

**Improvements Are Needed in the Timeliness
and Accuracy of Offers in Compromise
Processed by Field Offer Groups**

December 2004

Reference Number: 2005-30-013

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DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

INSPECTOR GENERAL
for TAX
ADMINISTRATION

December 2, 2004

MEMORANDUM FOR COMMISSIONER, SMALL BUSINESS/SELF-EMPLOYED
DIVISION

Gordon C. Milbourn

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

SUBJECT: Final Audit Report - Improvements Are Needed in the Timeliness
and Accuracy of Offers in Compromise Processed by Field Offer
Groups (Audit # 200330021)

This report presents the results of our review of Offers in Compromise (OIC) processed by Internal Revenue Service (IRS) field offer groups. The overall objective of this review was to determine whether the field offer groups are meeting the IRS OIC program objectives by processing offers accurately and timely.

In summary, the IRS' goal is to complete an OIC evaluation within 6 months (approximately 180 days) from the date the offer was received by the IRS. The offer inventory decreased approximately 45 percent from Fiscal Year (FY) 2002 to April 2004, and the overall percentage of offers processed within 180 days increased from 38 to 60 percent. While the IRS made progress in processing more offers within its goal of 180 days and reduced the backlog of offers in process at both the Centralized Offer in Compromise (COIC)¹ sites and field offer groups, the time in which offers are processed at the field offer groups has remained relatively unchanged. Approximately 80 percent of the offers closed by the field offer groups were over the 180-day goal during FY 2002, compared with approximately 78 percent during the first 7 months of FY 2004.

Our review of a sample of 100 closed offers (accepted and rejected) showed that appropriate decisions were not made in the final dispositions of 12 offers. We determined that improvement is needed in the accuracy of the financial analyses to

¹ For more information on the COIC program, see the Treasury Inspector General for Tax Administration report entitled, *Continued Progress Is Needed to Improve the Centralized Offer in Compromise Program* (Reference Number 2003-30-182, dated September 2003).

ensure accurate and consistent conclusions will be drawn. However, our review of a sample of 50 returned offers found that decisions to return offers complied with policy.

We recommended the Director, Payment Compliance, Small Business/Self-Employed (SB/SE) Division, ensure the OIC Manager's Supplemental Resource Guide to the Internal Revenue Manual (IRM) is fully developed and provided to managers in the OIC program, and clarify IRM guidance for the timeliness of follow-up actions when taxpayers timely respond to an information request or when the next case action does not involve a missed taxpayer deadline. We also recommended the Director consider requiring the use of a standardized tool, such as Decision Point,² or other analysis tools in the offer evaluation process and evaluate alternative case file documentation techniques for organizing the supporting documentation and calculations. Finally, we recommended the Director identify and provide additional training on financial analysis techniques used in support of the offer determinations.

Management's Response: The Commissioner, SB/SE Division, agreed with our recommendations and has either implemented them or is in the process of implementing them. The OIC Manager's Supplemental Resource Guide to the IRM has been completed and is in the IRS' IRM clearance process. The IRM guidelines for timely OIC case actions have been developed and will be issued after discussion with the National Treasury Employees Union (NTEU).³

The SB/SE Division is analyzing the Decision Point program and upgrading it to include applications for business-related financial statements. Once this is completed, the IRS intends to require the program's use on OICs evaluated by field offer groups. The implementation of Decision Point should help to reduce errors involving miscalculations and serve as a helpful guide to OIC specialists in analyzing the financial condition of businesses.

In this year's operational review, the SB/SE Division will include an objective to review current methods of case file organization. Based on the results of this review, it will develop IRM direction to standardize best practices. The SB/SE Division is also developing financial analysis training for revenue officers and has scheduled the training for delivery in FY 2005. Based upon funding availability, offer specialists will be included in this training. Management's complete response to the draft report is included as Appendix VIII.

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 Richard J. Dagliolo, Acting Assistant Inspector General for Audit (Small Business and Corporate Programs), at (631) 654-6028.

² Decision Point is a Microsoft Excel[®] spreadsheet application developed by the IRS to guide IRS employees through the financial evaluation of offers.

³ The NTEU represents IRS bargaining unit employees.

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Improvements Are Needed in the Timeliness and Accuracy of Offers in Compromise Processed by Field Offer Groups

Background

The Internal Revenue Service (IRS) is responsible for collecting taxes when taxpayers file tax returns but do not fully pay the tax liabilities. The IRS has the authority to settle or compromise Federal tax liabilities by accepting less than full payment under certain circumstances. This is accomplished through an Offer in Compromise (OIC) (Form 656). The OIC is an agreement between a taxpayer and the Federal Government that settles a tax liability for payment of less than the full amount owed.

The IRS is authorized to compromise a liability on any one of three grounds:

- Doubt as to Collectibility (DATC), where the taxpayer's assets and income are less than the full amount of the liability.
- Effective Tax Administration (ETA), 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.

Taxpayers initiate the OIC process by submitting a Form 656. For offers filed on the grounds of DATC or ETA, the IRS requires the taxpayer to also complete a financial statement¹ and provide supporting documents, such as wage and earning statements, to verify information reported on the financial statement.

The IRS' objectives for the OIC program are to:

- Effect collection of what could reasonably be collected at the earliest time possible and at the least cost to the Federal Government.

¹ The financial statement is also known as the Collection Information Statement for Wage Earners and Self-Employed Individuals (Form 433-A) and the Collection Information Statement for Businesses (Form 433-B). The Collection Information Statement (CIS) includes a monthly income and expense analysis as well as a listing of assets and liabilities.

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- Achieve a resolution that is in the best interest of both the taxpayer and the Federal Government.
- Collect funds which may not be collectible through any other means.
- Give taxpayers a fresh start to enable them to voluntarily comply with the tax laws.

Concerns relating to the administration of the OIC program have existed for some time. The Fiscal Year (FY) 1997 *Taxpayer Advocate's Annual Report to Congress*² highlighted the OIC program as 1 of the 20 most serious problems facing taxpayers. The *Report* stated that tax practitioners ranked "Offer in Compromise Issues" as the fourth most serious problem facing taxpayers and IRS management ranked "Delays in OIC Processing" as the fifteenth most serious problem. This concern still exists. In the *National Taxpayer Advocate's FY 2003 Annual Report to Congress*,³ the Taxpayer Advocate ranked the OIC program as the seventh most serious problem encountered by taxpayers. In addition, tax practitioners have expressed concerns that the IRS unnecessarily returns offers to taxpayers, rather than working the offers.

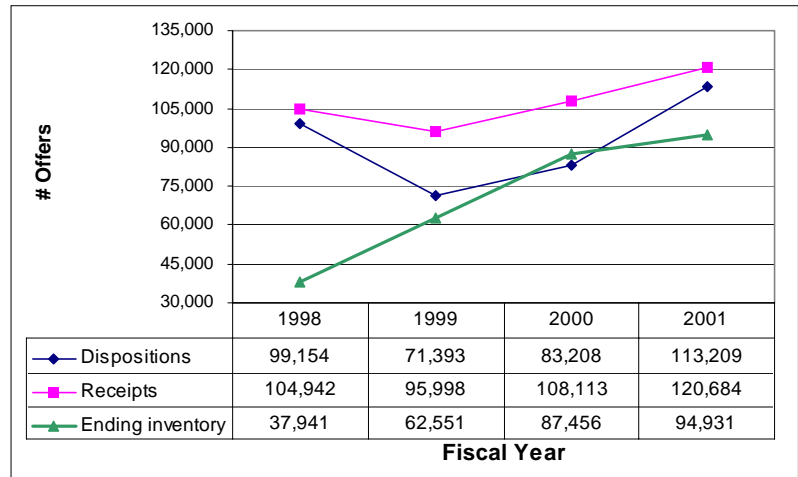
From FYs 1998 through 2001, the number of offers received outpaced the number of offers closed by the IRS. This resulted in substantial growth in the number of offers to be worked by the IRS in its ending inventory (see Figure 1). The age of offers in inventory, as well as the age of the offers at disposition, also grew. For example, the ending inventory of offers over 12 months old increased from approximately 6 percent at the end of FY 1998 to almost 19 percent by the end of FY 2001. Dispositions taking longer than 12 months also increased from approximately 7 to 25 percent.

² IRS Publication 2104 (Rev. 1-98).

