

GAO

Report to the Secretary of the Treasury
and the Director of the Office of
Management and Budget

October 2003

DEBT COLLECTION

Opportunities Exist for Improving FMS's Cross-Servicing Program



G A O

Accountability * Integrity * Reliability



Highlights

Highlights of [GAO-04-47](#), a report to the Secretary of the Treasury and the Director of the Office of Management and Budget

Why GAO Did This Study

GAO has previously reviewed facets of Treasury's Financial Management Service's (FMS) cross-servicing efforts. These reviews did not include FMS's handling of nontax debts that were returned to FMS uncollected by its private collection agency (PCA) contractors because FMS officials did not consider the cross-servicing program to be fully mature. During fiscal years 2000, 2001, and 2002, FMS's PCA contractors returned about \$3.9 billion of uncollected debts to FMS. This report focuses primarily on (1) actions taken by FMS on uncollected nontax debts returned from its PCA contractors and (2) actions taken, if any, by FMS and the Office of Management and Budget (OMB) to ensure that federal agencies are reporting their eligible uncollectible nontax debts to IRS as income to debtors.

What GAO Recommends

GAO recommends that Treasury (1) help ensure that all appropriate collection action is taken on debts returned from PCA contractors, (2) increase opportunities for collection, and (3) help maximize the soundness of FMS's cross-servicing program. GAO also recommends that OMB take steps to improve agencies' compliance with standards and policies for writing off and closing out debts. Treasury concurred with most of GAO's findings but raised a number of points about certain of the recommendations. OMB agreed with the thrust of GAO's recommendation.

www.gao.gov/cgi-bin/getrpt?GAO-04-47.

To view the full product, including the scope and methodology, click on the link above. For more information, contact Gary Engel (202) 512-3406 or EngelG@gao.gov.

DEBT COLLECTION

Opportunities Exist For Improving FMS's Cross-Servicing Program

What GAO Found

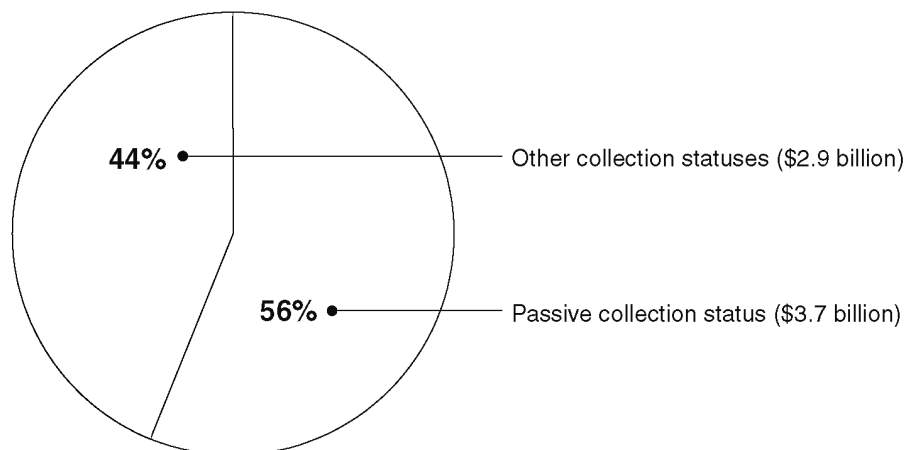
Although FMS has made progress in implementing its cross-servicing program and considers it to be fully mature, opportunities exist to improve the program.

FMS had not reviewed most of the debts returned to it by its PCA contractors to determine whether any opportunities for collection or other recoveries remained, including those possible from reporting closed-out debts to IRS as income to debtors. For example, as shown in the figure below, about \$3.7 billion of the \$6.6 billion of debts that were at FMS for cross-servicing as of February 28, 2003, were being kept in the Treasury Offset Program (TOP) for passive collection after they had been returned uncollected to FMS by PCA contractors. Passive collection entailed no further collection action on the part of FMS other than minimal efforts through offset, and collections on debts in passive collection through offset totaled only about \$9 million through February 28, 2003. Various problems hindered collections through offset, including the fact that many of the debts were beyond the 10-year statutory and regulatory limitations for offset.

GAO's analysis also showed that relatively few debts in cross-servicing were being referred to the Department of Justice for more aggressive enforced collection action. This analysis further showed that FMS continues to have problems with debt compromises and the reporting of a key cross-servicing performance measure.

Finally, neither FMS nor OMB monitored or reported the extent to which federal agencies governmentwide were closing out all eligible uncollectible debts and reporting those amounts to IRS as income to debtors.

Percentage of Cross-Serviced Debts in Passive Collection as of February 28, 2003



Source: GAO.

