



*Currently Not Collectible Decisions on
Delinquent Accounts Were Appropriate;
However, Closing Actions Need to Be
Improved*

September 27, 2006

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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.

Phone Number | 202-927-7037

Email Address | Bonnie.Heald@tigta.treas.gov

Web Site | <http://www.tigta.gov>



TREASURY INSPECTOR GENERAL
FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY

WASHINGTON, D.C. 20220

September 27, 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 – Currently Not Collectible Decisions on
Delinquent Accounts Were Appropriate; However, Closing Actions
Need to Be Improved (Audit # 200530018)

This report presents the results of our review of the Internal Revenue Service's (IRS) decisions on currently not collectible (CNC) delinquent accounts. The overall objective of this review was to determine whether the Small Business/Self-Employed Division Collection Field function used the proper procedures when closing delinquent accounts as CNC due to hardship (unable to pay). We reviewed individual and business taxpayer cases with balances due greater than \$100,000 because they accounted for approximately 78 percent of the dollars on cases closed as CNC due to hardship.

Impact on the Taxpayer

Closing a taxpayer balance-due account as CNC is a high-risk collection activity because the balance due from taxpayers may be at risk of never being collected. Revenue officers (RO) made the proper determinations to close the cases as CNC due to hardship, but did not always include sufficient documentation as required.

Synopsis

Our review showed ROs made the proper determinations to close the cases as CNC due to hardship because the taxpayers did not have the current ability to pay the taxes owed. ROs performed adequate research of assets, income, and the taxpayers' current financial and personal situations to make the decisions. However, ROs did not always include sufficient documentation



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that they had obtained credit reports when required or select the appropriate closing codes when closing the cases.

In 24 of 80 cases reviewed, ROs did not obtain or document the case file that they had received credit reports. In 11 of these cases, there were some extenuating circumstances for which a credit report would not have helped the case resolution; however, in the remaining 13 (16 percent) cases, ROs should have obtained credit reports. Credit reports show whether the taxpayers have additional income and/or available credit balances from which they could borrow or obtain funds.

For a case closed as CNC due to hardship, IRS procedures require the RO to input to the Integrated Data Retrieval System¹ a closing code containing account information. The closing code equates to an amount of income the taxpayer may claim on a future tax return and should be based on the taxpayer's current expenses. If the income on a future tax return exceeds the amount of those expenses, the case will be reactivated. Our review of 163 cases showed that, in 95 cases (58 percent), ROs either did not select the appropriate closing code (66 cases) or did not have documentation to support the closing code used (29 cases).

In 45 of the 66 cases with documentation, the RO selected a closing code higher than that supported in the case file. As a result, these cases may not be reactivated at the earliest appropriate time, as they would have been if a lower closing code had been used. For example, if a taxpayer starts earning income sufficient to cover his or her expenses and the closing code is set too high, the case may not be reactivated. The use of proper closing codes and reactivation procedures may allow better opportunities for the IRS to collect unpaid liabilities.

In 21 of the 66 cases, the RO selected a closing code lower than that supported in the case file. These cases may be reactivated sooner than appropriate. In these situations, the cases may be reactivated when taxpayers still do not have sufficient income to pay the taxes owed and could result in inefficient use of resources to work the cases.

Recommendation

We recommended the Director, Collection, reemphasize to managers and ROs the importance of performing proper credit report checks, properly documenting the case files, and properly selecting the appropriate closing codes. Managers should include evaluation of this in their CNC case reviews.

¹ The IRS computer system capable of retrieving or updating stored information; it works in conjunction with a taxpayer's account records.



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Response

The Commissioner, Small Business/Self-Employed Division, agreed with the recommendation. The Internal Revenue Manual (IRM)² will be revised to include additional direction regarding case file documentation, emphasize the requirement to secure credit reports, and delineate the proper selection of CNC hardship closing codes. Small Business/Self-Employed Division management issued a memorandum in January 2006 to Collection field employees clarifying and adding emphasis to procedures contained in the IRM regarding mandatory follow-up on cases reported as CNC. An additional memorandum addressing the revised IRM instructions will be issued to Collection field group managers and ROs to further emphasize the importance of following IRM procedures when making CNC determinations. Management's complete response to the draft report is included as Appendix VI.

