TREASURY INSPECTOR GENERAL FOR TAX ADMINISTRATION

Controls Over Partial Payment Installment Agreements Can Be Improved

May 6, 2013

Reference Number: 2013-30-040

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CONTROLS OVER PARTIAL PAYMENT INSTALLMENT AGREEMENTS CAN BE IMPROVED

Highlights

Final Report issued on May 6, 2013

Highlights of Reference Number: 2013-30-040 to the Internal Revenue Service Commissioners for the Small Business/Self-Employed Division and the Wage and Investment Division.

IMPACT ON TAXPAYERS

Taxpayers who enter into a Partial Payment Installment Agreement (PPIA) will not fully pay all of their delinquent tax liability, so it is important that PPIAs are carefully and accurately administered. However, the IRS is not always properly monitoring or establishing PPIAs. If the IRS does not effectively pursue collection of unpaid tax through the use of PPIAs, it could create an unfair burden on the majority of taxpayers who fully pay their taxes on time.

WHY TIGTA DID THE AUDIT

Because taxpayers with PPIAs will not fully satisfy their delinquent tax liability, it is critical that they pay the maximum amount determined by a complete financial analysis. This audit was initiated to determine whether the IRS was following procedures when establishing and monitoring PPIAs.

WHAT TIGTA FOUND

When establishing a PPIA, the IRS is required to complete a financial analysis of the taxpayer and assess the financial condition of taxpayers with a PPIA every two years. TIGTA reviewed a random sample of 100 PPIAs and found that the two-year reviews were not always properly performed and that some PPIAs were established without a complete financial analysis and/or manager approval.

To begin the two-year financial assessment, the IRS performs an automated review process of PPIAs at the two-year mark. However, the automated two-year review processes did not occur in eight (10 percent) of the 84 PPIAs requiring a two-year review. If the automated review process determines that the financial condition of the taxpayer may have improved, a manual review is required. However, the manual reviews were not performed properly for 15 (52 percent) of the 29 PPIA cases for which a manual review was required. IRS procedures do not require managers to review or approve the results of the two-year review of PPIAs.

In addition, 15 (15 percent) of 100 PPIAs sampled were established without a complete financial analysis. Without a complete financial analysis, there is a higher risk that the taxpayers are not paying the maximum amount they can afford or that they are unable to afford the amount in the agreement. Further, 34 (34 percent) of the 100 PPIAs did not have evidence that the manager approved the PPIA. The absence of documented manager approval indicates that the managers are not reviewing the PPIAs before they are established.

The IRS Collection Process Study report recommended that the IRS expand the use of PPIAs by offering a modified minimum PPIA to all individual taxpayers in uncollectible status. The report estimated that if PPIAs were offered to 230,000 individual taxpayers classified as unable to pay, the collection potential could be as high as $69 million annually. TIGTA was advised that the IRS does not have plans to implement this recommendation due to limited resources.

WHAT TIGTA RECOMMENDED

TIGTA made recommendations to improve controls over the two-year review process and establishment of PPIAs. TIGTA also recommended that management test the viability of expanding the use of PPIAs on a sample of taxpayers in uncollectible status.

In its response to the report, the IRS agreed with most of TIGTA's recommendations. IRS officials plan to revise procedures to improve controls over the two-year review process and the establishment of PPIAs. The IRS did not agree to test the viability of expanding the use of PPIAs. However, its disagreement was based on results from a different program which TIGTA does not believe is comparable.

TREASURY INSPECTOR GENERAL
FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY

WASHINGTON, D.C. 20220

May 6, 2013

MEMORANDUM FOR COMMISSIONER, SMALL BUSINESS/SELF-EMPLOYED DIVISION
COMMISSIONER, WAGE AND INVESTMENT DIVISION

FROM: Michael E. McKenney
Acting Deputy Inspector General for Audit

SUBJECT: Final Audit Report – Controls Over Partial Payment Installment Agreements Can Be Improved (Audit # 201230010)

This report presents the results of our review to assess the controls over and effectiveness of the Partial Payment Installment Agreement program. This audit is included in our Fiscal Year 2013 Annual Audit Plan and addresses the major management challenge of Tax Compliance Initiatives.

Management's complete response to the draft report is included as Appendix VII. Copies of this report are also being sent to the Internal Revenue Service managers affected by the report recommendations.

If you have any questions, please contact me or Augusta R. Cook, Acting Assistant Inspector General for Audit (Compliance and Enforcement Operations).

Table of Contents

Abbreviations

AMS	Account Management Services
CPS	Collection Process Study
FY	Fiscal Year
IA	Installment Agreement
ICS	Integrated Collection System
IDRS	Integrated Data Retrieval System
IRM	Internal Revenue Manual
IRS	Internal Revenue Service
NQRS	National Quality Review System
OIC	Offer In Compromise
PPIA	Partial Payment Installment Agreement
TPI	Total Positive Income
TIGTA	Treasury Inspector General for Tax Administration

Background

All taxpayers are expected to immediately pay delinquent tax liabilities in full. When this is not possible, taxpayers may be allowed to pay their liabilities over a prescribed period of time. If full payment cannot be achieved by the Collection Statute Expiration Date,[1] and taxpayers have some ability to pay, the Internal Revenue Service (IRS) and taxpayer can enter into a Partial Payment Installment Agreement (PPIA).

PPIAs were enacted by the American Jobs Creation Act of 2004.[2] In a PPIA, the taxpayer makes regular monthly payments to the IRS, but the payments do not pay off the tax debt in full. After the terms of the PPIA are fulfilled, the IRS is prohibited from collecting the remainder of the tax debt because the collection statute will have expired. PPIAs provide taxpayers with another alternative to settle their tax obligations.

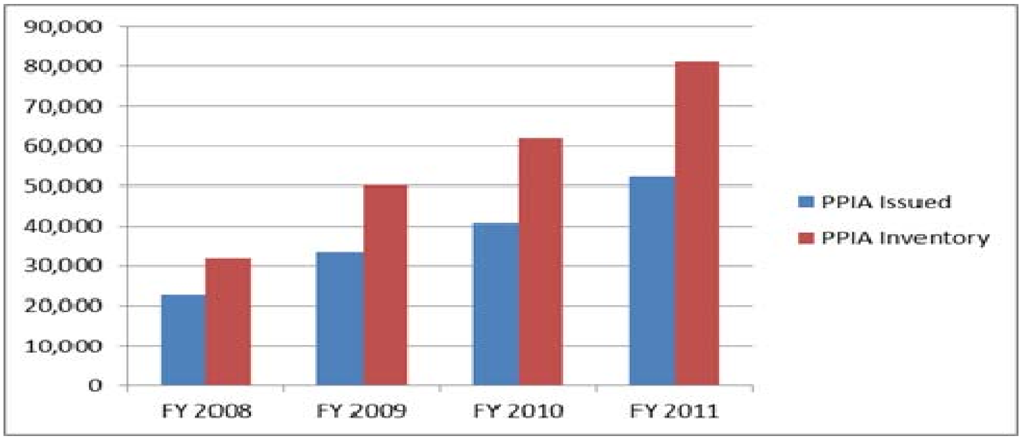
Prior to the enactment of the American Jobs Creation Act of 2004, taxpayers who could not immediately fully pay their tax liabilities could enter into installment agreements (IA) with the IRS only to fully pay their tax liabilities within the Collection Statute Expiration Date. A taxpayer who could not fully pay could also request an offer in compromise (OIC) to pay a portion of the tax liability. A PPIA is an alternative that allows the taxpayer to pay a portion of their obligations over a period of time.

The number of PPIAs established has steadily increased since their inception in FY 2005.

The number of PPIAs established has steadily increased since their inception in Fiscal Year (FY) 2005. Figure 1 shows that new PPIAs increased 132 percent from FY 2008 to FY 2011.

[1] See Appendix VI for a glossary of terms.
[2] Pub. L. No. 108-357, 118 Stat. 1418 (2004).

