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**TREASURY INSPECTOR GENERAL FOR TAX ADMINISTRATION**



***The Puerto Rico Collection Field Function  
Can Improve Internal Controls in Various  
Activities***

**June 2006**

**Reference Number: 2006-30-090**

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.

**Redaction Legend:**

1 = Tax Return/Return Information

3(d) = Identifying Information - Other Identifying Information of an Individual or Individuals

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TREASURY INSPECTOR GENERAL  
FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY

WASHINGTON, D.C. 20220

June 9, 2006

**MEMORANDUM FOR COMMISSIONER, SMALL BUSINESS/SELF-EMPLOYED  
DIVISION**

*Michael R. Phillips*

**FROM:**

Michael R. Phillips  
Deputy Inspector General for Audit

**SUBJECT:**

Final Audit Report – The Puerto Rico Collection Field Function Can  
Improve Internal Controls in Various Activities (Audit # 200530020)

This report presents the results of our review of various activities in the Internal Revenue Service's (IRS) Puerto Rico Collection Field function (CFf). The overall objective of this review was to evaluate whether internal controls over certain high-risk activities in the Puerto Rico CFf are being used effectively.

***Synopsis***

The Treasury Inspector General for Tax Administration Office of Investigations had identified concerns related to the internal controls of various collection activities in the Small Business/Self-Employed Division Puerto Rico office. As a result, we identified some high-risk areas within the CFf that generally require managerial oversight to ensure revenue officers (RO)<sup>1</sup> follow certain collection procedures and selected various judgmental samples of cases to perform our audit testing.

Controls were effective over remittance processing, Taxpayer Delinquency Investigations, and caseload rotation. However, controls and management oversight

***Controls were effective over remittance processing, Taxpayer Delinquency Investigations, and caseload rotation. However, controls and management oversight can be improved over open TDAs, CNC accounts, and OIC cases.***

<sup>1</sup> ROs are CFf employees who work collection cases.





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can be improved over open Taxpayer Delinquent Accounts (TDAs), Currently Not Collectible (CNC) accounts, and Offer in Compromise (OIC)<sup>2</sup> cases.

The CFf properly processed and timely submitted remittances received. ROs effectively used and accounted for Receipt for Payment of Taxes (Form 809) books. ROs followed proper procedures when closing Taxpayer Delinquency Investigations cases as unable to locate, not liable for a specific tax period, or no longer liable to file for a specific type of tax, and group managers properly approved cases. In those instances for which TDA caseload rotation would have been applicable, most TDAs were reassigned at least one time.

Our review of 25 open TDAs showed group managers were not performing sufficient reviews of cases. For the majority of the cases, additional managerial involvement could have helped to resolve balance-due accounts as early as possible. For example, 21 of the 25 TDAs were over-age,<sup>3</sup> but there was no managerial review on 17 of these cases. Also, ROs did not conduct timely follow-ups and group managers did not always use the Collection Consultation Initiative<sup>4</sup> process.

Procedures used to control and monitor Collection Statute Expiration Dates (CSED)<sup>5</sup> were not being used effectively. Group managers did not always take the proper actions to identify and monitor the CSEDs on 11 of the 14 cases reviewed. Five of the 14 cases were open cases for which the CSED was set to expire in the next few months. Of the remaining nine cases, ROs closed the cases prior to the CSED expiration in eight cases and<sup>1</sup>

<sup>1</sup> Managers should place a high priority on reviewing cases with imminent CSEDs, to ensure statutes are adequately protected to prevent the loss of revenue.

Our review of cases closed as CNC showed that ROs used an incorrect closing code<sup>6</sup> or we could not determine the correct closing code in 12 hardship closures based on the financial information available in the case file. These taxpayers owe money to the Federal Government, and using an incorrect closing code could result in loss of revenue or unproductive use of resources if the cases are reactivated.

Lastly, our review of OIC cases and timeliness of case actions identified that the length of time offers were in process when worked by the Puerto Rico field offer group substantially exceeded

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<sup>2</sup> An OIC (also referred to in this report as an “offer”) is an agreement between a taxpayer and the Federal Government that settles a tax liability for payment of less than the full amount owed.

<sup>3</sup> An over-age case is a case that has been in the CFf for 16 or more months.

<sup>4</sup> This Initiative was designed to be a process through which managers and ROs discuss actions taken and to take on collection cases.

<sup>5</sup> The CSED is a time period established by law to collect taxes; it is normally 10 years from the date of the tax assessment.

<sup>6</sup> The closing code identifies the reason the case was closed. Accounts reported as CNC due to hardship will systemically reactivate when the income on the taxpayer’s latest return is at least the amount of the unable-to-pay closing code.





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the IRS goal of closing cases within 9 months of receipt. Analysis of 45 (30 closed and 15 open) offers identified case inactivity of over 45 calendar days in 41 (28 closed and 13 open) offers.

Further review of the 30 closed offers showed that the offer specialists followed IRS procedures when returning offers; however, for the accepted and rejected offers, they did not always make appropriate determinations. We identified errors in some financial analyses that affected the outcomes of some of the accepted offers but did not change the final decisions in any of the rejected offers. The errors could result in a loss of revenue to the Federal Government.

Because the closing actions on some cases were questionable, we referred nine cases from our reviews of CSED, CNC, and OIC cases to the Treasury Inspector General for Tax Administration Office of Investigations for further investigation.

Small Business/Self-Employed Division management identified similar concerns to those identified in this review when they performed reviews during Fiscal Year 2005. Small Business/Self-Employed Division OIC Program management performed a review of the OIC field group in January 2005, and the International Operation performed a review of Collection activities in June 2005 that also included a follow-up to the OIC review. Action plans were implemented to help improve the timeliness and quality of casework. In addition, the acting Territory Manager<sup>7</sup> established an over-age case task force.

### **Recommendations**

We recommended the Director, Specialty Programs, use operational reviews to emphasize to managers the need for earlier reviews of over-age TDAs, use of required CSED controls, and effective use of the Collection Consultation Initiative. The Director, Specialty Programs, should reemphasize to managers the need for technical review of the CNC cases prior to closure to ensure ROs obtained all required documents, completed a financial analysis, and used correct closing codes. The Director, Specialty Programs, should continue to monitor the OIC program to ensure timeliness and to ensure proper managerial reviews for inactivity gaps are performed. Lastly, the Director, Specialty Programs, should provide additional training on financial analysis techniques used in support of the offer determinations.

### **Response**

The Commissioner, Small Business/Self-Employed Division, agreed with our concerns and is taking corrective actions. The Territory Manager completed operational reviews on four of five groups and will report the findings to the Chief, International. The Territory Manager will

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<sup>7</sup> Territory Managers are second-line managers within the Collection function. Several group managers report to the Territory Manager.



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review a sample of CNC cases and report the findings to the Chief, International Operations. Following this, a briefing will be conducted with group managers to discuss financial analysis, closing codes, and documentation. Each group manager will then discuss the CNC program in group meetings. The Territory Manager conducted an operational review of the OIC group and addressed issues cited in this audit report. The OIC work is being transferred to a domestic collection Territory by July 2006, and that organization will monitor the program as part of the general collection operational review cycle. Management's complete response to the draft report is included as Appendix V.

Copies of this report are also being sent to IRS officials affected by the report recommendations. Please contact me at (202) 622-6510 if you have questions or Curtis W. Hagan, Assistant Inspector General for Audit (Small Business and Corporate Programs), at (202) 622-3837.





