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IRS' Accounts Receivable Inventory

Statement of  
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Before the  
Subcommittee on Oversight  
Committee on Ways and Means  
House of Representatives



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## IRS' ACCOUNTS RECEIVABLE INVENTORY

SUMMARY OF STATEMENT BY  
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The reported amount of money owed the federal government in assessed but unpaid taxes--IRS' accounts receivable inventory --grew from \$24 billion in 1983 to nearly \$61 billion in 1989. While the amount that is actually collectible may be overstated by as much as a half, the growth is significant and represents a serious problem. The accounts receivable grew three times faster than collections of delinquent taxes and twice as fast as total net tax receipts. This growth persisted even though the Internal Revenue Service devoted more resources to collection activities and undertook numerous internal studies and projects aimed at slowing the growth.

On the basis of rough estimates made by GAO, IRS' Internal Audit, and Price Waterhouse, about half of the accounts receivable may be collectible. Some of the accounts are known to be erroneous, previously paid, or duplicates. Other accounts would not likely be paid because of the taxpayers' financial condition. IRS lacks the internal controls and the information systems to identify the extent of such accounts. Consequently, IRS cannot currently determine exactly how much of the inventory of delinquent taxes could be collected with either existing or additional resources. IRS also lacks basic information that would help in forging a more effective collection strategy.

The continuing budget deficits make it imperative that IRS take action now. In the short term, IRS needs to reduce its backlog by collecting what is owed as quickly and equitably as possible. In the long term, IRS needs to reevaluate its collection strategy. Because so many other IRS functions are involved when delinquencies occur, IRS needs to focus on Service-wide efforts to improve prevention, detection, and collection of delinquent taxes.

Mr. Chairman and Members of the Subcommittee:

We are pleased to be here today to assist the Subcommittee in its review of the Internal Revenue Service's (IRS) growing accounts receivable inventory. This is not a new topic for the Subcommittee or GAO, but one made more compelling by recent statistics. At a time when the government has a need to reduce a continuing high deficit, it is imperative to collect taxes that are properly owed.

Over the past 6 years, the reported amount of money owed the federal government in assessed but unpaid taxes--IRS' accounts receivable inventory--has skyrocketed from \$24 billion at the end of fiscal year 1983 to nearly \$61 billion at the end of fiscal year 1989. While the amount that is collectible may be overstated by as much as a half, the growth is significant and represents a serious problem. The accounts receivable inventory has grown three times faster than collections of delinquent taxes and twice as fast as total net tax receipts. This growth persists even though IRS has increased the amount of resources spent on collection activities and undertaken numerous internal studies and projects aimed at finding ways of slowing the growth.

Today, Mr. Chairman, I want to make four points. All of them relate to the failure of IRS' internal controls system to assure that assessed taxes are properly accounted for and collected. First, the overstatement of accounts receivable dollars may

mislead some into thinking that the full amount of the receivables balance could be collected and applied to reduce the budget deficit. Second, the continued growth of the accounts receivable inventory is a serious potential loss to the Treasury that cannot be allowed to continue. Third, IRS does not know conclusively why the inventory is increasing. It also lacks very basic management information that would enable it to fashion a better strategy for reducing the growth of these accounts and collecting them. Fourth, we believe that the current collection strategy will not lead to a reduction of the growth in accounts receivable anytime soon. Accounts receivable is an IRS-wide problem, and IRS must consider this in rethinking its overall collection strategy.

#### POTENTIAL REVENUES UNCERTAIN

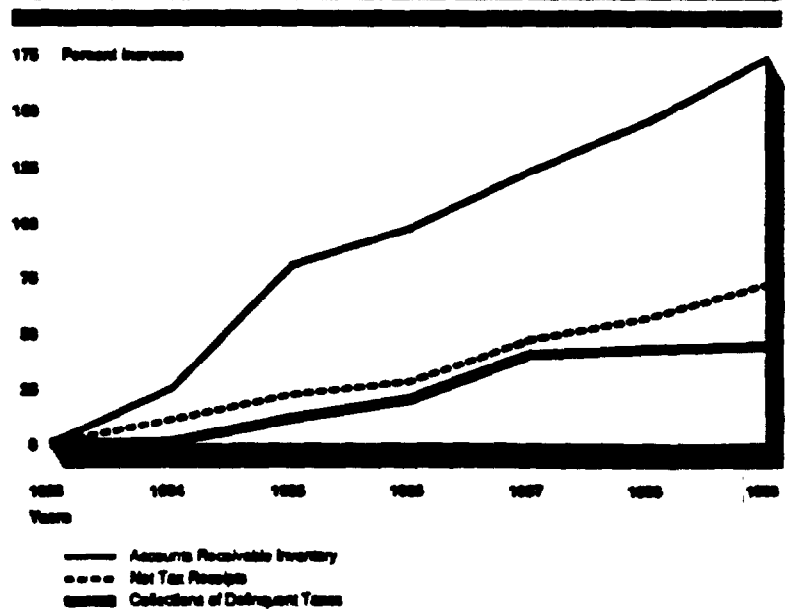
The reported accounts receivable inventory is overstated because it includes inaccurate account balances, duplicate receivables, and accounts that IRS will never be able to collect. IRS does not have the information to determine the extent that these receivables inflate the accounts receivable balance. However, on the basis of some limited analysis of the \$67 billion in accounts IRS closed over the past 2 years, we found that about half was due to inaccurate or duplicate receivables. This is consistent with studies done by IRS' Internal Audit and Price Waterhouse, which estimated that the amount of money owed the