³ IRS Publication 2104 (Rev. 12-2003).

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Figure 1: Change in Offer Inventories for FYs 1998 Through 2001



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

The IRS initiated the Centralized Offer in Compromise (COIC) program in August 2001. The concept was to control, gather required information about, and evaluate offers at two centralized sites.⁴ More complex offers (e.g., business and self-employed taxpayers) are forwarded to field offer groups where experienced revenue officers, known as offer specialists, conduct the offer evaluations. By reducing the number of offers worked by the offer specialists, the IRS expected that offers could be worked quicker.

We conducted our review at the Office of Payment Compliance of the Small Business/Self-Employed (SB/SE) Division in New Carrollton, Maryland, during the period June 2003 through April 2004. 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.

⁴ For more information on the COIC program, see TIGTA report entitled, *Continued Progress Is Needed to Improve the Centralized Offer in Compromise Program* (Reference Number 2003-30-182, dated September 2003).

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Offers Were Returned to Taxpayers According to Procedures

After offers are determined to be processable,⁵ they may still be returned to taxpayers for various reasons, including:

- The taxpayer fails to remain in compliance with the filing of required tax returns while the offer is under evaluation.
- The taxpayer fails to make required estimated tax payments or Federal tax deposits while the offer is under evaluation.
- The taxpayer fails to fulfill a request for information⁶ necessary to complete a full evaluation.
- The IRS determines that the offer was filed solely to delay collection actions.⁷

We reviewed a judgmental sample of 50 of the 12,844 processable offers returned to taxpayers between October 1, 2002, and June 30, 2003. We determined the field offer groups generally followed IRS procedures when returning offers and cases generally contained evidence that an appropriate official approved the return of the offers. The delays in offer processing discussed later in this report may have contributed to a taxpayer's nonresponse to information requests in a few instances; however, overall, we determined the requested information was necessary for the offer evaluation to continue. Figure 2 shows the various reasons for the return of the offers in our sample.

⁵ 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 Form 656, and has submitted the \$150 application fee or Income Certification for Offer in Compromise Application Fee (Form 656-A).

⁶ Additional information requested may include bank statements, income verification, home mortgage information, a completed CIS, etc.

⁷ "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.

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Figure 2: Reasons Offers Were Returned

Reason for Return	Number of Cases
Filing compliance	7
Tax payment or deposit compliance	15
Requested information not provided	21
Solely to delay collection action	2
Other (e.g., bankruptcy filed while offer pending)	5
Total	50

Source: TIGTA review of 50 offers closed as returned to the taxpayers.

Offers Were Not Timely Worked in the Field Offer Groups

The IRS' goal is to complete an offer evaluation within 6 months (approximately 180 days) from the date the offer was received by the IRS. The OIC program has made improvements in this area since implementation of the COIC sites. In addition, the number of offers pending in inventory has been reduced. Improvements include:

- The overall percentage of processable offers closed within 6 months increased from 38 percent in FY 2002 to almost 60 percent in the first 7 months of FY 2004.
- Ending inventory of all offers declined from approximately 95,000 at the end of FY 2001 to approximately 65,000 by the end of FY 2003. As of April 2004, there were approximately 53,000 offers in ending inventory.
- Ending inventory of offers being worked by the field offer groups also declined by approximately 63 percent from the beginning of FY 2002 to the end of April 2004 (from approximately 81,000 to approximately 30,000).

However, the length of time offers are in process when worked by the field offer groups continues to greatly exceed the IRS goal of closing cases within 6 months of receipt. Our analysis of the Automated Offer in Compromise

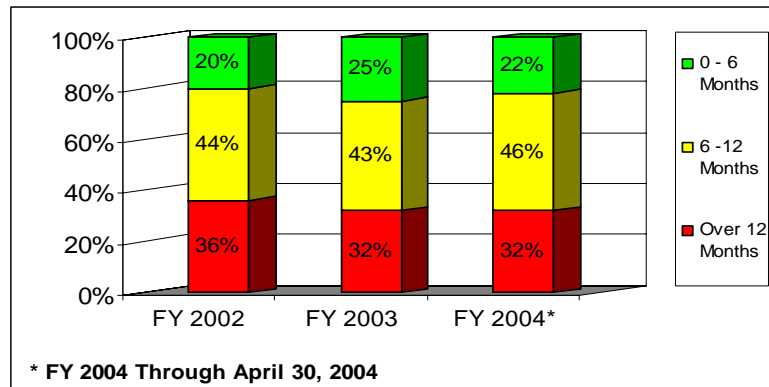
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(AOIC) system⁸ for offers closed by the field offer groups showed that the average length of time for closing⁹ processable offers was approximately:

- 337 days for FY 2002.
- 328 days for FY 2003.
- 330 days for FY 2004 through April 2004.

Figure 3 also shows the IRS field offer groups have generally not been meeting their goal of closing cases within 180 days. The percentage of offers closed by field offer groups within 6 months was only 20 percent in FY 2002, 25 percent in FY 2003, and 22 percent in FY 2004 (through April 30, 2004). See Appendix V for additional information on the timeliness of offer processing.

Figure 3: Age of Case Dispositions by Field Offer Groups



Source: TIGTA analysis of Collection Reports 5000-108 (Monthly Report of Offer in Compromise Activity).

To further evaluate the process used by field offer groups, we reviewed judgmental samples of 150 offers closed between October 1, 2002, and June 30, 2003 (first 9 months of FY 2003). The samples included 50 of the 10,000 offers

⁸ 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 April 30, 2004.

⁹ 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 SB/SE Division Compliance Field function is geographically organized into 15 Area Offices serving taxpayers nationwide and 1 Area Office serving international taxpayers.

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accepted by the IRS, 50 of 5,369 offers rejected by the IRS (the taxpayers did not exercise appeal rights), and 50 of 12,844 processable offers returned to taxpayers.

We determined the 150 offers were not timely processed. The IRS letter informing the taxpayer of the disposition of the offer evaluation was issued within 6 months of the offer receipt in only 24 (16 percent) of the 150 offers reviewed. We determined that, on average, these 150 offers took approximately 398 days from IRS receipt to issuance of the disposition letter and averaged approximately 417 days from IRS receipt to closure on the AOIC system. See Appendix VI for the average timeline of case processing steps.

When an offer evaluation is not timely completed, 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 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 occurred in the 150 offers reviewed because the backlog of offers delayed the assignment of offer cases to offer specialists and some offers had to be reassigned to other offer specialists. In addition, IRS guidance did not clearly communicate expectations for timely offer actions for employees or managers.

Some offers were not promptly assigned; others had to be reassigned

An offer needs to be promptly assigned to an offer specialist to help ensure the timely completion of the offer's evaluation. However, a backlog of offers in the field offer groups resulted in the delayed assignment of cases in 55 (37 percent) of the 150 offers reviewed. In these offer cases, delays of 45 days or more existed when assigning the offer to either an employee for preliminary actions¹⁰ or an

¹⁰ These include evaluating the cases for processability, researching internal sources, evaluating documentation provided for completeness, etc. The COIC sites now conduct most of these preliminary actions.

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offer specialist. These delays averaged approximately 148 days on the 55 offer cases and ranged from 48 to 394 days. These delays increased the average processing time for the 150 offers in our samples by approximately 54 days.

We also identified delays in the transfer of some offers from one offer specialist to another. Transfer delays occurred during periods of transition when offer specialists were returned to the general field collection program or because of other administrative actions such as promotion or retirement. The following events illustrate the changes that have occurred in recent years:

- The number of offer specialists dedicated to the OIC program was reduced from 1,078 in April 2001 to 452 in April 2004.
- Revenue officers were temporarily assigned to offer specialist positions to assist with the backlog of offers, and later, the offer specialists were reassigned to the general field collection program because the temporary assignments ended.
- Some revenue officers were returned to the general field collection program because some of the OIC workload shifted to the COIC sites.
- The number of field offer groups decreased from approximately 62 during FY 2003 to 52 during FY 2004.

In 19 (13 percent) of the 150 offers, there was at least 1 period of 45 days or more associated with transfer of the offer to another offer specialist. The delays averaged approximately 125 days on the 19 offer cases and ranged from 45 to 399 days. These delays increased the average processing time for the 150 offers in our samples by approximately 16 days.

