

**Efforts to Develop a Successful Collection
Contract Support Program Could Be
Enhanced**

March 2003

Reference Number: 2003-30-075

This report has cleared the Treasury Inspector General for Tax Administration disclosure review process and information determined to be restricted from public release has been redacted from this document.



INSPECTOR GENERAL
for TAX
ADMINISTRATION

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

March 14, 2003

MEMORANDUM FOR COMMISSIONER, SMALL BUSINESS/SELF-EMPLOYED
DIVISION

Gordon C. Milbourn III

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

SUBJECT: Final Audit Report - Efforts to Develop a Successful Collection
Contract Support Program Could Be Enhanced
(Audit # 200230030)

This report presents the results of our review of the Internal Revenue Service's (IRS) Collection Contract Support (CCS) Program. The IRS' records indicate that from the end of Fiscal Year (FY) 1996 through the end of FY 2001, gross accounts receivable due from unpaid taxes rose from \$216 billion to \$276 billion. Since the IRS has stated it does not have enough resources to work all accounts, it is exploring contracting out some collection activity to private contractors. The overall objective of this review was to determine whether the IRS has taken effective steps to plan for the proposed use of CCS companies.¹

In summary, the IRS' preliminary planning related to the use of CCS companies was extensive and included a detailed evaluation of similar existing programs at other federal and state government entities. In addition, the IRS contacted subject matter experts for input regarding industry practices. These efforts should help leverage the use of existing best practices and aid in ensuring that the design of the IRS' CCS program fully uses the benefits of private collection services.

The IRS also prepared a draft Request for Quotation (RFQ)² for the CCS initiative, which it plans to issue during the second quarter of FY 2003. The purpose of the draft RFQ is to promote awareness about this initiative, as well as to solicit feedback/questions from potential contractors regarding the IRS' requirements.

¹ CCS companies are private (non-government) collection businesses.

² An RFQ is a procurement tool used to describe desired supplies or services to potential contractors.

Although the IRS' preliminary planning efforts have been good, their effectiveness overall could be enhanced by taking the following actions:

- The IRS should provide greater specificity in the draft RFQ regarding the management information, such as weekly telephone reports, the IRS will require from contractors. By requiring CCS companies to provide key reports in a standardized electronic format, the IRS will effectively begin to lay the groundwork for the development of the management information it will need in the future. Also, providing these additional specifications will help clarify potential contractors' understanding of the IRS' requirements.
- The IRS should provide more detailed requirements in the draft RFQ regarding the protection of taxpayer rights. This would help ensure prospective contractors are aware of the applicable requirements of the IRS Restructuring and Reform Act of 1998 (RRA 98)³ and encourage feedback/questions in this critical area. Providing detailed information regarding this area is especially important given that the taxpayer protection provisions in the RRA 98 presently apply only to the IRS.
- The IRS' preliminary projections regarding the volume of cases to be initially released to CCS companies needs to be reexamined. Specifically, a more measured initial release of delinquent tax account cases to CCS companies would help minimize the likelihood of an overload of case referrals back to the IRS. Since baselines have not yet been established for the average level of support needed by the IRS on each case released, annual volume estimates should be adjusted to reflect this level of uncertainty.

We informed project management of our concerns regarding the need to add additional information to the draft RFQ during the audit, and they began to initiate corrective actions. For example, project management has already updated the draft RFQ with more specifics regarding the management information they will require from contractors. We further recommended that the IRS ensure the development of management information is integrated into all relevant design decisions as the project progresses.

Project management also informed us that they would add more information relating to the protection of taxpayer rights to the draft RFQ before it is issued. Finally, management informed us they would significantly reduce the initial volume of delinquent tax account cases placed with CCS companies until baselines can be established.

Because the detailed design for this project, including the system which will be responsible for selecting, controlling, and updating cases assigned to CCS companies, has not yet been developed, our review primarily focused on the IRS' preliminary planning efforts. Accordingly, we will initiate another review of this area once more

³ IRS Restructuring and Reform Act of 1998 (RRA 98), Pub. L. No. 105-206, 112 Stat. 685 (codified as amended in scattered sections of 2 U.S.C., 5 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.).

substantial progress on the development of the detailed design for the project has been made.

Management's Response: The Commissioner, Small Business/Self-Employed (SB/SE) Division, agreed to the recommendations presented and indicated that they have already implemented corrective actions to address the problems identified in our report. Specifically, management updated the draft RFQ with specific references to providing management information in an electronic format. The draft RFQ was also updated with specific information regarding taxpayer protections in anticipation that the statutory requirements concerning taxpayer protections will become part of the CCS' enabling legislation. Finally, the draft RFQ was updated to show a staggered implementation.