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### ***Background***

The Federal Managers' Financial Integrity Act of 1982<sup>1</sup> requires the Government Accountability Office to issue standards for internal control in the Federal Government. The standards provide the overall framework for establishing and maintaining internal control and for identifying and addressing major performance and management challenges and areas at greatest risks of fraud, waste, abuse, and mismanagement. Therefore, internal controls serve as a defense in safeguarding assets and preventing and detecting errors and fraud within an organization.

Based on prior allegations, the Treasury Inspector General for Tax Administration (TIGTA) Office of Investigations had identified concerns related to the internal controls of various collection activities in the Small Business/Self-Employed Division Puerto Rico office. Concerns included a general lack of consistent management oversight, over-age cases,<sup>2</sup> and potentially questionable disposition of Offer in Compromise (OIC)<sup>3</sup> cases.

Certain collection activities by their nature are high-risk activities, and the responsibility to monitor the internal controls and compliance with procedures within these high-risk areas rests with the Collection function managers. In addition, the revenue officers (RO)<sup>4</sup> who work collection field cases need to follow correct procedures while they perform their duties, to help ensure strong internal controls exist.

Some of the high-risk areas in the Collection Field function (Cff) included in this audit are remittance processing activities, delinquent unfiled returns (also known as Taxpayer Delinquency Investigations (TDI)) closed as not liable or unable to locate, currently not collectible (CNC) accounts, OICs, and open Taxpayer Delinquent Accounts (TDA). These areas generally require managerial oversight to ensure ROs follow required collection procedures.

This review was performed at the San Juan, Mayaguez, and Ponce, Puerto Rico, offices of the Small Business/Self-Employed Division Cff during the period August 2005 through February 2006. The audit was conducted 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.

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<sup>1</sup> 31 U.S.C §§ 1105, 1113, 3512 (2000).

<sup>2</sup> An over-age case is a case that has been in the Collection Field function for 16 or more months.

<sup>3</sup> An OIC (also referred to in this report as an "offer") is an agreement between a taxpayer and the Federal Government that settles a tax liability for payment of less than the full amount owed.

<sup>4</sup> ROs are Cff employees who work collection cases.





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***Results of Review***

***Collection Field Function Employees Timely Submitted and Properly Accounted for Remittances and Form 809 Books***

Internal Revenue Service (IRS) guidelines state that all remittances secured by Cff employees must be sent by overnight, traceable mail to the appropriate Submission Processing site<sup>5</sup> via a Daily Report of Collection Activity (Form 795/795A). This must occur on the day the remittances are collected or as soon as possible on the next business day because the remittances are due at the Submission Processing site within 2 business days from the date the employee receives the funds or within 3 business days if cash is received. Those Cff employees working Flexiplace<sup>6</sup> are given an additional 2 business days.

In addition, ROs are required to issue a Receipt for Payment of Taxes (Form 809) receipt when cash is received or for a check, money order, or draft if the taxpayer requests one. IRS guidelines require Cff employees to maintain strict control over Form 809 books and receipts. Managers assign a Form 809 book to an RO for his or her exclusive use. Each Form 809 book contains 50 sets of 4 parts each. When a Form 809 receipt is issued, Parts 1 and 3 must be kept in the book until they are submitted with the payment on a Form 795/795A; Part 2 is given to the taxpayer, and Part 4 stays in the Form 809 book permanently. Also, group managers are required to ensure employees who are assigned Form 809 books have only research command codes in their Integrated Data Retrieval System (IDRS)<sup>7</sup> profiles.

The Cff properly processed and timely submitted remittances received and safeguarded the remittances during transmission. Also, ROs effectively used and properly accounted for Form 809 books. We did not identify any indications of potential fraud.

***Remittances were properly processed and timely submitted, and Form 809 books were properly accounted for.***

Cff managers stated that ROs are responsible for recording their daily remittances on a Form 795/795A. Subsequently, the group clerk prepares a package including the daily remittances, a Form 795/795A, and a Document Transmittal (Form 3210) to be mailed via overnight, traceable mail to the Submission Processing site. Our observations of the procedures

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<sup>5</sup> A Submission Processing site receives, captures, and perfects tax, payment, and third-party information.

<sup>6</sup> Flexiplace provides employees the opportunity to perform their duties at alternative duty stations remote to the conventional office site (e.g., satellite location, employee's residence).

<sup>7</sup> The IDRS is an IRS computer system capable of retrieving or updating stored information; it works in conjunction with a taxpayer's account records.





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in two groups in one office, which included scanning the Forms 795/795A for several months and discussions with managers in those groups, showed proper procedures were being followed.

Our analysis of remittances on the Master File<sup>8</sup> received in the Puerto Rico Cff<sup>9</sup> in Calendar Year 2004 identified that remittances were potentially untimely deposited. We selected a judgmental sample of 90 of the potentially untimely remittances and calculated the number of calendar days<sup>10</sup> from the date of receipt in the Puerto Rico Cff to the date the remittances were received at the Submission Processing site. Our analysis showed 88 of 90 (98 percent) were received at the Submission Processing site within 7 days; therefore, remittances received were timely submitted by the Cff. Although IRS guidelines state that remittances are due at the Submission Processing site within 3 business days from the date the employee receives the funds, we used 7 days as our criteria to take into consideration the 5 business days for employees working Flexiplace and 2 additional days for those remittances that may have been received on a Thursday or Friday. Consequently, any delays appeared to have occurred after the remittances were received at the Submission Processing site. Figure 1 shows the processing time periods for the sample of 90 remittances.

***Figure 1: Remittance Processing Time in the Puerto Rico Cff***

Number of Calendar Days for Processing	Number of Remittances
2	34
3	9
4	18
5	15
6	7
7	5
8	1
10	1
Total Remittances	90

*Source: TIGTA analysis of the transaction codes<sup>11</sup> from a Master File data extract and remittance receipts from the Submission Processing site.*

<sup>8</sup> The IRS database that stores various types of taxpayer account information. This database includes individual, business, and employee plans and exempt organizations data.

<sup>9</sup> This includes Puerto Rico Cff groups 11, 12, 14, and 15. Group 13 was not included because it consists of OIC specialists and the St. Martin and St. Croix posts of duty.

<sup>10</sup> From this point on in the report, unless it is otherwise noted, “days” refers to calendar days.

<sup>11</sup> Various transaction codes are used on the IRS computer systems to designate different types of actions.





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Our review of a judgmental sample of 19 Form 809 books showed that all 19 ROs had their properly assigned Form 809 books, and all unissued receipts in the books were in numerical order with all 4 parts attached. We matched all the Part 4 issued receipts to Parts 1 and 3 received in the Submission Processing site and determined all issued receipts matched and had not been altered in any way. Group managers performed an annual inventory reconciliation of Form 809 books as required. Our observations in two offices showed that ROs maintained their Form 809 books in locked drawers or cabinets. Additionally, our analysis of the IDRS command code profiles of all 40 ROs in the Puerto Rico CFf confirmed that 39 had only research command codes as required. One RO had no IDRS profile.

### ***Procedures and Controls Over Taxpayer Delinquency Investigations Were Effective***

Many of the taxpayers served by the CFf are required to file a Federal business tax return. If a required tax return is not filed, it is considered a delinquent return. The IRS sends the taxpayer several notices requesting that the return be filed; if the taxpayer does not file the delinquent return, the IRS initiates a TDI in certain cases.

When a TDI is assigned to an RO in the CFf, all reasonable efforts should be made to secure the delinquent return. IRS guidelines require the following actions: the use of internal and external sources to locate the taxpayer, managerial approval before the case is closed, and the use of specific closing transaction codes.