IRS guidance did not clearly communicate expectations for timely case actions

In 68 (45 percent) of the 150 offers, there was at least 1 period of inactivity of 45 days or more after assignment to offer specialists. These delays occurred between the initial assignment and initial analysis of the offer, when reviewing

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the information provided from the taxpayer, or in calculating the reasonable collection potential (RCP).¹¹ The delays in the 68 offers averaged approximately 145 days and ranged from 45 to 666 days. These delays increased the average processing time for the 150 offers in our samples by approximately 66 days.

At the time of our review, IRS general guidance required that offer specialists make first contact with the taxpayer within 45 days of assignment. In addition, if a taxpayer did not provide information by a given deadline, the offer specialist was to follow up with the taxpayer within 15 days of the missed deadline. The procedures did not identify a time period for follow-up when the taxpayer submitted a timely response or when the next case action did not involve waiting for taxpayer correspondence.¹² In addition, the IRS manager 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.

Two types of reviews that can assist managers in ensuring offers progress timely include:

- Overage offer reviews - the review of offers identified based on the length of time the offers are in process.
- Inactivity reviews - the review of offers identified based on no documented actions over an extended period of time.

Our discussions with 5 group managers from 2 of the 16 Area Offices found differences in usage of these reviews. In the overage reviews, there was a difference in what is considered overage and the basis of inactivity measurement. For example:

¹¹ The RCP is the amount the IRS determines could be legally collected from the taxpayer.

¹² New IRS procedures for the OIC program were issued on May 15, 2004, but they do not identify a time period for follow-up when the taxpayer submits a timely response or when the next case action does not involve a missed taxpayer deadline.

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- While 1 group manager indicated he or she considered as overage those offers that are over 300 days from receipt, another considered offers to be overage when they are over 1 year from the date of the processability determination. In either case, these expectations exceed the IRS goal of processing offers within 180 days.
- One group manager indicated use of a 45-day period for identifying offers with inactivity, while other group managers indicated use of a 75-day period. While the use of 45 days in identifying offers for these reviews corresponds with the time period for initial case action, the use of 75 days to identify offers would not adequately promote timely case actions.

We could not readily evaluate the group manager review process in our samples of offers because documentation of reviews was not always recorded or was recorded in several different files that we did not obtain.

Headquarters office management has taken positive actions to address the timeliness issues

Our reviews of OIC headquarters office program reviews indicate that IRS program management has identified some of the same issues surrounding the timeliness of offers processed in the field offer groups. Our discussions with OIC program management indicate that they have initiated actions to improve the OIC program. These include:

- National program management oversight in the monitoring of the unassigned inventories. Generally, offers worked in the Area Offices are assigned to an Area Office based on the geographical location of the taxpayer. However, as the unassigned inventories become too high in an Area Office, the IRS management team redirects offers to other Area Offices with less unassigned inventory. This would appear to help address delays on the initial assignment identified in this review.
- Changes for the involvement of COIC sites. These include an expectation that the offers will be routed to the field offer groups within 45 days of receipt.

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The COIC sites initially processed 93 of the 150 offer cases we reviewed. We determined these offer cases were in process at a COIC site for an average of approximately 86 days, ranging from 2 to 402 days.

- Development of a supplemental managerial guide specifically for offer managers. Our review of a preliminary draft of the supplemental managerial guide found that the proposed procedures addressed timely assigning cases and outlined guidelines for the overage and inactivity reviews.

Recommendations

The Director, Payment Compliance, SB/SE Division, should:

1. Ensure the OIC Manager's Supplemental Resource Guide to the Internal Revenue Manual (IRM) is fully developed and provided to managers in the OIC program. This supplemental guidance should provide clear expectations as to the form and substance of reviews to ensure the timeliness of case processing, as indicated in the draft we reviewed. This includes specific information for managing unassigned offers and defined expectations for the identification and review of the offer inventory to reduce overage cases (e.g., overage and inactivity reviews).

Management's Response: SB/SE Division management indicated that the Supplemental Resource Guide has been completed and is currently in the IRM clearance process.

2. Clarify IRM guidance for the timeliness of follow-up actions when taxpayers timely respond to an information request or when the next case action does not involve a missed taxpayer deadline.

Management's Response: SB/SE Division management has developed the IRM guidelines for timely OIC case actions.

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Offer Specialists Did Not Always Properly Analyze Financial Information When Deciding to Accept or Reject Offers

The guidelines will be issued after discussion with the National Treasury Employees Union (NTEU).¹³

Our review of judgmental samples of 100 closed offers (50 accepted and 50 rejected) showed that offer specialists did not always make appropriate determinations and that improvement is needed in the accuracy and documentation of financial analyses conducted during offer evaluations.

In the analysis of offers based on DATC, the offer specialist compares the amount the taxpayer offered with the amount the IRS determines could be legally collected from the taxpayer (i.e., the RCP). When offers are submitted based on ETA, the offer specialist determines if the RCP is greater than the amount owed before considering the taxpayer's special circumstances.¹⁴

The RCP is based on the taxpayer's equity in assets and future income in excess of necessary living expenses. The IRS requires the taxpayer to complete a financial statement and provide documents to verify the amounts reported on the financial statements. 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 hardship¹⁵ when a special circumstance exists.

We identified errors or a combination of errors in the financial analysis on 37 (37 percent) of the 100 cases. These errors involved:

- Monthly income in 21 instances. This included the calculation of income for wage earners (eight), business income of self-employed or business taxpayers (eight), and unemployed persons (five).
- Monthly expenses in 10 instances. This included calculation of the allowable tax expense (four),

¹³ The NTEU represents IRS bargaining unit employees.

¹⁴ A special circumstance may include advanced age or serious illness of the taxpayer.

¹⁵ Through analysis and negotiation, the offer specialist determines an amount believed to be necessary for the taxpayer to meet basic living expenses.

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national standard or local housing standard¹⁶ (four), or other allowable expenses (two).

- The calculation of net equity in assets in six instances. This included the valuation for equity in investments (three) and the valuation of other assets such as real estate/residence (three).

For a more detailed discussion on the errors we identified, see Appendix VII.

The errors identified affected the outcome of 12 of the 50 accepted offers reviewed but did not change the final decisions in any of the 50 rejected offers reviewed. For the 12 offers affected by these errors, our evaluation showed:

- In 3 instances, the IRS accepted offers totaling approximately \$23,000 for outstanding liabilities of approximately \$62,000. The corrected RCPs indicated the taxpayers could fully pay the outstanding liabilities in all three cases. These offers should have been rejected; the IRS could have pursued collection of the entire \$62,000 in outstanding liabilities. A potential loss of revenue exists totaling approximately \$39,000.
- In 8 instances, the IRS accepted offers totaling approximately \$71,000 for outstanding liabilities of approximately \$485,000. The corrected RCPs indicated the offers could have been significantly increased to a total of approximately \$167,000. This represents a potential loss of revenue totaling \$96,000.
- In 1 instance, the IRS accepted an offer for outstanding liabilities over \$100,000. The corrected RCP indicated the original amount offered by the taxpayer could have been accepted. However, due to errors in the offer specialist's RCP calculation, a higher offer amount was solicited and obtained. The

¹⁶ The IRS uses standards for three general categories of expenses. National standards are used for food and clothing expenses. Local standards are used for housing and utilities expenses and transportation expenses (e.g., ownership and operating expense of automobiles).

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offer accepted was almost \$5,000 more than the original offer amount.

Improper decisions were caused by insufficient evaluation of data and inadvertent errors in calculations

Insufficient analysis of documentation provided and/or inadvertent errors in the calculation occurred because offer determinations involve 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.¹⁷ While managers reviewed and approved the final decisions in the offers included in our sample, the errors were not always identified. This is due to the managers' workloads and an emphasis on reasonableness of the offer conclusion rather than a recalculation of the offer.

Adequate documentation assists in maintaining the offer specialist's focus on the offer evaluation, assists in the managerial review, and provides a basis for discussion of the final determination with the taxpayer or the taxpayer's authorized representative. The offer case files for the 100 offers reviewed generally contained file separators with tabs for organizing information, the calculation of the RCP, a narrative called the case history, and a collection of supporting documentation.

When the file separators were used, the supporting documentation was maintained under a general category of asset verification. In the offers reviewed, many of the calculations and assumptions used could be verified with supporting documentation; however, considerable effort was sometimes required to find the information. Offer case files did not contain any cross-references to link RCP items with the calculations or supporting details.