However, the Commissioner, Small Business/Self-Employed Division, did not agree with the proposed outcome measures, indicating that while the sampling method chosen was appropriate for making population predictions on the number of cases closed correctly or incorrectly, the small number of cases in the audit sample resulted in imprecise benefit projections. A substantially higher sample size is needed to assure greater precision in estimating benefits.

Office of Audit Comment

We do not agree that a larger sample was necessary. We used a statistically valid stratified sampling method that was developed by our contracted professional statistician. While a higher number of sampled cases could have reduced the range of dollars that we estimated, the extra resources necessary for us to review more cases would not have been an efficient use of our resources.

Copies of this report are also being sent to the IRS managers affected by the report's recommendation. Please contact me at (202) 622-6510 if you have questions or Daniel R. Devlin, Assistant Inspector General for Audit (Small Business and Corporate Programs), at (202) 622-8500.

² The IRM contains the procedures and guidelines for IRS employees to follow.



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Abbreviations

CFf	Collection Field function
CNC	Currently Not Collectible
ICS	Integrated Collection System
IRM	Internal Revenue Manual
IRS	Internal Revenue Service
RO	Revenue Officer



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Background

The Internal Revenue Service (IRS) collection process begins with a series of delinquency notices or bills mailed to a taxpayer when the taxpayer does not file a required tax return(s) or pay taxes due. When the taxpayer fails to respond within a specified period of time, a delinquent return or balance-due account is generated. Generally, the IRS attempts to contact the taxpayer by telephone at this point. If telephone contact cannot resolve the account, certain cases are assigned to the Collection Field function (CFf)¹ where a revenue officer (RO) attempts face-to-face contact with the taxpayer. Once a delinquent account is assigned, the RO conducts an investigation to determine what collection procedures should be used to bring the taxpayer into full compliance and ultimately inputs case closing actions to the CFf computer system.

When the taxpayer has no ability to make payments on an account, the case can be closed as currently not collectible (CNC). This is a high-risk collection action because the balance due from taxpayers may be at risk of never being collected. The CNC hardship closing action stops IRS personnel from actively working the case and suspends collection action until the taxpayer's ability to pay improves. Before closing a case as CNC, the RO in the CFf is required to obtain and analyze information on the taxpayer's assets and financial information, if the taxpayer's liability exceeds a certain dollar amount. If the RO determines the taxpayer has some ability to pay or the taxpayer agrees to make payments, various collection options can be considered, including installment agreements. If the taxpayer has no ability to pay at the time, the case is closed as CNC. The decision to place an account in CNC status requires the approval of a manager.

Closing balance-due accounts as CNC is a high-risk collection activity because the balance due from the taxpayers may be at risk of never being collected.

Based on IRS statistical reports, the IRS closed approximately 2 million accounts as CNC in Fiscal Year 2005, for a total balance due of approximately \$15 billion. The CFf wrote off approximately \$7 billion in Fiscal Year 2005, approximately \$2 billion of which was due to hardship. Hardship closings accounted for the second largest dollar amount of all cases closed as CNC. During the same period, the CFf collected approximately \$3.9 billion on all delinquent accounts.

This review was performed at the Small Business/Self-Employed Division Collection function Headquarters in New Carrollton, Maryland, during the period June 2005 through July 2006. The audit was conducted in accordance with *Government Auditing Standards*. Detailed information

¹ The IRS function consisting of revenue officers in field offices who handle personal contacts with taxpayers to collect delinquent accounts or secure unfiled returns.