Figure 1: PPIA Activity From FY 2008 to FY 2011

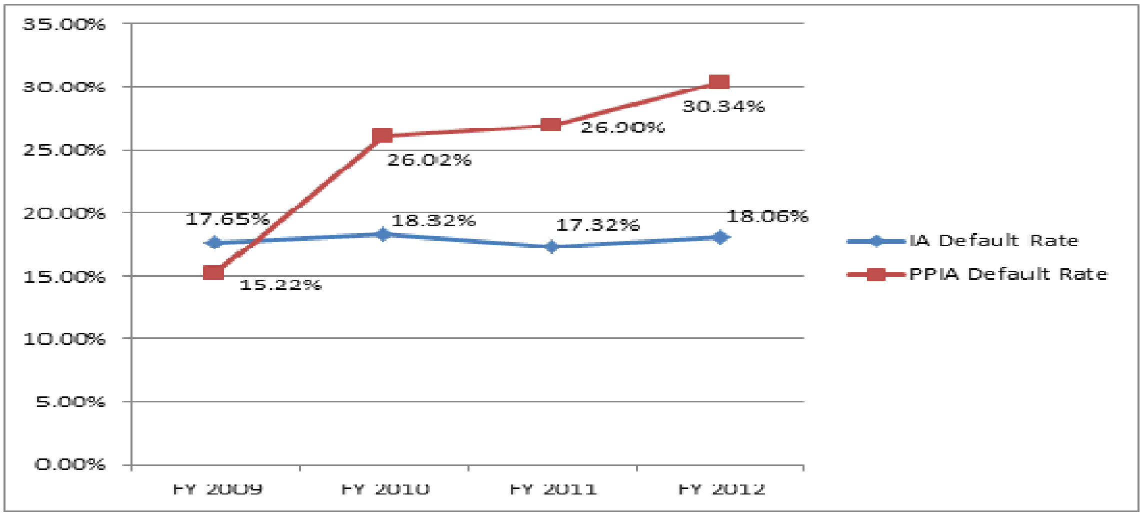


Source: FY 2008 through FY 2011 Collection Activity Reports.

During the same period, the delinquent tax liability pertaining to new PPIAs increased more than 163 percent, totaling more than $4 billion in FY 2011.

Similar to regular IAs, the taxpayers must make their monthly payments on time and remain compliant with all of their tax obligations during the term of the PPIA. If a taxpayer does not make two monthly payments, the IRS sends the taxpayer a letter instructing him or her to contact the IRS. If the taxpayer contacts the IRS, the IRS must attempt to get the taxpayer back on track. If the taxpayer does not contact the IRS or does not make another payment, the taxpayer defaults on the PPIA and the PPIA is terminated. A default notice is sent to the taxpayer explaining the reasons for terminating the PPIA and the corrective actions the taxpayer can take. Figure 2 shows the default rates for PPIAs and regular IAs from FY 2009 to FY 2012.

Figure 2: PPIA Default Rates From FY 2009 to FY 2012



Source: The IRS calculation of IA and PPIA default rates.

As Figure 2 illustrates, the default rate for IAs has remained relatively steady over the four-year period, while the PPIA default rate has nearly doubled. In FY 2012, the PPIA default rate was more than 12 percentage points higher than regular IAs.

Our audit was a follow-up to a review completed in FY 2007.[3] This audit was performed at the Small Business/Self-Employed Division Headquarters in New Carrollton, Maryland, during the period February through July 2012. We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective. Detailed information on our audit objective, scope, and methodology is presented in Appendix I. Major contributors to the report are listed in Appendix II.

[3] Treasury Inspector General for Tax Administration (TIGTA), Ref. No, 2007-30-170, *Employees Are Not Always Ensuring That Taxpayers Pay the Maximum Amount Possible When Granting Partial Payment Installment Agreements* (Sept. 2007).

Results of Review

Controls Are in Place to Help Guide Collection Program Employees to Establish and Monitor Partial Payment Installment Agreements

Ultimately, the IRS relies on its collection employees to ensure that PPIAs are properly established and monitored. To assist these employees in meeting this responsibility, the IRS has developed and implemented a number of internal controls and procedures. Internal controls are an integral component of an organization's management because they can provide reasonable assurance about the organization's:

- Effectiveness and efficiency of operations.
- Reliability of financial reporting.
- Compliance with applicable laws and regulations.

The IRS has established control components within the Collection program to help ensure that management plans and implements activities needed to attain IRS goals and objectives. For example, the Internal Revenue Manual (IRM) is one important control component because it contains the official compilation of detailed instructions and procedures for collection employees to follow when establishing or monitoring PPIAs. Throughout the IRM, collection employees are instructed to properly document in case files all aspects of their work pertaining to establishing PPIAs. In addition, the IRM requires first-line managers to document in the case file their approval when a PPIA is established. This documentation is important because it provides the principal evidence that procedures were followed as well as the foundation for other control processes such as managerial reviews and the quality measurement systems. The importance of documentation is further emphasized in the quality measurement standards and the *Standards for Internal Control in the Federal Government*.[4]

The IRS uses the National Quality Review System (NQRS) as its primary quality measurement system. This system is an important control component because it identifies managerial, technical, and procedural problems and provides a basis for corrective actions. The IRS uses the NQRS to assess the quality of its overall IA program. Figure 3 shows that Campus Compliance function employees establishing IAs during the three-year period ending FY 2012 consistently scored 95 percent or higher in procedural accuracy.

[4] Government Accountability Office (formerly known as the General Accounting Office), GAO/AIMD-00-21.3.1, *Internal Control: Standards for Internal Control in the Federal Government* (Nov. 1999).

**Figure 3: Campus Compliance Function
Quality Results for Establishing Installment Agreements**

Year	Cases Reviewed	Timeliness	Professionalism	Customer Accuracy	Regulatory Accuracy	Procedural Accuracy
2012	2,162	90%	98%	91%	99%	96%
2011	1,727	94%	97%	90%	99%	95%
2010	1,604	94%	99%	92%	99%	96%

Source: TIGTA analysis of IA NQRS data for FY 2010 to FY 2012.

A thorough review of the taxpayers' financial condition is an important control component because taxpayers may be expected to pay the available equity in their assets as well as their disposable household income over the remaining statutory period of collection of the tax assessment to satisfy the tax liability. Taxpayers who are being considered for a PPIA must provide complete and accurate financial information. PPIAs are established in the Collection Field function by revenue officers and in the Campus Compliance function by Automated Collection System or Compliance Services Collection Operations employees (all three are identified collectively as "collection employees" throughout this report). Before granting a PPIA, collection employees perform an initial review, which consists of a complete financial analysis of the taxpayer's situation, including a verification of the taxpayer's income and assets and a monthly income and expenses comparison to determine the amount of disposable income (gross income less all allowable living expenses) available to pay the tax liability. Based on the initial review, the collection employee calculates the amount that the taxpayers are expected to pay each month. In addition, taxpayers granted PPIAs are subject to a complete financial analysis every two years to determine if a taxpayer's financial condition has improved. Depending on the result of this two-year review, the amount of the installment payments could increase if the taxpayer's financial condition has improved. In some instances, the installment payments may be lowered if the taxpayer's financial condition has worsened.

First-line managers are another important control component because they are responsible for the quality of work performed by the employees they supervise. Prior to establishing a PPIA, the first-line manager must review the case and ensure that a complete financial analysis was completed and the monthly payment amounts were properly calculated. The first-line manager must also approve the PPIA.

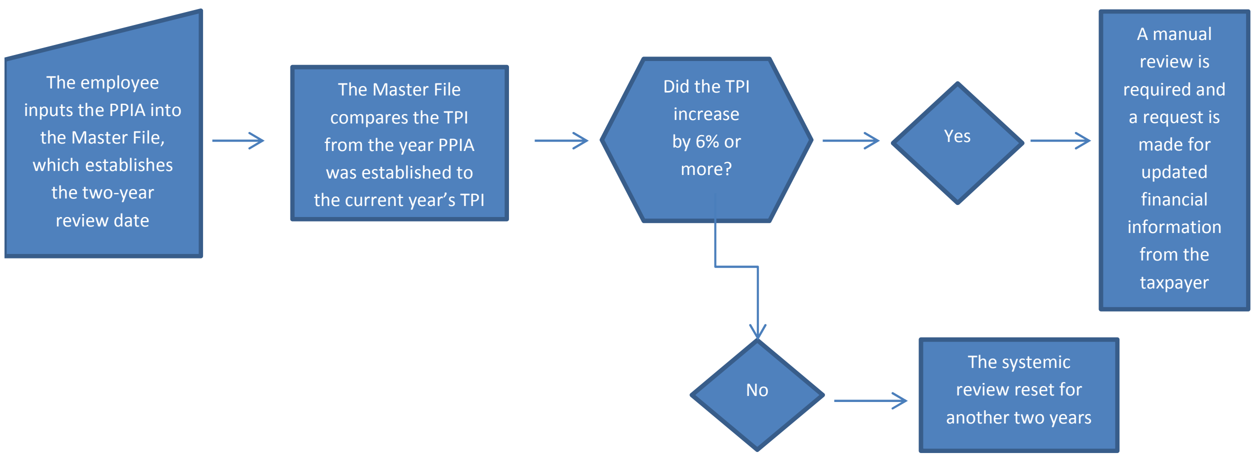
To determine whether the IRS was properly performing both the initial and the two-year financial analyses, we reviewed a statistically valid sample of open PPIA cases. To ensure that we selected a sample of PPIAs that would allow verification of the two-year review, we selected cases that as of October 25, 2011, had an IA acceptance date between January 1, 2008, and July 1, 2009. There were 4,447 cases identified from which we reviewed a random sample of 100 PPIA cases. Although we found controls in place to guide collection employees to establish and monitor PPIAs, our results indicate that additional steps can be taken to improve these controls. Specifically, we determined that:

- The two-year reviews were not always properly performed.
- PPIAs were established without a complete financial analysis or manager approval.

Two-Year Reviews Were Not Always Properly Performed

The American Jobs Creation Act of 2004 requires the IRS to assess the financial condition of taxpayers with a PPIA every two years. To comply with this requirement, the IRS performs an automated review process on PPIAs at the two-year mark. Figure 4 illustrates this two-year review process.

Figure 4: The PPIA Two-Year Review Process



Source: The IRS's Programming Requirements Package 460-48. TPI = Total Positive Income.

When the PPIA is first established, the collection employee inputs a specific computer code to the taxpayer's Master File account to schedule the automated two-year review process. Then, at the two-year mark, the automated review process uses Master File data to compare the taxpayer's total positive income (TPI) from the income tax return filed for the year in which the taxpayer entered into the PPIA with the TPI from the income tax return filed for the current tax year. If this comparison determines *******************2**********************, the automated review process is reset to occur two years later. However, if the taxpayer's TPI ***********2**************, a manual review is required. The manual review requires the taxpayer to submit updated financial information and the IRS to perform an updated complete financial analysis.

In our random sample of 100 PPIAs, we determined that a two-year review was not applicable for 16 cases. The taxpayers in these PPIAs originally entered into a regular IA between January 1, 2008, and July 1, 2009, and converted to a PPIA in FY 2010 or later. Therefore, the two-year review was not scheduled to occur during the time of our review.

For the remaining 84 PPIAs, we determined that:

- Automated two-year reviews did not always occur.
- Required manual reviews were not always performed properly.

Automated two-year reviews did not always occur

Our review of the 84 PPIAs requiring a two-year review showed that the automated two-year review process occurred on time in 76 (90 percent) of 84 sampled cases. However, the automated two-year review process did not occur in eight (10 percent) of the 84 cases. Specifically:

- In five (6 percent) of the 84 PPIAs requiring a two-year review, the employees establishing the PPIAs did not ensure that the taxpayers' accounts were properly scheduled for the automated two-year review. Instead, the automated two-year review process was erroneously scheduled to occur between three to six years after the PPIA was established because the collection employees input the wrong computer code. We determined that if an automated two-year review process had been performed timely at two years, *********************************1*************************** **************1** **2************************** *******2************** ***1***********[5] *************1************** ***********************************1****************************** ********************************1********************************* *******************1**************************.[6]
- In three (4 percent) of the 84 PPIAs requiring a two-year review, the taxpayers defaulted on their PPIAs before the automated two-year review process. As a result, there was no automated two-year review process to determine whether the taxpayers' financial condition changed. *****************************2*********************** *************************************2*************************** ***********************************2****************************** *************************************2************************* ***2*********************** ***********************************2******************************* **2*********************** ***2*****************

[5] **2*** ****************************2***************. See Appendix V for an example of how we performed our financial analysis estimates.

[6] **1*** **1*****************************

***********************************2******************************
***********************************2**************************** we estimate that if IRS employees had performed a manual review, *********1*********
1***********************
*******************1*******. Establishing a PPIA with a payment amount that the taxpayer can afford helps reduce the risk that the taxpayer will again default on the PPIA.

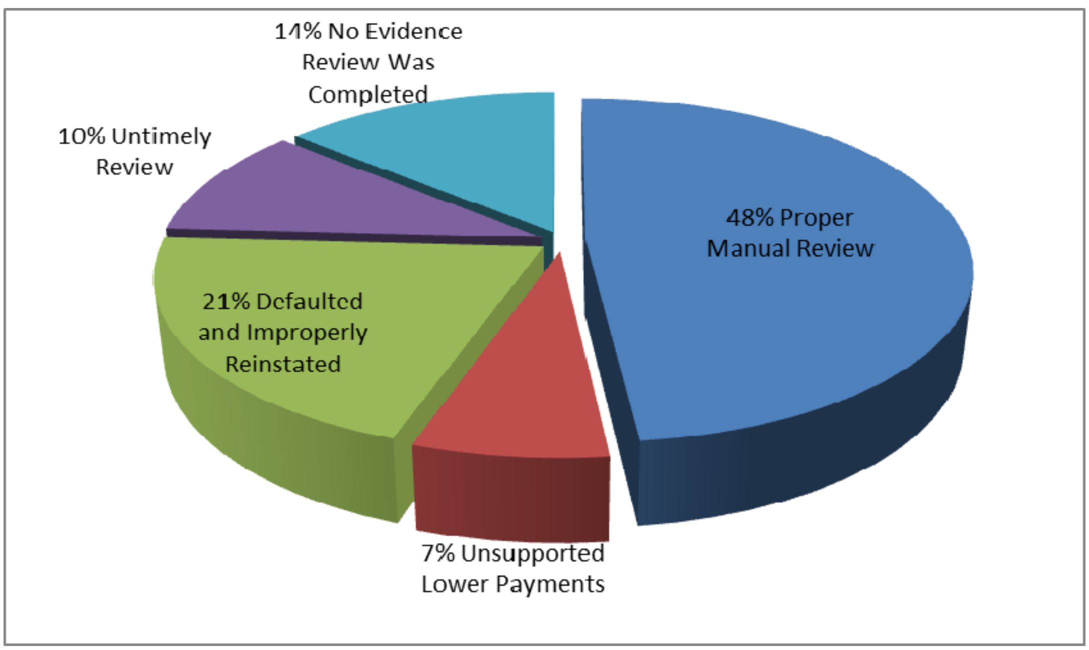
Required manual reviews were not always performed properly

The results for the 76 cases for which the automated two-year review was timely showed that:

- In 47 (62 percent) of the 76 PPIAs, the automated two-year review process properly determined that no manual review was required.
- In 29 (38 percent) of the 76 PPIAs, a manual review was required. IRS procedures required that current financial information be obtained from these taxpayers so that a manual review could be performed.

Figure 5 shows the results of the 29 PPIAs for which the automated two-year review determined that a manual review was required.

Figure 5: Results of the PPIA Cases Requiring a Manual Review



Source: TIGTA analysis of PPIA sample cases.

- In 14 (48 percent) of the 29 PPIAs, the IRS performed a proper manual review. **1** *********************1********************************.
- In six (21 percent) of the 29 PPIAs, the taxpayers defaulted on their PPIA after the automated review process had been completed but before the manual review took place. IRS procedures require a complete financial analysis before reinstatement of a defaulted PPIA. ****************************2********************************** *****************2*** ***********2*********************************1********************* **1************************ ***********************************1****************************** **1************************ ***1***.
- In four (14 percent) of the 29 PPIAs, there was no evidence that the required manual two-year review occurred. It is possible that a manual review would have determined these taxpayers had the ability to increase their monthly installment amounts or that they could not afford their monthly installments. For example, we estimate that if IRS employees had performed a manual review, these four taxpayers may have had their payment amounts reduced. Establishing a PPIA with a payment amount that the taxpayer can afford helps reduce the risk that he or she will default on their PPIA.
- In three (10 percent) of the 29 PPIAs, the IRS did not perform the manual review timely. The manual reviews were performed between 12 and 15 months late. The manual reviews determined that the financial condition of the taxpayer did not improve and their respective monthly payments were unchanged.
- ************************************1**************************** ************************************1*************************** ************************************1****************************** ************1******.

