July 2015

IRS CASE SELECTION

Collection Process Is Largely Automated, but Lacks Adequate Internal Controls

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Why GAO Did This Study

IRS's collection program pursues individuals and businesses that failed to fully pay their taxes or file returns. Since 2009, the total tax debt inventory has increased 23 percent to $380 billion, while collection staff declined 23 percent. Given its large workload and declining resources, it is important that IRS make informed decisions about the collection cases it pursues to enhance compliance and confidence in the tax system.

GAO was asked to review IRS's processes for categorizing and routing collection cases for potential selection. This report (1) describes collection processes and trends in priority areas; and (2) assesses how well controls support the mission, including applying tax laws with integrity and fairness to all.

GAO reviewed IRS guidance, processes, and controls for categorizing and routing collection cases, reviewed data on results in priority areas, assessed whether IRS's controls followed *Standards for Internal Control in the Federal Government*, and interviewed IRS officials.

What GAO Recommends

GAO recommends that IRS take five actions to improve collection controls, such as clearly defining and documenting program objectives and control procedures, and periodically evaluating the effectiveness of controls. In commenting on a draft of this report, IRS said it generally agreed with all of GAO's recommendations.

View GAO-15-647. For more information, contact James R. McTigue, Jr. at (202) 512-9110 or mctiguej@gao.gov.

What GAO Found

The Internal Revenue Service's (IRS) collection program largely uses automated processes to categorize and route unpaid tax or unfiled tax return cases for potential selection. The automated Inventory Delivery System (IDS) categorizes and routes cases based on many factors, such as type of tax and amount owed. Outside of IDS, collection managers set goals for closing cases in priority areas, such as delinquent employer payroll taxes and cases involving certain high-wealth taxpayers. If goals are at risk of not being met, officials may take action to select additional priority cases. In recent fiscal years, the collection program has exceeded nearly all case closure goals for priority cases. However, because IRS has not identified objectives for the collection program, such as fairness, it is difficult to assess the program's overall effectiveness.

GAO identified several areas where the lack of documented objectives and internal control deficiencies for categorizing and routing cases increase the risk that the collection program's mission, including fair case selection, will not be achieved. Examples of key internal control steps and deficiencies follow.

Selected Key Steps in Internal Control

Source: GAO. | GAO-15-647

Program objectives and key terms are not clearly defined: Although fairness is specified in the collection mission statement and IDS processes can affect how collection cases are selected, management has not defined fairness or any other program or case selection objectives. IRS collection's management referred to various documents as examples of program objectives. However, the documents were not specific enough nor codified in official IRS guidance to ensure proper control over the program. Without clearly defined objectives that can enhance program effectiveness, it is difficult for IRS to ensure it selected collection cases in a fair and unbiased manner.

Case categorization and routing procedures are not documented: According to management, case categorization and routing procedures were developed over several years as the result of incremental decisions and system changes. However, GAO found that the system and decisions were not documented, such as the selection of priority areas. Without documentation, it is difficult to determine whether processes are effective or consistently applied.

Effectiveness of processes is not routinely monitored: Despite some ad-hoc studies, IRS does not have procedures to periodically monitor IDS, including the dollar thresholds used to identify some cases for collection. Management could not provide GAO with justification for the thresholds because according to officials, they were set so long ago. Without periodic evaluations, out-of-date collection procedures could result in unnecessary costs or missed collections. Unadjusted dollar amounts could lead to inconsistent treatment of taxpayers over time as the real value of dollar thresholds decline over time due to inflation.

_____ **United States Government Accountability Office**

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Abbreviations

ACS	Automated Collection System
CSCO	Compliance Services Collection Operations
ERM	Enterprise Risk Management
FTE	Full-Time Equivalents
GHW	Global High Wealth
IDS	Inventory Delivery System
IRS	Internal Revenue Service
LB&I	Large Business & International division
SB/SE	Small Business/Self Employed division
TIN	Taxpayer Identification Number

July 29, 2015

The Honorable Paul Ryan
Chairman
Committee on Ways and Means
House of Representatives

The Honorable Peter Roskam
Chairman
Subcommittee on Oversight
Committee on Ways and Means
House of Representatives

By pursuing taxpayers who either failed to fully pay taxes owed or file a return, the Internal Revenue Service (IRS) enhances compliance and confidence in the tax system. This also helps to address the tax gap—the estimated difference between the amount of taxes owed by taxpayers and the amount voluntarily paid on time. IRS estimated that for tax year 2006, the $450 billion gross tax gap included $46 billion in delinquent tax liabilities and an estimated $28 billion from unfiled tax returns.[1] IRS refers to unpaid tax assessments of delinquent tax liabilities and unfiled tax returns that accumulate over time as the tax debt inventory. As of September 30, 2014, the total tax debt inventory was $380 billion (including interest and penalties), a 23 percent increase since 2009.[2] During this same 6-year period, IRS's collection staff declined by 23

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[1]This is the most recent estimate available. The most significant portion of the gross tax gap, $376 billion, comes from underreporting or not reporting the full tax liability on a timely-filed return. The $46 billion is the actual tax amounts that taxpayers reported on time, but did not pay on time.

[2]See GAO, *Financial Audit: IRS's Fiscal Years 2014 and 2013 Financial Statements,* GAO-15-173 (Washington, D.C.: Nov. 12, 2014). The tax debt inventory differs from the tax gap because the inventory is cumulative rather than annual and includes penalties and interest in addition to unpaid tax. Also, the debt inventory is of actual tax assessments while most of the tax gap—all except for the $46 billion—is an estimate of additional taxes owed as a result of underreporting or unfiled returns. The total tax debt inventory represents the cumulative amounts of unpaid tax assessments that IRS has a legal right to collect (i.e., the statutory 10-year limit on collections has not yet expired). Only a portion of the total tax debt inventory is in a status where IRS may attempt collection through telephone or in-person contact which, as of September 30, 2014, was $130 billion (representing about 17.8 million cases).

percent (from 10,546 to 8,139 full-time equivalents (FTE)).[3] Given the collection program's large workload and limited resources, IRS must make informed decisions about which cases to pursue for collection action.

Along with former Representative Dave Camp, in his role as Chairman of the House Committee on Ways and Means, you asked us to review the processes IRS uses to select collection cases for potential enforcement action.[4] Our work focused on collections at the enterprise level and on the Inventory Delivery System (IDS), which is the primary system IRS uses to categorize and route cases to be worked in collection functions. This report (1) describes IRS's processes for categorizing and routing collection cases, trends in priority areas, and key process changes for fiscal years 2012 through 2014; and (2) assesses how well the processes for case selection support the collection program's mission, including applying tax laws with integrity and fairness to all.

For the first objective, to describe IRS's processes for categorizing and routing collection cases, we reviewed IRS documents describing the processes and systems at the enterprise level, including program management reports and presentations prepared by IRS staff. We also analyzed system rules to determine how they affect case categorization and routing. We analyzed information about the collection program's statistical methods and procedures used in the modeling process, a statistical method that predicts likely case outcomes. We also visited the IRS office in St. Paul, Minnesota, that is responsible for building and maintaining the models. We analyzed documents to learn how the models were used and how they affect case categorization and routing for case selection. To describe trends in priority areas, we analyzed IRS case priorities and closure data in management reports for fiscal years 2013

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[3]These figures are for IRS staff in collection programs to contact taxpayers by telephone and in person, and do not include other collections FTEs.

[4]In 2014, IRS closed 7.5 million cases in its telephone and in-person enforcement programs. In this report, we generally use the term "cases" when referring to the units of work for IRS's collections process. IRS generally reports its collections data in terms of number of "modules." A module is a record of tax data for a specific taxpayer covering one tax period (such as a year or quarter). For example, a module could be of an unpaid balance from one tax return or an unfiled return from one period. Some taxpayers may have only one module (such as one unpaid debt from one return) but other taxpayers may have several modules (such as balances due from multiple returns, or multiple unfiled returns).

through 2014. To describe key process changes, we interviewed IRS officials, reviewed a study that resulted in process changes, and analyzed data on the application of various IDS business rules for calendar years 2011 through 2014.

For the second objective, we compared the processes identified above to the relevant federal standards for internal control.[5] We interviewed collection officials, including the Director of Collection, about the mission, objectives, and internal controls of the collection program and IDS. We also reviewed how case routing rules and models are managed, including the extent to which they were evaluated and revised. We then assessed whether the procedures met federal internal control standards on establishing objectives, identifying and assessing risks, establishing controls to address risks, and monitoring controls. For each objective, we interviewed IRS headquarters managers in the offices of Enterprise Collection Strategy, Campus Compliance Services, and Field Collection. We determined that the data used in our analysis were sufficiently reliable for the purposes of this review. Our data reliability assessment included reviewing relevant documentation, interviewing knowledgeable IRS officials, and manual testing of the data to identify obvious errors or outliers. For additional details on our scope and methodology, see appendix I.

We conducted this performance audit from August 2014 to July 2015 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 objectives. We believe the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Background

The mission of the collection program is to collect delinquent taxes and secure delinquent tax returns through the fair and equitable application of

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[5]GAO, *Standards for Internal Control in the Federal Government*, GAO/AIMD-00-21.3.1 (Washington, D.C.: November 1999). GAO, *Standards for Internal Control in the Federal Government,* GAO-14-704G (Washington, D.C.: September 2014). The new standards are effective beginning fiscal year 2016. We did not use the new standards to evaluate the current collection program, but as context in preparing for an effective internal control system in the future.

the tax laws, including the use of enforcement tools when appropriate. The collection program's mission also includes educating its customers to facilitate future compliance, thereby protecting and promoting public confidence in the American tax system.

In November 2014, IRS reorganized its collection program to produce greater efficiencies, reduce redundant efforts, streamline decision making, and improve customer service. Prior to the reorganization, the collections program was split between the Small Business/Self Employed (SB/SE) and Wage & Investment divisions. IRS's collections operations are now organized under one manager, the Director of Collection in SB/SE, as shown in figure 1.