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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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Results of Review

Revenue Officers Performed Sufficient Financial Analysis and Property Research to Make Appropriate Decisions to Close Cases As Currently Not Collectible

Prior to closing a case as CNC, ROs are required to obtain sufficient information about the taxpayer's financial situation and should determine whether there are any other payment options available for the taxpayer. When the aggregate balance due on the case is over \$100,000, this generally includes obtaining a current financial statement and credit report and researching whether the taxpayer owns any real or personal property. It also includes researching internal IRS records to obtain information about income sources and recently filed tax returns.

Our review of a judgmental sample of 80 individual and business taxpayer cases with a balance due of over \$100,000 showed that ROs made the proper determinations to close the cases as CNC. Many of the taxpayers in our sample had accrued the large tax liabilities in prior years, when they were in better financial condition. Their financial situations had changed considerably, and they did not have the current ability to pay the taxes owed. ROs performed adequate research of assets, income, and the taxpayers' current financial and personal situations to make the decisions. The case files contained sufficient documentation of real and personal property checks and verification of IRS internal data files that show income. Also, ROs generally obtained a current financial statement or equivalent financial information from the taxpayers to analyze the taxpayers' current financial situations. When applicable, ROs and taxpayers discussed other options for closing the cases, such as an installment agreement or offer in compromise, and appropriately determined these options were not feasible.

Our review of 80 cases showed ROs made the proper determinations to close cases as CNC due to hardship.

Revenue Officers Did Not Always Follow Procedures When Closing Cases

Although ROs made appropriate decisions to close the accounts as CNC and performed most of the required research, they did not always include sufficient documentation that they had obtained credit reports when required or select the appropriate closing codes when closing the cases.



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ROs did not always obtain or document that they had obtained credit reports

To support the decision to close a case as CNC, ROs are required to document the case file with evidence of asset checks and financial analysis. One of the required items for financial analysis is a credit report. As stated previously, ROs sufficiently documented asset and property checks and generally documented sufficient financial analysis to make the CNC determination.

Although most procedures were followed, in 24 of 80 cases reviewed, ROs did not obtain or document that they had obtained credit reports. In 11 of these cases, there were some extenuating circumstances for which a credit report would not have helped the case resolution; however, in the remaining 13 (16 percent) cases, credit reports should have been obtained to identify potential current sources of money. Credit reports show whether the taxpayers have additional income and/or available credit from which they could borrow or obtain funds, which in turn could be made available to pay the taxes owed.

While the CNC cases we reviewed had the required managerial approvals, the reviews did not appear to address the missing credit reports. It is important for the group manager to ensure all required credit report checks are completed and properly documented to ensure the ROs researched all potential income sources.

The lack of credit reports in these cases did not affect the ultimate decisions to close the cases as CNC because the ROs performed other research sufficient to ascertain the taxpayers' current financial situations. However, analysis of credit reports is required to ensure all potential income sources are researched. When credit reports are not evaluated, potential means of payment may be missed.

ROs frequently did not select the appropriate closing codes

When ROs close a case as CNC due to hardship, they are required to input to the Integrated Data Retrieval System² a closing code that contains account information. The closing code equates to an amount of income the taxpayer may claim on a future tax return and should be based on the taxpayer's current expenses. Accounts reported as CNC due to hardship will systemically reactivate when the income on the taxpayer's latest return is at least the amount related to the unable-to-pay closing code. Once a case is reactivated, the IRS sends a notice to the taxpayer about the taxes still owed and reassigns the case to the CFf inventory system. Depending on resources, inventory, and priorities, the reactivated case could be assigned to an RO to try again to collect the taxes owed.

Our review of a statistically valid sample of 163 cases showed that, in 95 cases (58 percent), there was some type of error related to the closing code determination. See Appendix V for a breakdown of liabilities for these cases.