The actual calculation of the RCP was done using a variety of methods including narrative in the case history, proforma handwritten worksheets, proforma electronic spreadsheets, and older versions of Decision Point. Decision Point is a Microsoft Excel[®] spreadsheet application developed by the

¹⁷ For the 100 offers in our review, our calculation of the RCP identified approximately 836 RCP components with a determined value.

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IRS to guide employees through the financial evaluation of offers. Decision Point uses information input by users to perform an offer's automated calculations necessary in determining the RCP. This includes identification of applicable standard amounts and other calculations such as those involved in determining gross monthly income.

Figure 4 shows the methods used to document the RCP calculation in the 100 offers reviewed and whether an error in analysis was identified. While in 3 of the 100 cases Decision Point (4/26/00 version) was used, this version did not always automatically link to the applicable standards. The use of a program such as the more recent versions of Decision Point in the offer evaluation process could help to reduce mathematical errors identified in our review.

Figure 4: Methods of Documenting RCP Calculation

RCP Calculation Format	Total Cases	Error Case	
		Yes	No
Electronic Worksheets (other than Decision Point)	58	21	37
Handwritten Worksheets	37	14	23
Decision Point (4/26/00 Version)	3	1	2
Case History Narrative	2	1	1
Totals	100	37	63

Source: TIGTA review of 100 offers closed as accepted or rejected between October 1, 2002, and June 30, 2003.

Training in financial analysis techniques can improve an employee's ability to know what to obtain from the taxpayer and how to evaluate the information for use in the offer calculation. Our discussions with management indicated the offer specialists received only limited training in the last fiscal year. This was due to funding issues and technical issues experienced when attempting to provide remote training, such as online, computer-based training. The group managers indicated they hold group meetings in which they provide local training topics; however, this type of training was not consistently provided. Headquarters officials are aware that training is needed and are attempting

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to identify alternative methods for delivery of training, as funds are not available to hold formal classroom training.

Additional guidance for calculation of gross monthly income was provided

We identified errors in the offer specialists' determinations of monthly income in 21 of the 100 cases reviewed. The inaccurate income determinations were significant contributing factors in 9 of the 12 instances in which the offer determination was adversely affected.

IRS procedures indicate that the income calculation is based on an estimate from current earnings information (e.g., wage statements for employed taxpayers or income statements for business and self-employed taxpayers) or from an average of the taxpayer's earnings from the prior years when the taxpayer is temporarily unemployed or employment is sporadic.

Income errors occurred because offer specialists used incorrect sources of information (e.g., income of an unemployed person based on unemployment benefits) or made inadvertent mathematical or other calculation errors, such as not adjusting business or self-employed income for asset depreciation expense. As we reported in our review of the COIC program,¹⁸ guidance in the IRM did not adequately cover many circumstances encountered in evaluating the various types of earning statements. The IRS revised the IRM procedures for financial analysis on May 1, 2004. These procedures included additional details for the calculation of income, which should help offer specialists analyze financial information more consistently.

¹⁸ For more information on the COIC program, see TIGTA report entitled, *Continued Progress Is Needed to Improve the Centralized Offer in Compromise Program* (Reference Number 2003-30-182, dated September 2003).

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Recommendations

The Director, Payment Compliance, SB/SE Division, should:

3. Consider requiring the use of a standardized tool, such as Decision Point, or analysis tools in the offer evaluation process. This would help reduce errors involving miscalculations.

Management's Response: The Decision Point program is currently being analyzed and upgraded to include applications for business-related financial statements. Once this is completed, the IRS intends to require the program's use on OICs evaluated by field offer groups. This program should not only help in reducing errors involving miscalculations but also serve as a helpful guide to OIC specialists in analyzing the financial condition of businesses.

4. Evaluate alternative case file documentation techniques for organizing the supporting documentation and calculations. This would assist with managerial review of the cases so calculations could be more easily reviewed for accuracy.

Management's Response: The implementation of Decision Point will assist in providing more consistency and quality assurance in OIC calculations and reports. This year's operational review plans include an objective to review current methods of case file organization, which will lead to IRM direction to standardize best practices in this area.

5. Identify and provide additional training on financial analysis techniques used in support of the offer determinations. Based on our limited review, training topics should include income determination issues.

Management's Response: Financial analysis training for revenue officers is currently being developed and scheduled for delivery in FY 2005. Based upon funding availability, offer specialists will be included in this training.

Improvements Are Needed in the Timeliness and Accuracy of Offers in Compromise Processed by Field Offer Groups

Appendix I

Detailed Objective, Scope, and Methodology

The overall objective of this review was to determine whether the field offer groups are meeting the Internal Revenue Service (IRS) Offer in Compromise (OIC) program objectives by processing offers accurately and timely. To accomplish this objective, we:

- I. Determined whether the offer determinations were appropriate and based on accurate and consistent financial analysis for offers closed during Fiscal Year 2003.
 - A. Held discussions to determine procedures used in conducting offer evaluations with Small Business/Self-Employed (SB/SE) Division program analysts and local management from 2 of the 16 Area Offices.¹ Our discussions with local management included two Territory Managers² over the OIC program in both Area Offices selected and five group managers. We selected the Area Offices included in the discussions based on timeliness information. One Area Office was selected because the Automated Offer in Compromise (AOIC)³ system data indicated that offers were taking longer to close than in most other Area Offices; in the other Area Office, the offers were being closed in the least amount of time.
 - B. Obtained a computer extract from the AOIC system of all OICs closed between October 1, 2002, and June 30, 2003. We chose this period because it represented current case closures and allowed time for any postprocessing actions (e.g., mail time for accepted offers sent to IRS campuses⁴ for monitoring of the terms of the offers). Our validation testing involved various analyses, including a comparison with selected information from the IRS Collection Reports 5000-108 (Monthly Report of Offer in Compromise Activity).
 - C. Reviewed a judgmental sample of 50 of the 10,000 offers accepted by field offer groups between October 1, 2002, and June 30, 2003. This sample was identified from the data extract discussed in Step I.B. We selected a judgmental sample since we did not want to project the results.
 - 1) Obtained and evaluated the IRS case files to determine whether correct conclusions were reached and evaluated the accuracy of the financial analyses used to determine equity in assets and future income.

¹ The SB/SE Division Compliance Field function is geographically organized into 15 Area Offices serving taxpayers nationwide and 1 Area Office serving international taxpayers.

² A Territory Manager is a second-level manager who oversees field groups within an Area Office.

³ The AOIC system is a centralized database used to control and track status and activities in offer cases. For Step I.A., our analysis included offers closed between October 1, 2001, and April 30, 2004.

⁴ The campuses are the data processing arm of the IRS. They process paper and electronic submissions, correct errors, and forward data to the Computing Centers for analysis and posting to taxpayer accounts.

Improvements Are Needed in the Timeliness and Accuracy of Offers in Compromise Processed by Field Offer Groups

- 2) Determined whether offer determinations were properly reviewed and approved.
- D. Reviewed a judgmental sample of 50 of the 5,369 offers rejected (the taxpayers did not exercise appeal rights) by field offer groups between October 1, 2002, and June 30, 2003. This sample was identified from the data extract discussed in Step I.B. We selected a judgmental sample since we did not want to project the results.
 - 1) Obtained and evaluated IRS case files to determine whether correct conclusions were reached and evaluated the accuracy of the financial analyses used to determine equity in assets and future income .
 - 2) Determined whether offer determinations were properly reviewed and approved.
- II. Determined whether the IRS field offer groups accurately and consistently followed IRS procedures when offers were returned.
 - A. Reviewed a judgmental sample of 50 of the 12,844 processable offers returned to taxpayers by field offer groups between October 1, 2002, and June 30, 2003. This sample was identified from the data extract discussed in Step I.B. We selected a judgmental sample since we did not want to project the results.
 - B. Obtained and evaluated the IRS files supporting the IRS' return decisions to determine whether conclusions reached were correct, reviewed, and approved as required.
- III. Determined whether the field offer groups timely arrived at ultimate conclusions about offers.
 - A. Held discussions with SB/SE Division program analysts and local management from 2 of the 16 Area Offices to determine expectations for timely closing OIC evaluations.
 - B. Evaluated the timeliness of actions on 150 offers (50 accepted, 50 rejected, and 50 returned) processed by field offer groups between October 1, 2002, and June 30, 2003. For this test, we used the cases selected in Steps I.C., I.D., and II.A.
 - C. Evaluated the amount of time required to process the 150 offers through the various stages and determined the reasons for delays in closing offers.
 - D. Analyzed a data extract from the AOIC system database for offers closed or in process between October 1, 2001, and April 30, 2004, for the age of dispositions and the age of cases pending in inventory. We selected this period to provide insight on the historical trends as well as to obtain current data. Our validation testing included various analyses, including a comparison with selected information from the IRS Collection Reports 5000-108.

