

**REVENUE COLLECTION:
ATF Needs To Improve Its
Offers In Compromise Process**

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Abbreviations

ATF	Bureau of Alcohol, Tobacco and Firearms
DIO	Director of Industry Operations
FAA Act	Federal Alcohol Administration Act
FMD	Financial Management Division
FY	Fiscal Year
IEM	Integrated Entity Module
IRC	Internal Revenue Code
ITC	Inventory, Tracking and Closure System
LICS	Leads, Investigations, Cases System
NRC	National Revenue Center
OIC	Offers In Compromise
OIG	Office of Inspector General
RAS	Revenue Accounting Section

*The Department of the Treasury
Office of Inspector General*

April 15, 2002

Bradley A. Buckles
Director
Bureau of Alcohol, Tobacco and Firearms

This report presents the results of the Office of Inspector General's (OIG) audit to determine whether the Bureau of Alcohol, Tobacco and Firearms (ATF) was using the offers in compromise (OIC) process effectively and in accordance with the intent of governing laws and regulations. We also conducted follow-up on a prior OIG report regarding OIC to determine whether planned corrective actions for recommendations were implemented.

ATF is authorized to initiate assessments of additional taxes, interest, and penalties; suspend or revoke permits; or take other adverse actions to ensure compliance with governing laws and regulations. An OIC is an agreement between ATF and a permittee to pay a lower amount to settle an adverse action. The OIC is an amount determined first by ATF guidelines, then negotiated with the permittee. This amount is deemed sufficient by ATF to ensure future compliance when a suspension or revocation of a permit is not warranted. ATF closed 28 OIC cases in Fiscal Years (FY) 1999 and 2000 with settlement amounts totaling over \$2 million. Individual OIC amounts ranged from \$500 to \$750,000.

This review was included in the OIG's *Annual Plan for Fiscal Year 2001*. We conducted our audit work from December 2000 to October 2001 at ATF Headquarters in Washington, D.C., and the National Revenue Center (NRC) in Cincinnati, Ohio. A more detailed description of our objectives, scope, and methodology is provided as *Appendix 1*.

Results in Brief

We found that ATF was using the OIC process in accordance with the intent of governing laws and regulations and that adequate controls existed to account for and safeguard OIC funds. ATF accepted OICs to resolve violations. All OIC cases required some level of Headquarters review. In addition, ATF developed standardized worksheets for processing OIC cases to better ensure consistency and fairness. However, we found that ATF could improve the OIC process to make it more effective and timely.

We found that ATF needs to track and monitor OIC cases better. ATF had a difficult time providing us with an accurate universe of OIC cases closed in FYs 1999 and 2000; was not using N-Spect (ATF's official system designed to provide automated reporting and tracking abilities for ATF's regulatory enforcement) effectively to track and monitor OIC cases; was not producing OIC management reports; and was not conducting OIC case trend analysis. We found that Directors of Industry Operations (DIOs) were maintaining their own internal tracking systems. ATF had difficulties tracking and monitoring OIC cases because there was confusion by the DIOs regarding the definition of a closed OIC case; OIC information entered into N-Spect was inaccurate, incomplete, and inconsistent; and N-Spect was behind schedule because inadequate funding did not allow it to progress as planned. Without consistent, reliable, and meaningful OIC data, ATF cannot measure the effectiveness of its OIC process, nor can it be assured that OIC amounts are adequate to accomplish ATF's goal of voluntary compliance.

We also found that OIC case processing procedures need improvement. OIC case processing procedures did not include timeliness guidelines. In addition, OIC case processing procedures were not always clear and were not always followed. Without the implementation of effective OIC procedures, ATF cannot ensure that OIC cases are processed consistently, fairly, and timely. ATF closed 28 OIC cases in FYs 1999 and 2000 with over \$10 million of tax liability being compromised and settlement amounts totaling over \$2 million. In our review of the 28 closed OIC cases, we

found that 15 cases were processed more than 2 years after the inspection report was completed. Two of these 15 OIC cases were closed approximately 6 years from the date of the completed inspection report. These 15 cases amounted to over \$1.8 million of revenue that was not recognized timely. We also looked at open cases and found that ATF still had open cases from FYs 1994 and 1995. By having OIC cases remain unresolved for a long period, ATF did not recognize revenue received from OIC cases timely and failed to provide permittees with timely adjudication of cases. We believe that ATF's reorganization in October 1998 from 5 regional offices to 23 field divisions and the consolidation of its 5 Technical Services Centers into the NRC contributed to some of the problems ATF experienced implementing its OIC case processing procedures timely and effectively.

Similar findings were also cited in a prior audit report, *Audit Report Bureau of Alcohol, Tobacco and Firearms Offers in Compromise*, OIG-92-058, dated September 23, 1992. Although ATF implemented planned corrective actions to address the recommendations in this prior report, we noted similar findings during our review. Therefore, we believe that corrective actions taken were not always effective in correcting the deficiencies cited in the prior report.

We made eight recommendations to improve ATF's OIC process. We recommended that ATF management should ensure that an appropriate case tracking system is implemented to (1) accurately and consistently track OIC cases; (2) produce meaningful management reports; and (3) identify trends and patterns in order to measure the effectiveness of the OIC process. In addition, we recommended that ATF management should ensure that OIC case processing procedures are revised and issued in order to provide clear guidance for processing OIC cases. These revised procedures should include timeliness guidelines. We believe that by ATF implementing these recommendations OIC funds would be put to better use.

ATF concurred with our eight recommendations and is taking appropriate corrective action. ATF is in the process of making

N-Spect modifications to ensure proper data input to enable monitoring and tracking of OIC cases from within N-Spect. As an interim measure, ATF will establish a separate tracking and monitoring system at the NRC. ATF is also in the process of revising OIC case processing procedures. ATF believes that these new procedures, which will include timeliness guidelines, will ensure that cases are resolved more expeditiously. The revised guidelines will also ensure greater consistency due to restoring centralized oversight and resolution.