Overall, we identified problems in 23 (27 percent) of the 84 PPIAs requiring a two-year review. These 23 PPIAs involved more than $1.2 million in delinquent tax. Four of the 23 PPIAs had monthly payment amounts reduced without documentation in the case files supporting the lower payment amounts. Based on our results, we estimate that 178 taxpayers will pay a total of $878,705 less than the amount that the financial analyses showed the taxpayers had the ability to pay. Further, although our estimate was based only on the 4,447 PPIAs established between January 2008 and July 2009, we found no evidence these PPIAs were established using different procedures or controls than the full population of 97,208 open PPIAs as of October 2011.

We determined that the IRM does not provide for manager oversight of the two-year review process. Management is not required to ensure that either the automated two-year review process or the manual review (when warranted) occurs. In addition, the IRM does not require a

manager to review or approve the results of the manual review. As a result, managers are not aware when required two-year reviews are not completed. ******2*******************
*************************************2******************************
**************************************2******************.

As a result, management does not have complete information about the quality of its PPIA program. Further, when a proper two-year review is not conducted, the IRS is not complying with the American Jobs Creation Act of 2004. The purpose of the two-year review is to determine if the taxpayer is now capable of fully paying his or her balance due, an adjustment in the payment amount is necessary, the agreement should continue without change, or the taxpayer is now unable to pay. Because the automated review process checks for taxpayers whose TPI has ************2***********, it is possible that a proper manual review would result in taxpayers paying more than their original agreement amount.

Recommendations

The Director, Collection Policy, Small Business/Self-Employed Division, should:

Recommendation 1: Revise the IRM to require that managers ensure that automated two-year reviews are properly scheduled and that financial analyses are performed prior to reinstating taxpayers that default on their PPIAs.

> ***Management's Response:*** IRS management agreed with this recommendation and will revise the IRM to require managers to ensure that automated two-year reviews are properly scheduled and to specify when financial analysis is required prior to revising or reinstating PPIAs.

Recommendation 2: Revise the IRM to require that the manual two-year reviews associated with PPIAs are fully documented and reviewed and are approved by the manager.

> ***Management's Response:*** IRS management agreed with this recommendation and will determine the type(s) of manual two-year review that will require management review and full documentation. They will also revise the IRM to include this information.

Partial Payment Installment Agreements Were Established Without a Complete Financial Analysis or Manager Approval

To enter into a PPIA, the taxpayer must agree to pay the monthly installment amount determined by a complete financial analysis. A complete financial analysis includes a monthly income and expenses comparison and verification of the taxpayer's income and assets. The collection employee performing the analysis verifies the taxpayer's income and assets using the Integrated Data Retrieval System (IDRS) via specific command codes. These command codes provide access to information on the IRS Master File pertaining to information documents submitted by a third party, *e.g.*, wage statements and investment income, and tax return information. Also, equity in assets must be addressed and, if appropriate, be used to make a payment. The financial analysis determines the maximum monthly payment amount the taxpayer has the ability to pay.

Collection employees must obtain their manager's approval prior to establishing a PPIA. When approving a PPIA, the manager must review the case and ensure that a complete financial analysis was performed.

In FY 2007, TIGTA reported[7] that the IRS was not always completing a sufficient financial analysis or verifying the taxpayer's financial status. TIGTA recommended that the IRS reemphasize that, when establishing PPIAs, employees need to obtain appropriate documentation of income, verify assets, and appropriately document the verification actions in the history sheets and case files. In response to the TIGTA report, the IRS revised PPIA procedures to clarify instructions and emphasize documentation and verification of income and assets when working PPIAs. We tested the effectiveness of these IRS corrective actions by reviewing our sampled cases for the initial financial analysis. Our sample was limited to PPIA cases that were established after the IRS's corrective actions were implemented. We also reviewed the cases for manager approval. Our case review results showed that IRS corrective actions were not fully effective. Specifically, we found that some PPIAs:

- Continued to be established without a complete financial analysis.
- Were established without manager approval.

PPIAs continued to be established without a complete financial analysis

In our sample of 100 PPIAs, we determined that 15 (15 percent) were established without a complete financial analysis. Specifically, of the 15 cases:

- Four PPIAs were established without evidence that any financial analysis was performed.
- Eleven PPIAs were established without a complete financial analysis because no required IDRS research was performed. IDRS research is required to verify the financial information provided by the taxpayer such as wages, investment income, and sources of financial accounts. However, employees relied upon only the financial information provided by the taxpayer. We reviewed the IDRS profiles for five of the employees who established these PPIAs, and none of the five had all the required command codes required to research and verify the taxpayer's financial information.

IRS management told us that sometimes the IDRS research may not be conducted because the employees may have obtained other information from the taxpayer, such as bank statements or

[7] TIGTA, Ref. No, 2007-30-170, *Employees Are Not Always Ensuring That Taxpayers Pay the Maximum Amount Possible When Granting Partial Payment Installment Agreements* (Sept. 2007).

earning statements. However, while other sources of information may exist, substituting these sources for verification via IDRS research is not allowable per IRS procedures. Further, only three of the 11 cases with no IDRS research included documentation that the IRS obtained a bank statement or earnings statements.

In addition, management reviews did not identify the problems with incomplete financial analyses. In 12 of the 15 cases, there was evidence of manager approval. Eleven of the 12 were cases for which proper IDRS research was not completed. However, when approving the PPIA, the manager did not ensure that IDRS research was performed.

We estimate that if IRS employees had conducted a complete financial analysis prior to establishing the PPIAs, **********************1******************************
**************************************1*********************************.
*************************************1*********************************
****************************1***********************.[8]

When a PPIA is established without a complete financial analysis, there is a higher risk that the taxpayers are not paying the maximum amount they can afford. There is also a higher risk that the taxpayer cannot afford the payments in the agreement. The lack of documentation for these cases prevented us from determining whether the taxpayer had the ability to pay more. However, if the taxpayers make all payments required by the terms of these PPIAs, the delinquent tax liability that the taxpayers will still owe on these 15 PPIAs will be $1,182,903.

Further, the PPIA default rate in FY 2012 nearly doubled compared to the default rate in FY 2009. A default on a PPIA could be an indication that the taxpayer may not be in a financial position to continue making the payments over a sustained period of time. The taxpayers in eight of 15 sampled PPIAs without a complete financial analysis defaulted on their PPIAs. As a result of each PPIA default, the taxpayer must pay an additional user fee[9] and the IRS has to expend additional resources to reinstate the agreement.

PPIAs were established without manager approval

In 34 (34 percent) of the 100 PPIAs reviewed, there was no evidence that the manager approved the PPIA. These 34 PPIAs were established at the campuses. Manager approval for the PPIAs established by the Collection Field function was adequately documented in the Integrated Collection System (ICS). For PPIAs established at the campuses, IRS procedures require managers document their approval in the Automated Collection System or the Account

[8] ***************************************1**************************************
1********************************
*************************1*****************************.

[9] The fee is $105 for IAs entered into on or after January 1, 2007. If the taxpayer makes their installment payments by way of a direct debit from the taxpayer's bank account, then the fee is $52. No matter the method of payment, the user fee is $43 if the taxpayer is a low-income taxpayer.

Management Services (AMS) application. For the 34 cases, we did not find any evidence that the manager reviewed or approved the PPIAs.

Our results also showed that employees may not be securing manager approval on PPIAs when they are converted from regular IAs. Nine (26 percent) of the 34 PPIAs with no manager approval were converted from regular IAs. IRS procedures pertaining to regular IAs are not specific about securing manager approval when converting a regular IA to a PPIA.

Earlier in this report, we showed NQRS results for the IRS's overall IA program. Specifically, the NQRS reported that Campus Compliance function employees who established IAs during the three-year period ending FY 2012 consistently scored 95 percent or higher in procedural accuracy. However, the NQRS data are insufficient to provide management with reliable information for evaluating overall quality, detecting error trends, or identifying possible systemic problems with PPIAs. PPIA cases accounted for just 1.7 percent of all IAs in inventory in FY 2012 and do not represent a separate product line so they cannot be identified in the samples of completed work selected pertaining to IAs. We could not determine how many PPIAs were sampled for these reviews. Similar to the NQRS, operational reviews at the campuses do not differentiate between PPIAs and regular IAs, even though the number of PPIAs issued increased by 132 percent over the past three years.

