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

JAN 12 2001

MEMORANDUM FOR DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: Joseph G. Kehoe
Commissioner, Small Business/Self-Employed Division

SUBJECT: Draft Audit Report – The IRS Needs to Improve the Development and Management Oversight of the Collection Field Function (CFf) Inventory Priorities

We appreciate the opportunity to respond to your draft report entitled "The IRS Needs to Improve the Development and Management Oversight of the Collection Field Function Inventory Priorities." The report is a review of the IRS's efforts to identify, prioritize, and manage CFf inventory. The audit focused its attention on the memorandum "Bringing the Collection Inventory into Balance with Resources – Casework Priorities and Internal Revenue Manual Deviations" dated March 19, 1999, herein, the memorandum. We are in disagreement with the narrow scope and some of the findings of this report.

As a backdrop to the memorandum, we need to understand and agree that the inventory buildup in the group manager hold files was increased by a number of factors and there was no immediate way to stop the inventory from being assigned to the CFf. We had far fewer revenue officers available to work this inventory and their focus was on training and adhering to the provisions of the IRS Restructuring and Reform Act of 1998 (RRA 98). From an inventory management perspective, RRA 98 increased the number of actions and time it takes to bring a case to resolution. At the same time, the Service was focused on increasing the level of quality of our customer service and shifted resource priorities to meet this goal. Our reduced resource base was made even smaller as more revenue officers were redirected to Customer Service operations, as well as bankruptcy and Offer-In-Compromise casework.

The deviation authority granted in the memorandum was never intended to represent a strategy or future vision on inventory management. It was intended to provide an interim response to a real problem and to focus our smaller field resources on cases having the greatest impact on compliance. It was one small step within a more complete plan. The decision by the Treasury Inspector General for Tax Administration (TIGTA) to limit its review to this one piece of the plan does not do justice to the scope and magnitude of the problem. During the opening meeting for this audit, and in several subsequent meetings, Collection management, to no avail, repeatedly raised the issue

of the audit's narrow focus. Unfortunately, the report erroneously portrays the memorandum as Collection's inventory plan, focuses on it in isolation, and ignores the bigger picture and the planned solutions.

In order to regain inventory balance, we needed to address the inventory problem over the entire collection process, not just one segment of it. At a high level, Collection defined "priority work" for both the Automated Collection System (ACS) and CFf in the new operating division environment, developed plans for implementation, and generated Requests for Information Services (RIS) to initiate these changes. Coordination and system changes were needed on numerous Information Systems (IS) platforms and many of the ACS changes are in place today. The control, prioritization and movement of the inventory through the collecting process are complicated and multifaceted. Collection took the position that this issue was important and should be resolved methodically and through careful research and planning, covering all the interrelated details.

The development and improvement of our inventory delivery system is dependent on the Service's change to a risk-based collection system. This union will ensure decisions as to workload assignment and taxpayer interaction are determined by assessment of the taxpayer's compliance risk. Commercial scoring models will be tested to validate the risk assumptions and make refinements. Some of this responsibility will be tasked to the modernization teams and delivered at a later date.

Collection management met with representatives from the Treasury Inspector General for Tax Administration (TIGTA) to discuss the initial draft response. Changes addressed in that meeting were not made in the revision. Subsequently, Collection asked for another meeting because of concerns over the accuracy of the Entity queries used during the audit. Collection also asked for copies of the work papers to review them in hopes of bringing the two positions closer together. Unfortunately, this request was denied; the Collection representatives were told the papers were too voluminous to copy.

The report focused on Collection's ability to track and monitor the specific categories identified in the memorandum. Although we recognized that our current systems did not provide complete tracking mechanisms, we thought that the field's immediate need for relief outweighed the short-term risk. While we agree in principle with many of the recommendations in the report, we think they should be implemented in the planned risk-based methodology instead of the priority plan outlined in the memorandum.