There are circumstances in which the RO can close the TDI without securing the delinquent return. These types of TDI closures are considered high-risk and include cases closed as unable to locate, not liable for a specific tax period, and no longer liable to file for a specific type of tax. The risk in using these types of closures improperly is that the IRS could incorrectly remove the filing requirements for these taxpayers, with the possibility that the delinquent returns will never be filed or taxes collected.

Our review of 40 judgmentally selected business TDI cases (15 no longer liable to file, 15 not liable for a specific period, and 10 unable to locate) closed between June 1, 2004, and May 31, 2005, showed ROs followed proper procedures when closing the cases. Group managers properly approved cases that required approval, such as cases closed as unable to locate and with minimal tax due. In addition, ROs generally performed sufficient research by using internal and external sources on unable to locate cases and made the proper closing code determinations.

***ROs followed proper procedures when closing TDI cases.***





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### ***Caseload Rotations Were Adequate***

IRS guidelines state that, where feasible, group managers should rotate ROs caseloads every 3 years so ROs will not get too familiar with taxpayers in a particular geographic area. Our discussions with three group managers in the Puerto Rico Cff showed there were reorganizations in Fiscal Years 2003 and 2004 during which ROs changed groups and there was turnover of employees. In addition, our review of 25 open TDA cases showed that, in 15 cases for which caseload rotation would have been applicable, most cases were reassigned at least 1 time. Therefore, although we determined that managers did not perform a formal caseload rotation, there were sufficient reassignments of cases during our audit period to prevent ROs from getting too familiar with specific taxpayers.

### ***Managers Need to Be More Involved in Taxpayer Delinquent Account Casework***

A TDA occurs when a taxpayer has an outstanding liability for taxes, penalty, and/or interest. A final notice of demand is mailed to those taxpayers requesting payment or information to resolve the tax problem. When the taxpayer fails to respond within a specified period and if the balance due meets certain criteria, the account becomes a TDA. Subsequently, based on additional criteria, the account will be assigned to either the Automated Collection System<sup>12</sup> or the Cff. The assigned Cff RO attempts to contact the taxpayer, to determine which collection procedures should be used for an effective case resolution.

The group manager is responsible for ensuring effective actions are being taken by the RO by reviewing and monitoring the casework. The Collection Group Manager Handbook provides procedures and guidelines for case management and review, to strengthen new managerial accountability requirements and to promote more effective case action. Monitoring and evaluating the casework help ensure taxes are collected, prevent wrongdoing by employees, and minimize any fraud activity.

The Collection Consultation Initiative (CCI) was implemented in March 2004. It was designed to be a process in which managers and ROs discuss cases actions, establish a plan of action, and follow up at various times during the case.

An imminent Collection Statute Expiration Date (CSED)<sup>13</sup> is any CSED with 12 or fewer months

***Managers did not effectively perform reviews of cases, always use the CCI process, or use the proper controls for CSED cases.***

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<sup>12</sup> The Automated Collection System is a telephone contact system through which telephone assistors collect unpaid taxes and secure tax returns from delinquent taxpayers who have not complied with previous notices.

<sup>13</sup> The CSED is a time period established by law to collect taxes; it is normally 10 years from the date of the tax assessment.





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remaining on the collection statute. The group manager is required to generate a report at least monthly to identify accounts for which the CSED will expire within the next 12 months. Each of these cases should be reviewed to verify the accuracy of the CSED, take corrective action if the CSED is incorrect, and ensure timely and effective action is taken on the account.

Our review of 25 open TDA cases showed group managers were not performing sufficient reviews of cases, especially over-age cases, and not always using the CCI process. In addition, our review of 14 cases with expired statutes or imminent statute expirations showed managers and ROs were not using the proper controls for CSED cases.

### **Managers did not perform required reviews**

Per IRS guidelines, there are several types of reviews relating to an RO's casework, such as mandatory reviews for over-age cases and taxpayers who are pyramiding their tax liabilities,<sup>14</sup> annual performance case reviews, reviews of various monthly reports including inactivity within the past 75 days, and other optional reviews.

We reviewed 25 business-taxpayer TDAs that had been open over 180 days with an aggregate balance greater than \$10,000 and determined managerial involvement was not adequate. Although there was some type of managerial involvement in the cases, such as approval of documents and case reassignment, 21 of the 25 cases were over-age, and we did not identify the required over-age managerial review in 17 (81 percent) of these 21 cases. These reviews are needed to ensure ROs take appropriate case actions and to provide any necessary guidance.

Also, ROs did not conduct timely follow-ups in 20 (80 percent) of the 25 cases. From the case histories for these 20 cases, we identified periods of inactivity of more than 75 days, yet there was no indication of group manager reviews for 14 (70 percent) of the 20 cases. Some of the untimely follow-ups were due to extensive periods of inactivity by the assigned ROs. (One case could have both scenarios described above.)

Additional managerial involvement could have resulted in more timely resolution of the majority of the cases. Insufficient managerial involvement in the resolution of balance-due accounts can cause cases to take longer to resolve and can affect the effectiveness and quality of case actions. Timely resolution of cases is beneficial to the IRS and to taxpayers.

### **Managers did not always use the CCI process**

The CCI process is designed to facilitate managerial engagement and knowledge-sharing in an informal setting, for the large portion of a group's caseload that does not fall under the formal review process. The CCI process involves three types of consultations, which correspond to the three major phases in the life cycle of a case:

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<sup>14</sup> Pyramiding involves the incurring of future additional tax liabilities.





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- Preliminary Case Resolution Plan (PCRP) – The discussion concerning this Plan occurs within 60 days of assignment of the case to the RO; the RO should have made initial contact with the taxpayer by this time.
- Actual Case Resolution Plan (ACRP) – The discussion concerning this Plan occurs based upon the date established during the PCRP discussion but not later than 120 days after the PCRP discussion or not later than 180 days from the date the case was assigned to the RO.
- Pre-Closure Case Resolution Plan – The discussion concerning this Plan occurs on the date established during the ACRP discussion. Quite often the case will have been resolved prior to this date.

TDA's are among the cases that fall under the CCI process, which requires monthly discussions about a selected portion of each RO's inventory to determine various issues such as status of contacts, case resolution plan, proposed case actions, and resolution and target dates. In early Fiscal Year 2006, Small Business/Self-Employed Division management, although still mandating the use of the CCI, recognized that not all cases required use of the CCI process and allowed managers to use their own judgment in deciding which cases should follow the process.

Our sample of 25 TDAs met the criteria for use of the CCI process, although the PCRP phase did not apply because most of the TDAs in our sample were over-age cases. Group managers were not always using the CCI process; the managers conducted an ACRP discussion in only 8 (32 percent) of the 25 cases. In addition, we identified the following from the eight cases in which managers used the CCI process:

- The group managers did not conduct an ACRP discussion until 212 days to 449 days from the date on which the CCI process was initiated.
- A Pre-Closure Case Resolution Plan discussion was not conducted in any of the applicable cases.
- The group managers did not conduct proper follow-ups in four of the six cases where we identified target dates. This allowed the ROs to not follow the action plans as established during the consultations in two of the four cases.

Two of the three managers interviewed informed us they did not see the benefit of performing these consultations in addition to other required managerial reviews. The CCI process facilitates managerial engagement in cases. It should be used more effectively because it promotes casework communication between the RO and the group manager, resulting in more timely resolution of cases.





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### **Managers did not always monitor CSEDs**

When a CSED becomes imminent, the RO and the group manager should discuss the case and agree on the most appropriate plan of action based on the facts of the case. Both the RO and group manager will document the initial plan of action in the case history. In addition, when only 120 days remain until the collection statute expires, the group manager should prepare a brief memorandum to the Territory Manager<sup>15</sup> advising of an imminent CSED and the plan of action to resolve it.

