self-Employed Division's Automated Collection System (ACS)¹ function and to ascertain the Division's plans and strategies for improving the delinquent account and delinquent investigation programs in the ACS function. To accomplish our objectives, we:

- I. Determined whether the Division's mission, strategies, plans, policies, procedures, and controls are effectively designed to direct program operations toward the attainment of desired objectives.
 - A. Ascertained the objectives and goals for the ACS function's programs.
 - B. Determined whether the annual performance program goals are quantifiable, measurable, and realistic.
 - C. Determined whether goals have changed significantly or will change in the near future.
 - D. Reviewed work plans for Fiscal Years 2001-2003 and determined whether these tie into program goals and objectives.
 - E. Discussed with managers at the Philadelphia, Pennsylvania, ACS site the objectives, plans, and goals to determine whether they have been clearly communicated to the field.
 - F. Determined how the ACS function's resources are allocated and whether the process corresponds with the program goals and objectives.
 - G. Determined whether any of the ACS function's resources have been reallocated to assist in the Internal Revenue Service's (IRS) toll-free operation.
 - H. Assessed whether sufficient resources are allocated to the ACS function's programs to achieve program objectives.
- II. Determined how management measures the results and success of the programs and effects changes to improve areas of concern.
 - A. Determined the elements of management's control system for measuring, reporting, and monitoring the effectiveness of the ACS function's programs.

¹ The ACS is a computerized system that maintains balance due accounts (called Taxpayer Delinquent Accounts) and return delinquency investigations (called Taxpayer Delinquency Investigations).

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- B. Determined what performance standards and results indicators management uses to measure program effectiveness.
 - C. Evaluated whether the performance standards and indicators provide a comprehensive measure of effectiveness.
 - D. Obtained and reviewed management information system and statistical reports, business reviews, studies, and documentation on program changes, initiatives, and problem evaluations.
 - E. Determined the method by which cases enter the ACS function and identified the treatment that various types of cases receive while in the ACS function.
 - F. Discussed with managers at the ACS site the methods they use to ensure effective work practices and quality casework.
 - G. Determined the extent to which the ACS function's programs achieved the desired or planned level of program results.
 - H. Determined whether management had identified any concerns about program results, either overall or with specific program components or sites, had probed for factors causing unsatisfactory results, and had taken or has plans to take action to improve the conditions.
 - I. Determined what systemic or other actions management has taken or planned to further improve the effectiveness and efficiency of the ACS function's programs.
- III. Determined whether management had addressed previous audit findings and considered the specific potential risks identified during the audit planning.
- A. Determined the status of the prior recommendation that the IRS develop a master implementation plan that integrates all of the ACS function's initiatives and necessary improvement actions and identifies the responsible management officials and related time lines.
 - B. Discussed the effects of the Division's compliance reengineering and strategic initiatives on the ACS function's inventory and program results, particularly nontrust fund return delinquencies. Obtained and evaluated documentation of any effects.
 - C. Discussed concerns identified during the Division's business reviews of the ACS function's operations.

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Recently Improved, but More Emphasis on Nonfilers Is Needed**

Appendix II

Major Contributors to This Report

Parker F. Pearson, Director
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Appendix III

Report Distribution List

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Audit Liaisons:
 Commissioner, Small Business/Self-Employed Division S
 GAO/TIGTA Liaison W:S:PA

Glossary of Terms

Automated Collection System (ACS) – The ACS is a computerized system that maintains balance due accounts (Taxpayer Delinquent Accounts [TDA]) and return delinquency investigations (Taxpayer Delinquency Investigations [TDI]).

Campus – The campuses are the data processing arm of the Internal Revenue Service (IRS). The campuses process paper and electronic submissions, correct errors, and forward data to the computing centers for analysis and posting to taxpayer accounts.

Collection Field function (Cff) – This unit consists of revenue officers who handle personal contacts with taxpayers to collect delinquent accounts or secure unfiled returns.

Currently Not Collectible (CNC) – The IRS designates an account as CNC when the taxpayer still has an outstanding balance due but the account is removed from active Collection inventory. Accounts are still subject to refund offsets and may be reactivated under certain conditions.

Cycle Timeliness – This is a measure of the number of cycles (weeks) elapsed between the time the module was received in the ACS function and the time it was disposed of.

Full-Time Equivalent (FTE) – An FTE is a measure of labor hours. One FTE is equal to 8 hours multiplied by the number of compensable days in a particular fiscal year.

Installment Agreement (IA) – An IA allows the taxpayer to pay a balance due over a period of time. An IA is based on the taxpayer's ability to pay.

Level of Service (LOS) – The LOS is the percentage of calls answered compared to the number of calls attempted in the ACS function. Calls where taxpayers hang up while awaiting the next available assistor are not included in the count of calls answered.