Figure 1: Excerpt of Small Business/Self Employed (SB/SE) Operating Division Organization after November 2014 Realignment
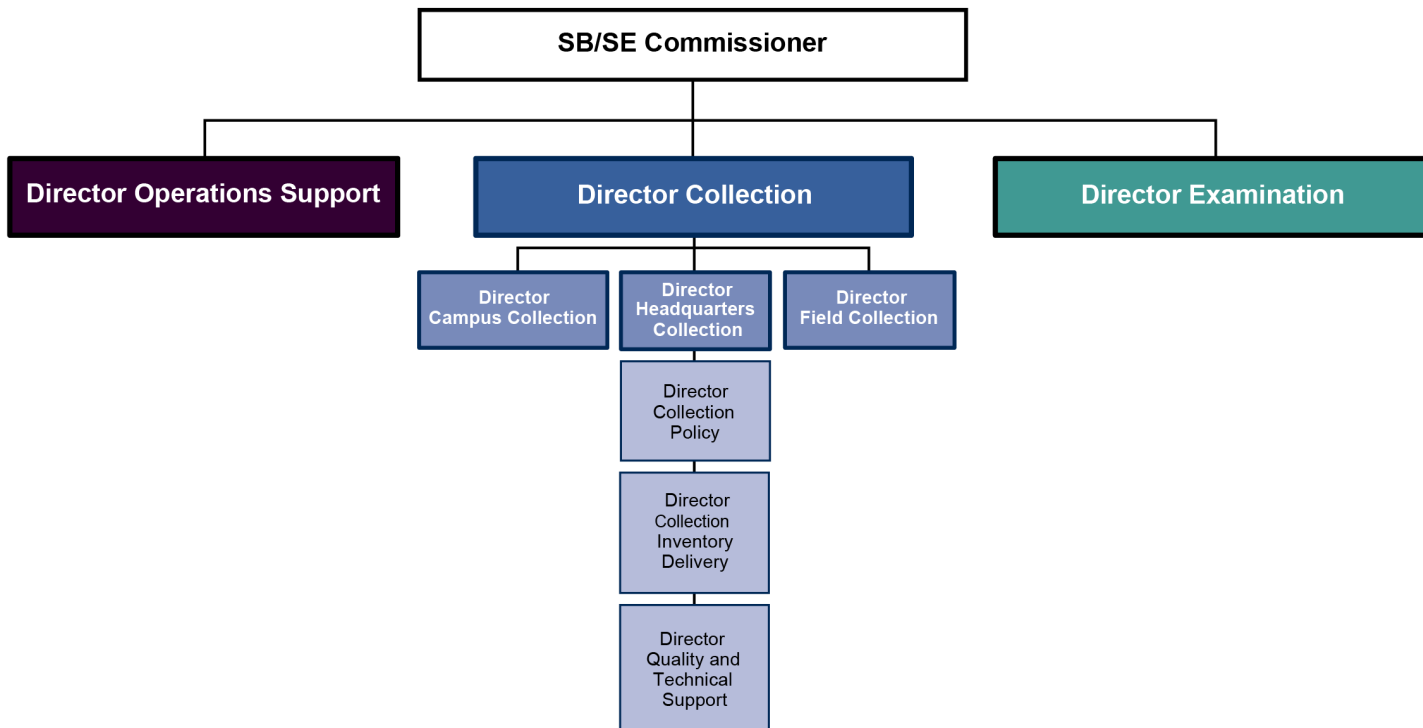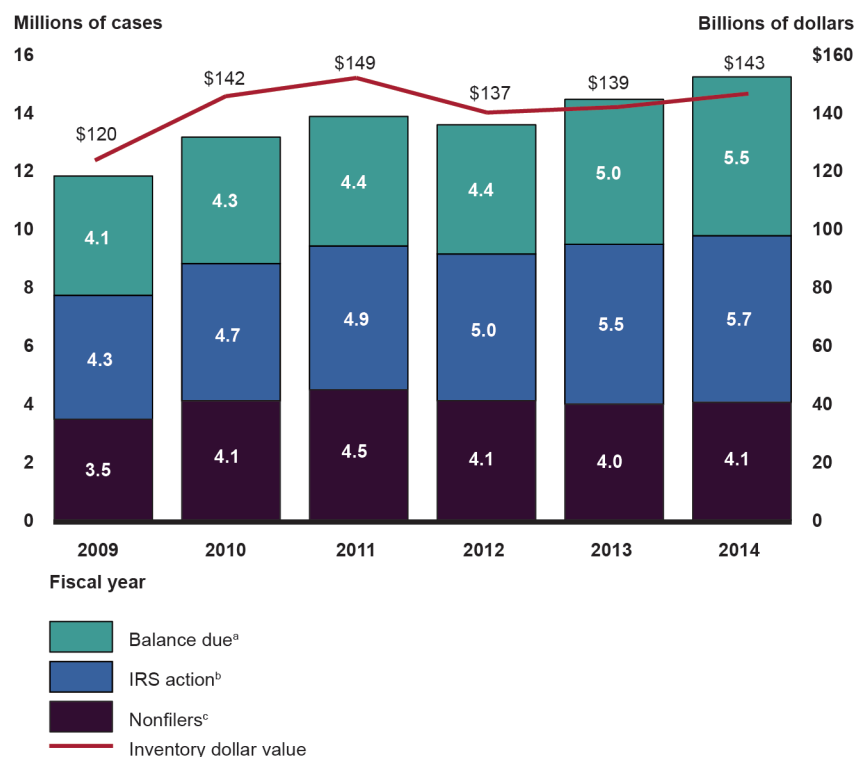

Source: GAO analysis of IRS data. | GAO-15-647

The tax debt inventory generally originates from one of three sources: (1) a tax return with a balance due; (2) an IRS program to collect taxes from individuals or businesses that did not file a return (nonfilers); or (3) an IRS action on a tax return, such as an audit.[6] As shown in figure 2, the source of assessments in the potentially collectible tax debt inventory has been roughly even among the three categories over the last 6 fiscal years.[7] Overall, the total tax debt inventory has been trending upward.

Figure 2: Year-End Count of the Potentially Collectible Tax Debt Inventory Cases, Classified by Origin for Fiscal Years 2009 through 2014

Source: GAO analysis of IRS Potentially Collectible Inventory (PCI) data. | GAO - 15-647

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[6]Other IRS actions include document matching processes where IRS compares information on a tax return to third-party information such as a Form W-2.

[7]The potentially collectible inventory is tax debt that IRS identifies as having the most potential for successful application of collection tools and resources. As discussed further on, this inventory includes cases in the three phases of the collection process and selected shelved cases.

Notes: Data are counts of modules. A module is a record of tax data for a specific taxpayer covering only one tax period (such as a year or quarter). The figure excludes approximately 50,000 modules under the category of "other" since they would not be visible in the figure.

[a]Balance due includes debts resulting from taxpayers filing a tax return, but not paying in full the amount due.

[b]IRS action generally includes debts that were the result of an IRS action, such as an audit.

[c]Nonfilers generally originate as a result of a taxpayer not filing a tax return and IRS preparing a substitute return that resulted in a balance due.

IRS has a three-phased process for collecting unpaid tax debts.[8]

- *Notice Phase:* IRS sends an automatically-generated series of letters to the taxpayer about unpaid debts or delinquent returns. The point of these letters is to prompt a payment by the taxpayer or a response if the taxpayer disagrees with the balance due or is unable to pay the amount owed.

- *Automated Collection System (ACS):* IRS's system attempts to make telephone contact with the taxpayer. If successful, ACS staffs discuss the debt with the taxpayer to prompt a payment or set up a payment plan (which IRS calls an installment agreement). ACS staff may also take enforcement actions, such as levying financial assets or filing a lien against the taxpayer's property.

- *Field Collection (Field):* IRS revenue officers attempt in-person contact with taxpayers to prompt a payment or take enforcement action such as those described above with ACS.

According to IRS officials, IRS designed the collection program to resolve taxpayers's debt at the earliest possible time and to use the least costly process. We previously reported that the notice phase provides IRS with an opportunity to maximize collections while minimizing costs in pursuing tax debts.[9] Notices are computer generated and mailed to taxpayers with little direct involvement by IRS employees. If taxpayers then take action to pay or otherwise resolve their debts, collections can occur with relatively little additional IRS investment. When individuals with tax debts do not respond to notices, IRS may route the case to either ACS or the Field for

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[8]We previously reported on the process in GAO, *Tax Debt Collection: IRS Has a Complex Process to Attempt to Collect Billions of Dollars in Unpaid Tax Debts*, GAO-08-728 (Washington, D.C.: June 13, 2008).

[9]GAO, *Tax Debt Collection: IRS Needs to Better Manage the Collection Notices Sent to Individuals*, GAO-09-976, (Washington, D.C: Sept. 30, 2009).

collections. While both of these processes are more labor intensive and expensive than the notice process, costs for routing a case to ACS or the Field differ significantly. Based on data from fiscal years 2010 through 2014, IRS's Office of Cost Accounting determined that it cost roughly $200 to close a case in ACS and about $2,500 to close a case in the Field.[10] According to IRS officials, Field case closures are more expensive, in part, because the cases are generally more complex and are handled by revenue officers who are at higher pay grades than ACS employees.

With few exceptions, every collection case goes through the notice phase. Of the total collections cases that were closed in fiscal year 2014, about 60 percent were closed in the notice phase (see figure 3). Closed cases are removed from the active inventory and may not include the collection of taxes. We reported on the notice phase in 2009.[11]

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[10]We did not assess the reliability of the cost data provided by the Office of Cost Accounting.

[11]GAO-09-976.

Figure 3: Collection Cases Closed by Notice, Automated Collection System (ACS), and Field Collection (Field) Phases, Fiscal Years 2009 through 2014

Millions of cases

| Fiscal year	Notice phase	ACS	Field
2009	14.4 (60%)	4.4 (19%)	3.1 (13%)
2010	14.7 (60%)	4.9 (20%)	3.1 (13%)
2011	14.8 (58%)	5.3 (21%)	3.4 (13%)
2012	13.7 (58%)	5.5 (23%)	3.2 (14%)
2013	13.3 (60%)	5.0 (22%)	2.9 (13%)
2014	13.2 (61%)	5.0 (23%)	2.5 (11%)

Legend:
- Notice phase
- ACS
- Field
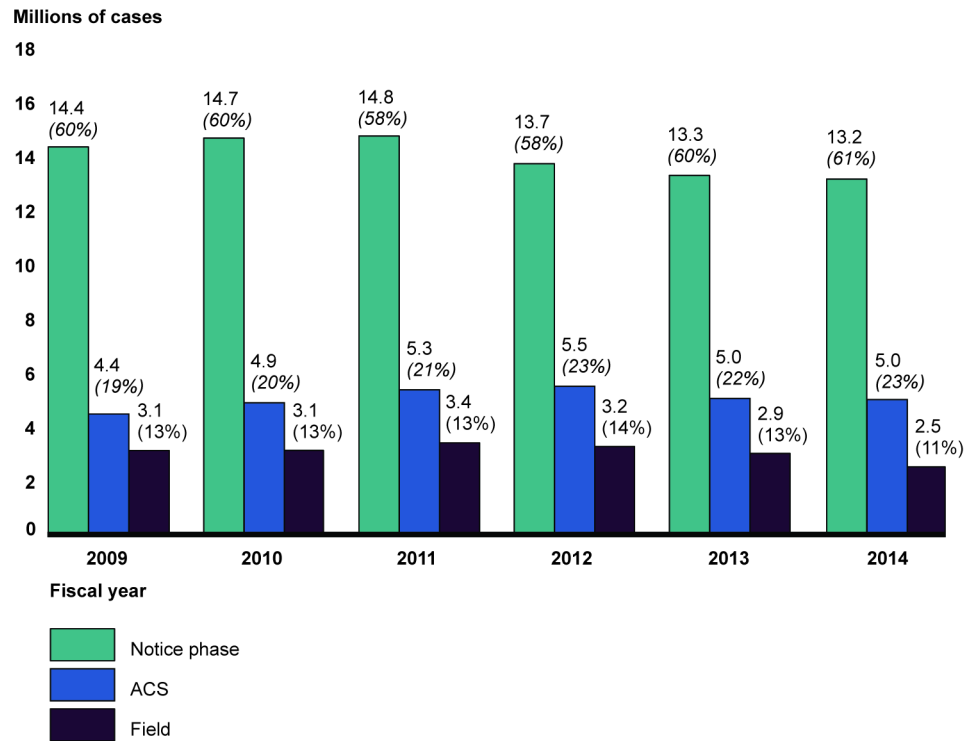
Source: GAO analysis of IRS data. | GAO - 15-647

Note: Data are counts of modules and percentages are of modules closed. Not depicted are modules closed by Compliance Services Collection Operations (CSCO), which closed around 1 million to 2 million annually. A module is a record of tax data for a specific taxpayer covering only one tax period (such as a year or quarter). Closed modules are removed from the active inventory and may not include the collection of dollars owed. Data are "net" module dispositions of balances due and unfiled returns, excluding any deferred or shelved modules.