Management's complete response to the draft report is included as Appendix IV.

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 Philip Shropshire, Acting Assistant Inspector General for Audit (Small Business and Corporate Programs), at (215) 516-2341.

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Background

The Internal Revenue Service (IRS) has historically been faced with a large and growing population of delinquent tax accounts. For example, the IRS' records indicate that from the end of Fiscal Year (FY) 1996 through the end of FY 2001, gross accounts receivable due from unpaid taxes rose from \$216 billion to \$276 billion. The number of taxpayers with unpaid liabilities in the Collection function's unassigned inventory also increased, from 317,865 with \$3 billion in liabilities as of the end of FY 1996, to 542,406 with \$18.5 billion in liabilities as of the end of FY 2001. Finally, during the period October 2001 through June 2002, \$2 billion in unpaid taxpayer accounts were removed as excess inventory.¹

Since the IRS has stated that it does not have enough resources to work all accounts, it is exploring contracting out some collection activity to Collection Contract Support (CCS) companies, which are private (non-government) collection businesses. The last time the IRS attempted to use CCS companies was in 1996. Based on the results of the 1996 project, the IRS concluded that the use of CCS companies was not economically viable at that time.

The IRS' present approach to the use of CCS companies differs significantly from the approach used in 1996. Most importantly, the IRS plans to request the authority to fund the use of CCS companies directly from the proceeds collected by those companies. Project management indicated that unless CCS companies can be funded from tax proceeds, their use would remain an uneconomical option for the IRS. The 1996 CCS project was paid for through the IRS' appropriated funds.

At present, the legislation needed to support the contracting out of collection cases by the IRS does not yet have Congressional approval. If the legislation were approved, project management informed us that the earliest they could begin providing cases to CCS companies would be late 2004.

¹ Excess inventory refers to delinquent unpaid accounts which have been taken out of Collection inventory because they are lower priority.

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This review was conducted at the CCS Project Team Headquarters in New Carrollton, Maryland. We performed the audit from July through November 2002 in accordance with *Government Auditing Standards*. Detailed information on our audit objective, scope, and methodology is presented in Appendix I. Major contributors to the report are listed in Appendix II.

Because the detailed design for this project, including the system which will be responsible for selecting, controlling, and updating cases assigned to CCS companies, has not yet been developed, our review primarily focused on the IRS' preliminary planning efforts. Accordingly, we will initiate another review of this area once substantial progress on the development of the detailed design for the project has been made.

Preliminary Planning Efforts for the Use of Contract Companies Were Very Extensive

The IRS CCS project team met with representatives from five state revenue departments and two Federal agencies with recent experience in administering programs involving collection contract companies. The IRS also analyzed the structure and administration of contracts for the private collection of outstanding receivables. In addition, state officials provided insights regarding data security, data transfer protocol, and the protection of taxpayer rights. The collection and analysis of data related to proposed operations is essential to sound planning and should help leverage the use of existing best practices.

The IRS also identified three commercial collection companies with whom they met on a regular basis to solicit input throughout the development of the preliminary project design. The IRS met with the collection companies five times during the period May through October 2002. Some of the areas in which feedback was solicited included case screening criteria, electronic data sharing capabilities, data security requirements, and potential compensation models. This effort should aid in ensuring that the design of the IRS' CCS program is compatible with industry strengths.

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The IRS also prepared a draft Request for Quotation (RFQ)² for the CCS initiative, which management plans to issue during the second quarter of FY 2003. The purpose of the draft RFQ is to promote awareness about this initiative, as well as to solicit feedback/questions from potential contractors regarding the IRS' requirements. While the issuance of a draft RFQ should help the IRS perfect its contract specifications, some critical requirements could be enhanced.

Requiring Key Reports in a Standardized Electronic Format Will Enhance Future Program Oversight

In developing the draft RFQ, management did not include a requirement that collection contractors provide key data, such as telephone reports and production reports, in a standardized electronic format. The IRS plans to eventually award up to 12 task orders to contract collection companies. Volume estimates are 110,000 total cases per month for the first 3 months after initial placement, with a total of 2.6 million cases annually by the end of the first year. Project management informed us that this effort might eventually involve as many as 2,500 collection contract employees.