From a computer analysis, we identified nine cases in which there was an indication the collection statute had expired while the RO was still working the case. Because some of these nine cases were closed a few years ago, we obtained from the current inventory an additional five cases in which the CSED was about to expire. For the nine cases obtained from the computer analysis, the RO closed the case before the collection statute expired in eight cases. <sup>1</sup>

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The results from our review of the 14 cases showed the procedures used to control and monitor CSEDs were not being used effectively. Group managers did not always take the proper actions to identify and monitor the CSEDs on 11 of the 14 cases as follows:

- In 6 cases, the group manager did not follow up with the RO when the CSED was within 52 weeks (12 months).
- In seven cases, the group manager did not review the cases.
- In eight cases, the CSED was not frequently followed up on to ensure the statute was adequately protected.
- In 10 cases, there was no indication the group manager prepared a brief memorandum to the Territory Manager when there were only 120 days remaining on the statute.

Managers should place a high priority on reviewing cases with imminent CSEDs to ensure statutes and potential revenue are adequately protected. We referred two cases to the TIGTA Office of Investigations for further investigation because the closing actions were questionable.

Small Business/Self-Employed Division International Operations management had conducted a review of general Collection function cases in June 2005. They identified concerns similar to those we identified related to lapses in activity on cases, untimely follow-ups, and management involvement. Action plans were developed to address timeliness and quality of case work. In addition, during the same period, the acting Territory Manager established an over-age case task force after conducting an operational review of over-age cases.

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<sup>15</sup> Territory Managers are second-line managers within the Collection function. Several group managers report to the Territory Manager.





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### ***Recommendation***

***Recommendation 1:*** The Director, Specialty Programs, should use operational reviews to emphasize to managers the need for earlier reviews of over-age TDAs, effective use of the CCI process, and use of required CSED controls.

***Management's Response:*** The Commissioner, Small Business/Self-Employed Division, agreed with the recommendation. The Territory Manager completed operational reviews on four of the five collection groups and will report the findings to the Chief, International. The reviews addressed the areas cited during this review, including potential over-age, use of the CCI by group managers, and CSED controls.

### ***Revenue Officers Did Not Fully Investigate or Use the Proper Closing Codes When Closing Accounts As Currently Not Collectible***

The IRS has the authority to report balance-due accounts as CNC and remove them from active inventory after taking the necessary steps in the collection process. Per IRS guidelines, accounts may be reported as CNC for a variety of reasons, such as inability to locate the taxpayer or assets, inability to contact a taxpayer although the address is known but there is no means to enforce collection, or collection of the liability would create an undue hardship for the taxpayer by leaving him or her unable to meet necessary living expenses. Based on the IRS' National statistical reports, for Fiscal Year 2005, the IRS closed as CNC over 2.4 million accounts that owed a total of over \$15 billion.

Per IRS guidelines, an RO should locate and contact the taxpayer using the appropriate research tools to determine the taxpayer's ability to pay. If neither the taxpayer nor assets can be located, the account is closed as unable to locate. If the taxpayer's ability to pay cannot be determined because he or she cannot be contacted and income and assets cannot be identified, the case is closed as unable to contact. Once the taxpayer is located, the RO should conduct an interview and perform a complete income and expense analysis to make the proper case resolution determination. The RO should obtain and analyze a current Collection Information Statement on the taxpayer's assets and financial information when the taxpayer's liability exceeds a certain dollar amount. Once an RO determines that the taxpayer has no ability to pay and it is best to close a delinquent account as CNC, the RO should use the appropriate closing code identifying the reason for the closure. Accounts reported as CNC due to hardship will systemically reactivate when the income on the taxpayer's latest return is at least the amount of the unable-to-pay closing code. The decision to place an account in CNC status requires the approval of a manager. The manager's review should address the decision to place the account in CNC status and the adequacy of the investigation, including any additional case development and steps that should be taken before closing the case as CNC.





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We reviewed 32 judgmentally selected TDA cases closed as CNC: 21 hardship, 7 unable to contact, and 4 unable to locate. In 2 cases

<sup>1</sup> [REDACTED], the decisions to close the cases as CNC may not have been appropriate.

***In 2 cases, the CNC decision may not have been appropriate. In 12 cases, the closing code was incorrect or we could not determine the correct closing code.***

<sup>1</sup> [REDACTED] The taxpayers owed a total of approximately \$111,000 on these 2 cases, and it is possible some or all of these liabilities could have been collected while the cases were open, if more work had been done. We referred the cases to the TIGTA Office of Investigations for further investigation.

Per IRS guidelines, once a case is determined to be CNC due to a hardship condition and is being closed, the RO should use the closing code that most closely corresponds to the taxpayer's allowable expenses<sup>16</sup> adjusted for the future. For 30 of the 32 cases we reviewed, the ROs properly closed the cases as CNC. However, the ROs used an incorrect closing code or we could not determine the correct closing code in 12 (40 percent) of the 30 cases; all 12 were closed due to a hardship condition. For 9 of the 12 cases, the closing code used was not correct if the expenses as documented in the case file or on the Collection Information Statement were used. For the remaining three cases, there was insufficient documentation of expenses, and we were unable to determine the correct closing code to use.

One reason these errors occurred is that, when approving the closures, managers did not ensure (1) all the required documentation was obtained or maintained in the case files prior to the CNC closing action and (2) the financial information was adequately reviewed so the correct closing code determination was made. These taxpayers owe money to the Federal Government, and incorrectly closing cases as CNC could result in loss of revenue. Also, using an incorrect closing code could potentially mean a loss of revenue or unproductive use of resources depending on if and when the cases are reactivated.

### ***Recommendation***

**Recommendation 2:** The Director, Specialty Programs, should reemphasize to managers the need for technical review of cases to be closed as CNC, prior to closure, for completeness of documentation, adequate financial analyses, and calculation of correct closing codes.

<sup>16</sup> Allowable expenses are defined as expenses necessary to provide for a taxpayer's and his or her family's health and welfare and/or production of income. To determine the amount allowable for future years, the RO considers the taxpayer's input and the IRS' standard allowances, then allows for a percentage increase.





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## ***The Puerto Rico Collection Field Function Can Improve Internal Controls in Various Activities***

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**Management's Response:** The Commissioner, Small Business/Self-Employed Division, agreed with the recommendation. The Territory Manager will review a sample of CNC cases and report the findings to the Chief, International Operations. Following this, a briefing will be conducted with group managers to discuss financial analysis, closing codes, and Integrated Collection System documentation. Each group manager will then discuss the CNC program in a group meeting with revenue officers.

### ***Controls Over the Offer in Compromise Program Were Not Effective***

The IRS has the authority to settle or compromise Federal tax liabilities by accepting less than full payment under certain circumstances. One way to accomplish this is through an OIC. Currently, the IRS is authorized to compromise a liability on any one of three grounds:

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

***There were delays in OIC case processing and errors in the offer evaluations.***

Our review of open and closed offers evaluated by the Puerto Rico office identified delays in case processing and errors in the offer evaluations.

### **Offer evaluations were not completed timely**

The IRS' goal for field offer groups was to complete an offer evaluation within 6 months of receipt in the field; however, the IRS modified this goal during Fiscal Year 2005 to 9 months (approximately 270 days). The length of time offers were in process when worked by the Puerto Rico field offer group substantially exceeded the IRS goal of closing cases within 9 months of receipt. Our analysis of the Automated Offer in Compromise (AOIC) system<sup>17</sup> for offers closed by the Puerto Rico field offer group showed the average length of time for closing<sup>18</sup> processable offers in Fiscal Years 2004 and 2005 (through July 1, 2005) was approximately 559 days and 491 days, respectively.