**Improvements Are Needed in the Timeliness and Accuracy of
Offers in Compromise Processed by Field Offer Groups**

Appendix II

Major Contributors to This Report

Richard J. Dagliolo, Acting Assistant Inspector General for Audit (Small Business and Corporate Programs)

Parker Pearson, Director

Amy Coleman, Audit Manager

Darryl Roth, Lead Auditor

Jeff Jones, Senior Auditor

Lynn Rudolph, Auditor

**Improvements Are Needed in the Timeliness and Accuracy of
Offers in Compromise Processed by Field Offer Groups**

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, Collection Policy, Small Business/Self-Employed Division SE:S:C:CP
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

Improvements Are Needed in the Timeliness and Accuracy of Offers in Compromise Processed by Field Offer Groups

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 the Congress.

Type and Value of Outcome Measure:

Increased Revenue – Potential; \$135,000 for 3 taxpayers whose Offers in Compromise (OIC) should have been rejected and the taxpayer accounts placed back into active collection status, and for 8 taxpayers whose OICs should have been significantly increased. It may be likely that some of the taxpayers will be reluctant to fully pay or increase the amount offered. However, Internal Revenue Service (IRS) procedures indicate that, when the amount offered does not reasonably reflect the reasonable collection potential (RCP),¹ the offer should be rejected or increased (see page 12).

Methodology Used to Measure the Reported Benefit:

We selected a judgmental sample of 50 from the 10,000 OICs that were accepted by the field offer groups between October 1, 2002, and June 30, 2003. We determined the amount of the increased revenue based on the difference between the amount accepted and the outstanding liabilities in three instances for which the RCP exceeded tax liabilities. In eight instances, we calculated the increased revenue potential based on the difference between the amount accepted and our calculation of the RCP.

Type and Value of Outcome Measure:

Taxpayer Rights and Entitlements – Potential; almost \$5,000 for 1 taxpayer whose original offer amount should have been accepted. The taxpayer's original offer exceeded our calculation of the RCP; however, due to an error in the offer specialist's calculations, a higher offer amount was solicited and obtained (see page 12).

Methodology Used to Measure the Reported Benefit:

We selected a judgmental sample of 50 from the 10,000 OICs that were accepted by the field offer groups between October 1, 2002, and June 30, 2003. We determined the amount of the taxpayer entitlement based on the difference between the amount accepted and the amount of the initial offer. In this instance, the initial offer amount exceeded our calculation of the RCP.

¹ The RCP is the amount the IRS determines could be legally collected from the taxpayer.

Improvements Are Needed in the Timeliness and Accuracy of Offers in Compromise Processed by Field Offer Groups

Appendix V

Selected Timeliness Information for Offer Processing

In recent years, the Internal Revenue Service (IRS) has improved the timeliness with which offers are processed and has reduced the level of offer inventories. These timeliness improvements have occurred because many offers are now processed at the Centralized Offer in Compromise (COIC) sites.¹ During Fiscal Year (FY) 2004 (through April 2004), the COIC sites processed approximately 93 percent of the processable² offers within 180 days and accounted for over 50 percent of the processable offer dispositions. See Figures 1 through 4 for additional information.

Figure 1 shows the increase in OIC inventories from FYs 1998 through 2004 (as of April 30, 2004). During August 2001, the IRS implemented the COIC program. During FY 2002, dispositions exceeded the number of offer receipts and ending inventory had a sharp decline. This trend in the reduction of ending inventory has continued through April 2004.³ While ending inventory has continued to decline with dispositions (approximately 77,800) exceeding receipts (approximately 65,200), this information is not presented because it is not comparable for graphic display.

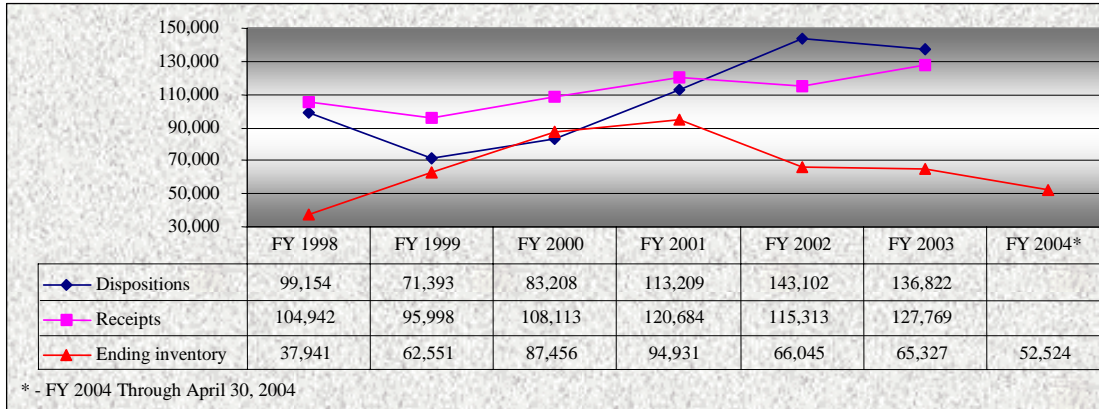
¹ For more information on the COIC program, see Treasury Inspector General for Tax Administration (TIGTA) report entitled, *Continued Progress Is Needed to Improve the Centralized Offer in Compromise Program* (Reference Number 2003-30-182, dated September 2003).

² 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 Offer in Compromise (Form 656), and has submitted the \$150 application fee or Income Certification for Offer in Compromise Application Fee (Form 656-A).

³ FY 2004 data are not for a complete fiscal year.

Improvements Are Needed in the Timeliness and Accuracy of Offers in Compromise Processed by Field Offer Groups

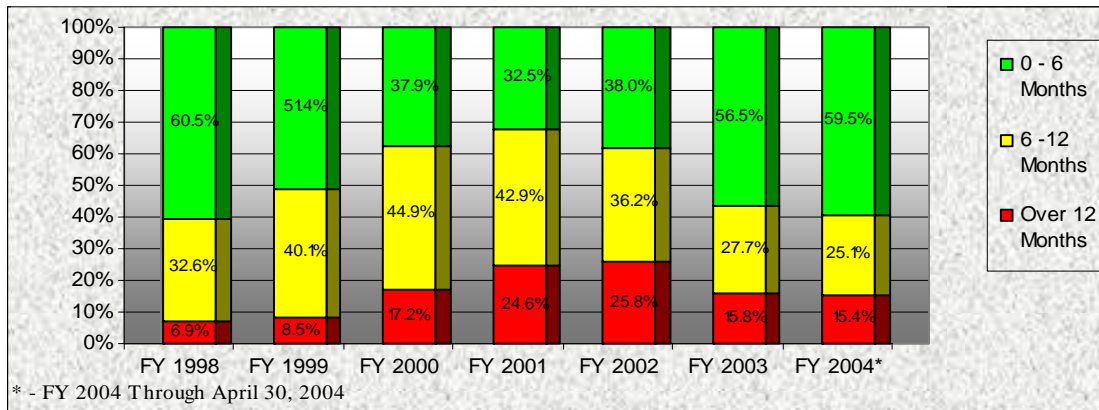
Figure 1: OIC Ending Inventories for FYs 1998 Through April 30, 2004



Source: TIGTA analysis of Collection Reports 5000-108 (Monthly Report of Offer in Compromise Activity).

Figure 2 shows that the percentages of offers closed within 6 months declined from FYs 1998 through 2001, as the ending inventories grew. The IRS data show that the percentage of offers closed within 6 months is improving and returning to FY 1998 levels.