Since fiscal year 2009, IRS's year-end collection inventory has increased by 27 percent (14 million to 17.8 million cases). During the same period, IRS has closed fewer cases, 9.6 million closed in fiscal year 2009 compared to 8.3 million closed in fiscal year 2014, a 13 percent difference (see figure 4). As previously noted, cases that are not resolved in the notice phase may be worked in ACS or the Field, in both functions, put on hold (known as a shelved case), or not worked at all. According to collection officials, shelved cases are generally not worked unless IRS later identifies additional tax debts or unfiled returns for a given taxpayer.

Figure 4: Collection Inventory Trends, Fiscal Years 2009 through 2014

Millions of cases

Fiscal year

- Closed[a]
- Shelved[b]
- Ending inventory[c]
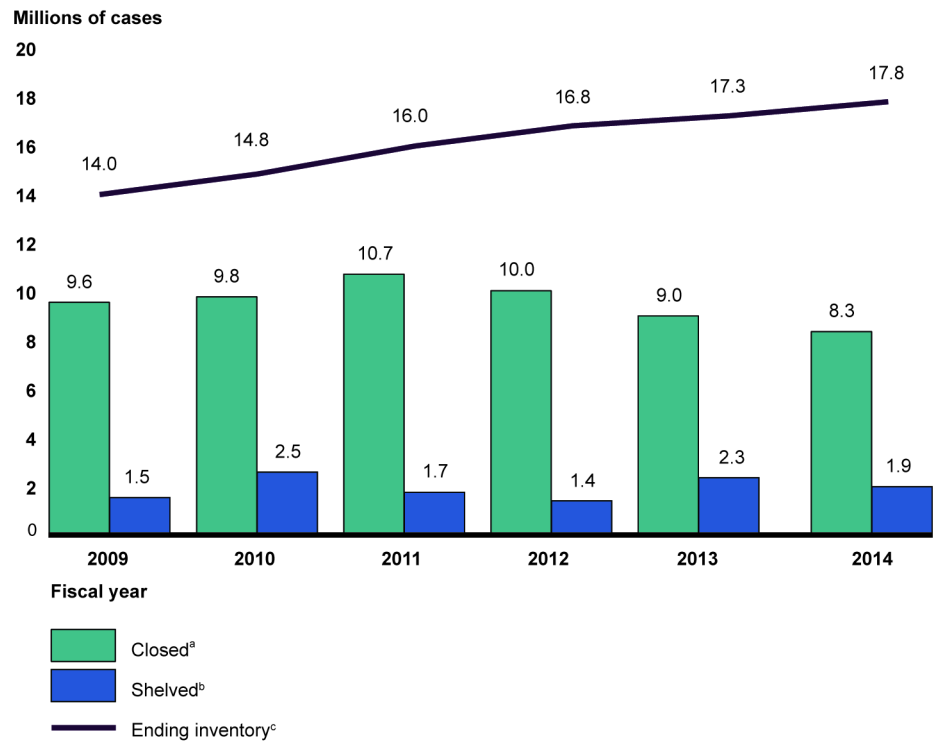
Source: GAO analysis of IRS data. | GAO - 15-647

Notes: Data are counts of modules. A module is a record of tax data for a specific taxpayer covering only one tax period (such as a year or quarter).
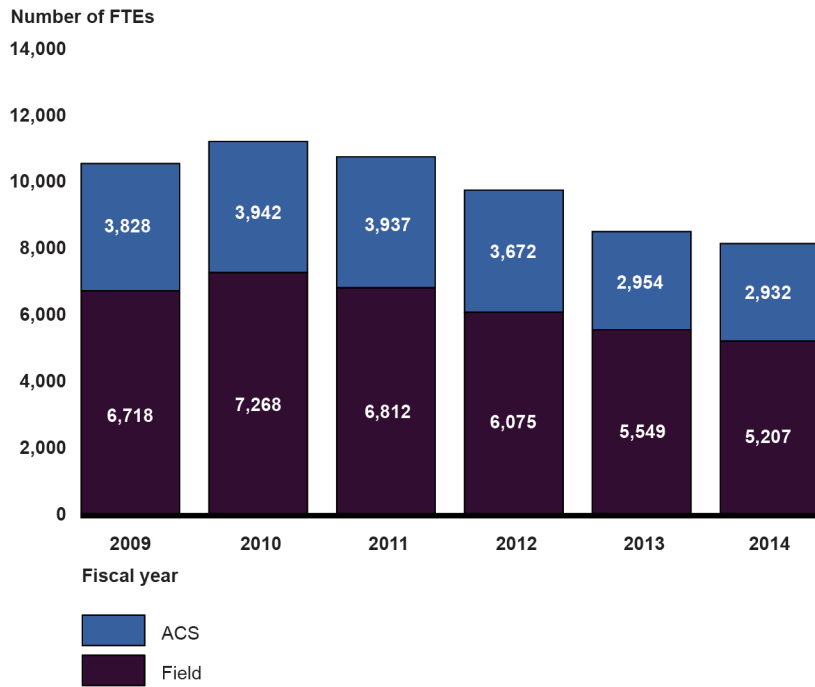
[a]Closed modules are dispositions of balances due and unfiled returns, closed primarily by the Automated Collection System and Field Collection.

[b]Shelved modules include unworked balances due or unfiled returns indefinitely set aside (subject to statute of limitations).

[c]Ending inventory is the total number of modules assigned to the Automated Collection System or Field Collection, or awaiting assignment in the Field Collection queue as of September 30.

During the past several years, IRS's collection staff has been reduced significantly. At the end of fiscal year 2014, IRS had 27 percent fewer collection staff in ACS and the Field than it had in fiscal year 2010 (from 11,210 full-time equivalents (FTE) to 8,139 FTEs) (see figure 5).

Figure 5: IRS Full-Time Equivalents (FTEs) in the Field Collection (Field) and Automated Collection System (ACS), Fiscal Years 2009 through 2014

Number of FTEs

Fiscal year	2009	2010	2011	2012	2013	2014
ACS	3,828	3,942	3,937	3,672	2,954	2,932
Field	6,718	7,268	6,812	6,075	5,549	5,207

■ ACS
■ Field

Source: GAO analysis of IRS data. | GAO - 15-647

Process for Categorizing and Routing Collection Cases Is Largely Automated, but Management Monitors Priority Cases to Achieve Program Goals

Automated Inventory Delivery System Categorizes and Routes Cases to Potentially Be Worked Based on Numerous Factors

IRS uses an automated process to categorize and route most collection cases for potential selection. Figure 6 shows how the automated Inventory Delivery System (IDS) fits into the collection process. IDS's key functions are to analyze cases to (1) identify and filter out cases that should not be pursued further (i.e., shelved), (2) categorize some cases as high risk,[12] and (3) determine whether cases should be routed to either ACS or the Field to potentially be worked.[13]

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[12]As previously discussed, shelved cases are those that IRS sets aside and does not take further action to attempt collection, usually for an indefinite period (subject to the 10-year statute of limitations). However, such cases may later be reactivated or subject to systemic collection action, such as when IRS retains all or a portion of a taxpayer's tax refund to help satisfy an unpaid tax debt. The various types of cases IRS shelves are discussed later. As it analyzes cases for routing, IDS assigns cases with a high-risk or nonhigh-risk designation, which influences how the case will be routed. In general, cases where taxpayers owe large dollar amounts or cases involving delinquent payroll taxes are high risk. Final case prioritization for selection takes place in ACS or Field inventory management systems, where cases are rank ordered in high-, medium-, and low-risk categories, or when Field group managers consider cases for assignment to revenue officers.

[13]IDS has several internal processes that support the three functions cited. For example, IDS "grades" cases. Grading determines the complexity of a case for potential assignment to a revenue officer in the Field. Revenue officers with higher skill levels and expertise are assigned more complex cases.

Figure 6: Collection Processes for Categorizing and Routing Cases for Selection
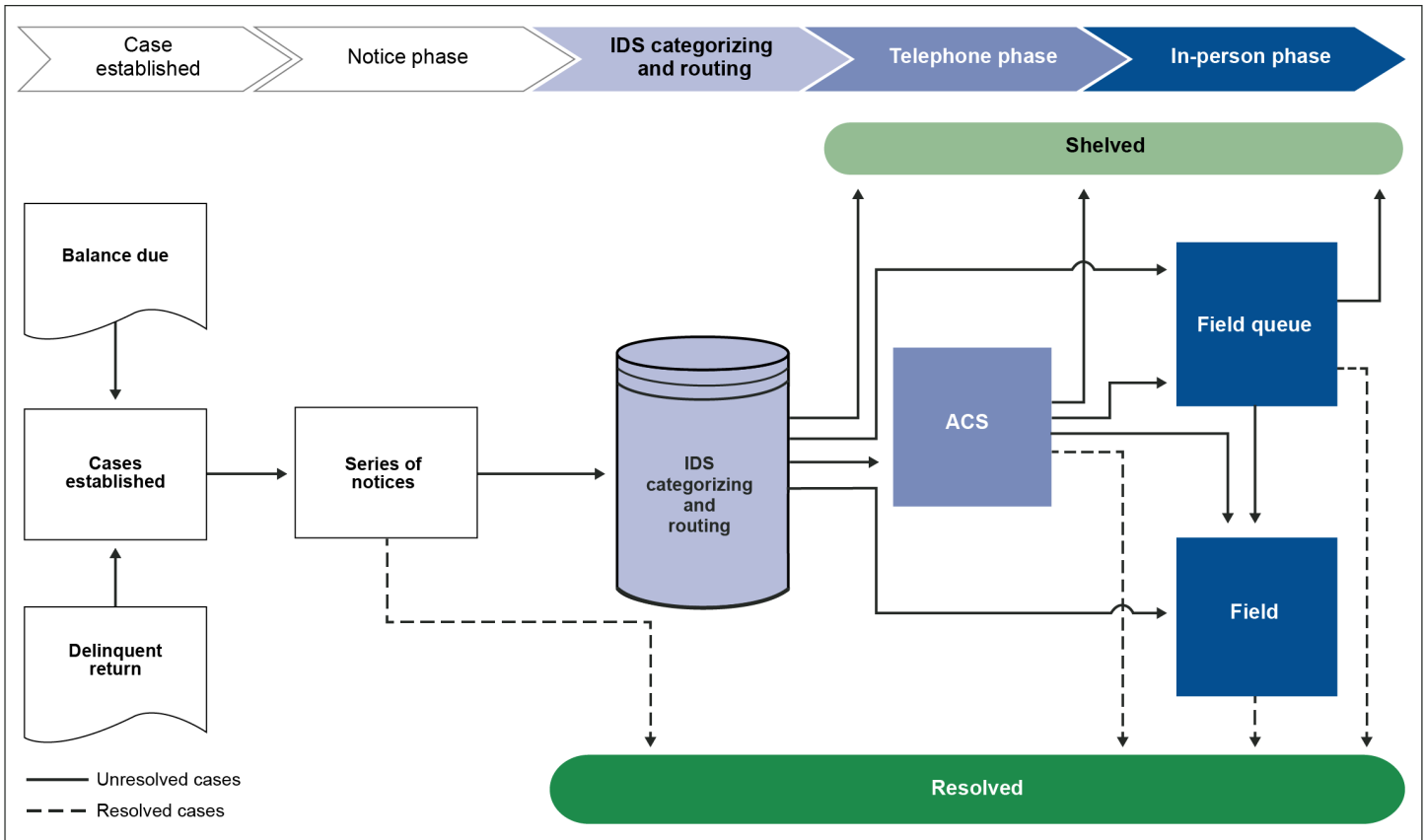
Source: GAO analysis of IRS data. | GAO - 15-647

Note: The Field queue holds cases for potential selection in the Field for assignment to a revenue officer. Resolved cases are those that IRS has assigned to one of the collection phases, resulting in a filed return or debt being fully or partially paid (such as in an installment agreement or offer-in-compromise), abated, or designated as currently not collectible because of circumstances such as taxpayer hardship or not being able to contact the taxpayer. Cases can also be resolved without IRS collections actions if, for example, the taxpayer pays the amount due or files the missing return while the case is in the notice phase or in the Field queue awaiting assignment.