federal government in back taxes may be overstated by as much as 40 to 60 percent. Thus, the actual receivables balance available for collection is probably about half the reported \$61 billion. But even that amount of money would go far in reducing the deficit and, as a matter of equity to all taxpayers, should be collected.

CONTINUED GROWTH OF ACCOUNTS RECEIVABLE INVENTORY

During the last 6 years, IRS' accounts receivable inventory increased over 170 percent, a much greater increase than the 44 percent increase in delinquency collections or the 71 percent increase in total net tax receipts. The graph shows the percentage increases in accounts receivable, delinquency collections, and total net tax receipts.

**Percent Increases in Accounts Receivable Inventory, Net Tax Receipts and Collections of Delinquent Taxes Since 1963**



Accounts Receivable Inventory and Collections of Delinquent Taxes on Fiscal Year Basis; Net Tax Receipts on Calendar Year Basis

For comparison purposes, this graph shows growth in the accounts receivable inventory for fiscal year 1989, based on \$66 billion, rather than the \$61 billion reported by IRS. This is because in September 1989 IRS recalculated its accounts receivable balance to include accrued interest and penalties, which were not previously reported, and exclude the \$25 billion of accounts it had classified as "currently not collectible." IRS plans further changes in the way it will report accounts receivable in future years, which are intended to better estimate potential revenues from the accounts receivable. However, while reducing the reported inventory, these changes will not necessarily reduce IRS' workload. These accounts will still remain on the books and require IRS resources to identify changes in taxpayers' ability to pay and to resolve the duplicate and inaccurate accounts.

In the past several years, IRS has paid increasing attention to this dramatic growth. It has done numerous internal studies of the accounts receivable inventory and has even sought help from Price Waterhouse in assessing the growth. IRS also increased its resources in this area. From 1987 to 1989, Collection staffing increased 13 percent and the amount of money IRS spent on collection activities increased 26 percent. Even with this increased attention, the amount of accounts receivable collected increased by less than 3 percent. This is not a very good return on the public's investment.

## LACK OF INFORMATION HINDERS COLLECTION EFFORTS

As we have said on numerous occasions over the last decade, IRS lacks basic information that would help in forging a more effective collection strategy. For example, IRS does not know

- enough about the reasons for the growth in the inventory;
- the effectiveness of its various collection programs and tools, such as levies or cases worked by revenue officers; and
- whether additional resources are needed.

IRS internal reports and a Price Waterhouse study done for IRS cited several possible reasons for the growth in accounts receivable. These reports indicated that some of the increase might be due to factors over which IRS has little control--more returns being filed, more cases in litigation or bankruptcy, or higher dollar values per account. Some of the increase was also said to be due to higher examination assessments and some due to IRS errors, such as returns processing errors or improper refunds.

IRS has little conclusive information on the extent of growth caused by each factor or whether all factors have been identified. For example, it would seem reasonable to expect collections to grow along with receivables if the only growth factors were higher assessments and higher accounts values. But

they have not.

Another reason for the growth could be inefficiencies in IRS' collection activities. While collections grew only 3 percent over the past 3 years, the amounts realized through various collection programs changed. Collections through the more cost-effective automated collection system declined about 25 percent, while those through revenue officers increased. Thus, it is costing more to collect each dollar.

Identifying the causes for growth in the accounts receivable inventory is important because it could lead to more effective efforts to reduce the inventory. For example, if IRS were to identify errors in returns processing as a major cause of growth, it could focus its efforts on the returns processing pipeline to reduce such errors.

IRS is gathering more information about its accounts receivable to better report the size of the inventory and learn more about the composition and age of its accounts. Much of this information is geared toward determining the proper amount of the receivables to report for financial statement purposes. We have long supported the need for federal agencies to prepare proper financial statements and believe that IRS' current efforts in this direction are appropriate.