Figure 2: Age of Offer Disposition for FYs 1998 Through April 30, 2004

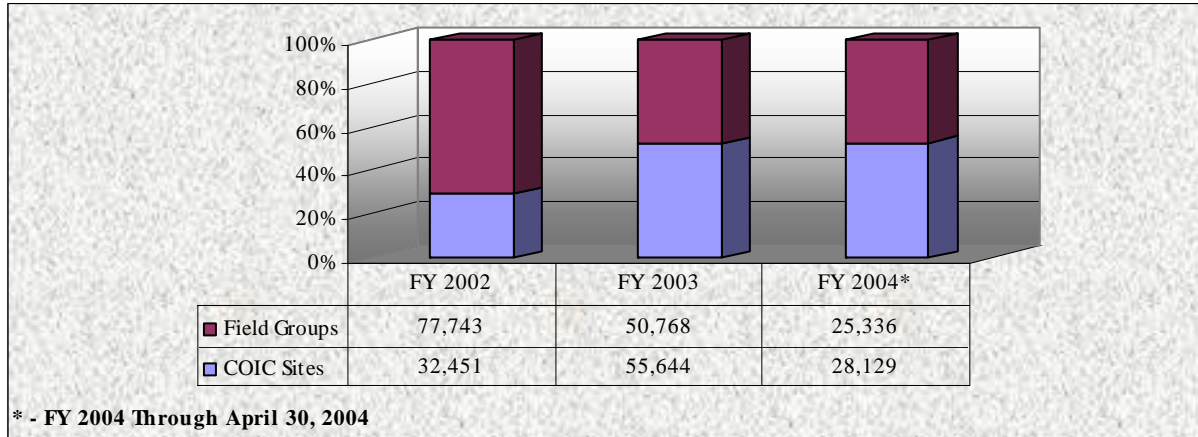


Source: TIGTA analysis of Collection Reports 5000-108.

Figure 3 shows that, in FY 2002, the COIC sites accounted for approximately 29 percent of the total processable dispositions; in FYs 2003 and 2004 (through April 2004), over 50 percent of the processable dispositions were from the COIC sites.

Improvements Are Needed in the Timeliness and Accuracy of Offers in Compromise Processed by Field Offer Groups

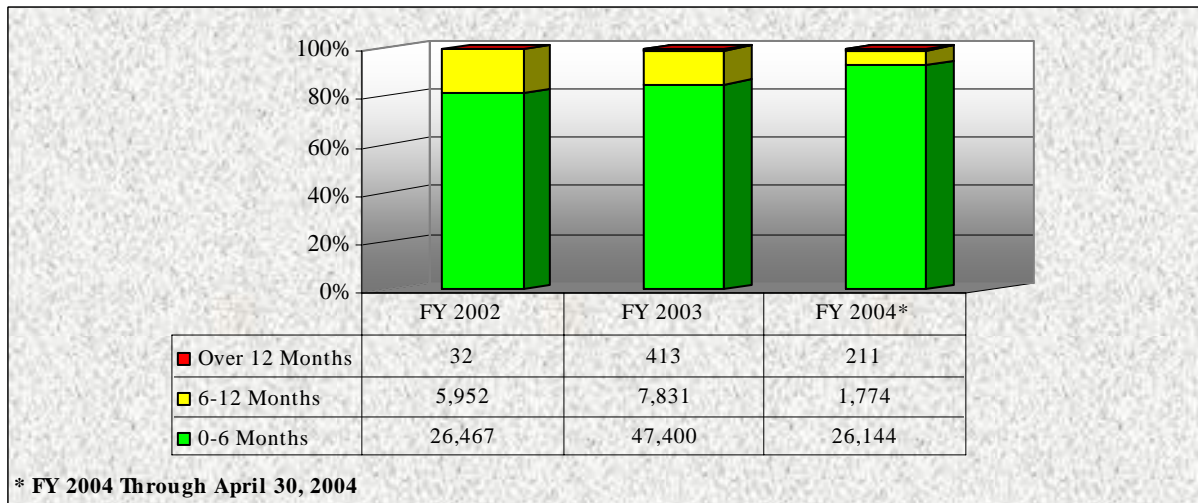
Figure 3: Comparison of Processable Dispositions Between COIC Sites and Field Offer Groups



Source: TIGTA analysis of Collection Reports 5000-108.

The percentage of offers processed within the IRS goal of 180 days shows continued improvement for the COIC sites. In FY 2002, approximately 82 percent of the processable dispositions by COIC sites were processed within 180 days, compared with approximately 93 percent in FY 2004 (through April 2004).

Figure 4: Age of Processable Offer Dispositions at COIC sites



Source: TIGTA analysis of Collection Reports 5000-108.

Improvements Are Needed in the Timeliness and Accuracy of Offers in Compromise Processed by Field Offer Groups

Appendix VI

Analysis of Offer Processing Time in Sample Cases

We reviewed the timeliness of processing activities for 150 offers (50 accepted, 50 rejected, and 50 returned) closed by the Internal Revenue Service (IRS) field offer groups between October 1, 2002, and June 30, 2003. Since August 2001, most new offers have been initially processed by the Centralized Offer in Compromise (COIC) sites.¹ When the COIC sites determine an offer contains complex issues (e.g., for business and self-employed taxpayers), the offer is transferred to a field offer group. In some instances, a COIC site may not have been involved in the initial offer processing, such as when a taxpayer submitted an offer with active field collection or when a field offer group had already begun the offer evaluation before the COIC program was implemented.

In our analysis of offer processing time, we measured the length of time, in terms of the number of days, from one processing activity to the next. Figure 1 shows that 93 of the 150 offers reviewed were initially processed by COIC sites (“Through COIC”) and the other 57 offers were evaluated entirely by field offer groups (“Field Groups Only”). The analysis shows that the offers processed initially by the COIC sites had been in process, on average, approximately 104 days when received at field offer groups, compared with approximately 6 days for offers evaluated entirely by field offer groups. However, by the time the offer evaluations were completed, offers processed completely by the field offer groups took approximately 252 more days to process.

The time disparity between the offers partially processed through the COIC sites and the offers processed entirely by field offer groups was a result of the backlogs and other delays in processing. Figure 2 shows that the offers processed entirely by field offer groups were delayed by approximately 197 more days than the offers partially processed through the COIC sites. This included:

- **Held for Assignment Delays:** This includes periods of 45 days or more when assigning the case to either an employee for preliminary actions² or to an offer specialist.
- **Transfer-related Delays:** This includes periods of 45 days or more associated with the transfer(s) of the offer to another offer specialist.
- **Inactivity Delays:** This includes periods of 45 days or more after assignment to offer specialists.

¹ For more information on the COIC program, see Treasury Inspector General for Tax Administration (TIGTA) report entitled, *Continued Progress Is Needed to Improve the Centralized Offer in Compromise Program* (Reference Number 2003-30-182, dated September 2003).

² These include evaluating the cases for processability, researching internal sources, evaluating documentation provided for completeness, etc. The COIC sites now conduct most of these preliminary actions.

Improvements Are Needed in the Timeliness and Accuracy of Offers in Compromise Processed by Field Offer Groups

Figure 1: Listing of Cumulative Days to Evaluate Offers at Field Offer Groups

Processing Activity	Through COIC (93 Offers)		Field Groups Only (57 Offers)		Combined (150 Offers)	
	Average Days	Cumulative Days	Average Days	Cumulative Days	Average Days	Cumulative Days
Receipt at the COIC Site	3.1	3.1	0	0	1.9	1.9
COIC Site Actions	64.0	67.1	0	0	39.7	41.6
Taxpayer Response - COIC Site Requests	22.3	89.4	0	0	13.8	55.4
Receipt at Area Office ³	14.4	103.8	6.3	6.3	11.3	66.7
Receipt at Field Offer Group	3.7	107.5	2.9	9.2	3.4	70.1
Preliminary Field Actions	5.7	113.2	50.1	59.3	22.6	92.7
Assigned to Offer Specialist	31.3	144.5	109.8	169.1	61.2	153.9
Preliminary Review by Offer Specialist	32.9	177.4	59.3	228.4	43.0	196.9
Request for Additional Information	6.9	184.3	35.9	264.3	17.9	214.8
Taxpayer Response	30.5	214.8	47.5	311.8	37.0	251.8
Full Analysis of Offer	27.1	241.9	80.5	392.3	47.4	299.2
Preliminary Results to Taxpayer	4.7	246.6	29.0	421.3	13.9	313.1
Taxpayer Response	15.8	262.4	25.9	447.2	19.6	332.7
Final Decision	19.8	282.2	58.1	505.3	34.4	367.1
Manager Review	11.2	293.4	18.6	523.9	14.0	381.1
Office of Chief Counsel or Independent Administrative Review ⁴	8.0	301.4	18.0	541.9	11.8	392.9
Decision Letter to Taxpayer	4.0	305.4	6.0	547.9	4.8	397.7
Closed on Automated Offer in Compromise (AOIC) system ⁵	15.7	321.1	24.8	572.7	19.1	416.8
Total	321.1		572.7		416.8	

Source: TIGTA analysis of 150 offers closed as accepted, rejected, or returned.