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<sup>17</sup> The AOIC system is a centralized database used to control and track status and activities in offer cases. Our analysis included offers closed between October 1, 2001, and July 1, 2005.

<sup>18</sup> We measured the average length of time to close an offer as the period of time from input to the AOIC system to the Area Office disposition date (i.e., the issuance of the disposition letter).

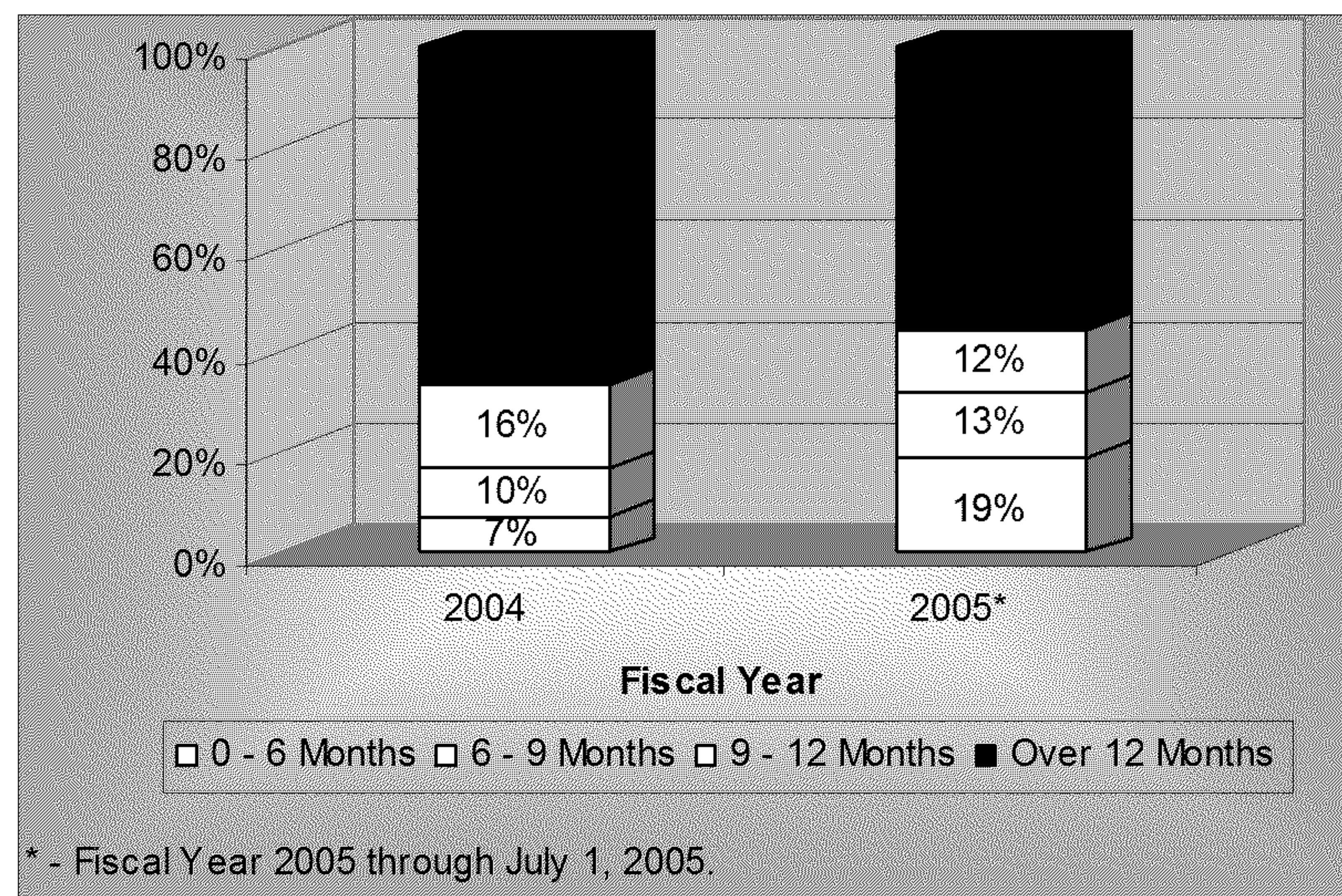




## ***The Puerto Rico Collection Field Function Can Improve Internal Controls in Various Activities***

Figure 2 shows the percentage of offers closed by the group exceeding the 9-month goal was approximately 83 percent in Fiscal Year 2004 and 68 percent in Fiscal Year 2005 (through July 1, 2005).

**Figure 2: Analysis of Days in Process for OIC Cases**



*Source: TIGTA analysis of an AOIC system data extract.*

To further evaluate the timeliness of offer processing, we reviewed a judgmental sample of 45 offers: 30 were offers closed between June 1, 2004, and May 31, 2005, and 15 were open offers from an August 26, 2005, AOIC system inventory listing. The closed offers included 10 accepted offers, 5 rejected offers (the taxpayers did not exercise appeal rights), and 15 processable offers that the IRS returned to the taxpayers because additional information was not provided by the taxpayers.

Our analysis of the case activities of the 45 offers identified delays of over 45 days in 41 offers (28 closed<sup>19</sup> and 13 open). These included a delay in the assignment of the offer (26 of the 41 offers; 63 percent) and/or periods of inactivity while the offer was assigned to an offer specialist or during transfer to another offer specialist (27 of the 41 offers; 66 percent). The delays averaged approximately 267 days on the 28 closed cases (range = 52 days to 550 days) and 280 days on the 13 open cases (range = 107 days to 526 days). These delays added unnecessary days to the evaluation process.

When an offer evaluation is not completed timely, both the taxpayer and the Federal Government are adversely affected. Taxpayers and their representatives have an expectation that offer conclusions will be reached in a reasonable amount of time. The Federal Government's interest

<sup>19</sup> Although 28 of these cases had delays in case activities of over 45 days, 4 involved cases in which the OIC evaluation took fewer than 9 months.





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## ***The Puerto Rico Collection Field Function Can Improve Internal Controls in Various Activities***

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is affected by delays in collection of the accepted offer amount or attempted collection of the tax liabilities for nonaccepted offers through the regular collection program.

Delays in offer processing occurred because:

- Offers were transferred to the Puerto Rico office from the former Washington, D.C., office during Fiscal Year 2003.
- A backlog of offers delayed the assignment of cases to offer specialists.
- Managerial oversight was not effective to ensure timely casework.

In a prior audit of field offer groups, we had determined IRS guidance did not contain a methodology for the periodic review of offers to provide timely and constructive feedback to the offer specialists for promptly resolving the offer evaluations.<sup>20</sup> The formal guidance requiring the bimonthly reviews of inactivity gaps was issued in February 2005.

The Small Business/Self-Employed Division OIC Program management conducted a review of the Puerto Rico field offer group in January 2005 and identified similar significant concerns over managerial oversight of the Puerto Rico OIC program. Action plans were developed to address timeliness and quality of case work.<sup>3(d)</sup>

In addition, the review indicated that a significant number of offers were transferred from the Washington, D.C., office during Fiscal Year 2003. At the time of the transfer, many of these offers were aged or close to being aged.

