

Office of the Auditor General
Performance Audit Report

Offer in Compromise Program

Department of Treasury

August 2021

The auditor general shall conduct post audits of financial transactions and accounts of the state and of all branches, departments, offices, boards, commissions, agencies, authorities and institutions of the state established by this constitution or by law, and performance post audits thereof.

The auditor general may make investigations pertinent to the conduct of audits.

Article IV, Section 53 of the Michigan Constitution



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Report Summary

Performance Audit

Offer in Compromise (OIC) Program

Department of Treasury (Treasury)

Report Number:
271-0145-20

Released:
August 2021

The OIC Program was established by Public Act 240 of 2014. An OIC is a request by a taxpayer to reduce an assessed tax liability, including penalty and interest. In fiscal year 2019, Treasury accepted 349 offers totaling \$1.6 million. The Technical Services Unit within Treasury administered the OIC Program, and as of June 30, 2020, it had 10 employees that processed OICs.

Audit Objective			Conclusion
Objective: To assess the effectiveness of Treasury's efforts to administer the OIC Program.			Moderately effective
Findings Related to This Audit Objective	Material Condition	Reportable Condition	Agency Preliminary Response
Treasury did not fully implement a process to evaluate whether the cost to administer the OIC Program exceeded its benefits (Finding 1).		X	Agrees
Treasury could maximize the collection of delinquent taxes with more detailed application questions, similar to the Internal Revenue Service (IRS) and other states' programs, and increased communication within its own operations (Finding 2).		X	Agrees

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Doug A. Ringler, CPA, CIA
Auditor General

August 26, 2021

Ms. Rachael Eubanks
State Treasurer
Richard H. Austin Building
Lansing, Michigan

Dear Ms. Eubanks:

This is our performance audit report on the Offer in Compromise Program, Department of Treasury.

Your agency provided the preliminary responses to the recommendations at the end of our fieldwork. The *Michigan Compiled Laws* and administrative procedures require an audited agency to develop a plan to comply with the recommendations and to submit it to the State Budget Office upon completion of an audit. Within 30 days of receipt, the Office of Internal Audit Services, State Budget Office, is required to review the plan and either accept the plan as final or contact the agency to take additional steps to finalize the plan.

We appreciate the courtesy and cooperation extended to us during this audit.

Sincerely,

A handwritten signature in black ink that reads "Doug Ringler". The signature is written in a cursive, flowing style.

Doug Ringler
Auditor General

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AUDIT OBJECTIVES, CONCLUSIONS, FINDINGS, AND OBSERVATIONS

ADMINISTRATION OF THE OIC PROGRAM

BACKGROUND

An Offer in Compromise (OIC) is a request by a taxpayer for the Department of Treasury (Treasury) to reduce an assessed tax liability. An assessed tax liability includes tax and any related interest and penalty.

Upon initial application, a taxpayer must submit a nonrefundable payment of \$100 or 20% of the taxpayer's offer, whichever is greater. A taxpayer can propose either a lump sum payment or up to 24 monthly installment payments. If Treasury accepts an OIC, the taxpayer must comply with the terms of the offer. If a taxpayer fails to comply with the terms, Treasury can revoke the offer and reinstate the tax liability.

If Treasury rejects an OIC, the taxpayer can, within 30 days, request an independent administrative review by Treasury's Office of Legal Affairs. The independent administrative review determination is final and may not be appealed. During the period October 1, 2017 through June 30, 2020, 75 requests for an independent administrative review occurred.

Section 205.23a(2) of the *Michigan Compiled Laws* requires Treasury to publish on its Web site a report containing the following information:

- The amount of tax assessed.
- The amount of interest or assessable penalty imposed by law on the person against whom the tax is assessed.
- The terms of the compromise and the amount actually paid in accordance with the terms of the compromise.
- The grounds for the compromise.

AUDIT OBJECTIVE

To assess the effectiveness* of Treasury's efforts to administer the OIC Program.

CONCLUSION

Moderately effective.