² The 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 66 cases, there was an incorrect closing code used when there was a document (usually a financial statement) showing the taxpayer's expenses. We calculated what closing code should have been used and determined our conclusion was different from the RO's decision, based on available documentation of the taxpayer's expenses.
 - In 45 cases, the RO selected a closing code higher than that supported in the case file.
 - In 21 cases, the RO selected a closing code lower than that supported in the case file.
- In an additional 29 cases, there was no support for the closing code determination because there were no documents in the case file, comments in the case history narrative, or financial statement to show the taxpayer's expenses.

Although the CNC cases reviewed had managerial approval, these errors were not addressed by the managers. ROs either did not know the correct way to calculate the closing code or did not document properly any modifications or adjustments of financial data obtained. The Cff quality review system also identified problems with selecting the appropriate closing code. During our audit period, it identified an error rate of approximately 26 percent.

The taxes due on the 45 cases noted above totaled approximately \$83 million. As a result, these cases may not be reactivated at the earliest appropriate time, as they would have been if a lower closing code had been used. For example, if a taxpayer starts earning income sufficient to cover his or her expenses and the closing code is set too high, the case may not be reactivated. This could mean a chance to collect the revenue is lost. We estimate that, for the population of 4,976 cases over \$100,000 in our sample period, ROs selected closing codes that were too high for 1,217 taxpayers. This is a potential loss or delay in collection of approximately \$440.4 million, ranging from approximately \$348 million to \$532 million. We recognize that not all this revenue will be collected because the increase in income does not necessarily mean the taxes will be fully collected. However, the use of proper closing codes and reactivation procedures may allow better opportunities for the IRS to collect unpaid liabilities.

For the 21 cases noted above, there is a risk the cases may be reactivated earlier than necessary. This could result in the unnecessary use of resources on cases for which the taxpayers still will not have enough income to cover their allowable expenses and be able to make any payments. These resources could be used on more productive cases. We estimate approximately 892 taxpayer cases in our population could have been closed with codes lower than appropriate. Based on this, we estimate staff hours and salary involved to work these potentially unproductive cases if they are reactivated and assigned to the Cff would total approximately \$574,983.³

³ See Appendix IV for details on outcome measures.



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Recommendation

Recommendation 1: The Director, Collection, should reemphasize to managers and ROs the importance of performing proper credit report checks, properly documenting the case files, and properly selecting the appropriate closing codes. Managers should include evaluation of this in their CNC case reviews.

Management's Response: The Commissioner, Small Business/Self-Employed Division, agreed with the recommendation. The Internal Revenue Manual (IRM)⁴ will be revised to include additional direction regarding case file documentation, emphasize the requirement to secure credit reports, and delineate the proper selection of CNC hardship closing codes. Small Business/Self-Employed Division management issued a memorandum in January 2006 to Collection field employees clarifying and adding emphasis to procedures contained in the IRM regarding mandatory follow-up on cases reported as CNC. An additional memorandum addressing the revised IRM instructions will be issued to Collection field group managers and ROs to further emphasize the importance of following IRM procedures when making CNC determinations.

However, the Commissioner, Small Business/Self-Employed Division, did not agree with the proposed outcome measures, indicating that while the sampling method chosen was appropriate for making population predictions on the number of cases closed correctly or incorrectly, the small number of cases in the audit sample resulted in imprecise benefit projections. A substantially higher sample size is needed to assure greater precision in estimating benefits.

Office of Audit Comment: We do not agree that a larger sample was necessary. We used a statistically valid stratified sampling method that was developed by our contracted professional statistician. While a higher number of sampled cases could have reduced the range of dollars that we estimated, the extra resources necessary for us to review more cases would not have been an efficient use of our resources.

⁴ The IRM contains the procedures and guidelines for IRS employees to follow.