Following this visitation, a large number of offers were reassigned to another field offer group, thus reducing the number of offers pending in inventory; this assisted in eliminating the backlog of offers awaiting assignment in the field offer group. In addition, the June 2005 review conducted by the Small Business/Self-Employed Division International Operations management included follow-up on the OIC program. This review determined that, since the January 2005 review, the manager was conducting overage reviews as outlined in the Internal Revenue Manual and was providing guidance to the employees on performance.

We identified three documented group manager reviews of inactivity gaps. These reviews were conducted in January, April, and August 2005.<sup>21</sup> Our review of 15 cases judgmentally selected from these reviews conducted by the group manager determined that, when the no-activity reviews were conducted, the employees followed up timely. These reviews, when

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<sup>20</sup> *Improvements Are Needed in the Timeliness and Accuracy of Offers in Compromise Processed by Field Offer Groups* (Reference Number 2005-30-013, dated December 2004).

<sup>21</sup> The January 2005 review coincided with the Small Business/Self-Employed Division OIC Program review, and the August 2005 coincided with our onsite review.





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## ***The Puerto Rico Collection Field Function Can Improve Internal Controls in Various Activities***

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conducted as often as required, may reduce the potential for untimely follow-up and risk of unnecessary delays in case processing.

### ***Offer specialists made errors in financial analyses, resulting in some offers being improperly accepted***

In the analysis of offers based on doubt as to collectibility, the offer specialist compares the amount the taxpayer offered with the amount the IRS determines could be reasonably collected from the taxpayer. This calculation is called the reasonable collection potential (RCP). When offers are submitted based on effective tax administration, the offer specialist determines if the RCP is greater than the amount owed before considering the taxpayer's special circumstances.<sup>22</sup>

The RCP is based on the taxpayer's equity in assets and future income in excess of necessary living expenses. The offer should be accepted when the offer amount reasonably reflects the RCP or the offer amount adequately reflects the offer specialist's consideration of economic hardship<sup>23</sup> when a special circumstance exists. In some instances, the IRS may return an offer when the taxpayer does not provide necessary information to determine the RCP, the offer was filed solely to delay collection actions,<sup>24</sup> or the taxpayer no longer meets the criteria for processable<sup>25</sup> offers. Except for certain return dispositions, such as returning offers for filing or payment compliance, offer dispositions require managerial review and approval.

Our review of a judgmental sample of 15 of the 190 processable offers returned to taxpayers between June 1, 2004, and May 31, 2005, indicated (1) the OIC field offer group followed IRS procedures when returning offers to taxpayers and (2) cases contained evidence that an appropriate official approved the return of the offers. However, our review of a judgmental sample of 15 offers (10 accepted and 5 rejected) closed between June 1, 2004, and May 31, 2005, indicated offer specialists did not always make appropriate determinations. In addition, improvement is needed in the control over managerial review and approval to ensure offer determinations are accurate and adequately documented.

We identified errors or a combination of errors in the financial analyses on 9 (60 percent) of the 15 accepted or rejected cases. These errors involved:

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<sup>22</sup> A special circumstance may include advanced age or serious illness of the taxpayer.

<sup>23</sup> Through analysis and negotiation, the offer specialist determines an amount believed to be necessary for the taxpayer to meet basic living expenses.

<sup>24</sup> "Solely to delay collection" may include the resubmission of an offer, after a prior offer has been returned or rejected, and the new offer is essentially the same as the prior returned or rejected offer.

<sup>25</sup> The preconditions a taxpayer must meet, as of November 1, 2003, include the taxpayer cannot be in bankruptcy, has filed all required tax returns, has used the most current version of the Offer in Compromise (Form 656), and has submitted the \$150 application fee or Income Certification for Offer in Compromise Application Fee (Form 656-A).





## ***The Puerto Rico Collection Field Function Can Improve Internal Controls in Various Activities***

- Insufficient verification to properly determine business income of in-business taxpayers (three instances). This included the determination of gross receipts and allowable business expenses.
- Inaccurate valuation of net equity in assets (three instances). This included improper application of the exemption for tools of the trade<sup>26</sup> (two instances) and [redacted] (one instance).
- Insufficient determination of value, if any, of dissipated<sup>27</sup> assets (two instances).
- [redacted] (one instance).

The errors identified affected the outcome of 5 of the 10 accepted offers reviewed but did not change the final decisions in any of the 5 rejected offers reviewed. For the five offers affected by these errors, our evaluation showed:

- In 2 instances, the IRS accepted offers totaling approximately \$16,000 for outstanding liabilities of approximately \$56,000. The corrected RCPs indicated the taxpayers could fully pay the outstanding liabilities in both cases. These offers should have been rejected; the IRS could have pursued collection of the entire \$56,000 in outstanding liabilities. A potential loss of revenue exists totaling approximately \$40,000.
- In 3 instances, the IRS accepted offers totaling approximately \$443,000 for outstanding liabilities of approximately \$1,126,000. The corrected RCPs indicated the offers could have been significantly increased to a total of approximately \$850,000. This represents a potential loss of revenue totaling approximately \$407,000.

We referred all five cases to the TIGTA Office of Investigations for further investigation because the closing actions on these cases were questionable.

Improper decisions were caused by insufficient evaluation of data and inadvertent errors in calculations. An offer determination involves indepth evaluation of the taxpayer's assets and ability to pay. This process is complex, requiring offer specialists to pay close attention to detail and to make numerous calculations. These errors were not identified and corrected by the managerial review process. [redacted]

<sup>26</sup> A statutory exemption from levy is applied to the taxpayer's value of tools used in a trade or business. The levy exemption does not apply to corporate entities, only to individual business taxpayers. For asset valuation, the exemption is treated as a reduction to the asset's value.

<sup>27</sup> Dissipated assets are assets (liquid or nonliquid) that have been sold, gifted, transferred, or spent on items or debts and are no longer available to pay the tax liability.

<sup>28</sup> The IRS established a national standard for expenses of food, housekeeping supplies, apparel and services, personal care, and miscellaneous expenses. The national standard varies by family size and income.

<sup>29</sup> In the remaining instance, the offer decision was approved by an employee designated as acting group manager.





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***The Puerto Rico Collection Field Function Can Improve Internal Controls in Various Activities***

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were finalized by 5 different offer specialists, the majority of the cases in our sample (9 of 15)

3(d)

## ***Recommendations***

**Recommendation 3:** The Director, Specialty Programs, should continue to monitor the OIC program to ensure timeliness and to ensure operational review and managerial reviews for inactivity gaps are performed.

**Management's Response:** The Commissioner, Small Business/Self-Employed Division, agreed with the recommendation. The Territory Manager conducted an operational review of the OIC group and addressed issues cited in this review. The OIC work is being transferred to a domestic collection Territory by July 2006, and that organization will monitor the program as part of its general collection operational review cycle.

**Recommendation 4:** The Director, Specialty Programs, should identify and provide additional training on financial analysis techniques used in support of the offer determinations.

**Management's Response:** Although the Commissioner, Small Business/Self-Employed Division, agreed with the recommendations in the report, no corrective action is needed for this recommendation because the OIC program is currently being transferred to a domestic collection Territory manager.





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## ***The Puerto Rico Collection Field Function Can Improve Internal Controls in Various Activities***

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### **Appendix I**

#### ***Detailed Objective, Scope, and Methodology***

The overall objective of this review was to evaluate whether internal controls over certain high-risk activities in the Puerto Rico Collection Field function (Cff) are being used effectively. The results of our audit tests relate to conditions in the Puerto Rico office only. We visited the three offices located on the island of Puerto Rico because integrity issues were related to cases worked there.