Requiring collection contractors to submit key reports in an electronic format would facilitate automated analysis of the data and allow the IRS to quickly identify trends, such as calls made outside timeframes as prohibited by the Fair Debt Collection Practices Act.³ In addition, requesting key reports in an electronic format would allow the IRS to combine data from all contractors and provide the summary-level management information needed to effectively oversee the program. Conversely, not having timely and comprehensive management information would reduce the IRS' ability to make effective program decisions. Providing these additional specifications will also help clarify the IRS requirements to potential contractors.

² An RFQ is a procurement tool used to describe desired supplies or services to potential contractors.

³ The Fair Debt Collection Practices Act, 15 U.S.C. § 1692d (1996), Section 806 prohibits a debt collector from any conduct that would "harass, oppress, or abuse any person in connection with the collection of a debt."

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Project planning to date has been primarily focused on case processing actions, data privacy and security, and contractor compensation. Because of the critical nature of management information, planning for information needs should be performed concurrently with program planning. After we informed management of our concerns regarding the need for management information to be in a standardized electronic format, the CCS project team quickly revised the draft RFQ to specifically require collection contractors to submit management reports in a standardized electronic format.

Recommendation

1. The Commissioner, Small Business/Self-Employed (SB/SE) Division, should ensure that the development of management information is integrated into all relevant design decisions as the project progresses.

Management's Response: SB/SE Division management updated the draft RFQ with specific references to providing management information data in an acceptable electronic format before they released it to the industry for comment.

Better Development of Detailed Requirements Will Help Ensure Taxpayer Rights Are Protected

The IRS did not include in its draft CCS RFQ any information or requirements regarding how the IRS Restructuring and Reform Act of 1998 (RRA 98)⁴ Sections 1203 and 1204 should be implemented and monitored. RRA 98 Section 1203 establishes 10 provisions which, if violated by an IRS employee, will result in their termination. Some examples include falsifying documents to cover a mistake concerning a taxpayer, or violating the IRS regulations concerning taxpayer harassment. RRA 98 Section 1204 prohibits the use of tax enforcement results or establishment of production quotas for evaluating employee performance within the IRS.

⁴ IRS Restructuring and Reform Act of 1998 (RRA 98), Pub. L. No. 105-206, 112 Stat. 685 (codified as amended in scattered sections of 2 U.S.C., 5 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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Although the IRS included the RRA 98 in the listing of statutes applicable to CCS contractors, it did not specify those actions that constitute violations of Section 1203 or what is required of the contractor in those instances where a violation is found. Similarly, the draft RFQ offered no information as to what would constitute a Section 1204 violation and what actions will be required to monitor for such violations. Providing detailed information regarding this area is especially important given that the taxpayer protection provisions in the RRA 98 presently apply only to the IRS.

Project management informed us that they expect contractors reviewing the draft RFQ to have a number of questions regarding the RRA 98. Any information regarding Sections 1203 and 1204 will be disseminated in response to those questions. Project management also noted that they were concerned about making the draft RFQ too lengthy.

In the proposed legislation allowing contracting out, the IRS noted that private contractors will be required to comply with all provisions of the Internal Revenue Code that afford taxpayers protections during the tax collection process. The absence of specific information in the draft RFQ regarding the protections that need to be afforded to taxpayers under the RRA 98 significantly increases the likelihood of confusion among potential contractors as to the IRS' requirements. It could also deprive the IRS of early feedback from potential CCS contractors regarding obstacles in implementing the taxpayer protections contained in the RRA 98. Ultimately, this could result in CCS contractors unevenly applying the taxpayer protections in the RRA 98, or not applying them at all.

After we discussed our concerns in this area with CCS project management, they informed us that more information relating to the protection of taxpayer rights will be added to the draft RFQ before it is issued.

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Recommendation

2. The Commissioner, SB/SE Division, should follow through with plans to provide more direction regarding RRA 98 Sections 1203 and 1204 to potential CCS contractors in the draft RFQ. This could include, for example, a listing of the applicable provisions of RRA 98 Sections 1203 and 1204, consequences of violations, and procedures related to monitoring for violations. To the extent specific details regarding the application of the RRA 98 are considered too voluminous, general criteria and principle protections of the RRA 98 could be provided along with a notification of where more specific information can be found if needed.

Management's Response: In anticipation that statutory requirements regarding taxpayer protections will become part of the enabling legislation, SB/SE Division management updated the draft RFQ with specific information about taxpayer protections before they released it to industry for comment.