If managers do not review and approve the PPIAs before they are established, there is a higher risk that PPIAs are not established properly. This condition could result in lost revenue or a higher default rate. For example, we determined that three (9 percent) of the 34 taxpayers with PPIAs that were not approved by a manager may have had the ability to make payments sufficient to fully pay the balances due by their respective Collection Statute Expiration Dates. As a result, these three taxpayers may have qualified for regular IAs, and the IRS could have potentially collected an additional $74,188.[10]

Recommendations

The Director, Campus Compliance Services, Small Business/Self-Employed Division, and the Director, Collection Policy, Small Business/Self-Employed Division, should:

Recommendation 3: Ensure that managers provide their employees with IDRS profiles that contain the command codes required to perform their duties and ensure that managers are knowledgeable of the command codes and how they can be used to enhance the financial analyses performed by employees establishing PPIAs.

[10] Currently, the three taxpayers will pay a total of $142,800 with their PPIAs. However, based on our financial analysis estimate, the three taxpayers would qualify for regular IAs. As a result, the three taxpayers would potentially pay the full amount owed for a total of $216,988.

Management's Response: IRS management agreed with this recommendation and will revise the appropriate IRM sections to include language directing managers to ensure that employees have the proper IDRS command codes necessary to perform their assigned tasks and required research. Additionally, IRS management will review the IDRS command codes relative to the role of supporting documentation and revise the IRM to address the types of documentation that can be used in lieu of specific IDRS command code research.

Office of Audit Comment: In their response, IRS management asserted that our findings may not be indicative of current case work because of the date range of our sampled PPIA cases (which was necessary to review the two-year review process). However, IRS management could not provide us with any information to support this assertion during our audit. Further, current PPIA procedures are the same as they were during the date range of our sample and, therefore, the PPIA cases we reviewed were processed using the same procedures now used.

Recommendation 4: Establish systemic or procedural controls to prevent PPIAs from being established without manager review or approval. The manager review should ensure that a complete financial analysis was performed and fully documented.

Management's Response: IRS management agreed with this recommendation. IRS management will make necessary changes after they review their procedural controls to ensure that they adequately prevent PPIAs from being established without manager approval. They will also reiterate via memorandum the importance of manager review of the financial analysis.

Recommendation 5: Remind managers that the IRM for quality review of cases and feedback to collection employees includes the quality and documentation of their financial analyses and related opportunities for improvement on PPIA cases.

Management's Response: IRS management agreed with this recommendation and will remind managers via a memorandum that their review of cases should identify specific improvement opportunities with respect to the quality of financial analysis and documentation.

Recommendation 6: Request that a separate product line be created for PPIAs on the NQRS and that campus operational reviews specifically review PPIAs as part of their review of IAs to ensure that IRM procedures are followed.

Management's Response: IRS management partially agreed with this recommendation. To ensure that IRM procedures pertaining to PPIAs are followed, the IRS agreed to include PPIAs in the campus operational reviews of installment agreements. However, it stated that it does not have the resources required to conduct separate product line reviews for PPIAs on the NQRS.

Office of Audit Comment: Although we believe a separate product line for PPIAs on the NQRS would also be effective in ensuring IRM procedures are followed, management's planned corrective action meets the intent of the recommendation.

Partial Payment Installment Agreements Can Increase Collections on Uncollectible Inventory

The Deputy Commissioner for Services and Enforcement chartered the Collection Process Study (CPS)[11] in order to conduct a broad-based review of the current collection processes of the IRS, identify opportunities for improvement, and recommend specific actions that can be implemented to improve the Collection program. The study examined all areas across the IRS engaged in or supporting collection activities and proposed a number of policy and process change recommendations. The recommendations have the potential for improving collection operations and merit further study and testing. One of the recommendations was to expand the use of PPIAs by offering a modified minimum PPIA to all individual taxpayers currently in the uncollectible status through a letter mailing campaign notifying them of the PPIA opportunity. This recommendation included other modifications to the PPIA process, including the following incentives for taxpayers who enter into a PPIA:

- A reduced Failure to Pay penalty rate.
- The possibility of lien withdrawal after two years of compliance.
- Protection from collection action by the IRS during the term of the PPIA.

The CPS report went on to recommend that if a taxpayer defaults on the PPIA, the case should return to the uncollectible status. Currently, the IRS collects refund offsets from currently not collectible inventory. By offering a slightly modified version of the current PPIA, the IRS would have the potential to collect some of the amount owed beyond the annual offset collected.

The CPS recommends setting a minimum monthly payment of $25 for the PPIA, which is the minimum payment amount for current PPIAs. The IRS can include the PPIA offer letter in the annual notice mailed to uncollectable inventory. Although we did not conduct an in-depth analysis of the study, we did evaluate how the CPS was conducted and found it to be consistent with Government Accountability Office best practices.

In addition, we tested the viability of the PPIA recommendation. We selected a random sample of 265 OICs rejected between October 1, 2010, and September 30, 2011. We used rejected OIC cases because the financial analyses were available for review. We analyzed our sample cases based on the collection status after the OIC was rejected and determined that:

[11] IRS, *Collection Process Study Final Report* (Sept. 30, 2010).

- 13 (5 percent) of the 265 cases had already become PPIAs. We also determined that in 10 of the 13 cases, the PPIA would collect more than had the OIC been accepted.
- 55 (21 percent) of the 265 cases had already been paid in full by the taxpayer.
- 180 (68 percent) of the 265 cases were still considered to be collectible and placed in the Queue, assigned to a revenue officer, established a regular IA, or had some other active collection activity.
- 17 (6 percent) of the 265 cases were in an uncollectible status. For these 17 cases, we reviewed the information available on the Automated OIC application and ICS and determined that a PPIA at $25 a month could be a viable option in all 17 cases.

The CPS report recommends the IRS test this modified minimum PPIA on 2,000 taxpayers before full implementation. Since the CPS report was issued in September 2010, the Collection Policy function has not pursued this recommendation, and there are no specific plans to do so at this time. We were advised that the Collection Policy function is committed to pursuing CPS recommendations while balancing the limited resources available for testing and implementing new initiatives with other mission critical priorities.

The IRS is losing the opportunity to expand the use of PPIAs and collect some of the delinquent taxes owed by taxpayers in uncollectible status. Specifically, the CPS reported that the collection potential for offering a PPIA with a minimum payment of $25 a month to the 1.2 million individual taxpayers with balance due modules closed in the uncollectible status could be as high as $383 million annually. More conservatively, if the IRS focused only on the 230,000 individual taxpayers in the uncollectible status and classified as unable to pay, the report estimates the collection potential could be $69 million annually. Because of the projected monetary benefits, we believe the IRS should test the viability of this recommendation.

Recommendation

Recommendation 7: The Director, Collection Policy, Small Business/Self-Employed Division, should implement the CPS report's recommendation by testing the viability of expanding the use of PPIAs on a sample of taxpayers in uncollectible status.

> ***Management's Response:*** IRS management disagreed with this recommendation. They conducted two similar tests with the OIC program for taxpayers in currently not collectible status, which did not yield significant results; therefore, they do not believe implementation of this recommendation at this time would be an efficient use of their resources.
>
> ***Office of Audit Comment:*** The IRS's tests involved taxpayers who were asked to consider applying for an OIC, not a PPIA. Because of the differences between the two Programs, we do not believe it is appropriate to draw conclusions about taxpayer

willingness to establish a PPIA. For example, unlike a PPIA, taxpayers entering into an OIC may have to pay 20 percent of their offer amount before the IRS will consider their request.

Appendix I

Detailed Objective, Scope, and Methodology

Our objective was to assess the controls over and effectiveness of the PPIA program. To accomplish the objective, we:

I. Evaluated IRS policies, procedures, goals, and monitoring of the PPIA program.

A. Reviewed IRM procedures and other guidance used in conducting PPIA evaluations.

B. Assessed IRS corrective actions in response to TIGTA Audit Report No. 2007-30-170 by reviewing management responses and corrective action status documents and evaluated whether the corrective actions were timely and effectively implemented.

II. Determined whether the IRS is performing proper financial verification/analysis prior to establishing taxpayers' PPIAs.