A summary of Collection's inventory plan is attached and our comments related to each issue are as follows:

IDENTITY OF RECOMMENDATION 1

The Assistant Commissioner (Collection) should use data from existing management information systems (i.e., the Integrated Collection System (ICS)/Entity) to identify high-priority work.

ASSESSMENT OF CAUSE
Current systems did not allow for this. Since the priorities established by the memorandum were intended as an interim solution and not a permanent change, the systems were not modified.

CORRECTIVE ACTION
We do agree, however, with the need to identify work that is considered priority. In the future, we will be able to identify priority work based on our new compliance risk-based methodology, using a variety of Entity reports.

IMPLEMENTATION DATE
July 2001

RESPONSIBLE OFFICIAL
Director, Compliance, Small Business/Self-Employed

CORRECTIVE ACTION MONITORING PLAN
This corrective action is being monitored as part of the enhancement plan for ICS/Entity.

IDENTITY OF RECOMMENDATION 2
Develop a method to uniformly identify 'Priority 1' cases.

ASSESSMENT OF CAUSE
Current systems did not allow for this.

CORRECTIVE ACTION
We agree and system changes have been made to identify cases referred to the CFf for customer assistance.

IMPLEMENTATION DATE
Completed: October 2000

RESPONSIBLE OFFICIAL
Director, Compliance, Small Business/Self-Employed

CORRECTIVE ACTION MONITORING PLAN
N/A

IDENTITY OF RECOMMENDATION 3
Use the existing capabilities of the ICS/Entity to track Priorities 2 through 6.

ASSESSMENT OF CAUSE
TIGTA was unable to track these priorities within the group manager hold files and revenue officer inventories. Again, we believe the March memorandum was an interim action and current systems did not completely allow for this.

CORRECTIVE ACTION
We do not agree that we should track the priorities identified in the memorandum. We do agree that a tracking or monitoring mechanism should be included in the implementation of the risk-based case selection system.

IMPLEMENTATION DATE
July 2001

RESPONSIBLE OFFICIAL
Director, Compliance, Small Business/Self-Employed

CORRECTIVE ACTION MONITORING PLAN
This corrective action is being monitored as part of the enhancement plan for ICS/Entity.

IDENTITY OF RECOMMENDATION 4
Develop a methodology to measure the impact of the priorities on the CFf inventory levels.

ASSESSMENT OF CAUSE
We do not agree that there is a need to develop a specific methodology to measure the impact of the memorandum on inventory levels. Existing reports are available to measure impact. The charts in the attachment demonstrate substantial movement of inventory in a positive direction.

CORRECTIVE ACTION
We do not agree with this recommendation. The current reports can accomplish this measurement.

IMPLEMENTATION DATE
N/A

RESPONSIBLE OFFICIAL
N/A

CORRECTIVE ACTION MONITORING PLAN
N/A

IDENTITY OF RECOMMENDATION 5
The field offices should ensure managers assign inventory within the required 30-day timeframe.

ASSESSMENT OF CAUSE
In the past, most of the inventory assigned to CFf could be best described as non-discretionary and without any regard to resource availability.

CORRECTIVE ACTION
System and procedural changes will be made in January 2001, so that assignments are based on the group manager's ability to assign them within a thirty-day time frame. Reports will be available at the group, territory, and area levels. While we agree with this recommendation and believe that the above procedural change will correct the situation, it is important to point out that our group managers' responsibilities continue to increase and it is not realistic to expect them to handle everything as priority one.

IMPLEMENTATION DATE
July 1, 2001

RESPONSIBLE OFFICIAL
Director, Compliance, Small Business/Self-Employed

CORRECTIVE ACTION MONITORING PLAN
This corrective action is being monitored as part of the enhancement plan for ICS/Entity.

IDENTITY OF RECOMMENDATION 6
Collection management should use the sub-code capabilities of the ICS/Entity to identify and track priority work.

ASSESSMENT OF CAUSE
Current systems did not allow for this.

CORRECTIVE ACTION
We do not agree that the sub-code capability should be routinely used to identify and track priority work. This would interfere with the primary purpose for sub-codes. We will use sub-codes to identify 'taxpayer needs contact' cases.