Background

An OIC is an agreement between ATF and a permittee to pay a lower amount to settle an adverse action. An OIC is a settlement to any case where the violations are not strong enough to warrant permit action or criminal prosecution and where lesser administrative action is deemed not sufficient to ensure future compliance. Also, an OIC may be warranted where the evidence supports permit action or prosecution, but where (1) the violations were committed under extenuating circumstances or (2) the violator's character, conduct, and compliance history mitigate the effects of the violation.

ATF is authorized to accept an OIC under the following three laws as a means to resolve violations:

- Internal Revenue Code (IRC) of 1986, Title 26, United States Code, Section 7122. These violations involve alcohol and tobacco products or firearms that are taxed and regulated under the IRC.
- Federal Alcohol Administration (FAA) Act, Title 27, United States Code, Section 207. The violations covered include inappropriate labeling, advertising, or marketing through unfair trade practices. Each improper label or advertisement is considered a violation.
- Alcohol Beverage Labeling Act of 1988, Title 27, United States Code, Section 219. This law imposes the

requirement that the Government Warning Statement appear on labels of alcohol beverages imported, bottled, or distributed in the United States. Violation of this requirement may be resolved through an OIC.

In the OIC process, the original assessment is reduced because: (1) the amount of the liability or the ability to collect is in doubt, or (2) mitigating circumstances exist whereby the payment of a lesser amount is deemed sufficient to ensure voluntary compliance in the future. The amount of the OIC is determined first by ATF guidelines, and then negotiated with the permittee.

The Office of Alcohol and Tobacco is responsible for administering programs relating to federal tax collection and regulation of the alcohol and tobacco industries. The primary mission of the Office of Alcohol and Tobacco is to develop national priorities and strategies and evaluate field implementation of these priorities and strategies. The Office is responsible for providing oversight and advice for OIC cases. The Office of Alcohol and Tobacco is comprised of four divisions and the NRC.

The NRC located in Cincinnati, Ohio, administers policy and programs supporting ATF's "collect the revenue" strategic goal by reconciling tax returns, reports and claims; processing applications for and issuing permits; and providing technical advice. The NRC processes OIC cases and maintains historical files and serves as the repository for files relating to permittees.

The Revenue Accounting Section (RAS) of the Financial Management Division (FMD), located at the NRC in Cincinnati, Ohio, deposits the OIC checks and records the OIC amounts into a suspense account. Once the NRC sends notification letters to the permittees notifying them their OIC has been accepted, the FMD is responsible for transferring the money from the suspense account to the revenue account.

The Director of Industry Operations (DIO) is the deciding official in the field for settling OIC cases and is responsible for determining the appropriate range of an OIC. ATF has developed standardized

worksheets to use for determining the correct amount of an OIC and the level of Headquarters review and concurrence. These worksheets help ensure consistency and fairness of OIC cases nationwide throughout ATF. The DIOs report to the Division Director located in each field office and are required to keep the Division Directors informed on all actions and decisions made regarding the regulated industries.

The Intelligence Systems Branch is responsible for coordinating the design, development, installation, training and service of all information technology efforts within the ATF's Intelligence Division. These efforts include intelligence specific applications such as the automated case management system used across the country. N-Spect is a designed part of that case management system.

Findings and Recommendations

Finding 1 ATF Needs To Track and Monitor OIC Cases Better

We found that ATF was not effectively tracking and monitoring OIC cases. We found that ATF was not (1) using N-Spect effectively to report and track OIC cases; (2) producing any OIC management reports; and (3) conducting OIC case trend analysis.

In our prior audit of ATF's OIC process, we reported that ATF could not provide an accurate universe of OIC cases closed in FYs 1990 and 1991. During our current review, we found that ATF still had a difficult time providing an accurate universe of closed OIC cases. During December 2000 and January 2001, ATF Headquarters provided us with three different lists of OIC cases closed in FYs 1999 and 2000. According to Headquarters officials, the lists of closed OIC cases were obtained from internal records maintained by the Chief, Market Compliance Branch, from information received from the NRC, and from information received from all 23 DIOs. However, the list of closed cases identified by Headquarters did not agree with accounting records maintained by the FMD in Cincinnati, Ohio. The lists provided by Headquarters did not

identify 8 OIC cases closed in FY 1999 and included 12 cases as closed that were still open.

ATF had difficulties tracking and monitoring OIC cases because (1) there was confusion by the DIOs regarding the definition of a closed case; (2) OIC information contained in N-Spect was inaccurate, incomplete, and inconsistent; (3) N-Spect is 2-3 years behind schedule due to inadequate funding that did not allow the development to progress as planned; and (4) the prior OIC tracking system -- Leads, Investigations, Cases System (LICS) -- was discontinued before N-Spect was fully operational.

As a result, various types of manual and internal tracking systems were maintained by most of the 23 DIOs who had OIC cases. Without consistent, reliable, and meaningful data, ATF cannot readily measure the effectiveness of its OIC process, nor can it be assured that OIC amounts are adequate to accomplish ATF's goal of encouraging industry members to voluntarily comply with FAA Act and IRC regulations.

N-Spect Was Not Being Used Effectively To Report and Track OIC Cases

According to ATF's *N-Force/N-Spect Development Strategy*, N-Spect is a database designed to provide automated reporting and tracking abilities for ATF's regulatory function and inspectors. We found that N-Spect was not being used effectively to report and track OIC cases because (1) OIC information contained in N-Spect was inaccurate, incomplete, and inconsistent; and (2) due to inadequate funding, N-Spect was not developed and implemented as planned. As a result, various types of manual and internal tracking systems were maintained by most of the 23 DIOs who were processing OIC cases.

Use of N-Spect is mandatory and N-Spect procedures state that supervisors are to consider an employee's ability to accurately maintain N-Spect records during the completion of performance appraisals. According to existing procedures, the Alcohol and Tobacco Programs Division and Revenue Division are to monitor

FAA Act and IRC cases in N-Spect to keep Headquarters managers aware of the nature of every case involving potential adverse actions. We found that ATF officials were not adequately monitoring OIC cases in N-Spect.

ATF planned to implement N-Spect in four phases to replace LICS, ATF's former tracking system which was discontinued in 1998. Prior to N-Spect, LICS was used to track OIC cases and produce management reports regarding OIC cases. LICS now exists at the NRC as a historical database containing information on OIC cases.