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United States General Accounting Office
Washington, D.C. 20548

October 31, 2003

The Honorable John W. Snow
The Secretary of the Treasury

The Honorable Joshua B. Bolten
Director, Office of Management and Budget

The Debt Collection Improvement Act of 1996 (DCIA) gave the Department of the Treasury (Treasury) significant governmentwide responsibilities for collecting federal nontax debts delinquent more than 180 days that are referred by federal agencies for collection action, known as cross-servicing. Treasury's Financial Management Service (FMS) is responsible for carrying out Treasury's cross-servicing responsibility. Nontax debts that federal agencies reported as delinquent more than 180 days totaled over \$60 billion at the end of each of the last 4 fiscal years.¹ However, as of September 30, 2002, federal agencies reported to FMS that only about \$8.5 billion, or approximately 13 percent, of the approximately \$64 billion of reported nontax debts delinquent over 180 days were eligible for cross-servicing. FMS has continued to express concern about the accuracy, completeness, and validity of debts reported by agencies as eligible for and excluded from the DCIA cross-servicing provisions, and over the years, we have identified and reported on problems regarding the accuracy and completeness of exclusions from cross-servicing as reported by certain federal agencies.² Nonetheless, for the billions of dollars of nontax delinquent debts that agencies do refer for cross-servicing, it is critical that FMS manage its collection activities to fully utilize available debt collection tools and maximize collection opportunities.

¹These debts include those classified by federal agencies as "currently not collectible" (CNC). Generally, write-off is mandatory for delinquent debts older than 2 years. The agency must either classify the debts as CNC or discharge the debts. The collection process continues on debts classified as CNC until the agency determines it is no longer cost-effective to pursue collection. At that point, the debt should be discharged or closed out.

²See, for example, U.S. General Accounting Office, *Debt Collection Improvement Act of 1996: Department of Agriculture's Farm Service Agency Has Not Yet Fully Implemented Certain Key Provisions*, [GAO-02-463](#) (Washington, D.C.: Mar. 29, 2002).

In January 2003, we reported that FMS had made significant progress in implementing key provisions of DCIA, which directs and authorizes use of a wide range of collection tools.³ For example, we reported that FMS's successful merger of the Tax Refund Offset Program with the Treasury Offset Program (TOP), both of which are designed to offset federal payments up to the amount of the delinquent federal debt, and system enhancements have streamlined operations and contributed over \$1 billion in nontax debt collections from tax refund offsets during each of fiscal years 2000, 2001, and 2002. In addition, FMS's incorporation of Social Security benefit payments into TOP in May 2001 resulted in about \$114 million in reported nontax debt collections from Social Security benefit offsets through early July 2003.

While we have previously reviewed various facets of FMS's cross-servicing efforts, we did not review FMS's handling of nontax debts that remained uncollected after being returned to FMS from its private collection agency (PCA) contractors because FMS did not consider the cross-servicing program to be fully mature at that time.⁴ FMS officials now consider the cross-servicing program to be fully mature. Therefore, as follow-up to our prior work, this review focused primarily on nontax delinquent debts that remained uncollected after they had been at both FMS and its PCA contractors for cross-servicing. Specifically, our objectives were to evaluate (1) actions taken by FMS on uncollected nontax debts returned from its PCA contractors; (2) FMS's efforts to ensure that eligible uncollectible nontax debts, which federal agencies rely on FMS to report on their behalf to the Internal Revenue Service (IRS) as income to the debtors, are promptly identified and accurately reported; and (3) actions taken, if any, by FMS and the Office of Management and Budget (OMB) to ensure that federal agencies are reporting their eligible uncollectible nontax debts to IRS as income to the debtors. In addition to addressing these objectives, this report discusses opportunities for FMS to (1) improve collection of nontax debts through cross-servicing and (2) enhance the soundness of certain operational and reporting facets of its cross-servicing program.

³U.S. General Accounting Office, *Major Management Challenges and Program Risks: Department of the Treasury*, [GAO-03-109](#) (Washington, D.C.: January 2003).

⁴U.S. General Accounting Office, *Debt Collection: Treasury Faces Challenges in Implementing Its Cross-Servicing Initiative*, [GAO/AIMD-00-234](#) (Washington, D.C.: Aug. 4, 2000).

Results in Brief

Opportunities exist to improve FMS's cross-servicing program for federal nontax debts in the following areas: (1) the extent to which debts are kept in TOP for passive collection after they have been returned uncollected to FMS by PCA contractors; (2) FMS's adherence to its procedures for returning certain uncollected debts to referring agencies; (3) the extent to which FMS and OMB monitor federal agencies' reporting of closed-out debts to IRS as income to debtors; (4) the extent to which FMS refers debts to the Department of Justice (DOJ) for enforced collection and reports debts to TOP; (5) the adequacy of FMS's system for tracking debt amounts forgiven and PCA contractors' adherence to regulatory and contractual policies and procedures for forgiving debts through compromises with debtors; and (6) the reliability of FMS's reporting on the extent to which agencies are referring eligible debts for cross-servicing.