IMPLEMENTATION DATE
N/A

RESPONSIBLE OFFICIAL
N/A

CORRECTIVE ACTION MONITORING PLAN
N/A

IDENTITY OF RECOMMENDATION 7
Collection management should take steps to ensure cases are not prematurely transferred to the Queue, shelved, or closed while potentially lower priority cases (under $25,000) are in open inventory.

ASSESSMENT OF CAUSE
This recommendation does not appear to be supported. This is one of the areas where a further review of the work papers would have helped understand the true nature of the recommendation.

CORRECTIVE ACTION
We do not agree with this recommendation.

IMPLEMENTATION DATE
N/A

RESPONSIBLE OFFICIAL
N/A

CORRECTIVE ACTION MONITORING PLAN
N/A

IDENTITY OF RECOMMENDATION 8
Collection management should reevaluate the March 1999 procedures and consider the impact of potential inequitable taxpayer treatment and the risk of not protecting the government's interest...

ASSESSMENT OF CAUSE
We are filing Notices of Federal Tax Lien in accordance with RRA 98 provisions. These provisions require an "attempted" contact prior to lien filing. This recommendation relates to shelved cases. There are no attempts to contact when a case is shelved.

CORRECTIVE ACTION
We do not agree with this recommendation. To comply with legal requirements, we would have to attempt contact on each case. This would defeat the purpose of allowing cases to be shelved. It is important to note, however, that we continue to have discussions with our Counsel on how best to protect the government's interest without violating the provisions of RRA 98.

IMPLEMENTATION DATE
N/A

RESPONSIBLE OFFICIAL
N/A

CORRECTIVE ACTION MONITORING PLAN
N/A

If you have any questions, please call Frank Nixon, Acting Director, Compliance Policy, at (202) 622-5563.

Attachment

Attachment

The IRS Needs to Improve the Development and Management Oversight of the Collection Field Function Inventory Priorities

Summary of Collection Inventory Plan

In FY 1998, Collection convened the Delinquent Inventory Task Force to research and develop recommendations to address the inventory issue. This group included members from Collection, Customer Service, Research, and NTEU. The group developed the initial high, medium, and low risk criteria for inventory delivery.

The task force found that most field assignments could be classified as non-discretionary (not requested by the group manager or revenue officer). About 90 percent of the receipts results from direct assignments bypassing ACS or the Queue, other human intervention, or transfers resulting from address changes.

The task force pursued changes to all of the collecting inventory delivery practices in order to realign case assignment priorities. Eventually, it was determined that ACS should decrease its overall inventory while sending field priority cases to the Queue where they would be available for field assignment. This was achieved by applying risk criteria to the ACS inventory database.

Collection also pursued many changes in CFf:

1. The March 19, 1999, memorandum provided interim inventory procedures to the CFf.
2. We submitted RIS to eliminate ACS bypass criteria and eliminate barriers to moving cases into the Queue.
3. We developed recommendations to increase ACS authority levels to close uncollectible cases and installment agreements.
4. Resource Workload Management System (RWMS) cutoff scores were raised to the limit and RWMS functionality for assigning cases was disabled.
5. The Queue was identified as the central repository for unassigned Collection cases, and a strategy was developed to move cases to and from the Queue.
6. The Queue will be prioritized by high, medium, and low risk criteria. Risk level will be computed for open inventory, unassigned inventory and the Queue.

    - High risk cases require early revenue officer intervention. They represent mostly business or self-employed taxpayers, and are assigned based on available staffing.

- Medium risk cases require less urgent CFf intervention. ACS will work these cases for 26 weeks and if no activity results, the cases are directed to the Queue.

- Low risk cases are worked only in ACS. These cases represent a high percentage of Wage and Investment Division (W&I) work and if no activity results, the cases will be shelved after 65 weeks.