A More Measured Initial Release of Cases to Collection Contract Support Companies Should Be Considered

In some instances the CCS companies will not be able to resolve the accounts and will need to refer the cases back to the IRS. IRS personnel assigned to work these referrals may be quickly overwhelmed with cases based on the current inventory release schedule. First year annual volume estimates do not reflect the present uncertainty and risk regarding the average level of IRS support needed on each case released.

Present CCS plans call for the placement of 110,000 cases per month for the first 3 months of the project, with a total of 2.6 million cases annually by the end of the first year. To support this effort, the CCS project team informed us that they initially plan to hire a staff of 20 to 30 Collection function personnel to work referrals of taxpayers from the CCS companies back to the IRS. However, based on the 67 percent referral rate experienced by the IRS in the 1996 CCS project, the current projected placement population would require a supporting IRS staff of over 300 Collection

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function personnel. The analysis of all potential risks is an essential part of effective project management.

While the IRS is working on a number of strategies that should help reduce the population of cases that need to be referred, even a 20 percent referral rate would require a support staff of roughly 100 IRS Collection function personnel. In addition, depending on the experience level of the personnel hired for the referral unit, there may be a significant learning curve that would further affect the unit's initial productivity.

The IRS' review of the results of the 1996 CCS project identified that contractors referred cases for a variety of actions, including responding to taxpayer questions which the CCS companies were unable to answer and evaluating options in instances in which the CCS companies determined that the taxpayer refused to pay. Initial case release estimates were based on an analysis of accounts receivable from unpaid taxes and an assessment of the maximum number of collection contractors that the IRS could reasonably manage at one time. An overload of case referrals could result in delays in case processing and a reduction in quality of customer service.

After we discussed our concerns in this area with CCS project management, they informed us that the initial volume of delinquent tax account cases placed with CCS companies will be reduced until baselines can be established.

Recommendation

3. The Commissioner, SB/SE Division, should follow through with plans to reduce initial tax delinquent account case placement until a baseline for referrals can be established. In addition, first year annual volume estimates should be adjusted to reflect the reduced initial placement and uncertainty regarding the level of support needed on each case released.

Management's Response: SB/SE Division management updated the draft RFQ to show a staggered implementation before they released it to the industry for comment.

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Appendix I

Detailed Objective, Scope, and Methodology

The overall objective of this review was to determine whether the Internal Revenue Service (IRS) has taken effective steps to plan for the proposed use of Collection Contract Support (CCS) companies.¹

To accomplish this objective we:

- I. Determined what steps the IRS took to ensure that the current CCS project leverages the use of existing industry best practices and avoids the difficulties encountered in the 1996 project.
- II. Ascertained whether the protection of taxpayer rights was effectively addressed in the development of the current CCS project.
 - A. Interviewed the Taxpayer Advocate to identify specific concerns regarding the interaction of CCS companies with taxpayers.
 - B. Determined how the protections afforded to taxpayers by the IRS Restructuring and Reform Act of 1998 (RRA 98)² Sections 1203 and 1204 will be applied to CCS company contacts with taxpayers.
 - C. Evaluated any internal controls CCS companies will be required to implement to ensure taxpayer rights are protected.
 - D. Evaluated how the IRS plans to monitor contractor activities to ensure the overall protection of taxpayer rights.
 - E. Determined whether a background check will be required for all CCS company personnel involved in the collection of delinquent federal tax debt.
- III. Determined whether the appropriateness of case closure actions was addressed in the development of the current CCS project.
 - A. Evaluated the methodology the IRS plans to use to ensure CCS company case actions are appropriate.
 - B. Determined which case actions will be subject to approval by the IRS.

¹ CCS companies are private (non-government) collection businesses.

² IRS Restructuring and Reform Act of 1998 (RRA 98), Pub. L. No. 105-206, 112 Stat. 685 (codified as amended in scattered sections of 2 U.S.C., 5 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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- IV. Determined whether the CCS project included the development of sufficient management information to allow for effective monitoring of the project.
 - A. Evaluated the completeness and reliability of the management information the CCS project team will use to monitor the business results of CCS companies.
 - B. Determined whether access for both the IRS and the Treasury Inspector General for Tax Administration to CCS company facilities, personnel, and records is incorporated into all CCS contracts.