IDS considers hundreds of factors about a case while carrying out two activities that facilitate closures, categorization, and routing:

- **Modeling** is a statistical process that analyzes the results of previously resolved cases to predict likely case outcomes. In IDS, this

process helps determine if a case should be shelved if a model predicts it would not be collectible.[14]

- **Risking** determines whether a case is high risk and influences case-routing and shelving decisions. For example, cases where a taxpayer owes a large amount of money would be considered high risk and would be a priority for selection.

IDS uses the outputs from the risking process in conjunction with hundreds of routing rules to route cases for further collections actions in ACS or the Field. Some common factors considered in IDS routing rules include dollar amount owed, type of tax owed, type of taxpayer, and age of the accounts. Other factors are also considered and can lead to cases not being processed for further collection actions. For example, routing rules test whether the taxpayer is in bankruptcy. IRS suspends taking further collections actions (like levying a taxpayer's wages or putting a lien on property) if the taxpayer is in bankruptcy or litigation.

If there is not enough information to contact or locate a taxpayer, IDS may route cases to the Locator Services System, which researches taxpayer addresses and telephone numbers. This may occur if taxpayer correspondence has been returned as undeliverable or if IRS does not have a valid telephone number for the taxpayer.

IDS routes cases for further collections actions to ACS or the Field, or shelves the cases for no action. Based on our analysis of IRS data, IDS routes most cases (about 70 percent) to ACS.[15] About 25 percent of cases go to the Field, and nearly all of them are placed in the Field queue for potential assignment to a revenue officer; only a very small percentage are routed directly to the Field for immediate assignment. IDS shelves about 5 percent of cases based on certain characteristics described below.

The IDS system can shelve cases by removing them from the Field queue inventory and indefinitely suspending (subject to the 10-year

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[14]ACS and, to a lesser extent, the Field inventory management systems also use IDS model outputs to prioritize cases routed to them.

[15]Based on discussions with IRS officials, it is not possible to calculate precise figures or percentages on IDS case routing decisions. See appendix I for further discussion of how we estimated these general percentages.

statute of limitations) them for further collection action. As previously noted in figure 4, IRS shelved about 2 million cases in each of the past 2 fiscal years. Most of these cases were shelved by the IDS system.[16] IDS shelves some cases upon receipt and others after they have been routed to ACS or the Field for potential collection action but were not been resolved.

Cases shelved by IDS generally fall into three categories:

- cases with a low dollar amount owed or where IRS is unable to contact the taxpayer or identify a levy source, or a combination of these factors;
- cases predicted as unproductive by IDS modeling; and
- cases that have not been assigned to a revenue officer after 52 weeks of waiting in the Field queue.

When a case is shelved, IRS posts a closing transaction code to the taxpayer's account indicating that the case conditions noted above apply. However, these cases are not necessarily closed permanently. According to officials, IRS may reactivate these cases for collection actions if, for example, IRS later identifies another tax debt or unfiled return for the taxpayer.

IDS shelves the cases in the first and second categories as soon as they leave the notice phase, rather than routing them to a downstream collections function. Of shelved cases in the third category, some were originally assigned to the Field queue by IDS, and others were transferred there after ACS was unable to resolve them within a given period of time. IDS regularly reevaluates cases that have been sitting in the Field queue for 52 weeks. Provided there are no prohibitions on shelving that type of case, IDS shelves and removes the cases from active collections inventory.[17]

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[16]Other modules were shelved by collection functions such as ACS or the Field; for example, according to IRS Collection Activity Reports, ACS shelved approximately 500,000 modules in fiscal year 2014.

[17]Current IDS rules prohibit shelving cases identified by IDS as "high risk" (mostly large debts owed and payroll taxes) and cases involving federal employees or retirees. These cases will remain in active inventory until resolved.

Management Identifies and Monitors Cases in Priority Areas

IRS's executives set priorities for closing cases in certain priority areas. Since fiscal year 2012, IRS's collection executives have developed work plans that establish which areas are priorities. IRS managers and executives establish goals for the number of cases to close, and then throughout the year, monitor progress toward the goals. Closures in priority areas account for roughly 17 percent of all collection case closures in recent years. Priority cases are identified in the collection program's annual program letter, which communicate plans and priorities for the year.

Most collections cases in these priority areas are already categorized as high risk by IDS, ACS, and Field inventory management systems. However, according to IRS officials, if periodic monitoring indicates that goals may not be met, collection headquarters and program staff collaborate to determine if they should take action to select and work priority cases in sufficient numbers to achieve case closure goals.

The seven priority areas for fiscal year 2015 are:[18]

- *Delinquent employer payroll tax cases:* Cases where employers have not complied with requirements to withhold and pay federal employment taxes imposed on wages paid to their employees.

- *Large dollar account cases:* Cases with high dollar amounts due. [19]

- *Global High Wealth (GHW) cases:* IRS developed a list of GHW individuals who have histories of balance dues and wealth in the tens of millions of dollars. This list is developed by IRS's Large Business & International (LB&I) division.

- *Return preparer penalty cases:* Cases where IRS has imposed certain civil penalties on a person or business that has violated laws related to preparing tax returns.

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[18]IRS identifies a total of eight case priorities in their annual work plan; however we are not including the Withholding Compliance (WHC) priority in this report. The WHC program establishes accurate tax withholdings between taxpayers and their employers. WHC cases are not balance due cases or processed by IDS routing rules. These cases are worked separately by CSCO, a division which primarily handles taxpayer mail correspondence and is outside the scope of our audit.

[19]We are not reporting the actual dollar amount that IRS uses to define cases as "large dollar cases" because IRS considers this information to be sensitive.

- *Federal employees and retirees (Federal Employee/Retiree Delinquency Initiative, or FERDI):* FERDI cases were established to promote federal tax compliance among current and retired federal employees.

- *High-income nonfilers taxpayers:* These cases include taxpayers with estimated high incomes who have not filed tax returns.

- *Large business taxpayers with delinquent accounts:* LB&I operating division taxpayers, which may include corporations and partnerships with assets in the tens of millions of dollars.

IRS officials told us that delinquent employer payroll taxes and large-dollar account cases have been priority areas for several years. IRS officials explained that nonpayment of employer payroll taxes can involve "pyramiding," or instances where a business withholds taxes from its employees, but intentionally fails to remit them to IRS.[20] Within the inventory management rules for ACS and the Field, payroll tax cases are assigned a high priority so that actions can be taken quickly to address noncompliance against payroll offenders to help prevent pyramiding.[21]

Other priorities like GHW and return preparers were recently added to align collections activities with other IRS strategic goals. For example in 2009, IRS created a GHW industry group within LB&I to centralize and focus IRS compliance expertise involving high-wealth individuals and their related entities (we previously reported on GHW cases).[22] LB&I requested that collections prioritize GHW cases because, if the unpaid tax debts

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[20]According to a 2004 IRS alert on questionable employment tax practices (http://www.irs.gov/uac/IRS-Warns-Businesses,-Individuals-to-Watch-for-Questionable-Employment-Tax-Practices), pyramiding often results from a lack of profit or capital for operating costs. So, the business owner uses payroll trust funds to pay other liabilities. The quarterly employment tax liabilities accumulate (or "pyramid") until the employer has little hope of catching up. Businesses involved in pyramiding may shut down or file for bankruptcy and then start a new business under a different name, which restarts the cycle.

[21]In 2008, we reviewed IRS's processes and procedures to prevent and collect unpaid payroll taxes. In that report, we recommended that IRS develop processes and performance measures to monitor collection actions against egregious payroll tax offenders. GAO, *Tax Compliance: Businesses Owe Billions in Federal Payroll Taxes,* GAO-08-617 (Washington, DC: July 25, 2008; corrected Dec. 19, 2008).

[22]GAO, *Tax Gap: IRS Can Improve Efforts to Address Tax Evasion by Networks of Businesses and Related* Entities, GAO-10-968 (Washington, DC: Sept. 24, 2010).

identified in such programs are not effectively collected, the deterrence effect of the audits themselves could be greatly diminished. To track the number of GHW taxpayer cases that are closed as compared to goals, collection staff use a list of Taxpayer Identification Numbers (TIN) of GHW taxpayers developed by LB&I. According to IRS officials, collection staff compares the list of TINs to cases in active collection inventory to ensure all cases are worked and closed.

While IRS automatically prioritizes most of the cases that would be covered by the seven priority areas for selection, there are times when IRS managers take actions to manually prioritize cases to ensure the agency achieves its goals. Cases in four priority areas (payroll taxes, large-dollar accounts, high-income nonfilers, and return-preparer penalties) are generally identified as "high risk" by IDS and assigned high priority by ACS's and the Field's inventory management systems. Similarly, IDS automatically routes all FERDI cases involving delinquent IRS employees directly to the Field. Non-IRS employee FERDI cases are automatically routed to a dedicated ACS unit, and the cases are assigned the highest priority within ACS's inventory management system. In the remaining two areas—large business and GHW—IRS officials told us these taxpayers typically owe large dollars and would similarly be deemed high risk by IDS. However, IRS officials also said that they periodically search available collections inventory for large business or high-wealth individuals with unpaid balances when goals are at risk of not being met.

IRS Exceeded Case Closure Goals for Priority Areas

During fiscal years 2013 and 2014, IRS exceeded nearly all of its goals for collections in its priority areas. As shown in table 1, in fiscal year 2014, IRS exceeded its targets for closing payroll modules by 11 percent, and its targets for closing large dollar modules by 16 percent. Payroll cases account for most of the priority cases tracked. Other priority areas such as taxpayer cases involving large businesses, high-income nonfilers, and federal employees exceeded their respective targets by about 20 to 30 percent. IRS collections management reports for the first 6 months of fiscal year 2015 also project that IRS will meet or exceed its targets for six of its seven collection priorities by the end of fiscal year 2015.

Table 1: IRS Collections Priority Area Closures, Fiscal Years 2013 and 2014

	2013		2014	
Priority areas cases	Closures	Percent above or below plan	Closures	Percent above or below plan
Delinquent employer payroll tax[a]	955,188	-2%	883,140	11%
Federal employee and retiree taxpayer[b]	88,905	-2%	86,892	33%
Large dollar amount[a]	62,043	18%	56,774	16%
High income nonfiler taxpayer[b]	40,984	-2%	44,859	33%
Large business taxpayer[b]	9,554	22%	9,793	24%
Global high wealth[a]	5,430	32%	5,088	-4%
Return preparer penalty[a]	603	-7%	595	16%

Source: GAO analysis of IRS data. | GAO-15-647

Note: IRS considers results up to -2.9% below the plan to still be "within plan."