As a result of funding secured for Phase I, ATF began implementing N-Spect in April 1999, with full deployment occurring in September 1999. However, ATF's ability to report and track OIC cases became more difficult when LICS was discontinued before N-Spect was fully up and running. As a result, all OIC information was not entered in LICS or N-Spect during the transition from one tracking system to another.

During Phase II, LICS functions were to be integrated into N-Spect, along with the ability to query existing data. However, N-Spect received no funds for Phase II development in FY 1999 and received limited funds for maintenance and minor enhancements. The major components of N-Spect Phase II have still not been funded and ATF is behind in the original development plan. ATF officials informed us that N-Spect was currently 2-3 years behind schedule.

During our review, ATF provided us with printouts of OIC data from N-Spect. However, we found that we could not rely on the data because it was inaccurate, incomplete, and inconsistent. All OIC cases were not being consistently entered and closed in N-Spect, some OIC cases were incorrectly identified in N-Spect, and in some cases, field divisions were closing OIC cases in N-Spect prematurely.

During our exit conference in January 2002, ATF officials informed us that a case tracking system is planned to improve the

monitoring and tracking of cases. However, this system is not operational yet.

OIC Management Reports Were Not Produced

At this time, N-Spect is not producing any OIC management reports. An ATF official informed us that even if N-Spect was producing management reports, the information would not be meaningful because N-Spect data is inaccurate, incomplete, and inconsistent. Because N-Spect is not producing any management reports, Headquarters officials and many of the DIOs are tracking OIC cases manually through the use of electronic spreadsheets or other means. We were told that area supervisors were responsible for keeping OIC cases timely and ensuring that the statute of limitations did not run out.

Our prior OIG report on ATF's OIC process recommended that ATF establish management exception reports which included early warning systems in LICS on OIC cases where no action had been taken in a specific time period and where the statutes of limitations were about to expire. The report also recommended that supervisory reviews of these exception reports be required. ATF concurred with the recommendation and created an exception report that would bring to management's attention any case that had no action for a 30-day period. ATF also created an additional report for management to indicate when the statutes of limitations were about to expire. However, because ATF no longer uses LICS, these two exception reports are no longer being created.

OIC Trend Analysis Was Not Conducted

ATF was not analyzing OIC cases to identify trends, techniques, or patterns that might impact ATF. ATF's FAA Act case processing guidelines state that one of the responsibilities of the Alcohol and Tobacco Programs Division is to analyze both closed and in process FAA Act cases to identify trends, techniques, or patterns that may impact the Bureau's enforcement or policy considerations. ATF's draft IRC case processing guidelines state that the Revenue Division is to

analyze closed IRC cases. OIC trend analysis would provide ATF management with pertinent information regarding the timeliness process, the compromised penalties, and the overall impact on the Bureau's ability to ensure that OIC amounts are sufficient to achieve ATF's goal of voluntary compliance.

Recommendations

1. The Director should take appropriate action to ensure that N-Spect integration efforts progress as originally planned and/or an appropriate case tracking system is implemented to accomplish accurate and consistent tracking and monitoring of OIC cases.

Management Comment.

ATF concurred and stated that the strategic plan for N-Spect includes future interfacing with the NRC's database that contains OIC collection data. This interface will provide the ability to look at OIC collection data tracked within N-Spect and automatically populate the corresponding data fields in the systems used by the NRC. This interface between N-Spect and the NRC's Integrated Entity Module (IEM) is dependent upon the development and implementation of Phase II of N-Spect and Phase II of the Integrated Revenue Information System, which contains the IEM. The action due date for the N-Spect modifications is September 2003.

As an interim measure, ATF will establish a separate tracking and monitoring system at the NRC and will provide written procedures for reporting and entering data as well as producing management reports and trend analysis. The beginning point for this tracking system will be the submission of an OIC by an industry member. The action due date for ATF's interim system is June 2002.

OIG Comment.

The OIG believes that the actions taken and planned by ATF address the intent of the recommendation.

2. The Director should ensure that OIC information entered in N-Spect or other appropriate system is reviewed and that any necessary adjustments are made to correct any OIC information that is inaccurate, incomplete, and/or inconsistent.

Management Comment.

ATF concurred and stated that the Field Management Staff, Office of Field Operations, will advise all field divisions that had inspections, audits, or investigations that resulted in the acceptance of an OIC to review data posted in N-Spect and make any necessary changes and/or corrections. Furthermore, Field Management Staff and the NRC will provide written policies and procedures to their employees to provide guidance for monitoring OIC cases to ensure information entered in N-Spect is accurate and complete. The action due date for this recommendation is March 2003.

OIG Comment.

The OIG believes that the actions taken and planned by ATF address the intent of the recommendation.

3. The Director should ensure that there is an adequate system in place capable of reporting and tracking OIC cases so that meaningful management reports can be produced.

Management Comment.

ATF concurred and stated that N-Spect maintenance release Version 1.5 will make posting to certain OIC data fields mandatory on the inspection results screen when an OIC is recommended. This will ensure proper data input to enable

monitoring and tracking of OIC cases from within N-Spect. The action due date for these N-Spect modifications is March 2003.

As an interim measure, ATF will establish a separate tracking and monitoring system at the NRC and will provide written procedures for reporting and entering data as well as producing management reports and trend analysis. The action due date for the interim system is June 2002.

OIG Comment.

The OIG believes that the actions taken and planned by ATF address the intent of the recommendation.

4. The Director should ensure that OIC cases are monitored and analyzed to identify trends and patterns in order to measure the effectiveness of the OIC process.

Management Comment.

ATF concurred and stated that once N-Spect maintenance release Version 1.4 is placed into production and all mandatory data has been posted, ATF will be able to monitor and analyze data to identify trends and patterns through the use of Oracle Discoverer, a data query and report generation tool. The OIC case processing procedures, which are currently being revised, will identify the office(s) responsible for monitoring and analyzing OIC cases. The action due date for these N-Spect modifications is March 2003.

As an interim measure, ATF will establish a separate tracking and monitoring system at the NRC and will provide written procedures for reporting and entering data as well as producing management reports and trend analysis. The action due date for the interim system is June 2002.

OIG Comment.

The OIG believes that the actions taken and planned by ATF address the intent of the recommendation.