For all case reviews described below, we used judgmental sampling to select cases because we did not plan to project results or conclude anything beyond what was occurring in the Puerto Rico office. In addition, we validated all data extracts by conducting queries on the extracts to ensure we obtained records meeting our extract criteria. We determined data obtained from Internal Revenue Service files were sufficiently reliable to select samples.

To accomplish the audit objective, we:

- I. Determined whether the Cff followed proper procedures when closing delinquent accounts as currently not collectible (CNC) by reviewing case files for a judgmental sample of 32 CNC cases closed by revenue officers (RO)<sup>1</sup> as due to hardship (21 cases) or unable to locate or contact (11 cases). We judgmentally selected cases from the population on the Treasury Inspector General for Tax Administration Data Center Warehouse's Integrated Collection System<sup>2</sup> Taxpayer 53 File of cases that were closed between June 1, 2004, and May 31, 2005, having an aggregate balance greater than \$5,000. The population was 61 taxpayer cases. We selected the dates to get a year's data; these were the latest data available. We selected the dollar criteria for significance.
- II. Determined whether Cff managers were effectively involved in reviewing open Taxpayer Delinquent Account (TDA) cases, including using the Collection Consultation Initiative process, applying caseload rotation when applicable, and reviewing Collection Statute Expiration Dates (CSED)<sup>3</sup> and over-age<sup>4</sup> cases.
  - A. Identified and discussed the procedures and guidelines for the consultation process, caseload rotation, pending statute expiration, and over-age cases.

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<sup>1</sup> ROs are Cff employees who work collection cases.

<sup>2</sup> The Integrated Collection System is an automated system used to control and monitor delinquent cases assigned to ROs in the Cff offices.

<sup>3</sup> The CSED is a time period established by law to collect taxes; it is normally 10 years from the date of the tax assessment.

<sup>4</sup> An over-age case is a case that has been in the Cff for 16 or more months.





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## ***The Puerto Rico Collection Field Function Can Improve Internal Controls in Various Activities***

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- B. Reviewed a judgmental sample of open cases to determine whether the consultation process was being properly used by managers and ROs.
    - 1. From the open Integrated Collection System case inventory as of July 5, 2005, selected a judgmental sample of 25 open TDAs with an aggregate balance greater than \$10,000 that had been open over 180 days. The population was 573 taxpayers. We selected the dates based on the date we did our analysis, the dollars based on significance, and the 180 days to identify cases open a long time.
    - 2. Determined whether there was documentation that the various phases of the consultation process took place if appropriate and that ROs and managers followed up appropriately.
  - C. Determined whether there was evidence of other managerial involvement in cases.
  - D. Evaluated whether case inventories were being rotated as required.
  - E. Reviewed a judgmental sample of 14 cases in which it appeared the CSED either had expired while the case was assigned (9) or was about to expire (5), to determine whether group managers and ROs followed proper procedures. We identified the nine cases from an analysis of Master File<sup>5</sup> and the Integrated Collection System; these were all the cases for which the CSED was before the date the RO closed the case. We identified the 5 cases from open inventory on August 29, 2005.
- III. Determined whether the CFf followed proper procedures when closing Taxpayer Delinquency Investigation (TDI) cases as unable to contact or locate, not liable to file for a specific period and type of tax, or no longer liable to file. We reviewed a judgmental sample of 40 business TDI cases that were closed as unable to contact or locate (10), not liable to file for a specific period (15), or no longer liable to file (15). We judgmentally selected the cases from the population of 700 taxpayer cases closed on the Integrated Collection System between June 1, 2004, and May 31, 2005. We selected the dates to get a year's data; these were the latest data available.
- IV. Determined whether employees effectively followed the procedures for timely submitting and properly safeguarding remittances.
- A. Identified, observed, and discussed remittance processing procedures.
  - B. Determined whether ROs properly and timely submitted remittances.

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<sup>5</sup> The Master File is the IRS database that stores various types of taxpayer account information. This database includes individual, business, and employee plans and exempt organizations data.





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## ***The Puerto Rico Collection Field Function Can Improve Internal Controls in Various Activities***

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1. Identified from the Master File Return Processing Data remittances posted for Calendar Year 2004 (the latest data available at the Data Center Warehouse) and attempted to identify those received by the Puerto Rico ROs. It was too difficult and time-consuming to obtain a valid population using this method; however, we were able to identify a possible 2,520 remittances that appeared untimely. We judgmentally selected 90 remittances to follow up on and determine whether they were submitted timely.
  2. Scanned several months of the Daily Report of Collection Activity (Forms 795/795A) in two groups to identify any possible late remittances or errors.
- C. Determined whether Receipt for Payment of Taxes (Form 809) books were properly controlled and used. We conducted an independent verification of a judgmental sample of 19 Form 809 books assigned to 19 ROs and verified with the Submission Processing site<sup>6</sup> whether all Form 809 receipts were received and accounted for.
- D. Determined whether ROs had adjustment capabilities on the Integrated Data Retrieval System.<sup>7</sup>
- V. Determined whether proper procedures were followed on Offer in Compromise (OIC)<sup>8</sup> cases.
- A. Identified and discussed procedures for OIC cases and determined National and local office managerial involvement in the program.
  - B. Reviewed judgmental samples of various types of OIC cases to determine whether they were timely and properly worked and whether proper conclusions were reached.
    1. Reviewed a judgmental sample of 30 offers closed between June 1, 2004, and May 31, 2005. These included 10 of 124 accepted, 5 of 28 rejected, and 15 of 190 returned offers.

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<sup>6</sup> A Submission Processing site receives, captures, and perfects tax, payment, and third-party information.

<sup>7</sup> The Integrated Data Retrieval System is an IRS computer system capable of retrieving or updating stored information; it works in conjunction with a taxpayer's account records.

<sup>8</sup> An OIC (also referred to in this report as an "offer") 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 Puerto Rico Collection Field Function Can Improve Internal Controls in Various Activities***

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2. Reviewed a judgmental sample of 15 of 112 open offers from an August 26, 2005, Automated Offer in Compromise<sup>9</sup> system inventory listing.
- C. Obtained group manager inactivity reviews to identify the frequency and effectiveness of the reviews. We reviewed a judgmental sample of 15 of 43 cases from the group manager no activity reviews. These include cases identified from the group manager reviews dated January 19, 2005, and April 28, 2005.

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<sup>9</sup> The Automated Offer in Compromise system is a centralized database used to control and track status and activities in offer cases.





***The Puerto Rico Collection Field Function Can Improve Internal Controls in Various Activities***

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**Appendix II**

***Major Contributors to This Report***

Curtis W. Hagan, Assistant Inspector General for Audit (Small Business and Corporate Programs)

Parker Pearson, Director

Lynn Wofchuck, Audit Manager

Doris Cervantes, Lead Auditor

Darryl Roth, Senior Auditor

Pillai Sittampalam, Senior Auditor

Joseph Snyder, Senior Auditor

Phyllis Heald, Auditor

Cristina Johnson, Auditor

Nina Julius, Auditor





***The Puerto Rico Collection Field Function Can Improve Internal Controls in Various Activities***

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Appendix III

***Report Distribution List***

Commissioner C  
Office of the Commissioner – Attn: Chief of Staff C  
Deputy Commissioner for Services and Enforcement SE  
Deputy Commissioner, Small Business/Self-Employed Division SE:S  
Director, Collection, Small Business/Self-Employed Division SE:S:C  
Director, Specialty Programs, Small Business/Self-Employed Division SE:S:SP  
Chief Counsel CC  
National Taxpayer Advocate TA  
Director, Office of Legislative Affairs CL:LA  
Director, Office of Program Evaluation and Risk Analysis RAS:O  
Office of Management Controls OS:CFO:AR:M  
Audit Liaison: Commissioner, Small Business/Self-Employed Division SE:S





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## ***The Puerto Rico Collection Field Function Can Improve Internal Controls in Various Activities***

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### **Appendix IV**

### ***Outcome Measure***

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

#### **Type and Value of Outcome Measure:**

- Increased Revenue – Potential; \$558,000 in taxes owed.