The group manager, in the near future, will use a newly developed ICS/Entity Interface to request work. Entity will present the manager, on screen, with the highest risk cases that meet the inventory needs. Built into this method is what we call a "plus" value routine that automatically increases the number requested. This allows the manager to use his/her institutional knowledge to select case x over y, if warranted. For example, the manager requests five cases for a revenue officer. Entity would present the manager with 10 of the highest risk cases for that employee. The manger would then "select" five cases balancing revenue officer skills and/or needs with any local knowledge of the taxpayer. Behind the scenes, Entity would assign these taxpayers and they would arrive in the revenue officer inventory the following Monday.

The following are our comments by issue:

The IRS Implemented the Collection Field Function Inventory Without Analytical Data to Support the Decision

The claim as it is stated is not true. TIGTA states that they are looking for "a direct link" between the Delinquent Inventory Task group recommendations and the priorities listed in the memorandum. It is unclear to us what "direct link" they expected us to provide.

TIGTA expected a single document showing numerical analysis that supported the adoption of the March 19 memorandum priorities and the authorized deviation procedures. The content of the memorandum was based on the analysis and preliminary recommendations of the Delinquent Inventory Task Force. These recommendations were further discussed and reviewed by the Collection office directors, and by a special task group of field and National Office senior managers and executives. The Assistant Commissioner (Collection), based on advice from this special task group, issued the guidance within the memorandum. It is not unreasonable to expect that an Assistant Commissioner would, upon the advice of his staff, issue guidance to the field on use of resources without a white paper to support the decision. This does represent sound management practice.

TIGTA states that "Without determining the effect, the National Office requested the districts to raise Queue cutoff scores to whatever level necessary to limit the issuance of excess inventory." They also state that "raising the cutoff score had little effect on decreasing the issuance of inventory to the field." They have not supported these

statements. It was never expected that this action alone would dramatically reduce field issuances. It can be logically assumed, however, that raising the cutoff score would eliminate case receipts arising from this one method of direct case issuance.

There is no correlation between the selection of the six priorities and the decrease of assigned inventory. The deviation authority contained in the March 19 memorandum was the intended vehicle to reduce unassigned inventory. The priorities were identified to focus field resources on the cases having the greatest impact on non-compliance. Priorities 2,3,and 4 relate to trust fund taxes.

Since the March 19 memorandum, data relative to field inventory has changed, clearly showing movement in the desired direction. It is important to note that TIGTA's inventory level (pages 5 & 6) statements seem to be modular driven. Revenue officers work accounts by taxpayer not module. While the number of modules contained within a "taxpayer" case may be germane on some issues – applying it here is inappropriate.

CFf Inventory	Mar '99	Mar '00	Change
TDA or COMBO	275,909	213,296	22.69%
TDI ONLY	38,491	25,344	34.16%
TOTAL	314,400	238,640	24.10%

Other than the mere numbers of "taxpayer" cases, other aspects of the composition of the inventory are also crucial. Data relative to our focus on more "payroll tax" taxpayers, especially those owing tax, also moved in the right direction. Additionally, inventories have been transitioning to more Business Masterfile (BMF) than the IMF taxpayers, something that our task force strongly pushed for, and had not been achieved for some time.

CFf TDA Inventory	Mar '99	Mar '00
% BMF Taxpayers	44.83%	52.97%
% Payroll Tax Issues	41.02%	49.47%

We also expected to see IMF accounts below $25,000 drop and a higher concentration of "high income" nonfilers than in the past. Our existing National reports only separate out Select Code 38 totals, and they are used below:

CFf Inventory	Mar '99	Mar '00	Change
IMF TDA < $25,000	70,770	44,272	37.44%
SEL 38 TDIs	5,066	6,226	22.90%

The IRS Has No Methodology to Measure the Impact of the Priorities on Collection Field Function Inventory Levels

The claim assumes that the impact of the new priorities would require a distinct methodology to capture appropriate data. While TIGTA acknowledges that the six priorities were set as an interim solution, they seemed to view them as a permanent change which required an immediate, new management information system. It should be noted that during the time of this review, we were in the middle of rolling out ICS/Entity. This rollout was completed in March 2000.