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Appendix II

Major Contributors to This Report

Philip Shropshire, Acting Assistant Inspector General for Audit (Small Business and Corporate Programs)

Parker F. Pearson, Director

Gary L. Swilley, Audit Manager

Todd M. Anderson, Senior Auditor

Anthony J. Choma, Senior Auditor

Seth Siegel, Auditor

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Appendix III

Report Distribution List

Acting Commissioner N:C
Deputy Commissioner, Small Business/Self-Employed Division S
Deputy Commissioner for Modernization and Chief Information Officer M
Associate Commissioner, Business Systems Modernization M:B
Deputy Associate Commissioner, Systems Integration M:B:SI
Director, Strategy and Finance S:SF
Director, Compliance S:C
Chief Counsel CC
National Taxpayer Advocate TA
Director, Legislative Affairs CL:LA
Director, Office of Program Evaluation and Risk Analysis N:ADC:R:O
Office of Management Controls N:CFO:F:M
Audit Liaison: Commissioner, Small Business/Self-Employed Division S

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Appendix IV

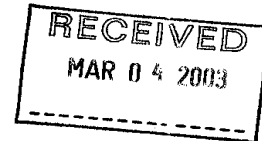
Management's Response to the Draft Report



COMMISSIONER
SMALL BUSINESS/SELF-EMPLOYED DIVISION

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

MAR - 4 2003



MEMORANDUM FOR DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: *JK* Joseph G. Kehoe *David F. Hark*
Commissioner, Small Business/Self Employed Division

SUBJECT: Draft Audit Report – Efforts to Develop a Successful
Collection Contract Support Program Could Be Enhanced
(Audit # 200230030)

I reviewed your report and agree with your assessment to add information to the draft Request for Quotes (RFQ) for the Collection Contract Support project. Our project management staff incorporated the corrective actions you requested into the draft RFQ posted to the IRS procurement website on February 14, 2003.

Our comments to your recommendations follow.

RECOMMENDATION 1

The Commissioner, Small Business/Self-Employed (SB/SE) Division, should ensure that the development of management information is integrated into all relevant design decisions as the project progresses.

ASSESSMENT OF CAUSE

The draft RFQ did not specify that management information data be provided electronically as design decisions are made throughout the project.

CORRECTIVE ACTION

We updated the draft RFQ with specific references to providing management information data in an acceptable electronic format before we release it to industry for comment.

IMPLEMENTATION DATE

February 14, 2003

RESPONSIBLE OFFICIAL(S)

Director, Strategy and Finance, Small Business/Self Employed Division

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CORRECTIVE ACTION MONITORING PLAN

N/A

RECOMMENDATION # 2

The Commissioner, SB/SE Division, should follow through with plans to provide more direction regarding RRA 98 Sections 1203 and 1204 to potential CCS contractors in the draft RFQ. This could include, for example, a listing of the applicable provisions of RRA 98 Sections 1203 and 1204, consequences of violations, and procedures related to monitoring for violations. To the extent specific details regarding the application of the RRA 98 are considered too voluminous, general criteria and principle protections of the RRA 98 could be provided along with a notification of where more specific information can be found if needed.

ASSESSMENT OF CAUSE

RRA 98 Sections 1203 and 1204 would not apply to private collection agencies and their employees without specific statutory requirements in the enabling legislation. The Administration has requested the required statutory changes for sections 1203 and 1204.

CORRECTIVE ACTION

In anticipation that statutory requirements regarding taxpayer protections will become part of the enabling legislation, we updated the draft RFQ with specific information about taxpayer protections before we released it to industry for comment.

IMPLEMENTATION DATE

February 14, 2003

RESPONSIBLE OFFICIAL(S)

Director, Strategy and Finance, Small Business/Self Employed Division

CORRECTIVE ACTION MONITORING PLAN

N/A

RECOMMENDATION # 3

The Commissioner, SB/SE Division, should follow through with plans to reduce initial tax delinquent account case placement until a baseline for referrals can be established. In addition, first year annual volume estimates should be adjusted to reflect the reduced initial placement and uncertainty regarding the level of support needed on each case released.

ASSESSMENT OF CAUSE

Previous collection contracting out efforts required significant IRS resources to address collection agency referrals to IRS for resolution of taxpayer questions.

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CORRECTIVE ACTION

We updated the draft RFQ to show a staggered implementation before we released it to industry for comment.

IMPLEMENTATION DATE

February 14, 2003

RESPONSIBLE OFFICIAL(S)

Director, Strategy and Finance, Small Business/Self Employed Division

CORRECTIVE ACTION MONITORING PLAN

N/A

If you have any questions, please call me at (202) 622-0600 or Brady R. Bennett, Director, Strategy and Finance, Small Business/Self-Employed, at (202) 283-7660.