A. Obtained a computer extract from the IRS's IDRS[1] Taxpayer Information File of taxpayer accounts with IAs established between January 1, 2008, and July 1, 2009, with an Agreement Locator Number ending in "12" (indicating PPIA) as of October 25, 2011. We selected this time period to ensure that the cases in our sample would have been due for a two-year review while not including PPIAs from TIGTA's prior PPIA audit.

B. Selected a random sample of 256 PPIAs from the universe of 4,447 PPIAs obtained in Step II.A. We selected our sample using a confidence level of 90 percent, an expected error rate of 50 percent (unknown), and a precision rate of ±5 percent. We selected a random sample in order to project the number of cases with errors. In accordance with advice from our statistical sampling consultant, we reduced our sample size to 100 based on limited resources and the actual error rates found for the first 30 cases.

C. Validated our data by selecting a subsample from the sample in Step II.B. and reconciled the data to Master File data using the IDRS. We determined the data were sufficiently reliable for this audit.

D. For each sampled case, we reviewed the AMS or ICS information supporting the IRS determination to accept the PPIA. We analyzed the available information. We also:

[1] See Appendix VI for a glossary of terms.

1. Checked the ICS and the AMS and determined that verification of income was properly documented and also evaluated the financial analysis conducted. For the exception cases for which we determined that the IRS relied on an incomplete financial analysis, our statistical sampling consultant projected our exception rate against the population of 4,447 PPIAs using a 90 percent confidence level and a precision rate of ± 5 percent.
2. Checked the ICS and the AMS and ensured that management approval was documented for each PPIA.
3. Checked the current status of our cases and ensured that the IRS is following procedures in cases involving missed PPIA payments and/or subsequent delinquent tax modules.
4. For those cases in which a complete financial analysis was not conducted, we estimated the taxpayer's ability to pay their delinquent tax liability. Using taxpayer income from the Master File and the IRS's allowable living expense items, we calculated the taxpayers' monthly disposable income available to pay their delinquent tax (payment amount) and compared this payment amount with the taxpayers' current payment amount. When our payment amount was greater than the taxpayers' current payment amount, we multiplied our payment amount by the remaining months on the Collection Statute Expiration Date to determine the amount the taxpayer could possibly pay. We subtracted the amount the IRS is currently going to collect to determine how much additional income the IRS could collect.

III. Determined whether the IRS is performing required two-year reviews on taxpayers within the PPIA program.

A. For cases in the sample from Step II.B. that originated in the field:

1. Checked IDRS command code ENMOD for correspondence from the IRS to the taxpayer in the time period that the two-year review should be conducted. When reviewing ENMOD, we ensured that the IRS provided a 30-day follow-up letter should the taxpayer not have responded to the initial letter for the two-year review.
2. If no taxpayer response after the 30-day follow-up was documented on the ICS or AMS, we ensured that default procedures were followed by reviewing ICS and AMS narratives.
3. Checked IDRS IMFOLT and ensured that the taxpayer was taken out of IA status.
4. Ensured that the two-year review was completed and documented according to the standards/processes identified from discussions in Steps I.A. and I.B.

B. For cases in the sample from Step II.B. that originated in the Automated Collection System or the campus:

   1. Checked the AMS for notation that a two-year review was conducted.

   2. Checked the IDRS audit trail and verified that the last two returns filed were accessed by the IRS.

C. For each sampled case, reviewed the AMS or ICS information supporting the IRS's two-year reviews.

   1. If the IRS noted that the financial analysis indicated the taxpayer's ability to pay an amount different from the existing agreement and the payment amount needs to be increased, ensured that these revisions to the IA were conveyed to the taxpayer and that the IA was revised by reviewing ENMOD.

   2. For the cases that indicated there was no change to the taxpayer's financial situation, ensured that it was notated in the ICS narrative.

   3. Reviewed IMFOLT for Transaction Code 971 Action Code 174 to note if a two-year review was completed. Note: Transaction Code/Action Code may be used for a financial analysis other than a two-year review.

   4. For the exception cases for which we determined the IRS did not perform a complete and proper two-year review, our statistical sampling consultant projected our exception rate against the population of 4,447 PPIAs as of October 25, 2011.

   5. To compute the dollars the IRS is not collecting, we used the balance due from the last notice sent to the taxpayer before the PPIA was initiated. This information was found on IDRS's TXMOD command code. However, TXMOD is only available for modules with a balance due; therefore, we used IMFOLT and added all entries until the PPIA was initiated for those modules that were satisfied.

   6. For those cases in which a proper two-year review was not conducted, we estimated the taxpayers' ability to pay their delinquent tax liability. Using taxpayer income from the Master File and the IRS's allowable living expense items, we calculated the taxpayers' monthly disposable income available to pay their delinquent tax (payment amount) and compared this payment amount with the taxpayers' current payment amount. When our payment amount was greater than the taxpayers' current payment amount, we multiplied our payment amount by the remaining months on the Collection Statute Expiration Date to determine the amount the taxpayer could possibly pay. We subtracted the amount the IRS is

currently going to collect to determine how much additional income the IRS could collect.

IV. Determined the current status of delinquent accounts of taxpayers who had an OIC rejected by the IRS.

A. Selected a statistical sample of 265 cases from the universe of 11,677 OICs rejected between October 1, 2010, and September 30, 2011, from the Automated OIC system. In accordance with the advice of our statistical sampling consultant, we selected our sample using a confidence level of 90 percent, expected error rate of 50 percent (unknown), and a precision rate of ±5 percent. We selected a random sample in order to project the number of cases with errors.

B. Matched the data in Step IV.A. to our Taxpayer Information File extract from Step II.A.

1. Determined the current status of delinquent accounts for those taxpayers who were put into a PPIA after being rejected for an OIC. We also determined whether the PPIA was established for an amount less than the taxpayers' proposed OIC amount.

2. Determined the current status of delinquent accounts for those taxpayers who were not put into a PPIA after being rejected for an OIC. We also determined whether these cases would be good candidates for a PPIA based on the financial information provided by the taxpayer.

3. We verified the reasonableness of the Automated OIC system data by reconciling entity information, status codes, transaction codes, action codes, and processing dates to Master File data used in completing Steps IV.B.1. and IV.B.2.

Internal controls methodology

Internal controls relate to management's plans, methods, and procedures used to meet their mission, goals, and objectives. Internal controls include the processes and procedures for planning, organizing, directing, and controlling program operations. They include the systems for measuring, reporting, and monitoring program performance. We determined the following internal controls were relevant to our audit objective: the Small Business/Self-Employed Division collection policies, procedures, and practices for appropriately establishing and reviewing PPIAs. We evaluated these controls by interviewing management and reviewing samples of PPIA cases.

Appendix II

Major Contributors to This Report

Margaret E. Begg, Assistant Inspector General for Audit (Compliance and Enforcement Operations)
Augusta R. Cook, Acting Assistant Inspector General for Audit (Compliance and Enforcement Operations)
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Beverly Tamanaha, Acting Audit Manager
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Nicole DeBernardi, Auditor

Appendix III

Report Distribution List

Acting Commissioner C
Office of the Commissioner – Attn: Chief of Staff C
Deputy Commissioner for Services and Enforcement S
Deputy Commissioner, Small Business/Self-Employed Division SE:S
Deputy Commissioner, Wage and Investment Division SE:W
Director, Campus Compliance Services SE:S:CCS
Director, Collection SE:S:FC
Director, Customer Account Services SE:W:CAS
Director, Account Maintenance SE:W:CAS:AM
Chief Counsel C
National Taxpayer Advocate TA
Director, Office of Legislative Affairs CL:LA
Director, Office of Program Evaluation and Risk Analysis RAS:O
Office of Internal Control OS:CFO:CPIC:IC
Audit Liaisons:
    Commissioner, Small Business/Self-Employed Division SE:S
    Commissioner, Wage and Investment Division SE:W

Appendix IV

Outcome Measures

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

Type and Value of Outcome Measure:

- Increased Revenue – Potential; $878,705 for 178 taxpayers who had their PPIA monthly payments reduced to an amount less than the financial analysis showed the taxpayers had the ability to pay (see page 6).