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Appendix I

Detailed Objective, Scope, and Methodology

The overall objective of this review was to determine whether the Small Business/Self-Employed Division CFF¹ used the proper procedures when closing delinquent account cases as CNC due to hardship (unable to pay). We reviewed individual and business taxpayer cases with balances due greater than \$100,000 because they accounted for approximately 78 percent of the dollars that were closed as CNC due to hardship. To accomplish this objective, we:

- I. Determined whether Small Business/Self-Employed Division CFF employees followed proper procedures when closing cases as CNC due to hardship.
 - A. Identified policies and procedures used to evaluate delinquent accounts' eligibility for closure as CNC due to hardship.
 - B. Identified the total population of individual and business taxpayer cases closed as CNC due to hardship by CFF employees.
 - C. Extracted all cases closed as CNC due to hardship by CFF employees on the Integrated Collection System (ICS)² open case Tax Module 53, Currently Not Collectible, from the Treasury Inspector General for Tax Administration Data Center Warehouse³ for the period June 1, 2004, through May 31, 2005.
 - D. From the population identified in Step I.B., identified a population of 4,976 cases closed as CNC due to hardship with a balance due greater than \$100,000. From this population, we reviewed a statistically valid sample of 163 taxpayers using a 90 percent confidence level, 20 percent expected error rate, and ± 5 percent precision rate for the selection criteria. (We initially selected 168 cases from this population; we reviewed 163 cases, which was a statistically valid sample size.)
 - E. Reviewed the 163 cases from Step I.D. to determine whether the ROs used the correct closing code when closing the case and projected the results to the population.

¹ The IRS function consisting of ROs in field offices who handle personal contacts with taxpayers to collect delinquent accounts or secure unfiled returns.

² The ICS is an automated system used to control and monitor delinquent cases assigned to the ROs in the CFF offices.

³ The Data Center Warehouse provides centralized storage, security, and administration of data files. It provides data and data access services enabling auditors to access historical IRS data files.



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- F. Reviewed a judgmental sample of 80 of the 163 cases from Step I.D. to determine whether ROs followed the proper procedures and made the proper closing determinations when closing cases as CNC due to hardship. The judgmental sample was based on reviewing the first 80 cases received. We determined that 80 cases were sufficient to make a positive conclusion on the following procedures.
1. Determined whether the taxpayer's asset and financial information was obtained and analyzed when the taxpayer's liability exceeded a certain dollar limit.
 2. Determined whether required research was performed and all documents and reports were obtained and reviewed, if necessary, to substantiate the closure as CNC due to hardship.
 3. Performed our own research of independent sources such as tax return information or Choice Point ^{TM4} to verify information in the case file when appropriate.
 4. Determined whether the closure as CNC due to hardship was approved by the manager when necessary.
 5. Determined whether the RO released wage levies, if applicable or filed a lien, if appropriate.
 6. Verified Reports of Currently Not Collectible Taxes (Form 53) for accuracy, completeness, correct closing codes, and evidence of request for refund freeze (Transaction Code 130).
 7. Determined whether the proper closing determination was made when closing a case as CNC due to hardship.
- G. Determined the reliability of data by relying on our Data Center Warehouse, which has procedures in place to ensure the data it receives from the IRS are valid. Various procedures are performed to ensure the all the records in the ICS and IRS databases are received. In addition, on randomly selected taxpayer accounts, we performed other reliability testing, which included a comparison of the RO case closed date from the Data Center Warehouse with the IRS Integrated Data Retrieval System⁵ CNC transaction code date and a comparison of the ICS module balance amount with the Integrated Data Retrieval System assessed balance amount. We are satisfied that the data are sufficient, complete, and relevant to the review.

⁴ Choice Point TM is a provider of identification and credential verification services for business and government.

⁵ The IRS computer system capable of retrieving or updating stored information; it works in conjunction with a taxpayer's account records.



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- H. Identified quality review results related to cases closed as CNC by obtaining the Fiscal Year 2004 Collection Quality Measurement System⁶ reports to identify trends and verify the standards specifically related to procedures for closing cases as CNC due to hardship.

⁶ This quality process uses numerous important standards to evaluate the key aspects of CFf work on balance due accounts, which are unpaid tax liabilities, including determining whether the right procedures were followed and if the case was closed correctly.