Levy – A levy is a method the IRS uses to collect balance due accounts that are not voluntarily paid. To levy means to take property by legal authority to satisfy a tax debt. The IRS can attach property held by third parties or the taxpayer. Generally, a Notice of Levy is used to attach funds a third party owes the taxpayer (such as wages or funds on deposit at a bank). Levies can be made on real or personal property.

Lien – A Lien is an encumbrance on property or rights to property as security for a debt or obligation. The Federal Tax Lien provides the statutory basis for all the enforcement actions the IRS takes to secure payment for outstanding taxes. A Notice of Federal Tax Lien notifies creditors that the Federal Government has a claim against a taxpayer's property and rights to property.

Module – A tax module is part of a taxpayer's account; it reflects tax data for one type of tax and one tax period.

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Percent Overage – This is the percentage of Collection cases in process for 16 months or longer, averaged over the previous 12 months.

Productivity – This is a measure of the number of TDA or TDI modules disposed of, divided by the TDA or TDA staff years expended.

Queue – This is an automated holding file for unassigned inventory of lower-priority delinquent cases that the Collection function does not have enough resources to immediately assign for contact.

Rate – The Fully Paid, CNC, and IA rates are the number of modules disposed of in those categories, divided by the total modules disposed of.

Shelved Account – This is a delinquent unpaid account, or investigation of an unfiled return, that has been taken out of Collection inventory because it has lower priority.

Taxpayer Delinquency Investigation (TDI) – An unfiled tax return for a taxpayer.

Taxpayer Delinquent Account (TDA) – A balance due account of a taxpayer.

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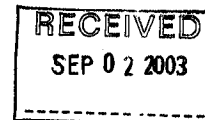
Appendix V

Management's Response to the Draft Report



COMMISSIONER
SMALL BUSINESS/SELF-EMPLOYED DIVISION

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



SEP - 2 2003

MEMORANDUM FOR TREASURY INSPECTOR GENERAL FOR TAX
ADMINISTRATION

FROM: Dale F. Hart *Dale Hart by MSK/LZ*
Commissioner, Small Business/Self-Employed Division

SUBJECT: Draft Audit Report -- Some Automated Collection System
Business Results Have Recently Improved, but More Emphasis
on Nonfilers Is Needed (Audit # 200330005)

I have reviewed your report and agree with your recommendation. Several reports by the Treasury Inspector General for Tax Administration (TIGTA) and the General Accounting Office (GAO) have addressed the decline in our enforcement programs since the mid-1990's. We too, are concerned about the growing compliance gap.

As we have previously reported, many factors contributed to program declines including an overall reduction in staffing, loss of the 1995 Compliance Initiative, the resulting staffing reduction to Compliance and the shift of resources from Compliance programs to customer service. These factors as well as the legislative changes mandated by the Restructuring and Reform Act of 1998 (RRA '98), that increased administrative and procedural responsibilities have impacted our overall productivity. In addition, employee concerns with Section 1203 of RR '98 caused a delay in enforcement actions.

Since the IRS completed its reorganization, the Automated Collection System (ACS) has operated as a shared resource between the Small Business/Self-Employed (SB/SE) and Wage and Investment (W&I) Divisions. A number of factors affected ACS' ability to efficiently address its assigned inventories. In addition, a significant change to the SB/SE Division's inventory mix, moving to an inventory of self-employed taxpayers versus wage earners, resulted in fewer closures

We are pleased your report noted that during the first seven months of FY 2003, the SB/SE Division's ACS function reversed some of these trends. Your report also noted that most Taxpayer Delinquent Account (TDA) measures improved. In order to achieve these results, we:

- o refocused on collection activities
- o changed IRM procedures
- o streamlined some internal processes and
- o focused the call sites inventories, via the ACS program letter, on cases that generate more taxpayer response.

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2

We are taking aggressive steps to improve Collection operations. A number of teams, composed of SB/SE employees and contractors are working on improvement of Collection processes. In addition, the Collection Reengineering Design Team is developing models to identify the most productive TDIs to work in ACS and the field. We will roll out portions of the models in January 2004 and make them fully operational by July 2004.

Our response to your recommendation is as follows:

RECOMMENDATION

The Director, Compliance, SB/SE Division, should continue to monitor and evaluate the results of the various initiatives. Resources for the Taxpayer Delinquency Investigation (TDI) Program need to be reevaluated to reinforce a balanced program that continues to not only encourage payment compliance but also ensure that filing compliance does not erode

CORRECTIVE ACTION

We monitor and evaluate the results, as well as recommend improvements to the Collection process, through regular meetings. Filing compliance has been addressed through the inclusion of the Taxpayer Delinquency Investigation Program as part of our improvement of the Collection process.

IMPLEMENTATION DATE

Completed

RESPONSIBLE OFFICIAL(S)

N/A

CORRECTIVE ACTION MONITORING PLAN

N/A

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.