Methodology Used to Measure the Reported Benefit:

We obtained a computer extract from the IRS's IDRS[1] Taxpayer Information File of taxpayer accounts with IAs established between January 1, 2008, and July 1, 2009, with an Agreement Locator Number ending in "12" (indicating PPIA) as of October 25, 2011. From this population, we reviewed a random sample of 100 PPIAs. We determined that of the 100 PPIAs, 84 required a two-year review. *********************************1************************
1**************************
1**********************
1**************************
1**************************
1************************
********************1******************.

2*****************************
2***************************
***************************************2******************************
************2**********. We estimated that 178 taxpayers will pay $878,705 less than the financial analysis showed they had the ability to pay. We are 90 percent confident that this amount is between $137,716 and $1,897,564.

Type and Value of Outcome Measure:

- Increased Revenue – Potential; $345 million for a five-year period by offering a PPIA for $25 a month to more than 230,000 individual taxpayers deemed unable to pay (see page 15).

[1] See Appendix VI for a glossary of terms.

Methodology Used to Measure the Reported Benefit:

The IRS CPS report issued in September 2010 recommended offering a modified minimum PPIA to all individual taxpayers in uncollectible status. The modified PPIA would set a minimum monthly payment of $25 for the PPIA, which is the minimum payment amount for current PPIAs. The IRS can include the PPIA offer letter in the annual notice mailed to uncollectible status inventory.

The CPS report estimates that if the IRS was to focus on the 230,000 individual taxpayers in uncollectible status and classified as unable to pay, the collection potential could be $69 million a year. The collection potential from the 230,000 individual taxpayers for one year was multiplied by five to obtain a five-year projection of $345 million.

Appendix V

Financial Analysis Example

We used the taxpayer's monthly income amount and the IRS's allowable living expense items to estimate the taxpayer's ability to pay his or her delinquent tax liability. The allowable living expense items are guidelines established by the IRS to provide consistency in certain expense allowances such as food and household expenses, medical expenses, housing, and transportation. While we used maximum amounts, taxpayers can claim actual living expenses that exceed the maximum if they provide adequate supporting documentation. There are several allowable expense items that the IRS does not provide a maximum amount. For these, we assigned a reasonable estimate. In addition, the IRS collects certain asset information (such as bank account and investment balances) directly from the taxpayer. We did not include asset information in our estimates. The chart below shows how we performed our financial analysis. We did not contact the taxpayers.

Calculation of Additional Amount Available for Payments	Dollars	Dollars	Summary of Allowable Expenses
Example Taxpayer's Annual Income	$150,000		
Taxpayer's Monthly Income (Annual Income/12)	$12,500		
		$3,321	* Standard House and Utilities Expense
		$992	* Car Expenses (two cars)
		$684	* Operating Costs (two cars)
		$1,152	* National Standard for Food, Clothing, and Other Items
		$180	* Out-of-Pocket Health Costs
		$1,875	** Federal Taxes (15% estimated effective tax rate)
		$1,103	** State Taxes (8.82% in taxpayer's State)
		$181	** Medicare (1.45%)
		$552	** FICA (6.2% on first $106,800 of income)
		$400	** Health Insurance
		$200	** Secured Debt
		$300	** Child Dependent Care
Less Total Allowable Expenses	($10,940)	$10,940	Total Allowable Expenses
Amount Available for PPIA Payments	$1,560		
Less Current PPIA Payment	($1,000)		
Additional Available for Payment	**$560**		

Source: Example analysis performed by TIGTA.
* IRS maximum allowed. ** No IRS maximum; TIGTA estimate. FICA = Federal Insurance Contributions Act.

Appendix VI

Glossary of Terms

Account Management Services – Formerly known as Desktop Integration, it is a web-based resource which will enable campus employees to interface with various IRS systems bringing them together into one common view. The AMS emphasizes sharing of key business data by integrating access to many tools into a common interface.

Agreement Locator Number – A four-digit number used to identify IAs by type and originator. The first two digits denote either "Initiator" or "Agreement Type" and the second two digits denote whether the agreements are a PPIA, a streamlined IA, a regular IA, *etc*.

Area Office – A geographic organizational level used by IRS business units and offices to help specific types of taxpayers understand and comply with tax laws and issues.

Audit Trail – A chronological record of system activities that is sufficient to permit reconstruction, review, and examination of a transaction from inception to final results.

Automated Collection System – A telephone contact system through which telephone assistors collect unpaid taxes and secure tax returns from delinquent taxpayers who have not complied with previous notices.

Balance Due – A balance due occurs when the taxpayer has an outstanding liability for taxes, penalties, or interest.

Campus – The data processing arm of the IRS. The campuses process paper and electronic submissions, correct errors, and forward data to the computing centers for analysis and posting to taxpayer accounts.

Collection Activity Reports – A group of reports providing management information to field and Headquarters Collection function officials. The reports reflect activity associated with taxpayer delinquency accounts; the issuance of taxpayer delinquency inquiries; and the issuance, disposition, and inventories of IAs as well as collection-related payments.

Collection Field Function – The unit in the Area Offices consisting of revenue officers who handle personal contacts with taxpayers to collect delinquent accounts or secure unfiled returns.

Collection Statute Expiration Date – The time period established by law to allow the IRS to collect taxes. The Collection Statute Expiration Date is normally 10 years from the date the tax is assessed, as provided by Internal Revenue Code Section 6502. Once this 10-year period has ended, the Government can no longer initiate collection action, unless the Collection Statute Expiration Date is extended by case action, event, or agreement.

Compliance Services Collection Operations – A unit of Collection function employees in the campuses who process balance due and nonfiler correspondence.

Currently Not Collectible – An account status that allows the account to be removed from active inventory after necessary steps taken in the collection process have indicated that an account receivable is currently not collectible.

Effective Tax Rate – Refers to the average rate at which an individual is taxed. An individual's effective tax rate is calculated by dividing total tax expense by taxable income

ENMOD – An IDRS command code that displays taxpayer's name, address, and other entity information.

Failure to Pay Penalty – Penalty assessed for failure to pay tax on or before the date fixed for payment.

IDRS Command Code – A five-character abbreviation for a particular inquiry or action requested through the IDRS. Each command code is used for a specific purpose.

IDRS Profile – Limits employee access to IDRS and is determined by each employee's specific need to access taxpayer data to perform his or her duties.

IMFOLT – An IDRS command code that displays various module amounts and dates along with a list of posted transactions for the specified tax module.

Installment Agreement – Arrangements by which the IRS allows taxpayers to pay liabilities over time.

Integrated Collection System – An information management system designed to improve revenue collections by providing revenue officers access to the most current taxpayer information while in the field using laptop computers for quicker case resolution and improved customer service.

Integrated Data Retrieval System – The IRS computer system that is capable of retrieving and updating stored taxpayer information. It works in conjunction with a taxpayer's account records.

Lien Withdrawal – Internal Revenue Code Section 6323(j) gives the IRS the authority to withdraw a Notice of Federal Tax Lien under certain circumstances and to provide notice of the withdrawal to credit agencies.

Master File – The IRS database that stores various types of taxpayer account information. This database includes individual, business, and employee plans and exempt organizations data.

Module – Refers to each tax return filed by the taxpayer for a specific period (year or quarter) during a calendar year for each type of tax.

National Quality Review System – Used by quality reviewers to capture national program review data obtained through case reviews. The NQRS is also used to report the official organizational business quality results.

Offer in Compromise – An agreement between a taxpayer and the IRS that settles the taxpayer's tax liabilities for less than the full amount owed.

Operational Review – An in-depth review and analysis of a particular program or function. Operational reviews are conducted in the following manner: department managers review frontline teams, operation chiefs review department managers, and Planning and Analysis function staff review operations.

Programming Requirements Package – The instructions that define how tax returns and tax forms can be processed to the Master File.

Queue – An automated holding file for unassigned inventory of delinquent cases for which the Collection function does not have enough resources to immediately assign for contact.

Revenue Officer – Employees in the Collection Field function who attempt to contact taxpayers and resolve collection matters that have not been resolved through notices sent by the IRS campuses or the Automated Collection System.

Taxpayer Information File – IRS data that provide tax account information for certain taxpayers (generally involving only active accounts) on the database. Balance due notices are issued from the Taxpayer Information File.

Total Positive Income – A calculation using only total positive values for income items, *e.g.*, wages, interest, Schedule C, from a tax return. Losses reported for any of these items are treated as a zero.

Transaction Code – Three-digit codes used to identify a processed transaction and to maintain a history of actions posted to a taxpayer's account on the Master File.