FMS did not review most debts returned uncollected from PCA contractors to determine the appropriate next step to maximize collection of the debts. As of February 28, 2003, FMS had approximately \$6.6 billion of debts in cross-servicing. About \$3.7 billion of these debts had been returned uncollected by FMS's PCA contractors and were being kept in TOP for passive collection through offset.⁵ While offset yielded some collections for debts in passive collection, the amounts were small, totaling only about \$9 million on debts returned to FMS by its PCA contractors. In addition, many of the debts returned to FMS by its PCA contractors had no prospects for collection through offset because they were beyond the 10-year statutory and regulatory limitations applicable to offset.⁶

FMS also did not review about \$446 million of the approximately \$1.1 billion of uncollected debts that it returned to referring agencies during fiscal years 2000, 2001, and 2002 to determine whether it should close out and report the debts to IRS on behalf of agencies that had authorized FMS to do so. We determined that FMS summarily returned these debts to referring agencies without ensuring that the required collection activities had been performed. For example, FMS did not review debts totaling about \$97 million to determine their eligibility for IRS reporting even though they met two key criteria for IRS reporting—they

⁵For the purpose of this report, offset refers to administrative offset and tax refund offset.

⁶31 U.S.C. 3716(e)(1) is applicable to administrative offset and 31 C.F.R. 285.2(d)(1)(ii) is applicable to tax refund offset to collect nontax debts.

had Taxpayer Identification Numbers (TIN) and their referring agencies had granted FMS authority to report them to IRS.

Neither FMS nor OMB monitored or reported the extent to which federal agencies were closing out uncollectible debts and reporting eligible amounts to IRS. The Treasury Reports on Receivables (TROR) for the 24 Chief Financial Officers (CFO) Act agencies⁷ showed that for calendar year 2002, of the approximately \$3.2 billion of nontax debts that these agencies reported as closed out, about \$1 billion, or approximately 31 percent, of this amount was reported to IRS as income to the debtors.⁸ FMS does not require federal agencies to disclose in their TRORs why closed-out debts are not reported to IRS, and neither FMS nor OMB officials could specifically explain why certain federal agencies had reported different amounts for closed-out debts and debts reported to IRS.

In looking for missed cross-servicing collection opportunities, we further found that FMS had referred only a small amount of debt to the Department of Justice (DOJ) for enforced collection because FMS did not establish effective processes or procedures for identifying debts to forward to DOJ. We also found that FMS had not reported about \$356 million of debts to TOP for offset payments as required by FMS procedures. As of February 28, 2003, most of these debts were at secondary PCA contractors and had been in cross-servicing for an average of about 11 months without having been sent to TOP. Further, although many nontax debts involved secondary debtors, such as cosignors, from which collection can be pursued, FMS had not reported such debtors to TOP.

⁷One of the 24 CFO Act agencies, the Federal Emergency Management Agency (FEMA), was transferred to the new Department of Homeland Security (DHS) effective March 1, 2003. With this transfer, FEMA will no longer be required to prepare and have audited stand-alone financial statements under the CFO Act, leaving 23 CFO Act agencies. DHS, along with most other executive branch agencies, will be required to prepare and have audited financial statements under the Accountability of Tax Dollars Act of 2002, Pub. L. No. 107-289, 116 Stat. 2049 (Nov. 7, 2002).

⁸The format of the TROR is on a fiscal year basis (i.e., October 1, 2001 to September 30, 2002). To determine the reported amounts for closed-out debts and debts reported to IRS for the 24 CFO Act agencies for calendar year 2002, we obtained and analyzed the 24 CFO Act agencies' quarterly TRORs for fiscal years 2001, 2002, and 2003. GAO has not assessed the completeness and accuracy of the information in the TRORs for the 24 CFO Act agencies; therefore, we have not determined whether the TROR figures reported by the agencies are understated, overstated, or accurate.

In addition, we identified continuing problems in FMS's administration of compromises with debtors. FMS's cross-servicing database showed that in-house FMS collectors and FMS's PCA contractors had established repayment agreements forgiving a total of at least \$51 million of delinquent debts during fiscal years 2000, 2001, and 2002. However, the cross-servicing database did not identify the forgiven amounts on debts. Specifically, it did not include amounts forgiven by in-house FMS collectors in accordance with established compromise agreements between FMS and debtors unless the agreed-upon reduced amount had been paid in full. In addition, PCA contractors that established compromise agreements with debtors often did not have documentation to justify their rationale for concluding that debtors could not pay the full debt amount or to support the amounts forgiven.

Finally, FMS overstated federal agencies' progress in referring eligible nontax debts for cross-servicing. Although FMS reported that agencies had referred about 96 percent of over \$8 billion of reported eligible debts, we determined that the referral rate was about 79 percent, thereby leaving room for improvement.