³ The Small Business/Self-Employed Division Compliance Field function is geographically organized into 15 Area Offices serving taxpayers nationwide and 1 Area Office serving international taxpayers.

⁴ The IRS Office of Chief Counsel reviews are conducted for offers recommended for acceptance when the total liability is \$50,000 or greater. Independent Administrative Reviews (IAR) are required for all offers recommended for rejection. The IAR is conducted by an independent third party who is not in the chain of command of the employees responsible for the rejection of the offer.

⁵ The AOIC system is a centralized database used to control and track status and activities in offer cases.

Improvements Are Needed in the Timeliness and Accuracy of Offers in Compromise Processed by Field Offer Groups

Figure 2: Processing Delays in Offers Processed in the Field Offer Groups

	Through COIC (93 Offers)			Field Groups Only (57 Offers)			Combined (150 Offers)		
	Number of Offers	Percentage of Total	Average	Number of Offers	Percentage of Total	Average	Number of Offers	Percentage of Total	Average
Held for Assignment	19	20.4%	22.1	36	63.2%	106.6	55	36.7%	54.2
Transfer-related Delays	5	5.4%	3.9	14	24.6%	35.4	19	12.7%	15.9
Inactivity Delays	33	35.5%	34.7	35	61.4%	116.2	68	45.3%	65.7
Total Delays*	48	51.6%	60.7	48	84.2%	258.1	96	64.0%	135.8

* Some offers had more than 1 type of delay; therefore, the number of offers does not total and the percentage of total does not equal 100%.

Source: TIGTA analysis of 150 offers closed as accepted, rejected, or returned.

**Improvements Are Needed in the Timeliness and Accuracy of
Offers in Compromise Processed by Field Offer Groups**

Appendix VII

Financial Analysis Errors Identified in Sample Cases

We reviewed a judgmental sample of 100 offers (50 accepted and 50 rejected) closed by the Internal Revenue Service (IRS) field offer groups between October 1, 2002, and June 30, 2003. We identified financial analysis errors in 37 of the 100 cases reviewed. As some cases contained multiple errors, we categorized the errors based on the significance to the reasonable collection potential (RCP)¹ calculation. The items with a higher impact on the calculation were considered primary, with other errors being nonprimary. Figure 1 shows, by the various items in the RCP calculation, the total number of offers containing an error for the item and distinguishes between whether we considered the error primary or nonprimary in the RCP calculation.

Figure 1: Financial Analysis Errors Identified in Sample Cases

Item	Errors Observed	Primary Error	Nonprimary Error
Income	21	21	0
Expenses:			
National Standard	4	2	2
Housing and Utilities	4	2	2
Tax	12	4	8
Transportation	2	1	1
Health Care	2	0	2
Child Care	3	0	3
Other Expenses	1	1	0
Total Expense Errors	28	10	18
Assets:			
Bank Accounts	2	0	2
Investments	6	3	3
Real Estate	1	1	0
Vehicles	3	0	3
Other Assets	2	1	1
Personal Assets	1	1	0
Total Asset Errors	15	6	9
Total Errors	64	37	27

Source: Treasury Inspector General for Tax Administration review of 100 offers closed as accepted or rejected.

¹ The RCP is the amount the IRS determines could be legally be collected from the taxpayer.

Improvements Are Needed in the Timeliness and Accuracy of Offers in Compromise Processed by Field Offer Groups

Income:

We identified 21 errors involving incorrect calculation of income. For 13 of these errors, the taxpayers were individual wage earners or unemployed persons; the remaining 8 errors involved businesses or self-employed individuals. These errors involved instances when the offer specialist:

- Considered wage statements to be semimonthly rather than biweekly, used individual pay period information which did not include bonus pay, or calculated monthly income based on a wage statement containing only bonus pay information which differed from regular pay (five instances).
- Calculated monthly earnings from wage or return information that reflected taxable income rather than total income, such as income that was reduced by 401(k) deductions or other tax-exempt earnings (three instances).
- Calculated monthly earnings for unemployed taxpayers based on a prior year's earning information,² information provided on the Collection Information Statement for Wage Earners and Self-Employed Individuals (Form 433-A) or Collection Information Statement for Businesses (Form 433-B) or unemployment benefits (three instances).
- Did not sufficiently probe to determine the period of current employment following a period of unemployment for use in analyzing a year-to-date earning statement or possible disability benefits (two instances).
- Used income from return information that was reduced by depreciation or other allowable deductions (three instances).
- Did not adequately evaluate or include business income of related businesses (three instances).
- Made an inadvertent math error in adding income information or overlooked bank deposit information (two instances).

Monthly Expenses:

We identified 28 errors in the calculation of monthly expenses in 18 cases. The errors in the monthly expense calculations were the most significant errors identified in the financial analysis for 10 of the 28 errors identified. For 18 of the 28 errors identified, the errors affected the RCP calculation, but other errors in the financial analysis had a more significant impact on the RCP calculation. These errors involved instances when the offer specialist:

² The offer specialist used the prior year return information to determine monthly income; however, the taxpayer was unemployed during a portion of that year.

Improvements Are Needed in the Timeliness and Accuracy of Offers in Compromise Processed by Field Offer Groups

- Calculated tax on a basis that was not consistent with the method for determining income,³ calculated tax based on Federal income tax only, did not sufficiently document the calculation to allow for us to determine why the error occurred, or made other inadvertent errors in the tax calculation (12 instances).
- Selected incorrect amounts from the national standard tables or did not accurately determine the national standard for taxpayers that shared living conditions (four instances).
- Allowed the amount of housing and utility expense as claimed, which was in excess of the standard where no special circumstances were identified; used a standard amount for an incorrect county of residence; or made other inadvertent errors in the amount of housing and utility expenses allowed (four instances).
- Did not fully evaluate information available to determine the proper amount of the expense or made inadvertent errors in the amount allowed for other monthly expenses, such as transportation, health care, or child care (eight instances).

Asset Valuation:

We identified 15 errors in the calculations of net realizable asset value in 12 offer cases. The errors in asset calculation were the most significant errors identified in the financial analysis for 6 of the 15 errors identified. The other nine errors identified affected the RCP calculation, but other errors in the financial analysis had a more significant impact on the RCP calculation. The asset errors included instances when the offer specialist:

- Either did not adjust the assets' market value for quick sale or did not accurately reduce the assets' value for applicable reductions such as outstanding loan balances, exemptions, or tax implications (seven instances).
- Overlooked information on supporting documentation and/or did not obtain supporting documentation to determine the value of investments (401(k) accounts) (four instances).
- Made inadvertent errors when recording information on proforma worksheets used to calculate the RCP (four instances).

³ For example, the offer specialist estimated monthly income from the current year information but based tax on a prior year.

Improvements Are Needed in the Timeliness and Accuracy of
Offers in Compromise Processed by Field Offer Groups

Appendix VIII

Management's Response to the Draft Report



COMMISSIONER
SMALL BUSINESS/Self-EMPLOYED DIVISION

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

November 19, 2004

RECEIVED
NOV 19 2004

MEMORANDUM FOR ACTING DEPUTY INSPECTOR GENERAL FOR AUDIT

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

SUBJECT: Draft Audit Report – Improvements Are Needed in the
Timeliness and Accuracy of Offers in Compromise
Processed By Field Offer Groups (Audit # 200330021)

I have reviewed your report and agree with the recommendations. The Treasury Inspector General for Tax Administration (TIGTA) review of the field-based portion of the Offer in Compromise (OIC) program identified several valid concerns regarding the timeliness of case actions and the accuracy of the financial analysis completed in these investigations. In most instances, these recommendations support the corrective actions that have already been initiated by the IRS to improve the efficiency and effectiveness of the OIC program. We appreciate that our efforts in correcting the timeliness issues are acknowledged in this report.