FACTORS IMPACTING CONCLUSION

- For the 38 OIC applications that we examined, Treasury:
 - Appropriately accepted or rejected the taxpayer's offer and maintained documentation supporting its review, including approvals.

* See glossary at end of report for definition.

- Accurately calculated an acceptable offer amount.
 - Monitored to ensure taxpayers made agreed-upon payments.
- The Technical Services Unit (TSU) implemented improvements to timeliness of application review.
- Treasury published complete and accurate OIC Program reports.
- Reportable conditions* (Findings 1 and 2) related to identifying and evaluating OIC Program expenditures and the need for improvements in the OIC process.

** See glossary at end of report for definition.*

FINDING 1

Identification and evaluation of Program costs needed.

Treasury should fully implement a reporting process to identify OIC Program expenditures to determine Treasury's cost to administer the Program.

Section 18.1485(2)(c) of the *Michigan Compiled Laws* requires State departments to establish an internal control system that includes recordkeeping procedures to identify and control expenditures. Also, Section 205.23a(1) of the *Michigan Compiled Laws* states that the State Treasurer "may compromise all or any part of any payment of a tax subject to administration" by Treasury.

TSU, charged with administration of the OIC Program, informed us that staff work on multiple programs and record their time based on organizational unit rather than by task.

Accordingly, TSU was unable to quantify OIC Program expenditures. Identifying Program expenditures, including payroll and benefits, would allow TSU to evaluate the cost-effectiveness of the OIC Program.

RECOMMENDATION

We recommend that Treasury implement a reporting process to identify OIC Program expenditures to determine Treasury's cost to administer the Program.

AGENCY PRELIMINARY RESPONSE

Treasury provided us with the following response:

Treasury agrees with the recommendation.

Since 2018, Treasury has tracked OIC-specific tasks and time spent by staff to complete the OIC-related tasks. Upon OAG request, Treasury collected and shared the pertinent cost information including payroll and benefits to support expenditures for OIC program administration. Going forward, Treasury will implement this reporting process to monitor and evaluate Treasury's cost effectiveness to administer the OIC program.

AUDITOR'S COMMENTS TO AGENCY PRELIMINARY RESPONSE*

Treasury provided summary Program expenditure information after the completion of our audit fieldwork. This information could be evaluated in a future audit or follow-up review.

* See glossary at end of report for definition.

FINDING 2

Improvements needed to OIC process.

Treasury could improve the OIC process to maximize the collection of delinquent taxes.

Section 205.23a(3) of the *Michigan Compiled Laws* allows Treasury to revoke any compromise and reestablish all compromised liabilities, without regard to any statute of limitations that otherwise may be applicable, if it determines that the taxpayer:

- Concealed assets or, with the intent to mislead, withheld, destroyed, mutilated, or falsified information to obtain a compromise.
- Failed to file subsequent required returns and pay subsequent final tax liabilities.

Our review of the OIC Program noted:

a. Treasury could enhance the OIC application process by:

(1) Soliciting more detailed information when evaluating an OIC.

We reviewed OIC programs from the Internal Revenue Service (IRS) and other states and identified questions not utilized in Treasury's application, including:

- (a) Have you ever transferred any assets, including real property, for less than full value?
- (b) Are you the beneficiary of a trust, estate, or life insurance policy?
- (c) Are you a trustee, fiduciary, or contributor of a trust?
- (d) Do you have any funds held in trust by a third party?
- (e) Do you anticipate any increase in income?

Utilizing these and other more detailed questions could help ensure that taxpayers include all information necessary for TSU to evaluate OIC applications and calculate acceptable offers.

(2) Including in TSU manuals information regarding when to use available computer software to verify applicant employment and assets.

b. Treasury could improve internal communications to enhance OIC compliance.

We noted:

- (1) Treasury did not have a policy to require the sharing of monitoring results with TSU.

Treasury subjects business taxpayers to random audits and individual taxpayers to an IRS match program. However, Treasury did not provide guidance on how or when to inform TSU of audit or IRS match results.