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Appendix II

Major Contributors to This Report

Daniel R. Devlin, Assistant Inspector General for Audit (Small Business and Corporate Programs)

Parker F. Pearson, Director

Lynn W. Wofchuck, Audit Manager

Julian E. O'Neal, Lead Auditor

Donna L. Saranchak, Senior Auditor

Pillai Sittampalam, Senior Auditor



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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, Communications, Liaison, and Disclosure, Small Business/Self-Employed Division
SE:S:CLD
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 Internal Control OS:CFO:CPIC:IC
Audit Liaison: Commissioner, Small Business/Self-Employed Division SE:S



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Appendix IV

Outcome Measures

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

Type and Value of Outcome Measure:

- Increased Revenue - Potential; 1,217 taxpayers affected and \$440.4 million (see page 3).

Methodology Used to Measure the Reported Benefit:

For the period June 1, 2004, through May 31, 2005, we identified from the ICS¹ a population of 4,976 taxpayer cases closed as CNC due to hardship with balances due of greater than \$100,000. From this population, we reviewed a statistically valid sample of 163² taxpayer cases based on a confidence level of 90 percent, a precision level of ± 5 percent, and an expected error rate of 20 percent (based on quality review results).

We reviewed all 163 cases to determine whether the closing code was appropriate. In 45 (27 percent) of the 163 taxpayer cases, the RO selected a closing code higher than that supported by the documentation. Although the overall CNC determination was appropriate, when the closing code is set at an income level higher than that supported, the case may not be reactivated at the time when the taxpayer starts earning enough income to pay back the taxes owed.

Based on these 45 taxpayer cases, we estimate 1,217 cases may have had the same situation (based on the population of 4,976 cases multiplied by the weighted average error rate of 24.47 percent). Using a 90 percent confidence level, we also calculated the dollar value of potentially affected taxpayer cases in the population. We estimate approximately \$440.4 million written off as CNC due to hardship from June 2004 through May 2005 could be affected. The dollar value could range from \$348 million to \$532 million. This is based on the population of 4,976 multiplied by a weighted average dollar per error case in the population with the higher closing code (\$88,514). We recognize that not all this revenue will be collected because the increase in income does not necessarily mean the taxes will be fully collected.

¹ The ICS is an automated system used to control and monitor delinquent cases assigned to the ROs in the CFF offices.

² The sample size was originally 168; however, we could not obtain all the cases even after considerable over-sampling. The 163 cases were considered statistically valid, and the final calculations are based on the 163 cases.



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Type and Value of Outcome Measure:

- Inefficient Use of Resources - Potential; 892 taxpayers affected and \$574,983 (see page 3).

Methodology Used to Measure the Reported Benefit:

For the period June 1, 2004, through May 31, 2005, we identified from the ICS a population of 4,976 taxpayer cases closed as CNC due to hardship with balances due of greater than \$100,000. From this population, we reviewed a statistically valid sample of 163 taxpayer cases based on a confidence level of 90 percent, a precision level of ± 5 percent, and an expected error rate of 20 percent (based on quality review results).

In 21 (13 percent) of the 163 taxpayer cases, the RO selected a closing code lower than that supported by the documentation. These cases may be reactivated earlier than necessary. This could result in the use of unnecessary resources on cases in which taxpayers still will not have enough income to cover their allowable expenses and be able to make any payments. These resources could be used on more productive cases.

Therefore, based on the 21 taxpayer cases for which the closing code was set lower than it should have been, we estimate that approximately 892 cases could have had lower closing codes than were appropriate (based on the population of 4,976 cases multiplied by the weighted average error rate of 17.92 percent). Using an average of 29.3 hours to work a similar case and multiplying it by the 892 cases equals 26,135.6 hours. Using the 26,135.6 hours and multiplying it by a grade 11 RO base salary per hour of approximately \$22 would be \$574,983 in salary to work these potentially unproductive cases if they are reactivated and assigned to the CFf.