[a]Data are dispositions of modules. A module is a record of tax data for a specific taxpayer covering only one tax period (such as a year or quarter). For the global high wealth category, data include closures during the notice phase. Where systems allow, data are "net" dispositions to generally exclude shelved cases.

[b]Data are dispositions of taxpayers. Individual taxpayers in the collection process on average (both priority and non-priority) have two modules; business taxpayers on average have four modules.

IRS Changed Collection Processes to Route More of Two Types of High-Priority Cases to ACS

In recent years, IRS made two key changes to IDS routing rules for two types of high-priority cases—(1) unpaid payroll tax debts and (2) what IRS calls "large-dollar cases." As a result, significant numbers of these types of cases have been routed to ACS rather than the Field queue.

IRS changed payroll case routing rules in October 2011 after a 2010 study, which found that about 1 million payroll tax cases were sitting unworked in the Field queue, and were unlikely to be selected to be worked by revenue officers. [23] At the time of the study, most payroll cases were assigned to the Field queue based on routing rules that tested the total dollar amount owed. Generally, only cases where the business owed less than a few thousand dollars were routed to ACS, and all other payroll tax cases were sent to the Field queue. The study recommended increasing the dollar amount used for splitting payroll cases between ACS and the Field so more cases would be routed to ACS where they would be more likely to be worked. Once assigned to ACS, these payroll cases would then be assigned high priority within ACS's inventory.

[23]Internal Revenue Service, *IRS Collection Process Study: Final Report (*Sept. 30, 2010).

Regarding the second key change, in October 2012, IRS cancelled a large-dollar case routing rule that was sending all "large-dollar" taxpayer cases to the Field queue. IRS had previously decided to send all "large-dollar" cases to the Field in response to recommendations in the same 2010 study mentioned above.[24] IRS officials told us they cancelled the rule because the Field did not have enough resources to work the new influx of large dollar cases. By cancelling this rule, IRS shifted many large dollar cases to ACS. Once assigned to ACS, these large dollar cases were generally assigned the highest priority in ACS's inventory system. A much smaller number of very large-dollar cases were still reserved for the Field, and assigned the highest priority within the Field's inventory.

IRS officials told us that it is not possible to quantify precisely how many collections cases were routed differently because of the rule changes. We analyzed IRS routing rule data and estimate that, as a result of the changes, several hundred thousand more payroll and large dollar cases were routed to ACS. IRS officials agreed with our estimate.

Insufficient Internal Controls for Case Selection Could Limit the Collection Program's Ability to Carry out Its Mission

Having effective internal control is a fundamental component of managing an organization. As set forth in *Standards for Internal Control in the Federal Government*, also known as the "Green Book," internal control comprises the plans, methods, policies, and procedures used to meet an entity's mission, goals, and objectives.[25] Internal control helps agency program managers achieve desired results and provide reasonable assurance that program objectives are being achieved through, among other things, effective and efficient use of agency resources. Further, an effective internal control system helps agencies adapt to shifting environments, evolving demands, changing risks, and new priorities. Figure 7 illustrates selected key steps in internal control.

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[24]IRS's 2010 Collection Process Study noted that high-dollar tax modules for delinquent business taxes (Business Master File) made up only 0.5 percent of all new modules in the notice stream; they represented 65 percent of the total value of new BMF inventory in fiscal year 2009. Although the study's original recommendation was focused on businesses owing large-dollar amounts, IRS changes its routing rules in 2011 so that both business and individual large-dollar cases were routed to the Field queue.

[25]GAO/AIMD-00-21.3.1 and GAO-14-704G.

**Figure 7: Selected Key Steps in Internal Control**
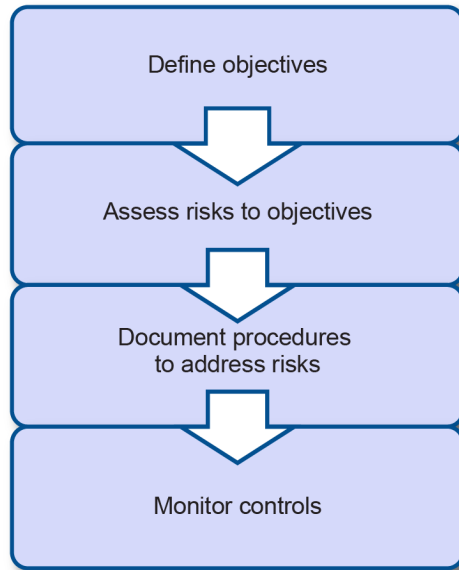
Source: GAO. | GAO-15-647

Internal control standards can serve as tools to help IRS management meet the collections program's mission of applying the tax law with integrity and fairness. IRS has an internal control framework in place. However, when we compared IRS's processes to standards in the Green Book, we found that they were deficient in some areas, thereby increasing the risk that the collections program may not meet its stated mission.

IRS Has Not Clearly Defined Objectives or Key Terms, Such as Fairness, for the Collection Program and Case Selection Process
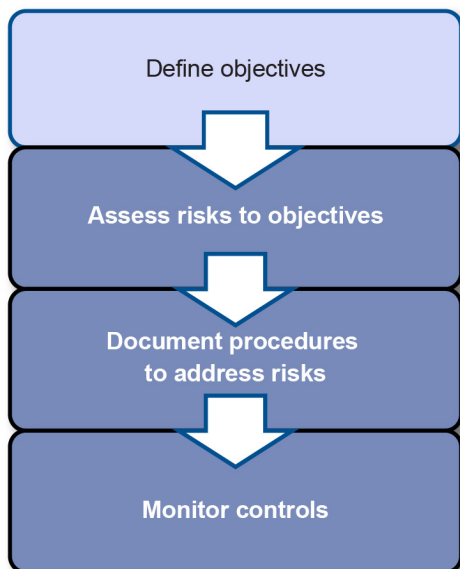
Define objectives

Assess risks to objectives

Document procedures to address risks

Monitor controls

Source: GAO. | GAO-15-647

Internal control standards call for management to set program objectives that align with an entity's mission, strategic plan, goals, and requirements of applicable laws and regulations. Clearly defined objectives can enhance the effectiveness and efficiency of a program's operations, and are a prerequisite for risk assessment. Documenting objectives allow agency officials and staff to understand the organization's purpose consistently. IRS's Chief Risk Officer agreed that clearly articulated program objectives are essential for effective risk assessments and should be documented. He provided us with documentation from IRS's Enterprise Risk Management Office (ERM) that also outlined this process.

IRS has not defined clear objectives for the collection program, IDS, or any other parts of its enterprise collection case selection process. We did not identify any documented objectives, and collection officials had difficulty articulating the objectives of the program. When we questioned IRS officials about possible program objectives, we received multiple and conflicting answers.

During our discussion with IRS collection officials, they referred to the collection mission statement, contents of the annual program letter, and program performance measures as potential examples of program objectives. However, the mission statement, while summarizing the overall purpose and functions of collection, is not intended to provide direct program guidance or be used for internal control.[26] Further, the annual program letter does not identify program objectives, but instead identifies distinct projects or activities (including the seven priority areas) grouped underneath IRS's broad strategic goals. Performance measures do not serve as objectives, but rather should be derived from objectives. Having clear objectives, especially as they relate to the seven priority

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[26]IRS Collection's mission statement is: "To collect delinquent taxes and secure delinquent tax returns through the fair and equitable application of the tax laws, including the use of enforcement tools when appropriate, provide education to customers to enable future compliance, and thereby protect and promote public confidence in the American tax system."

areas, is important to support management decisions about high priority areas. For example, collection executives cited GHW and return preparer penalty cases as high priority areas to enhance the deterrent effect of the respective completed audits and other IRS compliance initiatives. Without clear objectives, it is difficult to know whether any other types of audits warrant priority oversight and attention in collection.

In reviewing IRS's strategic plan, collection program documents, and the collection case selection processes, and in discussion with IRS officials, we identified language that IRS officials could consider using to articulate clear program objectives. Although we identified potential objectives language in various program documents, none of the documents identified them as such. Potential objectives include:

- collect the greatest amount of potentially collectible debt,

- ensure fairness by selecting cases to achieve "coverage" across all types of taxpayers and encourage voluntary compliance,

- act promptly to resolve taxpayer filing or payment compliance,

- make the best use of resources by matching cases with the appropriate IRS resources,

- reduce taxpayer burden, and

- support IRS's strategic compliance initiatives, such as to collect on tax debts identified by audits intended to address particular compliance problem areas.

IRS also has not clearly defined important terms such as fairness. Although fairness is in the collection mission statement and IDS processes may affect how collection cases are selected, collection officials had not defined fairness or established it as a program or case selection objective. A clear definition of fairness is needed because program managers provided us with differing explanations of how to achieve fairness in case selection. An IRS official responsible for case selection functions defined fairness as when taxpayers with similar case characteristics—such as the amount or type of tax owed—have an equal chance of being selected for collection action. However, it is not clear from this definition which case characteristics should be taken into consideration and which should not when selecting cases for collection. Others have suggested that fairness means ensuring that all taxpayers are pursued to the same degree.

Another collection official discussing fairness said that if the public had information on IRS's methods for prioritizing and routing cases for selection, they would agree that the process was fair. This suggests that, in addition to comparing chances of selection, the public's perception of fairness is an important consideration. Collection program managers stated that their processes were inherently fair and that they did not see the need to define fairness. These varying views illustrate that without fairness being clearly defined and established as a program or case selection objective, however, IRS management cannot adequately determine if the collection process is being implemented fairly or in an unbiased manner. Moreover, officials cannot systematically identify and address risks to help ensure that fairness is continually achieved, leaving the agency vulnerable to selecting taxpayer's collection cases in an inconsistent manner.

Another important and widely used term—risk—is also missing a clear definition and officials we spoke with had a variety of ideas as to its meaning. Officials said that a key concept in IDS and other case selection processes is to give higher priority to "high risk" or "high compliance risk" cases. However, program managers have not clearly defined risk. As we attempted to clarify this, we asked if risk pertained to the amount of debt due. A program manager responded that risk does not just entail the amount due and noted that unfiled tax returns do not have a definite amount due, but IRS still considers them important. Another IRS official said "risking" included the concept of tradeoffs. A collection program manager explained that the term risking was established during the term of a previous IRS commissioner who had promoted the concept as used in the private sector, where it generally refers to decision making based on data analytics or modeling. However, the manager said IRS's use of the term is not similar to the private sectors, but rather refers to using case variables and thresholds for prioritizing and routing cases. In reviewing the types of cases IRS gives high priority—including payroll tax cases—we found that the concept of compliance risk may also include the potential future revenue loss, the number of taxpayers affected, and/or the likelihood that tax debts, if allowed to accumulate, might not be collectible in the future. Further, risking at the enterprise level seems to be different than risking in ACS and the Field; IDS risking refers to processes that identify only high priority cases, whereas in ACS and Field risking refers to processes that rank order cases in high-, medium-, and low-priority categories. These various concepts of risk demonstrate that the term is not clearly or consistently defined or understood even though the term is widely used by program officials and program documents.