- (2) Treasury did not determine if taxpayers with completed OICs filed future tax returns and paid future tax liabilities.

RECOMMENDATION

We recommend that Treasury improve its evaluation of OIC applications and monitoring of completed offers.

**AGENCY
PRELIMINARY
RESPONSE**

Treasury provided us with the following response:

Treasury agrees with the recommendation.

- a. *Treasury will review the OAG questions listed in the document and the TSU manual, and determine what information is needed to improve the process(es).*
- b. *Treasury will review our current internal communication process to determine what improvements can be made to enhance OIC compliance.*

SUPPLEMENTAL INFORMATION

UNAUDITED

OFFER IN COMPROMISE PROGRAM

Department of Treasury

Summary of Accepted Offers by Fiscal Year

October 1, 2014 Through June 30, 2020

Fiscal Year	Tax Due Before Compromise	Penalty and Interest Due Before Compromise	Total Tax, Penalty, and Interest Due Before Compromise	Total Accepted Offer Amount	Total Amount Paid During Fiscal Year	Number of Accepted Offers	Percent of Total Tax, Penalty, and Interest Compromised
2015	\$ 530,487	\$ 257,694	\$ 788,181	\$ 122,616	\$ 112,637	45	84%
2016	6,210,218	2,951,179	9,161,397	828,203	673,055	205	91%
2017	7,770,367	4,692,746	12,463,113	1,489,800	1,336,592	297	88%
2018	11,632,127	6,590,182	18,222,309	1,320,247	685,466	365	93%
2019	11,205,612	5,496,124	16,701,736	1,620,122	1,397,576	349	90%
2020*	18,139,270	10,043,936	28,183,206	1,883,790	1,017,139	449	93%
Total	\$ 55,488,081	\$ 30,031,861	\$ 85,519,942	\$ 7,264,778	\$ 5,222,465	1,710	92%

*2020 data presented includes 9 months (through June 30).

Source: The OAG prepared this exhibit based on information reported by Treasury.

PROGRAM DESCRIPTION

The OIC Program was established by Public Act 240 of 2014 and administered by TSU within Treasury. There are three grounds under which an OIC is available:

- **Taxpayer Received OIC From the IRS:** The IRS offer must be for the same tax periods for which the taxpayer is requesting State relief. Only individual income tax and corporate income tax are eligible.
- **Doubt as to Collectability:** The taxpayer must show that the amount offered is the most that can be expected to be paid or collected from the taxpayer's current assets and income and that the taxpayer does not have reasonable prospects of acquiring increased assets or income within a reasonable period of time.
- **Doubt as to Liability:** Based on a review of evidence provided by the taxpayer, Treasury must determine that the taxpayer would have prevailed in a contested case if the taxpayer had appealed the assessment.

In fiscal year 2019, Treasury accepted 349 offers totaling \$1,620,122 (10%) related to \$16,701,736 of tax, penalty, and interest assessed (see supplemental information). As of June 30, 2020, TSU had 10 employees that processed OICs.

Effective July 12, 2021, the OIC Program moved to the Office of the Taxpayer Advocate within Treasury.

AUDIT SCOPE, METHODOLOGY, AND OTHER INFORMATION

AUDIT SCOPE

To examine records related to the administration of the OIC Program. We conducted this performance audit* in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

As part of the audit, we considered the five components of internal control (control environment, risk assessment, control activities, information and communication, and monitoring activities) relative to the audit objectives and determined that all components were significant.

PERIOD

Our audit procedures, which included a preliminary survey, audit fieldwork, report preparation, analysis of agency responses, and quality assurance, generally covered October 1, 2017 through June 30, 2020.

METHODOLOGY

We conducted a preliminary survey of Treasury's processes and controls related to the OIC Program. During our preliminary survey, we:

- Interviewed TSU and independent administrative review management and staff regarding their job functions and responsibilities.
- Reviewed applicable State laws and Treasury manuals.
- Reviewed the IRS's OIC Program manual.
- Reviewed and compared other states' OIC programs.
- Reviewed all 7 rejected offers that were remanded or reversed through the independent administrative review process to gain an understanding of why the rejected offers were remanded or reversed.
- Randomly sampled 5 of the 611 applications rejected between October 1, 2017 and June 30, 2020 to determine if the applications were appropriately rejected.