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Appendix V

Tax Liabilities of Sample Cases

Tax Liabilities	Number of Taxpayer Cases Reviewed for Closing Code Determinations
\$100,000 – \$249,999	58
\$250,000 – \$999,999	60
\$1,000,000 – \$2,999,999	25
\$3,000,000 and greater	20
Total	163

Tax Liabilities	Number of Taxpayer Cases Reviewed for Overall CNC Determinations (included in the 163 cases shown above)
\$100,000 – \$249,000	27
\$250,000 – \$999,000	32
\$1,000,000 – \$2,999,000	14
\$3,000,000 and greater	7
Total	80



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Appendix VI

Management's Response to the Draft Report



COMMISSIONER
SMALL BUSINESS/SELF-EMPLOYED DIVISION

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

RECEIVED
SEP 21 2006

September 20, 2006

MEMORANDUM FOR DEPUTY INSPECTOR GENERAL FOR AUDIT

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

SUBJECT: Draft Audit Report – Currently Not Collectible Decisions on
Delinquent Accounts Were Appropriate; However, Closing
Actions Need to Be Improved (Audit # 200530018)

We have reviewed your report and appreciate your acknowledgement that revenue officers performed sufficient financial analysis and research to make appropriate decisions to close cases as Currently Not Collectible (CNC).

We have had several initiatives in the past year impacting CNC accounts. We conducted a targeted review of mandatory follow-up CNC cases. Because the findings suggested further emphasis was necessary to delineate the requirements, we issued a memorandum dated January 9, 2006, to our Collection field employees re-emphasizing procedures contained in IRM 5.16.1.6 regarding mandatory follow-up on cases reported CNC.

We also initiated a review of cases to determine the effect on future CNC hardship reversals when the taxpayer failed to file a return subsequent to the CNC determination. As noted in the subject review, income levels on returns filed after the hardship CNC closure determine the possible reactivation of the case. Results of this review will be utilized to make additional improvements to the CNC program.

Attached is a detailed response outlining our planned corrective actions. If you have any questions, please contact me at (202) 622-0600 or Brady R. Bennett, Director, Collection, SB/SE Division, at (202) 283-7660.

Attachment



Currently Not Collectible Decisions on Delinquent Accounts Were Appropriate; However, Closing Actions Need to Be Improved

ATTACHMENT

RECOMMENDATION

The Director, Collection, should reemphasize to managers and revenue officers the importance of performing proper credit report checks, properly documenting the case files, and properly selecting the appropriate closing codes. Managers should include evaluation of this in their CNC case reviews.

CORRECTIVE ACTION

The Internal Revenue Manual (IRM) Part 5.16 will be revised to include additional direction regarding case file documentation, emphasize the requirement to secure credit reports, and delineate the proper selection of CNC hardship closing codes. We issued a memorandum in January 2006 to our Collection field employees clarifying and adding emphasis to procedures contained in IRM 5.16.1.6 regarding mandatory follow-up on cases reported CNC. An additional memorandum addressing the revised IRM instructions will be issued to Collection field group managers and revenue officers to further emphasize the importance of following IRM procedures when making CNC determinations.

IMPLEMENTATION DATE

February 15, 2007

RESPONSIBLE OFFICIAL

Director, Collection, SB/SE Division

CORRECTIVE ACTION MONITORING PLAN

The Director, Collection, will advise the SB/SE Commissioner of any delays in implementing this corrective action.

OUTCOME MEASURES

We cannot agree with the proposed outcome measures. IRS statisticians reviewed the audit sampling methodology and results, and indicated that while the sampling method chosen was appropriate for making population predictions on the number of cases closed correctly or incorrectly, the small number of cases in the audit sample resulted in imprecise benefit projections.

A substantially higher sample size is needed to assure greater precision in estimating benefits. As indicated on Page 12 of the report, "This dollar value could range from \$320 million to \$499 million." A substantially higher sample number is necessary to make a dollar estimate with a 5% rate of precision and reduce the \$179 million range of the projection.