But while the information IRS is currently collecting may present a clearer picture of how much IRS expects to collect, it will not be sufficient for the purpose of managing the collections workload or devising a more effective and better targeted collection strategy. We believe that as IRS develops additional management information it should be sure to collect information that will help evaluate the effectiveness of its various collection programs and tools and determine whether or where additional resources are needed.

#### CONCLUSIONS

Additional management information, while vital, will not solve the accounts receivable problem by itself. And we recognize that getting control of the accounts receivable problem will not be a short-term effort. However, despite increased attention and resources, including a number of projects that are presently underway, the growth pattern continues. Mr. Chairman, this suggests to us that the current collection strategy lacks the proper structure and focus to lead to a reduction of the growth in accounts receivable anytime soon. Yet, the continuing budget deficits make it imperative to attack this problem now. We believe IRS should embark upon a short-term effort to collect more money from existing accounts and, for the long term, develop a more comprehensive collection strategy.

To this end, we believe that the Subcommittee may want to ask IRS to lay out its collection goals for the next 3 to 4 years. The major thrust should be to increase the amount of money collected. Within the assumed context of protecting taxpayers' rights, the goals should include well-defined time frames, financial targets, and an aggressive approach to reducing the inventory. One target of opportunity may be to reverse the declining collections of the automated collection system. The proposed fiscal year 1991 budget for IRS contemplates almost 1,000 more staff for the collection function; but the budget also reflects a relatively modest increase of \$150 million in collections. IRS should be poised to act should those resources become available: ready to train and put these new staff into action quickly. In sum, the short-term strategy should be to collect what is owed as quickly and equitably as possible.

In the long term, focusing solely on IRS' collection function is insufficient. Accounts receivable is an IRS-wide problem. If IRS were viewed as a factory, collection would be the end of the production line. Other IRS functions are involved when tax delinquencies occur. For example, many delinquencies are identified in examinations. Returns Processing has a role in posting payments to accounts. Taxpayer Services often deal with taxpayers who receive delinquency notices. In short, almost all IRS functions can affect the collection workload and the size of the accounts receivable inventory. We believe it is time for IRS

to rethink its overall collection strategy by focusing on Service-wide efforts that can lead to substantial improvements in the prevention, detection, and collection of delinquent taxes.

This concludes my prepared statement. I would be pleased to answer questions.

GAO PUBLICATIONS ON IRS' ACCOUNTS RECEIVABLE  
AND THE COLLECTION PROCESS

IRS Can Improve the Process for Collecting 100-Percent Penalties  
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Statistics on IRS' Use of Levies to Collect Delinquent Taxes  
(GAO/GGD-89-97FS, July 17, 1989).

Administration's Fiscal Year 1990 Budget Proposals for IRS and  
the Tax Court, Statement Before the Subcommittee on Oversight,  
Committee on Ways and Means, House of Representatives (GAO/T-GGD-  
89-16, Apr. 4, 1989).

Periodic Evaluation Needed If IRS Uses Levies to Collect Deferred  
Accounts (GAO/GGD-89-34, Feb. 14, 1989).

Internal Revenue Service Issues (GAO/OCG-89-26TR, Nov. 1988).

Managing IRS: Actions Needed to Assure Quality Service in the  
Future (GAO/GGD-89-1, Oct. 14, 1988).

The 1988 Tax Return Filing Season and IRS' Fiscal Year 1989  
Budget, Statement Before the Subcommittee on Oversight,  
Committee on Ways and Means, House of Representatives (GAO/T-GGD-  
88-30, Apr. 13, 1988).

IRS' Fiscal Year 1988 Budget Request, Statement Before the  
Subcommittee on Oversight, Committee on Ways and Means, House of  
Representatives (GAO/T-GGD-87-9, Apr. 23, 1987).

IRS' Automated Collection System (GAO/GGD-120BR, July 31, 1986).

The Administration's Fiscal Year 1987 Budget Request for the  
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Oversight, Committee on Ways and Means, House of Representatives  
(May 12, 1986).

Further Research Into Noncompliance Is Needed to Reduce Growing  
Tax Losses (GAO/GGD-82-34, July 23, 1982).

What IRS Can Do to Collect More Delinquent Taxes (GAO/GGD-82-4,  
Nov. 5, 1981).

Who's Not Filing Income Taxes? IRS Needs Better Ways to Find  
Them and Collect Their Taxes (GGD-79-69, July 11, 1979).

100-Percent Penalty Assessments (GAO/GGD-77-49, May 3, 1977).