Finding 2 OIC Procedures Need Improvement

In our prior audit of ATF's OIC process, we reported that ATF did not always process OIC cases timely and that procedures to process OIC cases needed improvement. During our current audit, we found that ATF still did not always process OIC cases timely and that OIC case processing procedures still needed improvement because procedures did not include timeliness guidelines, were not always clear, and were not always followed. ATF did not recognize over \$1.8 million in revenue timely and failed to provide permittees with timely adjudication of cases as a result of OIC cases that remained unresolved for a long period. We believe ATF did not make the development and implementation of clear and effective OIC procedures a management priority. Without the implementation of effective OIC procedures, ATF cannot ensure that OIC cases are processed consistently, fairly, and timely.

ATF officials informed us that they were in the process of revising OIC case processing procedures. ATF officials stated that they plan to issue one directive covering both FAA Act and IRC cases and that these revised procedures would include timeliness guidelines. ATF officials plan to complete the new procedures by March 31, 2002.

OIC Cases Were Not Always Processed Timely

We found that OIC cases were not always processed timely. ATF closed 28 OIC cases in FYs 1999 and 2000 with over \$10 million of tax liability being compromised and settlement amounts totaling over \$2 million. Individual OIC amounts ranged from \$500 to \$750,000. In our review of these 28 cases, we found that only 2 of the 28 OIC cases were processed in less than a year and 7 cases were processed between 1 and 2 years. Also, we found that 15 cases were processed more than 2 years after the inspection report was completed. Two of these 15 OIC cases were closed approximately 6 years from the date of the completed inspection report. These 15 cases amounted to over \$1.8

million not recognized timely as revenue. (See *Appendix 2*.) For the remaining 4 cases, it was difficult to determine exactly how timely the cases were processed, because the NRC did not have all the necessary documentation for us to make an assessment on the timeliness of the case.

In addition, during our visit to the NRC in February 2001, we found that ATF had numerous open OIC cases that were not processed timely. For example, 1 OIC case dated back to FY 1994; 1 OIC case had been open since FY 1995; 2 OIC cases had been open since FY 1996; 2 OIC cases had been open since FY 1997; and 4 OIC cases had been open since FY 1998. ATF closed 3 of these 10 cases in August 2001. The other 7 remained open. When OIC cases remain open for extended periods, ATF is not recognizing its revenue timely. These 10 cases amount to over \$338,000.

Money received from an OIC case is deposited into a suspense account where it remains until the OIC case is accepted and the NRC prepares a notification memorandum requesting the FMD's Revenue Accounting Section (RAS) to transfer the OIC funds from the suspense account to the revenue account. Until the offer is accepted and the permittee is notified in writing, the OIC may be withdrawn at any time by the permittee. As a result, unaccepted OIC amounts are not available for use by the Government, and those amounts held in escrow are liabilities to the Government.

Except for OIC cases involving firearms and ammunition taxes, all OIC amounts recognized as revenue are remitted to the Department of the Treasury General Fund. The Department further distributes this revenue to Federal agencies in accordance with various laws and regulations. OIC revenue involving firearms and ammunition taxes is transferred directly to the Department of the Interior to aid that Department.

By having OIC cases remain unresolved for long periods, ATF did not recognize over \$1.8 million in revenue timely and failed to provide all permittees with timely notification of acceptance

of offers and adjudication or settlement of cases. ATF delayed allowing these funds to be put to better use by not recognizing revenue timely.

We believe that OIC cases were not always processed timely due to several reasons. First, OIC timeliness guidelines were not included in current OIC case processing procedures. In our prior audit report, *Audit Report Bureau of Alcohol, Tobacco and Firearms Offers In Compromise*, we recommended that the Director establish separate IRC and FAA guidelines as to what constituted timely completion of an OIC case. ATF concurred with this recommendation and issued *Federal Alcohol Administration Act Case Processing Guidelines*, ATF B 5190.2, in January 1993 and *Internal Revenue Code Case Timely Processing Charts*, ATF B 5640.3, in October 1994. These guidelines stated that the OIC process should be completed within 175 workdays for FAA Act cases and 164 workdays for IRC cases, from the time of the completed inspection report with a recommendation for an OIC. The FAA Act guidelines expired in January 1995 and the IRC guidelines expired in December 1995.

ATF subsequently issued revised FAA Act guidelines in August 1999 and draft IRC guidelines in March 1999. However, neither of these revised procedures included timeliness guidelines. We were told that the revised procedures did not include timeliness guidelines because, in some cases, the timeliness guidelines were not reasonable and the guidelines were too hard to implement.

We asked the DIOs what they considered timely for processing OIC cases to completion. Their responses varied from 4-6 months from completion of the fieldwork to 18 months from completion of fieldwork. However, most of the DIOs stated that they considered OIC cases timely if they were processed in less than 1 year. We found that only two OIC cases in our sample were processed in less than a year. Processing times for the other cases ranged from about 16 months to about 6 years. Also, during our review of closed OIC cases we found

instances where ATF did not process the OIC timely once the OIC check was deposited and the offer was accepted.

Second, we believe that OIC cases were not always processed timely because ATF's reorganization and consolidation of the Technical Services Centers resulted in communication and/or coordination problems between some of the field divisions, NRC, and FMD. In October 1998, ATF reorganized and established the Field Operations Directorate with 23 DIOs responsible for settling OIC cases. Prior to ATF's reorganization, ATF had 5 Regional Directors responsible for processing OIC cases. In addition, by December 2000, ATF had consolidated its five Technical Services Centers, located throughout the country, into the NRC. ATF lost a lot of expertise due to turnover of knowledgeable staff as a result of the consolidation. Many of the newer employees hired did not have knowledge of and experience with the OIC process.

As a result of these organizational changes, the NRC did not always receive OIC case documentation timely. We also found that workflow between the field and the NRC was not always clear and that some communication and coordination problems existed between the NRC and DIOs because the NRC reported to the Headquarters Revenue Division under the Assistant Director, Alcohol and Tobacco, and the DIOs reported to the Field Division Directors under the Assistant Director, Field Operations.