Over the last several years, the IRS has made significant strides in improving the timeliness of OIC investigations. IRS has focused on managing the overall costs of the program, including efforts to reduce the number of revenue officers devoted to OICs from over 1100 in FY 2002 to approximately 425 as of October 2004. Consequently, the challenge of improving the currency of the OIC field inventories has been addressed while simultaneously reducing the number of OIC Specialists assigned to work these cases. We believe this challenge has been met in a very effective manner.

We have found that the most significant factors driving the cycle times in the OIC field program have been systemic in nature. Specifically, we have identified concerns with the length of time it was taking for OICs ultimately assigned to the field to be received by the Area offices, and the length of time it was taking the Area offices to assign these cases to OIC Specialists. On average, it was taking three months or more for a typical field assignment to be processed through our centralized processing sites (COIC) and delivered to the appropriate Area offices. As recently as early 2003, backlogs of unassigned cases were not unusual in field offices. However, within the last 18 months, the IRS has taken several actions that have substantially improved timeliness. One change is that OICs

Improvements Are Needed in the Timeliness and Accuracy of Offers in Compromise Processed by Field Offer Groups

assigned to the field are now considered to be "corporate inventory." While we attempt to assign OICs by geographic location, if the local office does not have the capacity to accept the inventory and ensure prompt assignment to OIC Specialists, the new receipts are redirected to another location with the capacity to promptly open the investigations. This practice has resulted in the elimination of backlogs in our field offices. Additionally, earlier this year we addressed the problem with untimely delivery of field cases from COIC by modifying our front-end case processing, eliminating unproductive procedural requirements, and requiring that field assignments be received in the Area offices within 45 days of the IRS receipt date. COIC continues to conduct the processability determinations, application fee processing, and limited case-building, but must also ensure timely delivery to the field. This change has worked well, and most cases are delivered well in advance of the 45 day requirement.

The results of these efforts have been very encouraging. Field cases that have taken over 12 months to resolve have been reduced by 48 percent from October 2002 to September 2004. Cases in active inventory for six months or less have increased by 29 percent since January 2004. As we continue to work through the remaining inventories of older cases, we expect to see continued improvements in our timeliness indicators.

We have also found that the "back-end" reviews and approvals required for most OICs in the field result in increased cycle time. While 45-60 days has been common, we believe in some locations these reviews and approvals have taken much longer. We have built an analysis of this issue into our review plans for FY 05, and anticipate improvements in this area. However, since most of these reviews are currently required by statute, our improvement opportunities may be limited. We believe that the front-end requirements (processability determinations, application fee processing, limited case-building conducted by COIC) and back-end requirements (reviews and approvals) that remain built into the process, while necessary and/or required to add value to overall OIC processing, also add approximately 90 days or more to the cycle time for field-based OICs. In recognition of this, we have adjusted the cycle time processing goal for field-based OICs to nine months, effective October 2004.

TIGTA's observations regarding the accuracy of financial analysis in OICs worked by the field mirror some of our own findings in operational reviews conducted within the last year. We agree that IRS needs to improve the skills of our OIC Specialists to ensure quality casework and proper decisions, particularly in the area of analyzing the financial statements of businesses. Additionally, we need to improve the documentation of the reasoning behind the OIC acceptance and rejection determinations to ensure these case decisions can stand up to third party scrutiny. However, we have some doubt about the report's estimate of the amount of additional revenue that could have been realized on the 12 accepted OICs that were cited as inaccurate. While we concur that TIGTA's review accurately followed the IRS' currently prescribed procedures for arriving at these

Improvements Are Needed in the Timeliness and Accuracy of Offers in Compromise Processed by Field Offer Groups

decisions, recent program reviews of the OIC program indicate our procedures could lead to determinations of reasonable collection potential that are not realistic or attainable. We believe that several of the cases cited by TIGTA as inaccurate acceptances may fall into this category. We are currently considering several process changes that will assist the IRS in improving our performance in this area.

Our comments on your recommendations follow:

RECOMMENDATION 1

The Director, Collection Policy, Small Business/Self-Employed Division, should ensure the OIC Manager's Supplemental Resource Guide to the Internal Revenue Manual (IRM) is fully developed and provided to managers in the OIC program. This supplemental guidance should provide clear expectations as to the form and substance of reviews to ensure the timeliness of case processing, as indicated in the draft we reviewed. This includes specific information for managing unassigned offers and defined expectations for the identification and review of the offer inventory to reduce overage cases (e.g., overage and inactivity reviews).

CORRECTIVE ACTION

The guide has been completed and is currently in clearance.

IMPLEMENTATION DATE

December 31, 2004

RESPONSIBLE OFFICIAL

Director, Collection Policy, Small Business/Self-Employed Division

CORRECTIVE ACTION MONITORING PLAN

Program Manager, Offer in Compromise Program, will advise the Director, Collection Policy, of any delays.

RECOMMENDATION 2

The Director, Collection Policy, Small Business/Self-Employed Division, should clarify IRM guidance for the timeliness of follow-up actions when taxpayers timely respond to an information request or when the next case action does not involve a missed taxpayer deadline.

CORRECTIVE ACTION

The IRM guidelines for timely OIC case actions have been developed. The National Treasury Employees Union (NTEU) has requested a briefing on this matter, which is currently in the process of being scheduled. The guidelines will be issued after the discussion process with NTEU, and any necessary negotiations, have been completed.

Improvements Are Needed in the Timeliness and Accuracy of Offers in Compromise Processed by Field Offer Groups

IMPLEMENTATION DATE

June 30, 2005

RESPONSIBLE OFFICIAL

Director, Collection Policy, Small Business/Self-Employed Division

CORRECTIVE ACTION MONITORING PLAN

Program Manager, Offer in Compromise Program, will advise the Director, Collection Policy, of any delays.

RECOMMENDATION 3

The Director, Collection Policy, Small Business/Self-Employed Division, should consider requiring the use of a standardized tool, such as Decision Point, or analysis tools in the offer evaluation process. This would help reduce errors involving miscalculations.

CORRECTIVE ACTION

The Decision Point program is currently being analyzed and upgraded to include applications for business-related financial statements. Once completed, the IRS intends to require its use on field-based OICs. This program should not only help in reducing errors involving miscalculations, but also serve as a helpful guide to OIC specialists in analyzing the financial condition of businesses.

IMPLEMENTATION DATE

June 30, 2005

RESPONSIBLE OFFICIAL

Director, Collection Policy, Small Business/Self-Employed Division

CORRECTIVE ACTION MONITORING PLAN

Program Manager, Offer in Compromise Program, will advise the Director, Collection Policy, of any delays.

RECOMMENDATION 4

The Director, Collection Policy, Small Business/Self-Employed Division, should evaluate alternative case file documentation techniques for organizing the supporting documentation and calculations. This would assist with managerial review of the cases so calculations could be more easily reviewed for accuracy.

CORRECTIVE ACTION

The implementation of Decision Point will assist in providing more consistency and quality assurance in OIC calculations and reports. This year's operational review plans include an objective to review current methods of case file organization, which will lead to IRM direction to standardize best practices in this area.

**Improvements Are Needed in the Timeliness and Accuracy of
Offers in Compromise Processed by Field Offer Groups**

IMPLEMENTATION DATE

June 30, 2005

RESPONSIBLE OFFICIAL

Director, Collection Policy, Small Business/Self-Employed Division

CORRECTIVE ACTION MONITORING PLAN

Program Manager, Offer in Compromise Program, will advise the Director, Collection Policy, of any delays.

RECOMMENDATION 5

The Director, Collection Policy, Small Business/Self-Employed Division, should identify and provide additional training on financial analysis techniques used in support of the offer determinations. Based on our limited review, training topics should include income determination issues.

CORRECTIVE ACTION

Financial analysis training for revenue officers is currently being developed and scheduled for delivery in FY 05. Based upon funding availability, offer specialists will be included in this training.

IMPLEMENTATION DATE

July 31, 2005

RESPONSIBLE OFFICIAL

Director, Collection Policy, Small Business/Self-Employed Division

CORRECTIVE ACTION MONITORING PLAN

Program Manager, Offer in Compromise Program, will advise the Director, Collection Policy of any delays.

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