This includes \$111,000 for 2 taxpayers whose accounts were closed as currently not collectible (CNC) (see page 9).

It also includes \$447,000 for (a) 2 taxpayers whose Offers in Compromise (OIC)<sup>1</sup> should have been rejected and whose taxpayer accounts should have been placed back into active collection status and (b) 3 taxpayers whose OICs should have been significantly increased. Some of these taxpayers may be reluctant to fully pay the taxes owed or increase the amounts offered. However, Internal Revenue Service procedures indicate that, when the amount offered does not reasonably reflect the reasonable collection potential (RCP),<sup>2</sup> the OIC should be rejected or increased (see page 11).

#### **Methodology Used to Measure the Reported Benefit:**

CNC methodology: We selected a judgmental sample of 32 taxpayer cases from a population of 61 cases closed as CNC by the Puerto Rico office between June 1, 2004, and May 31, 2005, having aggregate balances greater than \$5,000. The amount of increased revenue is based on the balances due for two taxpayers whose cases we concluded should not have been closed as CNC. It is possible that some or all of the balances due could have been collected if the cases had remained open and more work had been done; therefore, the range for potential revenue loss would be \$0 to \$111,000.

OIC methodology: We selected a judgmental sample of 10 from the 124 OICs accepted by the Puerto Rico field offer group between June 1, 2004, and May 31, 2005. We determined the amount of the increased revenue based on the differences between the amounts accepted and the outstanding liabilities in two instances for which the RCP exceeded tax liabilities. In three

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<sup>1</sup> An OIC (also referred to in this report as an “offer”) is an agreement between a taxpayer and the Federal Government that settles a tax liability for payment of less than the full amount owed.

<sup>2</sup> The RCP is the amount the IRS determines could be reasonably collected from the taxpayer.





***The Puerto Rico Collection Field Function Can Improve Internal Controls in Various Activities***

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instances, we calculated the increased revenue potential based on the differences between the amounts accepted and our calculation of the RCPs.






**The Puerto Rico Collection Field Function Can Improve Internal Controls in Various Activities**

Appendix V

**Management's Response to the Draft Report**

**RECEIVED**  
**MAY 30 2006**

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

**May 26, 2006**

**COMMISSIONER**  
**SMALL BUSINESS/SELF-EMPLOYED DIVISION**

**MEMORANDUM FOR DEPUTY INSPECTOR GENERAL FOR AUDIT**

**FROM:** Kevin M. Brown *KMB*  
Commissioner Small Business/Self-Employed Division

**SUBJECT:** Draft Audit Report -- The Puerto Rico Collection Field Function Can Improve Internal Controls in Various Activities (Audit # 200530020)

We have reviewed your report and agree with the recommendations. We share your concerns about the lack of documented managerial case reviews and with the timeliness and quality of Offer in Compromise (OIC) cases. We identified these same issues in our own operational reviews in 2005 and have taken steps to address the deficiencies.

As noted in your report, Collection Policy conducted an operational review of the International Offer in Compromise program in January 2005. This review was requested by the Chief, International SB/SE, as they did not yet have a Policy staff. As a result of the review, we developed and implemented an action plan and noted improvements in many of the areas cited in your review. Overage statistics and quality data show a positive trend in this program over the last year, and we are generally exceeding the national norms in these measures.

As you also noted, an International Policy program review of the Collection groups in Puerto Rico was conducted in June 2005 and identified problems with certain aspects of casework and group managers' consultations. A series of recommendations were developed to address these problems. In response to this operational review and associated recommendations, the acting territory manager began reviews of overage cases. The permanent territory manager selected in June 2005 initiated comprehensive operational reviews to address the full range of recommendations issued by International Policy, as well as those identified in the TIGTA review. We have completed four reviews to date, and based on our findings, developed expectations for each group manager under review.

We agree with your outcome measure for potential increased revenue from offer in compromise and currently not collectible cases. However, we want to emphasize that neither rejecting an offer in compromise nor taking further collection activity on a currently not collectible account assures collection of the full liability. This is particularly true for international cases where enforcement tools are limited.





## ***The Puerto Rico Collection Field Function Can Improve Internal Controls in Various Activities***

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Our comments on your recommendations follow:

### **RECOMMENDATION 1**

The Director, Specialty Programs should use operational reviews to emphasize to managers the need for earlier reviews of overage TDAs, effective use of the CCI process, and the use of required CSED controls.

### **CORRECTIVE ACTION**

During FY '06, the territory manager completed operational reviews on four of the five Puerto Rico Collection groups and will report the findings to the Chief, International. The reviews addressed the areas cited in TIGTA's review, including potential overage, use of Collection Consultations by group managers, and CSED controls.

### **IMPLEMENTATION DATE**

December 31, 2006

### **RESPONSIBLE OFFICIAL(S)**

Director, Specialty Programs SB/SE

### **CORRECTIVE ACTION MONITORING PLAN**

Chief, International Operations will advise the Director Specialty Programs of any delays.

### **RECOMMENDATION 2**

The Director, Specialty Programs should reemphasize to managers the need for technical review of cases to be closed CNC, prior to closure for completeness of documentation, adequate financial analyses, and calculation of correct closing codes.

### **CORRECTIVE ACTION**

The territory manager will review a sample of CNC cases and report the findings to the Chief, International Operations. Following this, a briefing will be conducted with group managers to discuss financial analysis, closing codes, and ICS documentation. Each group manager will then discuss the CNC program in a group meeting with revenue officers.

### **IMPLEMENTATION DATE**

September 30, 2006

### **RESPONSIBLE OFFICIAL(S)**

Director, Specialty Programs SB/SE





## ***The Puerto Rico Collection Field Function Can Improve Internal Controls in Various Activities***

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### **CORRECTIVE ACTION MONITORING PLAN**

Chief, International Operations will advise the Director, Specialty Programs of any delays.

### **RECOMMENDATION 3**

The Director, Specialty Programs should continue to monitor the OIC program to ensure timeliness and to ensure operational review and managerial reviews for inactivity gaps are performed.

### **CORRECTIVE ACTION**

The territory manager conducted an operational review of the OIC group and addressed issues cited in the TIGTA review. The OIC work is being transferred to a domestic collection territory by July 2006, and that organization will monitor the program as part of their general collection operational review cycle.

### **IMPLEMENTATION DATE**

September 30, 2006

### **RESPONSIBLE OFFICIAL(S)**

Director, Specialty Programs SB/SE

### **CORRECTIVE ACTION MONITORING PLAN**

Chief, International Operations will advise the Director, Specialty Programs of any delays.

### **RECOMMENDATION 4**

The Director, Specialty Programs should identify and provide additional training on financial analysis techniques used in support of the offer determinations.

### **CORRECTIVE ACTION**

No corrective action is needed as the OIC program is currently being transferred to a domestic collection territory manager.

### **IMPLEMENTATION DATE**

N/A

### **RESPONSIBLE OFFICIAL(S)**

N/A

### **CORRECTIVE ACTION MONITORING PLAN**

N/A

If you have any questions about this response, please call me at (202) 622-0600 or Bill Conlon, Director, Specialty Programs, Small Business/Self-Employed Division, at (202) 283-6874.