Third, in some cases, delays in OIC case processing occurred because legal and compliance approval reviews were not timely. In one case, the Market Compliance Branch was unable to locate the OIC case and the NRC had to make copies and resubmit the case. In another case, there was some disagreement on ATF's position between Chief Counsel at Headquarters, the Assistant Chief Counsel in Cincinnati, and Counsel in San Francisco. As a result, the NRC was waiting to get a clear consensus from Counsel.

Although the RAS was monitoring OIC cases for timeliness and requesting follow-up regarding the status of these cases from the Chief, NRC, ATF officials did not take the necessary action to ensure that timeliness issues were addressed and resolved.

OIC Case Processing Guidelines Were Not Always Clear and Not Always Followed

We found several instances where OIC procedures were not clear and/or were not followed. For example, we found that:

- OIC case processing guidelines did not include a clear definition of what constituted a closed OIC case. Confusion regarding the definition of a closed case resulted in difficulties and differences in reporting the number of OIC cases closed in FYs 1999 and 2000. FAA Act and IRC case processing guidelines state that a case is closed when all resolving actions are completed and final N-Spect entries have been made. We asked the DIOs when they considered an OIC case closed. Their responses varied. Some DIOs regarded a case as closed when the offer was accepted by ATF. Other DIOs stated that they believed an OIC case was closed when the notification letter was sent to the permittee or to the Internal Revenue Service. Other DIOs stated they believed a case was closed when the OIC information was entered into N-Spect. One DIO considered a case closed when the OIC payment was received. Without a more specific definition of when an OIC case should be considered as closed, ATF will continue to capture and report inaccurate and unreliable information regarding its closed OIC cases.
- All open OIC cases were not entered into N-Spect. In addition, the DIOs had multiple definitions for determining when an OIC case was considered opened for tracking purposes. One DIO stated that an OIC case was considered open when the inspection report was completed and the DIO concurred with the recommended action. Another DIO considered a case open when the

case was entered into N-Spect with a recommendation for an OIC. Another DIO considered a case open when the case was forwarded to Counsel for review. Another DIO stated that an OIC case was not considered open until an OIC was offered by the permittee. According to ATF procedures, it is important to develop consistency in inputting information into the system. This will reduce time spent by employees at every level in recovering information, compiling statistics, and updating and correcting files.

- The field divisions were not always notifying the NRC when an FAA Act case resulted in a recommendation for an OIC. According to case processing procedures, area supervisors are responsible for notifying, by electronic mail, the DIO and the NRC when an FAA Act case is opened. We found four OIC cases that had not been communicated to the NRC.
- Standardized worksheets were not always prepared or documented in the case files. The use of standardized worksheets helps ensure that OIC cases are processed fairly and consistently through ATF's 23 field divisions. According to ATF, consistent treatment of all regulated industry members is essential to continued compliance on the part of industry and essential to the integrity of ATF's inspection and enforcement programs. Beginning in FY 1999, both FAA Act and IRC case processing procedures required a Case Review Formula Worksheet to be completed for each OIC case to determine the appropriate level of Headquarters review and concurrence. We found that this worksheet was not always prepared and/or was not documented in the OIC case file. Other worksheets, including worksheets to determine a recommendation for an appropriate range of an OIC, were also either not always completed or not documented in OIC case files at the NRC.

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- The Offer in Compromise Form, ATF F 5640.1 (3-95) and ATF F 5640.2 (1-84), provides incorrect locations to the permittees on where to file the offers. The OIC form for IRC violations lists the old Technical Services Offices - all of which were closed by December 2000. The OIC form for FAA Act violations states that the OIC is to be filed with the Regional Director (Compliance) - a position that no longer exists. The correct location on where to file the offers is the NRC in Cincinnati, Ohio.
 - OIC cases were not being closed in N-Spect. OIC case processing procedures dated August 1999 stated that the NRC was responsible for closing N-Spect entries for cases recommending an OIC. NRC officials informed us that the field division was responsible for closing N-Spect entries. NRC personnel also explained that they did not even obtain read-only access to N-Spect information until March 2001. Of the 28 OIC cases that were closed in FYs 1999 and 2000, only 2 were entered as closed in N-Spect. ATF cannot effectively monitor OIC cases using N-Spect if OIC information is not properly entered.
 - Completed OIC case files were not always sent to the NRC. Case processing procedures require that all closed case files be sent to the NRC for inclusion in the permittee's file. The NRC is responsible for maintaining custody of official case files. Without the complete file documentation, ATF cannot ensure that the correct OIC amount was accepted and that the entire amount was collected.
 - IRC case processing guidelines, which have been in draft status since March 1999, have not yet been finalized. One of our audit objectives was to determine whether corrective actions were taken to address recommendations made in our prior OIG audit report, *Audit Report Bureau of Alcohol, Tobacco and Firearms Offers In Compromise*. The prior report found that IRC procedures were in draft and the OIG recommended that the Director issue final IRC guidelines. ATF took

corrective action and issued IRC guidelines, *Review and Resolution of Internal Revenue Cases*, ATF 5640.2B, in October 1992 and *Internal Revenue Code Case Timely Processing Charts*, ATF B 5640.3, in October 1994. However, although corrective action was implemented, IRC procedures were subsequently revised and issued again in draft in March 1999. As of January 15, 2002, these procedures have still not been finalized.

Recommendations

1. The Director should ensure that timeliness guidelines are established for processing OIC cases to timely recognize revenue and allow funds to be put to better use.

Management Comment.

ATF concurred and stated that it is in the process of revising OIC case processing procedures. These revised procedures will include timeliness guidelines. The action due date for this recommendation is March 2003.

OIG Comment.

The OIG believes that the actions taken and planned by ATF address the intent of the recommendation.

2. The Director should re-emphasize to the field divisions the importance of sending completed OIC case documentation promptly to the NRC.

Management Comment.

ATF concurred and stated that this will be emphasized in the new case processing procedures currently under development. The action due date for this recommendation is March 2003.

OIG Comment.

The OIG believes that the actions taken and planned by ATF address the intent of the recommendation.

3. The Director should ensure that appropriate follow-up action is taken to resolve OIC cases identified by the RAS as untimely to more quickly recognize revenue received as a result of an OIC.

Management Comment.