Collection management was trying to provide relief to certain districts, even just certain locations within districts, when the memorandum was issued. TIGTA has not recognized this in its report. The regions specifically asked for the authority to grant the memorandum provisions to districts as the regions saw the need. National Office agreed, and relied on the regions to determine the use of the memorandum deviations and to keep data on the cases removed from inventory using the deviations. The regions informed National Office of their decisions. National Office monitored the case activity through routine analysis of management information reports.

The report further suggests that Collection utilize Entity subcodes to identify Priority 1 cases. The identification of Priority 1(Taxpayer needs Contact) cases is more involved than just assigning a subcode **after the case is assigned to a revenue officer.** It is Collection's intention to give the utmost priority to these cases. In order to achieve this objective, the case must be recognized for what it is when it is received by the ICS. At the present time, there is no systemic way to make this identification. We are working on identifying the best way to correct this. Tracking the case after assignment is not addressing the real issue.

The IRS Has Not Consistently Followed Its Inventory Priorities

- **The priorities have not alleviated unassigned inventory concerns**

We agree that significant unassigned field inventory cases has remained a problem. When we issued the March 19 memorandum, most field assignments could be classified as non-discretionary (not requested by the group manager or revenue officer). Instead, about 90 percent of the receipts were delivered by the system (direct assignments bypassing ACS or the Queue), or by human intervention, or transfers resulting from address changes. To the extent these cases come to the field faster than they can be assigned, we will continue to see hold files with more inventory than can be assigned in 30 days. Although the memorandum provided authorization to shelve cases, it should be noted that the process by which this is accomplished is done during "real time" as opposed to "batch processing" and is resource intensive. When both the systemic and procedural changes related to the inventory plan take effect, we

expect the field's non-discretionary receipts to drop dramatically and the "hold file" issue to be manageable.

Many Cases in the CFf Inventory May Not Be Priority Cases

Collection recognizes that there is some non-priority work within revenue officer inventories. However, TIGTA must also recognize that there will be some non-priority cases associated with priority cases in revenue officer inventories, such as a BMF trust fund taxpayer with associated IMF liabilities. Collection also realizes that, currently, all priority cases are not easily identified. As stated previously, we are taking steps to resolve that problem.

TIGTA also states that there was an increase in the number of cases in the Queue with balances greater than $100,000 from January 1999 to January 2000. This increase occurred because IMF taxpayers with aggregate balances greater than $100,000 move into the Queue from ACS after one cycle. This is being done in preparation for the implementation of risk-based inventory management. In January 2001, these cases will go directly to the Queue after fourth notice. Cases with balances greater than $100,000 are not one of the six priorities, but are one of the high-risk categories.

Actions on Closed Cases May Cause Inequitable Taxpayer Treatment and Do Not Ensure the Government's Interest is Protected

The "Inequitable treatment of taxpayer" issue raised two concerns: not filing Notices of Federal Tax Liens; and no systemic follow-up when closing a case using transaction code (TC) 530 closing code (cc)39 (shelve due to limited resources).

TIGTA does not recognize the crucial difference between the closing code 39 that shelves a case due to limited resources, and the other TC 530 closing codes. Although the same transition code (530) is used, there is a vast difference in their intended result. The other closing codes initiate case resolution and require specific actions, such as, consideration of lien filing before the case can be closed as uncollectible due to hardship, unable to locate or contact. We believe this is an unfair comparison and we do not agree with this logic.

The provisions of RRA 98 require that before the IRS can file a Notice of Federal Tax Lien, we must attempt to contact the taxpayer. In the case of the closing code 39, we are making a decision to shelve the case and as such will not make any attempt to contact the taxpayer. The filing of a Notice of Federal Tax Lien in these cases is inappropriate.

As we have already made a decision to shelve cases due to lack of resources, it would not serve us to have a systemic reactivation of these cases with no change in available resources. If sufficient resources become available and we want to look back at those we set aside, we have the ability to reactivate them.