OBJECTIVE

To assess the effectiveness of Treasury's efforts to administer the OIC Program.

* See glossary at end of report for definition.

To accomplish this objective, we:

- Randomly and judgmentally sampled 33 of the 1,152 offers accepted between October 1, 2017 and June 30, 2020. We examined the documentation and:
 - Determined if the taxpayer met all initial eligibility criteria for the OIC Program.
 - Analyzed the timeliness of TSU's review of the offer applications.
 - Determined if the accepted offer was appropriately approved.
 - Assessed if TSU accurately calculated an acceptable offer amount and verified asset and expense information provided by taxpayer.
 - Reviewed TSU's monitoring of accepted offers to ensure taxpayers made the agreed upon payments.
- Verified the accuracy of the fiscal year 2018, 2019, and 2020 (through June 30) reports prepared by TSU.
- Analyzed TSU expenditures to determine total OIC Program expenditures between October 1, 2017 through June 30, 2020.

Our random samples were selected to eliminate any bias and enable us to project the results to the respective populations. For our judgmental samples, we could not project the results to the respective populations.

CONCLUSIONS

We base our conclusions on our audit efforts and any resulting material conditions* or reportable conditions.

When selecting activities or programs for audit, we direct our efforts based on risk and opportunities to improve State government operations. Consequently, we prepare our performance audit reports on an exception basis.

AGENCY RESPONSES

Our audit report contains 2 findings and 2 corresponding recommendations. Treasury's preliminary response indicates that it agrees with the recommendations.

The agency preliminary response that follows each recommendation in our report was taken from the agency's written comments and oral discussion at the end of our fieldwork. Section 18.1462 of the *Michigan Compiled Laws* and

* See glossary at end of report for definition.

the State of Michigan Financial Management Guide (Part VII, Chapter 4, Section 100) require an audited agency to develop a plan to comply with the recommendations and to submit it to the State Budget Office upon completion of an audit. Within 30 days of receipt, the Office of Internal Audit Services, State Budget Office, is required to review the plan and either accept the plan as final or contact the agency to take additional steps to finalize the plan.

**SUPPLEMENTAL
INFORMATION**

Our audit report includes a summary of accepted offers by fiscal year, presented as supplemental information. Our audit was not directed toward expressing a conclusion on this information.

GLOSSARY OF ABBREVIATIONS AND TERMS

auditor's comments to agency preliminary response	Comments that the OAG includes in an audit report to comply with <i>Government Auditing Standards</i> . Auditors are required to evaluate the validity of the audited entity's response when it is inconsistent or in conflict with the findings, conclusions, or recommendations. If the auditors disagree with the response, they should explain in the report their reasons for disagreement.
effectiveness	Success in achieving mission and goals.
IRS	Internal Revenue Service.
material condition	A matter that, in the auditor's judgment, is more severe than a reportable condition and could impair the ability of management to operate a program in an effective and efficient manner and/or could adversely affect the judgment of an interested person concerning the effectiveness and efficiency of the program. Our assessment of materiality is in relation to the respective audit objective.
OIC	Offer in Compromise.
performance audit	An audit that provides findings or conclusions based on an evaluation of sufficient, appropriate evidence against criteria. Performance audits provide objective analysis to assist management and those charged with governance and oversight in using the information to improve program performance and operations, reduce costs, facilitate decision-making by parties with responsibility to oversee or initiate corrective action, and contribute to public accountability.
reportable condition	A matter that, in the auditor's judgment, is less severe than a material condition and falls within any of the following categories: a deficiency in internal control; noncompliance with provisions of laws, regulations, contracts, or grant agreements; opportunities to improve programs and operations; or fraud.
Treasury	Department of Treasury.
TSU	Technical Services Unit.



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