ATF concurred and stated that since May 2001, the average age of an open case has dropped from 27 months to 15 months. ATF stated that its goal is to reduce the average processing time. ATF believes that the new case processing procedures, which include timeliness guidelines, will ensure that cases are resolved more expeditiously. The action due date for this recommendation is March 2003.

OIG Comment.

The OIG believes that the actions taken and planned by ATF address the intent of the recommendation.

4. The Director should ensure that OIC case processing procedures are revised and issued to provide clear guidance for processing OIC cases. Revised procedures should include a more specific definition for classifying a case as closed; specific instructions regarding OIC workflow processes, including entering and closing cases in N-Spect; an updated OIC form that lists the correct address for submitting an offer; and timeliness guidelines for processing OIC cases. The Director should emphasize the importance of implementing these procedures to ensure that OIC cases are processed fairly, consistently, and timely.

Management Comment.

ATF concurred and stated that revised case processing procedures will ensure greater consistency due to restoring centralized oversight and resolution. The revised procedures will include a more specific definition for classifying a case as closed, specific instructions regarding OIC workflow processes, and timeliness guidelines for processing OIC cases. In addition, ATF has already begun revising the OIC form, which will reflect both the correct name and address for mailing an OIC. The action due date is March 2003.

OIG Comment.

The OIG believes that the actions taken and planned by ATF address the intent of the recommendation.

* * * * *

We appreciate the cooperation and courtesies extended to our staff during the audit. If you have any questions, please contact me at (202) 927-5591, or a member of your staff may contact Lynn Richardson, Audit Manager at (202) 927-6367. Major contributors to this report are listed in Appendix 4.

Alexander Best, Jr.
National Director, Enforcement Program Audits

Our objective was to determine whether ATF was using the OIC process effectively and in accordance with the intent of governing laws and regulations. Our specific objectives were to determine whether:

- The OIC process was applied consistently, fairly, and timely;
- OIC amounts accepted were sufficient to achieve ATF's goal of obtaining voluntary compliance;
- Adequate controls existed to account for and safeguard OIC funds; and
- Planned corrective actions for recommendations on a prior OIG report were implemented.

Our review generally covered FYs 1999 and 2000. To accomplish our review, we conducted audit work at ATF Headquarters in Washington, D.C., where we interviewed officials in the Office of Alcohol and Tobacco and officials in the Intelligence Division of the Office of Field Operations. We also visited the NRC in Cincinnati, Ohio and interviewed NRC and FMD officials responsible for processing OIC cases. In addition, we prepared a data collection instrument that was sent to all 23 DIOs to obtain their views on the OIC process.

We reviewed applicable governing laws and regulations related to OIC. We reviewed ATF policies, procedures, and directives regarding the OIC process. In addition, we reviewed ATF policies and procedures regarding N-Spect. We reviewed all 28 OIC cases that ATF closed in FYs 1999 and 2000 to determine whether OIC cases were processed properly and in accordance with ATF guidelines. We obtained OIC case documentation, reviewed accounting reports, and verified that OIC funds were received by NRC and deposited by FMD. We evaluated whether effective internal controls existed to prevent or detect fraud and to safeguard OIC funds. We also reviewed numerous open OIC cases that we believed were not processed timely.

We conducted our audit between December 2000 and October 2001 in accordance with generally accepted government auditing standards.

We found that OIC cases were not always processed timely. Fifteen of the 28 OIC cases closed in FYs 1999 and 2000 were processed more than 2 years after the inspection report was completed (see schedule below). These 15 cases amounted to over \$1.8 million not recognized timely as revenue. ATF delayed allowing these funds to be put to better use by not recognizing revenue timely. We believe that funds could be used more efficiently, if management took actions to implement the four recommendations included in Finding 2. Accordingly, over \$1.8 million in OIC funds will be recorded in the Inventory, Tracking and Closure System (ITC) as funds put to better use and included in the OIG Semiannual Report to the Congress. It is ATF management's responsibility to record the actual funds put to better use as a result of its implementation of the recommendations in the ITC.

**SCHEDULE 1 - Finding 2 - Recommendations 1 to 4
 ACCEPTED OIC AMOUNTS CLOSED DURING FYS 1999 AND 2000**

Case	Type	Liability or penalty being compromised	OIC amount accepted by ATF	OIC amount that took over 2 years to close
1	IRC	\$1,191,773.70	\$450,000.00	\$450,000.00
2	IRC	\$4,823,311.58	\$300,000.00	\$300,000.00
3	IRC	\$175,128.15	\$85,000.00	\$85,000.00
4	IRC	\$1,333,513.69	\$80,000.00	\$80,000.00
5	IRC	\$129,825.06	\$45,000.00	\$45,000.00
6	IRC	\$499,437.46	\$40,014.26	\$40,014.26
7	IRC	\$65,655.61	\$37,737.00	\$37,737.00
8	IRC	\$203,671.18	\$17,000.00	\$17,000.00
9	IRC	\$47,288.09	\$15,000.00	\$15,000.00
10	IRC/FAA	\$26,214.75	\$13,000.00	\$13,000.00
11	IRC	\$38,701.74	\$10,000.00	\$10,000.00
12	IRC	\$7,472.38	\$3,700.00	\$3,700.00
13	IRC	\$1,219,417.48	\$45,000.00	(a)
14	IRC/FAA	\$257,000.00	\$65,000.00	(a)
15	IRC	\$37,277.41	\$1,000.00	(a)
16	IRC	\$23,115.38	\$10,000.00	(a)
17	IRC	\$5,145.77	\$1,000.00	(b)
18	IRC	\$882.77	\$500.00	(b)
19	IRC	Not provided	\$2,000.00	(b)
20	FAA/IRC non-tax	(c)	\$100,000.00	(a)
21	FAA	(c)	\$750,000.00	\$750,000.00
22	FAA	(c)	\$5,000.00	\$5,000.00
23	FAA	(c)	\$3,000.00	\$3,000.00
24	FAA	(c)	\$7,500.00	(a)
25	FAA	(c)	\$5,000.00	(b)
26	FAA	(c)	\$20,000.00	(a)
27	FAA	(c)	\$70,000.00	(a)
28	FAA	(c)	\$2,500.00	(a)
Totals		\$10,084,832.20	\$2,183,951.26	\$1,854,451.26

(a) = ATF processed case to closure in less than 2 years.
 (b) = Documentation was not provided to determine timeliness.
 (c) = FAA and IRC non-tax cases do not involve a tax liability.