User Fee – An amount charged to taxpayers to enter into a PPIA and to reinstate a PPIA after a default.

Appendix VII

Management's Response to the Draft Report

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

COMMISSIONER
SMALL BUSINESS/SELF-EMPLOYED DIVISION

APR 1 0 2013

MEMORANDUM FOR MICHAEL R. PHILLIPS
DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: Faris R. Fink , FOR
Commissioner, Small Business/Self-Employed Division

SUBJECT: Draft Audit Report - Controls Over Partial Payment Installment Agreements Can Be Improved (Audit # 201230010)

Thank you for the opportunity to review your draft report titled, "Controls Over Partial Payment Installment Agreements Can Be Improved." We generally concur with the recommendations in the report and appreciate your acknowledgment that we have established Partial Payment Installment Agreement (PPIA) control components to help ensure that management plans and implements activities needed to attain our goals and objectives.

We are proud of the actions taken to improve the PPIA program. We have enhanced tracking reports for PPIAs, revised notices, and improved telephone systems to better serve customers. Through training and Internal Revenue Manual (IRM) updates, employees are well aware of PPIAs as evidenced by their increased use over the past several years.

With respect to financial analysis and managerial approval, we generally agree with your recommendations; however, we have a concern that the date ranges chosen for your sample review may skew the results of your findings. The sample of reviewed cases only included PPIAs established between January 1, 2008 and July 1, 2009 and did not include any recent agreements. While this was necessary for the two-year review portion of the process, your findings may not be indicative of current case work. In addition, your review did not include any supporting documentation submitted by the taxpayer or any physical supporting documentation associated with a case file when a PPIA was established. Analysis of supporting documentation may provide additional insight into a taxpayer's ability to repay a liability. As such, we will conduct a review of recently established PPIAs and supporting documentation to determine if proper financial analysis, managerial review, and managerial approval are being done.

We agree to include PPIAs in campus operational reviews of installment agreements to ensure IRM procedures are followed. However, since PPIAs represent less than 2% of installment agreements, we do not believe it is appropriate to conduct separate National Quality Review System product line reviews for PPIAs.

With respect to the Collection Process Study recommendation to test the viability of expanding the use of PPIAs on a sample of taxpayers in uncollectible status, we do not believe it is an efficient use of our limited resources. We conducted two similar tests with the Offer in Compromise (OIC) program for taxpayers in currently not collectible (CNC) status. These taxpayers received a letter of solicitation informing them of the OIC program as a viable collection alternative. Even when offered an alternative that would fully resolve their accounts, the response rate was less than 3%.

Based on the assumptions in your report, we agree with the proposed outcome measures for taxpayers who had their monthly payments reduced. However, we do not agree with the outcome measure for offering a modified PPIA to taxpayers in CNC status. Similar tests have not yielded significant results and do not mirror the estimated outcomes identified in the Collection Process Study. Attached is a detailed response outlining our corrective actions addressing your recommendations.

If you have any questions, please contact me, or a member of your staff may contact Michael Julianelle, Director, Enterprise Collection Strategy, at 202-283-2548.

Attachment

Attachment

RECOMMENDATION 1:
Revise the IRM to require that managers ensure automated two-year reviews are properly scheduled and that financial analyses are performed prior to reinstating taxpayers that default on their PPIAs.

CORRECTIVE ACTION:
We will revise IRM 5.19 to require that managers ensure automated two-year reviews are properly scheduled and to specify when financial analysis is required prior to revising or reinstating PPIAs.

IMPLEMENTATION DATE:
September 15, 2013

RESPONSIBLE OFFICIAL:
The Director, Collection Policy, Small Business/Self-Employed Division

CORRECTIVE ACTION MONITORING PLAN:
The IRS will monitor this corrective action as part of our internal management system of controls.

RECOMMENDATION 2:
Revise the IRM to require the manual two-year reviews associated with PPIAs are fully documented and reviewed and are approved by the manager.

CORRECTIVE ACTION:
We will determine the type(s) of manual two year review PPIA's that will require management review and full documentation and update the next revision of IRM 5.4 to include that information

IMPLEMENTATION DATE:
September 15, 2013

RESPONSIBLE OFFICIAL:
The Director, Campus Compliance Services, Small Business/Self-Employed Division

CORRECTIVE ACTION MONITORING PLAN:
The IRS will monitor this corrective action as part of our internal management system of controls.

RECOMMENDATION 3:
Ensure that managers provide their employees with IDRS profiles that contain the command codes required to perform their duties and ensure that managers are knowledgeable of the command codes and how they can be used to enhance the financial analyses performed by employees establishing PPIAs.

CORRECTIVE ACTION:
We will incorporate language in the next revision of IRM 1.4.50, Collection Group Manager, Territory Manager and Area Director Operation Aid, and IRM 1.4.20, Filing & Payment Compliance Managers Handbook, directing managers to ensure employees have the proper IDRS command codes necessary to perform their assigned tasks and required research. Additionally, we will review the IDRS command codes relative to the role of supporting documentation and revise the IRM to address the types of documentation that can be used in lieu of specific IDRS command code research.

IMPLEMENTATION DATE:
March 15, 2014

RESPONSIBLE OFFICALS:
The Director, Collection Policy, Small Business/Self-Employed Division
The Director, Campus Compliance Services, Small Business/Self-Employed Division

CORRECTIVE ACTION MONITORING PLAN:
The IRS will monitor this corrective action as part of our internal management system of controls.

RECOMMENDATION 4:
Establish systemic or procedural controls to prevent PPIAs from being established without manager review or approval. The manager review should ensure that a complete financial analysis was performed and fully documented.

CORRECTIVE ACTION:
We will review our procedural controls to insure they adequately prevent PPIAs from being established without manager review or approval and make necessary changes. We will reiterate to managers via memorandum the importance of managerial review of the financial analysis.

IMPLEMENTATION DATE:
August 15, 2013

RESPONSIBLE OFFICIAL:
The Director, Collection Policy, Small Business/Self-Employed Division

CORRECTIVE ACTION MONITORING PLAN:
The IRS will monitor this corrective action as part of our internal management system of controls.

RECOMMENDATION 5:
Remind managers that the IRM for quality review of cases and feedback to collection employees includes the quality and documentation of their financial analyses and related opportunities for improvement on PPIA cases.

CORRECTIVE ACTION:
We will remind managers via a memorandum that their review of cases should identify specific improvement opportunities with respect to the quality of financial analysis and documentation.

IMPLEMENTATION DATE:
August 15, 2013

RESPONSIBLE OFFICIAL:
The Director, Collection Policy, Small Business/Self-Employed Division

CORRECTIVE ACTION MONITORING PLAN:
The IRS will monitor this corrective action as part of our internal management system of controls.

RECOMMENDATION 6:
Request that a separate product line be created for PPIAs on the NQRS and that campus operational reviews specifically review PPIAs as part of their review of IAs to ensure IRM procedures are followed.

CORRECTIVE ACTION:
At this time, we do not have the resources required to conduct separate product line reviews for PPIAs. A new Specialized Product Review Group (SPRG) requires resources to pull and review the sample and maintain the database. Each campus and each function processing PPIAs would need its own sample, meaning at least one or two additional reviewers per site and SPRG. We do agree that campus operational reviews of installment agreements will include PPIAs to ensure IRM procedures are followed.

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IMPLEMENTATION DATE:
April 15, 2014

RESPONSIBLE OFFICIALS:
The Director, Campus Compliance Services, Small Business/Self-Employed Division
The Director, Filing and Payment Compliance, Wage and Investment Division

CORRECTIVE ACTION MONITORING PLAN:
The IRS will monitor this corrective action as part of our internal management system of controls.

RECOMMENDATION 7:
The Director, Collection Policy, Small Business/Self-Employed Division, should implement the CPS report's recommendation by testing the viability of expanding the use of PPIAs on a sample of taxpayers in uncollectible status.

CORRECTIVE ACTION:
We conducted two similar tests with the Offer in Compromise (OIC) program for taxpayers in currently not collectible (CNC) status which did not yield significant results; therefore, we do not believe implementation of this recommendation at this time would be an efficient use of our resources.

IMPLEMENTATION DATE:
N/A

RESPONSIBLE OFFICIAL(S):
N/A

CORRECTIVE ACTION MONITORING PLAN:
N/A