GAO-15-647 IRS Case Selection

Without clear objectives for the program and case selection processes codified in official IRS guidance—including definitions for key terms like fairness and risk—IRS is hindered in its efforts to ensure the program is achieving its mission, including ensuring that taxpayers are treated fairly—should fairness become a program objective. Further, the lack of clear, widely understood objectives can complicate program management, as assessing risks, developing procedures to respond to risks, and monitoring program controls cannot be performed easily or with clarity.

IRS Has Taken Initial Steps to Identify Risks, but Additional Guidance Needed to Address Program Vulnerabilities

Internal control standard: assess risks to program objectives

Management is to comprehensively identify internal and external risks and determine relative risk rankings on a scheduled and periodic basis.
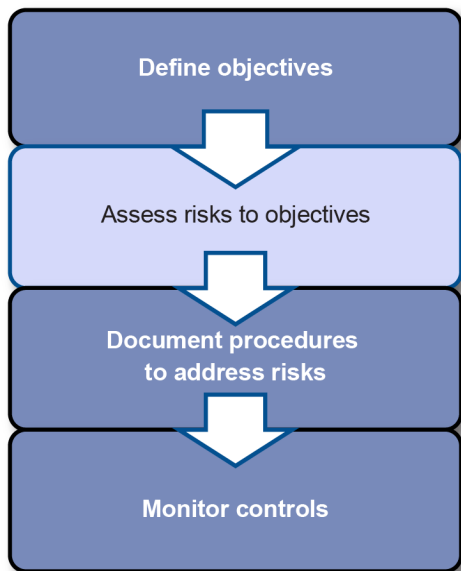
Source: GAO. | GAO-15-647

Risk assessment is the identification and analysis of relevant risks associated with achieving program objectives and forming a basis for determining how risks should be managed. Once risks have been identified, they should be analyzed for their possible effect. Risk analysis generally includes estimating the risk's significance, assessing the likelihood of its occurrence, and deciding how to manage the risk by determining what actions should be taken, if any.

The first and most critical step is risk identification. Management should have well-documented procedures for regularly identifying internal and external risks to program objectives and procedures, such as in short- and long-term forecasting and strategic planning. Procedures should include how internal risks are to be identified, such as risks resulting from downsizing of agency operations and personnel or redesigning business processes. Similarly, procedures should include how external risks—such as economic changes or changing needs or expectations of the Congress, agency officials, and the public—are to be identified.

Risk identification and assessments are not new to IRS. IRS has relied upon many long-standing processes and procedures, and conducted a variety of program reviews to identify and address risks. However, the agency's overall approach to risk management became more focused in 2013, when it established the Enterprise Risk Management Office (ERM) process. IRS implemented ERM, among other reasons, to serve as an early warning system to allow the agency to identify emerging challenges and address them before they affect operations. According to IRS's Chief

Risk Officer, the goal is to embed risk management principles and practices into the daily operations of the business units and integrate long-standing processes into the new, more holistic ERM approach.

Officials said the first year of ERM focused on enterprise-level risks that include potential major reputational risks to IRS. The second year of ERM has focused on risk at the operating division level. For example, in April 2015, Small Business/Self Employed (SB/SE) (the operation division that includes the collection program) completed its first division-level risk register. A risk register is a list of risks and related information, including strategies for mitigating them. To provide input into the SB/SE risk register, collection officials told us that they decided to use a "bottom up" approach whereby potential risks would be identified and elevated by frontline staff and other lower-level staff who may be aware of risks at an operational level. Future years of ERM will focus more on risks at the program level. Collection officials said they have started trying to integrate risk management into their program's daily operations. They also noted that in recent months they have been developing processes and documentation for the program's risk management strategy and establishing the infrastructure for its risk management process.

The risk management guidance collection used to provide input to the SB/SE risk register focused on how to assess risks identified at the employee and mid-management levels. Such methods of identifying risks would be useful for the bottom-up approach collection officials described to us. Although the guide encouraged managers and executives to self-identify risks—ostensibly to their program objectives for which they are responsible—the guide did not have information on how managers are to identify such risks. Collection management would need such information when determining the priority areas for a given year. For example, if fairness was defined as a key program objective, then management would want to define the risk associated with ensuring the priority cases were selected in a fair way. This underscores that risk assessments should be based on program objectives. Without clear objectives, as discussed earlier, comprehensive assessments of risks are difficult to conduct.

Collection program officials said that they had identified risks using processes and guidance established by ERM. Although officials said that managers were involved in identifying risks, they did not have documentation or guidance on how management identified risks. In May 2015, after the completion of the SB/SE risk register, ERM put forth guidance to help managers identify risks. While the guidance provides

helpful information for management, further information would be useful so that managers better understand how to integrate IRS's long-standing risk management processes with the new ERM approach. Officials said SB/SE is in the early stages of developing its own training for collection executives and managers, which may also provide useful information for management.

IRS's ERM efforts are at initial stages and it is too early to determine their effectiveness. Management's identification of risks is important because internal and external risks could affect the collection program and collection case selection in particular. For example, economic changes could affect the mix of complex cases that come into IDS and require IRS to consider making changes to case prioritization and routing. Similarly, downsizing of IRS operations—as discussed previously—has the potential for creating risks of greater imbalances between workload and resources, either overall or between ACS and the Field. Such risks could be better managed by IRS with guidance that helps to identify and manage them, particularly when changes occur to collection-wide case categorization and routing processes. Without risk identification and assessments linked to program objectives, vulnerabilities may go unaddressed, resulting in unfair case selection, decreased dollars collected, greater noncompliance, or other negative program effects.

IRS Has Not Documented Case Selection Procedures

> **Internal control standard: document controls to address risks to program objectives**
>
> Procedures should be clearly documented to ensure that management's plans, policies, and procedures are sufficiently and fully carried out.

Define objectives

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Assess risks to objectives

↓

Document procedures to address risks

↓

Monitor controls
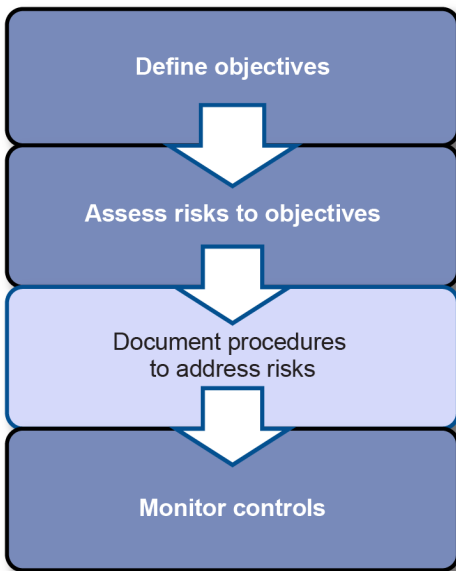
Source: GAO. | GAO-15-647

Internal control standards require documented procedures to ensure that management's plans to mitigate risks are carried out. Documentation is a necessary part of an effective internal control system and should clearly identify related objectives and control activities or procedures. Such documentation should allow agency officials and staff to understand the purpose of internal control procedures and be readily available for examination. Documentation provides a means to retain organizational knowledge and mitigate the risk of having that knowledge limited to a few personnel. Documenting procedures is evidence that the right controls are identified and that those procedures are capable of being communicated to those responsible for their performance, and capable of being monitored and evaluated.

Comprehensive documentation to describe IDS and the collection case selection processes was not available, and hinders managers's ability to assure these processes are effective in addressing risks. Most of the documents we were provided to describe IDS and the case selection process were developed for purposes of our review or for training staff, rather than for management and control purposes. Further, the documentation provided contained some errors. For example, one document showed that IDS uses statistical model results along with business rules to make decisions on whether to route cases to either ACS or the Field. IRS officials later told us, and our analysis of routing rules confirmed, that IDS only uses model results in deciding whether to shelve cases and not for deciding to which function to route them. As another example, a different document showed that IDS routes and prioritizes cases by using a series of business rules and predictive model scores, which again misstated how IDS uses model scores. Also, IRS officials later clarified that IDS actually does not prioritize cases. ACS and Field inventory management systems accomplish this function. Other documentation, including one 154-page document describing detailed "risking" and routing rules, was very complex, using multiple acronyms and code references. IRS officials agreed this documentation could generally only be interpreted by employees with experience in collection case routing and selection. We were only able to summarize the key functions of IDS categorizing and routing (as described earlier) after

conducting a detailed review of these documents and having multiple discussions with several IRS officials familiar with various parts of the process. According to IRS collection officials, documents identifying and describing IDS procedures and the case selection process are not available because they are the result of incremental decisions and system changes implemented over several years.

Similarly, we did not identify any guidance on how managers are to select high priority cases and little documentation exists as to how and why the priority areas were established, such as analyses of data to determine or demonstrate the relative benefits and costs of working priority areas as compared to others. Collection officials told us that management meets annually to determine what the priority areas should be. As described earlier, according to collection officials, some areas like delinquent payroll tax cases historically have been priority cases, in part, due to the pyramiding effect of the cases and therefore the need to address them quickly.[27] When we asked officials how they identified GHW taxpayers as a priority area, they said the collections program had committed to work all such cases but could not provide additional information on why, such as analyses for working these cases as compared to others. IRS's LB&I division develops the list of GHW taxpayers for collection. When we asked LB&I and collection program staff about procedures used to develop the data and list of GHW taxpayers, the officials were not sure of the answers and said the procedures had been in place for a few years. They stated that they thought they could get more information by reaching out to a recently retired person who had developed them. Program documents show that because the retired staff person did not leave instructions on how to develop the list, new staff had to recreate the process.

Without adequate documentation, it is difficult to determine whether the collection's case selection procedures are effective in supporting program objectives. For example, IDS decisions on shelving or routing a case to either ACS or the Field could have important implications for whether and when a debt will be collected (timeliness of collection or compliance) and IRS's costs (efficiency). According to IRS data, noted earlier, the costs for

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[27]Program officials said they also consider payroll cases a priority because of their revenue risk. According to IRS officials, when employees file their individual tax returns, IRS must give them credit for tax amounts withheld and reported on the W-2 form even if the employer did not actually pay them.

sending cases to ACS versus the Field are significant. Similarly, routing to either ACS or the Field could affect how long it takes IRS to resolve a case, which could affect the collection result. A lack of documented procedures also increases the risk that they will be consistently applied. This is important, for example, when considering the seven priority areas. Without documented procedures for how to select cases manually when goals are not being met, IRS risks ensuring fair selection to all taxpayers.