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DIRECTOR

DEPARTMENT OF THE TREASURY
BUREAU OF ALCOHOL, TOBACCO AND FIREARMS
WASHINGTON, DC 20226

MAR 29 2002

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MEMORANDUM TO: Assistant Inspector General for Audit
FROM: Director
SUBJECT: Management Response to Office of Inspector
General's (OIG) Draft Report on Revenue
Collection: ATF Needs To Improve Its Offers
In Compromise Process

This is a response to the OIG's February 20, 2002, draft audit report, *Revenue Collection: ATF Needs To Improve Its Offers In Compromise Process*.

We note that the overall finding of the audit was that "ATF was using the offer in compromise (OIC) process in accordance with the intent of governing laws and regulations and that adequate controls existed to account for and safeguard OIC funds." Beyond that, the audit found that the process could be improved through better tracking and processing procedures. This memo addresses each of the eight recommendations made in association with Findings 1 and 2 described in your draft report.

Finding 1. ATF Needs To Track and Monitor OIC Cases Better

The audit found that ATF had a difficult time providing an accurate universe of closed OIC cases. The report identifies problems with ATF's management information system "N-Spect" as the primary cause of these tracking difficulties.

N-Spect is a comprehensive record of all work performed by ATF's inspector workforce. A record is created for each

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field assignment - alcohol, tobacco, firearms and explosives. For the period under audit, something less than .1 percent of the assignments lead to an OIC. Furthermore, the settlement of violations or tax liability with an OIC is a negotiated outcome and not a pre-determined goal. An inspection, audit or investigation does not begin with an objective of an "OIC" and, in fact, the decision to accept an offer is typically late in the process, after all findings have been evaluated.

A recommendation by a field office to accept an OIC is frequently reversed in the review process and a recommendation for some other action (assessment, permit suspension, etc.) is frequently changed to an OIC during the review process.

Additionally, some OICs do not flow from assignments entered in N-Spect. These would include such things as the compromise of penalties relating to late filed tax returns/payments.

The point in this is that much of the confusion over tracking of OIC cases stems from the fact that we are attempting to set a beginning point prior to the time the case actually becomes an OIC case. That, combined with the very small numbers in relation to the number of assignments and the fact that some offers do not emerge from field inspections, suggests that N-Spect, as it currently exists, may not be the appropriate tracking mechanism for OICs.

Given the above, it makes sense to begin the tracking of **Adverse Action Cases** (including cases closed with an OIC) at some point other than the original issuance of an inspection assignment.

A related OIG Audit Report, OIG-02-059, cites OMB Circular A-50 in reference to "follow-up systems" for audit findings (GAO/OIG and Regulatory). These tracking systems are tied to the issuance of a "final report." The term "final report," as used by OIG offices and in the referenced OMB circular, refers to findings and conclusions of the audit after the subject of the audit has had an opportunity to respond. It follows that ATF should adopt a similar approach and begin tracking of **Adverse Action Cases** at the

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time the findings are finalized (after any response by the industry member) and an adverse action is recommended.

This likely could be done with existing functionality or with a modification of N-Spect to move the assignment from an open inspection, audit or investigation to a separate Adverse Action Case file. Additionally, the system will require modification to accommodate adverse actions originating other than from a field inspection.

The draft audit report listed four specific recommendations to address this finding. We will address the actions we have taken regarding these recommendations.

Recommendation 1. ATF should take appropriate action to ensure that N-Spect integration efforts progress as originally planned and/or an appropriate case tracking system is implemented in order to accomplish accurate and consistent tracking and monitoring of OIC cases.

We agree. The strategic plan for N-Spect includes future interfacing with the National Revenue Center's (NRC) database that contains OIC collection data. This interface will provide the ability to look at OIC collection data tracked within N-Spect and automatically populate the corresponding data fields in the systems used by the NRC. This interface between N-Spect and the NRC's Integrated Entity Module (IEM) is dependent upon the development and implementations of Phase II of N-Spect and Phase II of the Integrated Revenue Information System (IRIS), which contains the IEM.

As an interim measure, we will establish a separate tracking and monitoring system at the NRC and will provide written procedures for reporting and entering data as well as producing management reports and trend analysis. The point of beginning for this tracking system will be the submission of an OIC by an industry member.

Action Due Date: September 2003 (N-Spect modifications)
Action Due Date: June 2002 (Interim system)

Recommendation 2. ATF should ensure that OIC information entered in N-Spect or other appropriate system is reviewed

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and that any necessary adjustments are made to correct any OIC information that is inaccurate, incomplete, and/or inconsistent.

We agree. The Field Management Staff, Office of Field Operations, will advise all field divisions that had inspections, audits or investigations that resulted in the acceptance of an OIC to review data posted in N-Spect and make any necessary changes/corrections. Furthermore, Field Management Staff and the NRC will provide written policies and procedures to their employees to provide guidance for monitoring OIC cases to ensure information entered in N-Spect is accurate and complete.

Action Due Date: March 2003

Recommendation 3. ATF should ensure that there is an adequate system in place capable of reporting and tracking OIC cases so that meaningful management reports can be produced.

We agree. N-Spect maintenance release, Version 1.5, will make posting to certain OIC data fields mandatory on the inspection results screen when an OIC is recommended. This will ensure proper inputting of data to enable monitoring and tracking of OIC cases from within N-Spect.

As an interim measure, we will establish a separate tracking and monitoring system at the NRC and will provide written procedures for reporting and entering data as well as producing management reports and trend analysis. The point of beginning for this tracking system will be the submission of an OIC by an industry member.

Action Due Date: March 2003 (N-Spect modifications)

Action Due Date: June 2002 (Interim system)

Recommendation 4. ATF should ensure that OIC cases are monitored and analyzed to identify trends and patterns in order to measure the effectiveness of the OIC process.