IRS Does Not Regularly Monitor the Effectiveness of Collection Routing Rules and Has Not Reevaluated Dollar Thresholds Used to Identify High Priority Cases

> **Internal control standard: monitor controls**
>
> Internal control design should assure that ongoing monitoring of controls occurs in the course of normal operations

According to internal control standards, program managers should have a strategy and establish procedures to continually monitor and assure the effectiveness of its control activities. This strategy should trigger separate evaluations whenever monitoring identifies problems or improvement opportunities.
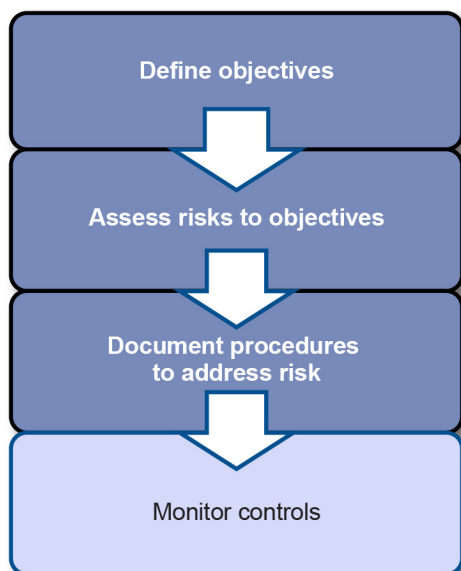
Although evaluations have been conducted from time to time, IRS does not have procedures to periodically monitor IDS categorization and routing rules, such as reevaluating dollar thresholds used for categorizing some cases as high priority and routing cases to one collections function instead of another (e.g., ACS versus the Field). IRS does not have any documentation showing when many rules were established, the rationales for them, or data supporting them because, according to IRS officials, most of the rules were established years before IRS starting keeping such records in 2009. Knowing the rules's rationales would help managers evaluate the rules's effectiveness. Most rules used to route or designate cases as high priority rely primarily upon tests of the dollar amount owed. But, IRS documentation does not show the rationale for using a specific dollar amount or any data to support the selection of the dollar amount. IRS has about 60 rules to categorize cases as high risk and more than half of these rules use the same dollar threshold. This same dollar amount is used to determine whether the case is high risk regardless of the type of tax owed; the amount owed is an actual current amount due or a previous amount from a prior return; or IRS has estimated an amount a taxpayer earned using third-party data.

Our prior reports indicate that the dollar thresholds IRS uses to classify some individual nonfilers as "high income" are the same as they were 20

Define objectives

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Assess risks to objectives

↓

Document procedures to address risk

↓

Monitor controls

Source: GAO. | GAO-15-647

years ago.[28] Our analysis of IRS Statistics of Income information concluded only 5 percent of individual taxpayers had adjusted gross incomes that exceeded this threshold about 20 years ago. By contrast, in 2012 (the most recent data available), 14 percent of taxpayers had adjusted gross incomes exceeding the threshold.[29] Assuming that nonfiling rates for "high income" taxpayers have remained constant, more nonfilers's incomes would be exceeding this dollar threshold as overall taxpayer incomes increased over time.

IRS officials were unable to provide analyses or justification on why the threshold was chosen, as opposed to a higher or lower amount. IRS officials told us they did not have documented rationales for thresholds in most cases because many routing rules were established long ago. Officials said that, rather than focusing on evaluating the rules, IRS had decided to dedicate its limited resources to improving other aspects of its case selection processes, such as modeling.[30]

IRS has evaluated business rules on an ad-hoc basis. For example, as previously noted, a 2010 study of IRS collections evaluated the routing rules being used to split the assignment of delinquent payroll tax cases between ACS and the Field. The study estimated that about 1 million delinquent payroll tax modules (with a total amount owed of $8 billion) were sitting in the Field queue and not being worked. The study recommended that the dollar threshold used to assign payroll tax cases to collections functions be adjusted so that more cases would be sent to ACS instead of the Field.

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[28]GAO, *Tax Administration: IRS Does Not Investigate Most High-Income Nonfilers*, GAO/GGD-91-36 (Washington, D.C.: Mar. 13, 1991.

[29] The margin of error for the total number of returns estimates is less than 500,000 returns and for the percents is less than 1 percentage point.

[30]IRS has conducted regular, periodic evaluations of the models it uses to determine what cases not to work and, according to IRS officials, plans to continue to regularly conduct such evaluations. For example, in 2013 IRS evaluated the effectiveness of its models in predicting the types of cases that would have likely closed as currently not collectible (CNC) if IRS had attempted to work them. Through evaluations of their models, IRS determined that working some of these predicted CNC cases could actually result in some revenue being collected. In April 2014, IRS adjusted these predictive models to better distinguish between likely CNC cases that will result in at least some revenue collected and those that will result in no revenue collected.

GAO-15-647 IRS Case Selection

If the rules are not periodically evaluated, over time they could lose their value and usefulness. Moreover, without adjusting the thresholds, more and more cases are selected, increasing collection's already very large workload. We previously recommended that Congress require IRS to regularly adjust the dollar amounts of penalties for taxpayer noncompliance. We found that because IRS penalty amounts had not been adjusted for decades in some cases, the real value of the fixed dollar amounts of penalties has decreased.[31] We also reported that not adjusting these penalties for inflation could lead to inconsistent treatment of otherwise equal taxpayers over time because taxpayers penalized when the amounts were set could effectively pay a higher penalty than those with the same noncompliance pay years later. Since we made our recommendation, IRS has indexed almost all of the penalties to inflation.

Another risk is that without systematic monitoring, collection procedures could result in unnecessary costs or missed collections. Given increases in taxpayer incomes and taxpayer debts over time, it is likely that more delinquent taxpayer accounts are exceeding the unchanged dollar amount limits and, as a result, being prioritized within IRS collections processes regardless of whether their cases are truly high risk. Not adjusting dollar amounts used to make collections case routing decisions could lead to inconsistent treatment of taxpayers over time as the real values of the dollar amounts declined due to inflation.

Conclusions

IRS's collection program is the federal government's primary enforcement tool for compelling noncompliant taxpayers to file their tax returns and pay taxes, encouraging voluntary compliance and thereby helping address the tax gap. The amount of tax debt cases is an ongoing and growing problem. With recent declines in collections staffing and a growing caseload, the problem is now more acute. With fewer resources available to work cases, proper case selection is more important than ever in ensuring IRS's ability to achieve compliance and other goals including that cases are selected fairly. We identified some internal control weaknesses that leave the collection program vulnerable to unfair case selection and inefficient use of resources, among other things. Without effective internal controls, the program may not achieve desired results

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[31]GAO, *Tax Compliance: Inflation Has Significantly Decreased the Real Value of Some Penalties,* GAO-07-1062 (Washington, D.C.: Aug. 23, 2007).

and lacks reasonable assurance that program objectives will be met. These basic management tenants are fundamental in promoting confidence in the tax system.

Recommendations for Executive Action

To help ensure the IRS collection program meets its mission and selects cases fairly, we recommend that the Commissioner of Internal Revenue take the following five actions:

1. Establish, document, and implement clear objectives for the collection program and enterprise-wide case categorization and routing processes, and define key terms, such as "fairness" and "risk."

2. Build upon existing Enterprise Risk Management (ERM) guidance to help managers identify internal and external risks to collection program objectives, and better understand how long-standing risk processes integrate with new ERM approaches; incorporate this guidance into existing or future ERM or collection program risk assessment processes.

3. Clearly establish, document, and implement case categorization and routing procedures—such as those for IDS, high priority case selection, and any other important processes—to support collection program objectives and IRS goals.

4. Establish, document, and implement procedures for the periodic evaluation of the efficiency and effectiveness of collection-wide case categorization, routing rules, and case selection processes.

5. Establish, document, and implement procedures for periodic updates of dollar thresholds for categorizing case selection, including those identified as "high risk."

Agency Comments and Our Evaluation

We provided a draft of this report to the Commissioner of Internal Revenue for review and comment. The Deputy Commissioner for Services and Enforcement provided written comments dated July 16, 2015, which are reprinted in appendix II. IRS stated that it generally agreed with our recommendations and it appreciated our insights as it strives to continue to strengthen its processes and programs. According to IRS, it is identifying the actions to be taken to effectively implement our recommendations and plans to provide a detailed description of them in response to our final report.

The comments also included an elaboration on the operations of IDS and case selection processes. Although IRS said our report described the case selection process as designed to be automated with no management discretion on choosing individual accounts or taxpayers, our report did not provide such a description. IRS's comments went on to discuss factors managers use to assign the "identified next best case" and variables managers consider in assigning work at IRS campuses and call sites. However, the issues of prioritization and discretion in function-level case selection processes were not in the scope of our report since we focused on collection at the enterprise level and on IDS.

IRS also stated that it agrees with the importance of internal controls and affirmed its commitment to making needed improvements in the areas we pointed out. To that end, IRS noted actions that it has taken to improve collection performance in fiscal years 2014 and 2015, including updates of analytical models and the realignment of the collection program to be entirely within SB/SE. IRS further noted that in some cases its documentation has not kept pace with these changes and committed to bringing these policies and procedures up-to-date.
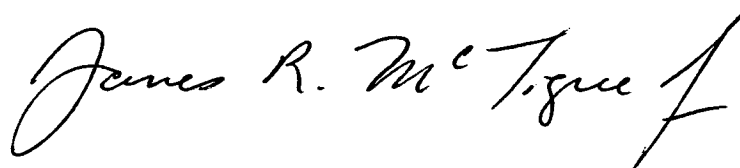
Lastly, IRS noted that our report did not identify any instances where the selection of a case was considered inappropriate or unfair. However, as described in our scope and methodology, we did not design our study to look for cases of inappropriate selection but rather to assess the internal controls that help safeguard the fairness of the case selection processes. By evaluating the collection program's enterprise-level internal control framework for selection, we were able to determine whether IRS had processes in place that help provide reasonable assurance of fair selection not just of cases selected in the past but also on an ongoing basis. IRS also provided us with technical comments, which we incorporated into the report as appropriate.

We are sending copies of this report to the Chairmen and Ranking Members of other Senate and House committees and subcommittees that have appropriation, authorization, and oversight responsibilities for IRS. We are also sending copies to the Secretary of the Treasury, Commissioner of Internal Revenue, and other interested parties. In addition, this report is available at no charge on the GAO website at http://www.gao.gov

If you or your staff have any questions about this report, please contact me at (202) 512-9110 or mctiguej@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. GAO staff who made key contributions to this report are listed in appendix III.

James R. McTigue, Jr.
Director, Tax Issues
Strategic Issues

Appendix I: Objectives, Scope, and Methodology

Our objectives were to (1) describe the Internal Revenue Service's (IRS) processes for categorizing and routing collection cases, trends in priority areas, and key process changes for fiscal years 2012 through 2014; and (2) assesses how well the processes for case selection support collection's mission, including applying tax laws with integrity and fairness to all.

To describe IRS's processes for categorizing and routing collection cases, we interviewed IRS officials and obtained available documents on how cases flow through the collection process after the collection notice phase for potential selection in the Automated Collection System (ACS) and Field Collection (Field). We interviewed IRS headquarters managers in the offices of Enterprise Collection Strategy, Campus Compliance Services, and Field Collection. To better understand background and context for these processes, we reviewed information on the processes ACS and the Field use to prioritize cases for selection. To better understand processes results, we reviewed general program management documents, including regular management reports on IRS's collections operations for fiscal years 2009 through 2014. We also reviewed Collections Pipeline Reports (CPR) and Monthly Monitoring Report (MMR) data on the inflows and outflows of collections inventory, as well as data on collections workforce levels (full-time equivalents). Most of the CPR and MMR data that we used in this report were originally from IRS Collection Activity Reports (CAR). We previously used CAR data to report on the IRS notice phase process in 2009.[1] At that time, we interviewed IRS officials with knowledge about CAR data about the steps taken to ensure data accuracy. We determined that the CAR data were sufficiently reliable for our purposes. The CPR also contained data prepared by the IRS Chief Financial Officer on the sources of assessment in potentially collectible inventory (PCI). We compared the PCI data to data from other collection reports and interviewed IRS officials knowledgeable about the PCI source of assessment data. We reviewed information on the Inventory Delivery System (IDS) and its various functions that prioritize and route cases to include functions that either exclude or include cases from potential selection by ACS or the Field, affect potential IRS costs (as in the costs to route a case to use ACS versus Field resources), or reflect how ACS and the Field rank order

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[1]GAO, *Tax Debt Collection: IRS Needs to Better Manage the Collection Notices Sent to Individuals*, GAO-09-976 (Washington, D.C.: Sept. 30, 2009.

cases for selection. Our review of available documents on IDS and discussions with program officials focused on the various factors IDS takes into account in deciding how to prioritize and route cases. We reviewed IRS documents describing the factors considered in routing and flowcharts illustrating how cases can flow from IDS to ACS and the Field, or be shelved and not actively pursued further. We also visited IRS offices in St. Paul, Minnesota, responsible for building and maintaining IDS models. We interviewed officials and reviewed documents to learn how the models were used and how they affect case routing and prioritization for case selection. In addition, we analyzed information about the collection program's statistical methods and procedures used in the modeling process, a statistical method that predicts likely case outcomes.