We agree. Once N-Spect maintenance release, Version 1.4, is placed into production and all mandatory data has been posted, we will be able to monitor and analyze data to

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identify trends and patterns through the use of Oracle Discoverer, a data query and report generation tool. The OIC case processing procedures, which are currently being revised, will identify the office(s) responsible for monitoring and analyzing OIC cases.

As an interim measure, we will establish a separate tracking and monitoring system at the NRC and will provide written procedures for reporting and entering data as well as producing management reports and trend analysis. The point of beginning for this tracking system will be the submission of an OIC by an industry member.

Action Due Date: March 2003 (N-Spect modifications)

Action Due Date: June 2002 (Interim system)

Finding 2. OIC Procedures Need Improvement - OIC Cases Were Not Always Processed Timely and OIC Case Processing Guidelines Were Not Always Clear and Not Always Followed.

The draft audit report listed four specific recommendations to address this finding. We will address the actions we have taken regarding these recommendations.

A major cause for the OIC monitoring process not getting priority attention is that since 1994 ATF has experienced two major reorganizations. The 1994 reorganization resulted in restructuring of Bureau Headquarters. In 1998, there was another reorganization. This resulted in field restructuring which eliminated the 5 regulatory districts and merged them into the 23 field divisions each of which is managed by a Division Director/Special Agent in Charge.

Interim guidelines were drafted to address this shift. The draft procedures that were implemented greatly expanded the settlement authority of the 23 Directors, of Industry Operations, (DIOs) over the 5 District Directors (up from \$10,000 to \$1,000,000 for an OIC with no limit on the liability to be compromised) and relaxed the requirement for case materials to be centrally reviewed. Predictably, this has led to problems with Bureau Headquarters left out of the loop on settlements and even one case where a field division ignored direction from Bureau Headquarters. Revised procedures are in development to restore central

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oversight and address deficiencies in the interim guidelines implemented in 1998.

Recommendation 1. ATF should ensure that timeliness guidelines are established for processing OIC cases to timely recognize revenue and put funds to better use.

We agree. ATF is in the process of revising OIC case processing procedures. ATF plans to issue one directive documenting procedures for the management of both Federal Alcohol Administration (FAA) Act and Internal Revenue Code (IRC) cases. These revised procedures will include timeliness guidelines. However, it is important to note that other factors such as the "Order to Show Cause" process required by regulation, contribute to processing delays that are outside of ATF's control. The "Order to Show Cause" process puts control of some aspects of settlement in the hands of administrative law judges who set dates for presentation of arguments and/or hearings. Sometimes, that process goes well beyond expectations.

Another factor beyond our control is the ability of the entity to use the courts to argue their case. For example, the Bronco Wine case was tied up in the courts for more than 2 years, which contributed almost 3 years to the time it took to settle the OIC. During that time ATF was prohibited by the Justice Department to discuss the case with Bronco attorneys. Therefore, notwithstanding establishing processing timelines, ATF does not always control the timelines.

Also, the recommendation claims that by establishing timeliness guidelines, ATF can timely recognize revenue and put funds to better use. While we agree that timeliness guidelines need to be established, we would like to point out that ATF does not put the funds "to use." The funds are deposited in Treasury's general fund.

Action Due Date: March 2003

Recommendation 2. ATF should re-emphasize to the field divisions the importance of sending completed OIC case documentation promptly to the NRC.

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We agree. This will be emphasized in the new case processing procedures currently under development.

Action Due Date: March 2003

Recommendation 3. ATF should ensure that appropriate follow-up action is taken to resolve OIC cases identified by the Revenue Accounting Section as untimely in order to more quickly recognize revenue received as a result of an OIC.

We agree. While the OIG audit was underway, the NRC identified 34 OIC cases that were still classified as "open." Some of those "open" cases were more than 5 years old and the "average age" of the cases was 27 months. Today 31 of those 34 cases have been closed. The three cases that remain "open" relate to industry members who are paying on installment.

Since May 2001, the NRC has also received 20 new OIC cases. In addition to the focus of our efforts on closing out the older case files, six of the newer cases have also been completed.

Since May 1, 2001, the average age of an open case (figured from date of receipt of the check) has dropped from 27 months to 15 months. When the installment cases are eliminated from the equation, the average age of the open cases drops from 24 months to 5 months.

Our goal is to reduce the average processing time. We believe that the new case processing procedures, which will include timeliness guidelines, will ensure that cases are resolved more expeditiously.

Action Due Date: March 2003

Recommendation 4. ATF should ensure that OIC case processing procedures are revised and issued in order to provide clear guidance for processing OIC cases. Revised procedures should include a more specific definition for classifying a case as closed; specific instructions regarding OIC workflow processes, including entering and

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closing cases in N-Spect; an updated OIC form that lists correct address for submitting an offer; and timeliness guidelines for processing OIC cases. ATF should emphasize the importance of implementing these procedures to ensure that OIC cases are processed fairly, consistently, and timely.

We agree. We believe ATF has processed OIC cases fairly and consistently; however, the revised case processing procedures will ensure greater consistency due to restoring centralized oversight and resolution. The revised procedures will include a more specific definition for classifying a case as closed, specific instructions regarding OIC workflow processes, and timeliness guidelines for processing OIC cases. In addition, we have already begun revising the OIC form, which will reflect both the correct name and address for mailing an OIC.

Action Due Date: March 2003

In conclusion, we concur with the recommendations and are taking appropriate corrective action. If you have further questions, please contact Mr. James A. Zammillo, Chief, Policy and Programs Coordination Staff, Office of Alcohol and Tobacco, at (202) 927-5000.



Bradley A. Buckles

Enforcement Directorate

Alexander Best, Jr., National Director, Enforcement Program
Audits
Lynn Richardson, Audit Manager
Irene Aultman, Lead Auditor
Annette Dunn, Auditor

U.S. Department of the Treasury

Under Secretary for Enforcement
Assistant Secretary (Enforcement)
Office of Accounting and Internal Control
Office of Strategic Planning and Evaluations

Bureau of Alcohol, Tobacco and Firearms

Director
Assistant Director, Alcohol and Tobacco
Assistant Director, Field Operations
Assistant Director, Inspection
Chief, National Revenue Center

Office of Management and Budget

OIG Budget Examiner