To describe trends in priority areas, we interviewed IRS officials and reviewed IRS documents and data, including MMR data on priority case closures during fiscal years 2013 and 2014, and the first six months of fiscal year 2015.

To describe key routing process changes, we interviewed IRS officials about recent changes that had significant impacts on case routing and reviewed a study that resulted in process changes. We also reviewed IRS records of routing rule changes from calendar years 2011 to 2014, and we evaluated available data showing how frequently business routing rules were applied ("rule firings") each calendar year from 2011 to 2014. Based on further discussions with IRS officials, we determined that the available data on routing rule firings was insufficiently reliable to report precise figures on how many cases were routed to different collections functions, or not pursued further, as a direct result of IDS routing rules. However, the rule firings data were sufficiently reliable to describe generally how recent routing rule changes have shifted significant portions of the collection inventory between ACS and the Field.

To assess the reliability of the data we analyzed for our first objective, we interviewed knowledgeable IRS officials, and conducted manual data testing for missing data, outliers, or obvious errors. We also reviewed relevant documentation on management reports and case routing data.

To assess how well the processes for case selection support collection's mission, we compared the processes identified above to selected standards in the *Standards for Internal Control in the Federal Government* (GAO/AIMD-00-21.3.1, November 1999). In regard to internal control standards on establishing program objectives, we interviewed various collection officials, including the Director of Collection and other IRS

headquarters managers in the offices of Enterprise Collection Strategy, Campus Compliance Services, and Field Collection, concerning their understanding of the mission, objectives, and internal controls of the collection program and IDS processes. We also and reviewed IRS and collection program guidance in which objectives could potentially be stated or implied, including the Internal Revenue Manual (which includes the mission statements of various collection program subunits and policy statements on collections), annual collection program letters for fiscal years 2013 through 2015, and potentially collection-program-related objectives in IRS Publication 3744, Internal Revenue Service Strategic Plan FY2014-2017.[2] In regard to internal control standards on assessing program risks, we reviewed the information on IRS's objectives discussed above, interviewed collection program officials, and reviewed documents on the collection program's identification of risks. This included input into the Small Business/Self Employed division's April 2015 risk register and guidance, and procedures officials used to identify risks. In regard to internal control standards on establishing and documenting control activities to address risks, we interviewed IRS officials and reviewed available documentation on the processes for categorizing and routing collection cases as gathered to answer our first objective. In regard to internal control standards on monitoring controls, we interviewed IRS officials and reviewed documents on procedures to evaluate IDS models in general and specifically those models used to shelve cases, including the Inventory Delivery System Model Evaluation study and Collection Workload Optimization Project study documents. We also interviewed IRS officials and gathered any available documents and plans on evaluations of rules and dollar thresholds used for IDS decisions to shelve cases, designate cases as high priority, and route cases to one collection function instead of another.

We conducted this performance audit from August 2014 to July 2015 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 objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

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[2]http://www.irs.gov/pub/irs-pdf/p3744.pdf (downloaded February 2015).

Appendix II: Comments from the Internal Revenue Service

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

DEPUTY COMMISSIONER

July 16, 2015

James R. McTigue, Jr.
Director, Tax Policy and Administration
Strategic Issues Team
U.S. Government Accountability Office
441 G Street NW
Washington, DC 20548

Dear Mr. McTigue:

Thank you for the opportunity to comment on the draft report titled, *IRS CASE SELECTION Collection Process Is Largely Automated, but Lacks Adequate Internal Controls (GAO 451115)*. As described in the draft report, the Collection selection process is designed to be automated with no discretion by Collection managers or employees to choose individual delinquent accounts or taxpayers for pursuit. Collection cases are identified through the automated Inventory Delivery System (IDS), with management's only discretion being the assignment of the identified next best case to employees, by geography and grade level. This is done in accordance with seven Collection priority areas, as reported, with the related goals exceeded for these priority areas in Fiscal Year 2015.

The mission of the Collection organization is to collect delinquent taxes and secure delinquent tax returns through the fair and equitable application of the tax laws, including the use of enforcement tools when appropriate, and to educate taxpayers so as to facilitate future compliance. By doing so, Collection protects and promotes public confidence in our tax system. Likewise, the mission of the Small Business/Self Employed (SB/SE) Division (under which Collection falls) is to apply the tax law with integrity and fairness to all.

In the Collection sphere, the concept of fairness has both a collective and individual component. We take into account the responsibilities and obligations that all taxpayers share, and we pursue those individuals and businesses who fail to fully pay or file their taxes to ensure fairness to those who do; and we do so while taking into account the individual ability of each taxpayer to meet his or her responsibilities.

While the Collection program is designed on extensive historical experience and its processes are quite mature, we agree with the importance of continuously improving

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our performance and with the need to conduct periodic evaluations of the models and dollar thresholds that are part of IDS, recognizing that out-of-date collection procedures could result in unnecessary costs or missed collections. To that end, in Fiscal Year 2014, we updated our analytical models to identify and work our most productive inventory sooner. Also to improve our performance, in Fiscal Year 2015, we realigned the Collection program entirely within the Small Business/Self-Employed Division. Our realigned Collection organization provides streamlined leadership accountability, makes processes more efficient, reduces redundancies, and helps us to quickly identify emerging issues. Additionally, call site, campus, field, and headquarters organizations are now aligned to eliminate barriers and ensure that strategic decisions support collection-wide operational goals.

As these changes have been made in the Collection program and leadership in recent years, the documentation of some changes has not kept pace. We are committed to bringing the policies and procedures up-to-date to ensure the continuity and consistency in program leadership and program execution as designed. We note that, while your report posits a hypothetical risk to fair case selection from the lack of documented objectives and internal control deficiencies, your report did not identify any instances where the selection of a case was considered inappropriate or unfair. As described in the enclosure, the internal controls over the Collection program are extensive to reflect the sensitive nature of this IRS responsibility and the importance of it being discharged in a fair and equitable manner.

We are nevertheless in agreement with the importance of sound internal controls, and are committed to their improvement; especially in the areas GAO recommends we strengthen them. While we generally agree with all of the GAO's recommendations, we are in the process of identifying the specific IRS actions to be taken to effectively implement them, and will provide a more detailed description of our actions, responsible officials, and implementation timelines in our response to the final report.

In closing, we appreciate your continued support and insight as we strive to further strengthen our processes and programs throughout the Service. If you have questions, please contact me, or a member of your staff may contact Karen Schiller, Commissioner, Small Business/Self Employed Division, at (202) 317-0600.

Sincerely,

John M. Dalrymple
Deputy Commissioner for Services and Enforcement

Enclosure

Enclosure

<u>Collection Case Selection Process Internal Controls, and Risk Management</u>

The IRS's processes for categorizing and routing Collection cases for potential selection is largely automated, relying not on individual discretion, but rather on a series of case selection and routing algorithms. Specifically, the Collection organization uses the Inventory Delivery System (IDS) for managing Collection inventory. The routing of cases through IDS is transparent to local management throughout the organization. Campus and Call Site managers assign work based on variables such as taxpayer written responses or telephone calls. Responses to our initial balance due and return delinquency notices are routed geographically to campus operations and assigned in batches to the next available Tax Examiner who has no discretion to select individual cases or taxpayers.

As unresolved cases progress to the Automated Collection System (ACS), the system itself issues notices and levies based on volume parameters set by Collection Headquarters that consider the availability of resources to handle the responses. When taxpayers call ACS, the calls are routed to the next available Collection Representative (CR) at any of our call sites across the country so that CRs have no discretion as to which cases to work or which calls to answer. To the extent CRs are able to work inventory, they are assigned cases sorted by task, working the "next case" selected by the system as having the highest priority.

Field Managers likewise assign cases after numerous systemic rules are applied and they evaluate the local conditions. For cases requiring Revenue Officer (RO) involvement, Group Managers assign cases based on priority levels subject to geography and grade level of available staff, which is effectively their only discretion. The Integrated Collection System (ICS) and Integrated Data Retrieval System (IDRS) maintain a strong audit trail so there is a record of all case assignments. Reports show Field Collection inventory that is comprised overwhelmingly of high priority assignments in accordance with established priorities. Group Managers follow this assignment plan. Senior Managers and Area Directors also conduct case reviews to assure conformance with the process and set priorities. They also review the case assignment to ROs during their reviews. Throughout the Collection process TEs, CRs, and ROs work with taxpayers to resolve cases in a manner that both protects taxpayer rights and protects the public interest.

We maintain a comprehensive system of checks and balances over our Collection case selection and routing processes; and these internal controls are designed to further support the Collection program's mission. For example, at all stages, we conduct numerous independent quality reviews. The embedded quality program is an independent review of the cases based on certain attributes. Feedback is shared with the local manager to identify training needs and opportunities. Line management conducts operational reviews to assess the level of management oversight and quality of case processing including with respect to taxpayer rights. Upper management

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conducts program reviews to assess the efficacy of our guidelines and ensure that our procedures are being followed, as well as to identify potential risks or vulnerabilities. All employees are evaluated on the basis of standards that include the retention standard relating to fair and equitable treatment of taxpayers. Quality reviews are completed to ensure that our treatment of similarly situated taxpayers is fair, equitable and consistent; for example, all cases selected for quality review in Field Collection are rated on adherence to taxpayer rights.

It is also important to note that in the course of carrying out these internal controls and conducting the various reviews described above, we also use these ongoing operational activities as informal opportunities for identifying risks to the Collection program, and have done so on a long-standing basis. Risks to the accomplishment of Collection program goals, process objectives, or organizational priorities are regularly identified through these methods and are addressed in various ways, which can include identifying and implementing a mitigating action as part of the respective review activity, reinforcing existing or implementing new controls, providing training or additional guidance, having managers assess and address the risk, updating guidance or policy, or involving upper level management or governance boards as necessary.

These methods for identifying risks are long-standing and should be distinguished from the Enterprise Risk Management (ERM) framework the IRS has recently begun to implement. ERM is providing a more formalized approach to the identification and consideration of risks across the IRS, leveraging and supplementing existing risk management capabilities such as those described above. Through ERM, IRS is being equipped with additional opportunities for identifying and mitigating risks before they adversely impact performance. So while ERM is new to the IRS, the performance of risk management activities for programs and projects is not.

Appendix III: GAO Contact and Staff Acknowledgments

GAO Contact

James R. McTigue, Jr., (202) 512-9110 or mctiguej@gao.gov

Staff Acknowledgments

In addition to the contact named above, Libby Mixon (Assistant Director), David Dornisch, Robert Gebhart, Raheem Hanifa, Ted Hu, Ronald Jones, Mark Kehoe, Albert Sim, Justin Snover, and A.J. Stephens made key contributions to this report.