We are making a number of recommendations to Treasury and OMB to increase opportunities for collections and other recoveries of debts and to help maximize the operational soundness of the cross-servicing program.

Treasury and OMB generally agreed with our findings. However, Treasury raised a number of points regarding our specific findings and recommendations that missed the central concerns conveyed in our report and tended to downplay their significance. How well these findings, along with others relating to cross-servicing that we have cited in previous reports, are addressed is central to success in collecting delinquent nontax debt and creating credibility among debtors that the federal government is serious about its collection efforts.

Background

DCIA was enacted by the Congress, in part, to collect nontax debts delinquent more than 180 days by referring such debts to Treasury or a Treasury-approved debt collection center for cross-servicing.⁹ FMS is the only Treasury-approved governmentwide debt collection center.

After receiving a debt from a referring federal agency, FMS generally keeps the debt for 30 days at its Debt Management Operations Center. During this time, FMS is to send a letter demanding payment to the debtor. An in-house FMS collector may attempt to contact the debtor to obtain payment in full or secure payment through other options, including compromise.¹⁰ If the debt has not been collected 20 days after the date of the demand letter, FMS is to report the debt to TOP if the referring agency has not already done so.¹¹

If the referred debt remains uncollected after it has been at FMS for 30 days, FMS typically sends the debt to one of its five PCA contractors.¹² The PCA contractor that receives the debt initially—the primary PCA contractor—is generally given 270 days from the date it receives the debt from FMS to collect or resolve the debt.¹³ If the primary PCA contractor is unable to collect or resolve the debt, it sends the debt back to FMS. FMS then typically sends the debt to another PCA contractor, the secondary PCA contractor for the debt. The secondary PCA contractor is also given 270 days from the date it receives the debt from FMS to collect or resolve the debt. FMS requires its PCA contractors to attempt to locate debtors, send demand letters, and attempt to obtain full payment before

⁹Federal agencies may, at their discretion, refer valid, legally enforceable debts for cross-servicing that are less than 180 days delinquent; however, it may not be feasible for certain agencies to do so.

¹⁰FMS's policy is to attempt to obtain payment in full. However, other payment options include (1) repayment agreement for payment in full, (2) lump sum compromise settlement, and (3) compromise repayment agreement.

¹¹DCIA requires that eligible debts delinquent more than 180 days be reported to TOP.

¹²FMS's current PCA contract covers fiscal years 2001 through 2006. The five PCA contractors are located in California, Florida, Georgia, New York, and Texas.

¹³FMS recently increased the number of days PCA contractors are given to collect or resolve referred nontax debts from 180 days to 270 days. Administrative debt resolution occurs when a PCA contractor determines that a delinquent debtor is either bankrupt, deceased, or disabled and financially unable to pay the debt.

compromising any debt. FMS may refer debts to DOJ for litigation and enforced collection at any time.

Debts that are returned uncollected to FMS from its secondary PCA contractors are to be either retained by FMS for additional collection action or returned to the referring agencies.¹⁴ According to the Federal Claims Collection Standards,¹⁵ federal agencies must terminate all collection action before closing out a delinquent nontax debt and must report certain closed-out debts to IRS.¹⁶

Federal agencies are required to report annually in their TRORs on the status of their nontax debts.¹⁷ TRORs are FMS's only comprehensive means of collecting information on the federal government's nontax debt portfolio, including debts written off, closed out, and reported to IRS. TRORs are also used to collect information on nontax debts delinquent more than 180 days to help FMS monitor federal agencies' implementation of DCIA. FMS summarizes the information in the federal agencies' TRORs annually in *Report to the Congress on U.S. Government Receivables and Debt Collection Activities of Federal Agencies*.

OMB assists the President by developing governmentwide policies for the effective and efficient operation of the executive branch. As such, OMB establishes credit management policy for the federal government, including setting standards for extending credit, managing lenders participating in guaranteed loan programs, servicing nontax receivables, and collecting delinquent nontax debts. In addition, OMB is responsible for reviewing federal agencies' policies and procedures related to credit programs and debt collection activities.

¹⁴FMS collectors are required to review debts to determine whether further collection actions, such as reporting debts to TOP or IRS, are needed prior to returning the debts back to the referring agencies. If no further collection actions are needed, the debt is returned to the referring agency.

¹⁵31 C.F.R. Parts 901-904.

¹⁶According to the Federal Claims Collection Standards, upon close-out of a debt, the agency must report the close-out to IRS in accordance with the requirements of 26 U.S.C. 6050P and 26 C.F.R. 1.6050P-1. IRS Form 1099C is used to report the uncollectible debt as income to the debtor, which may be taxable at the debtor's current tax rate.

¹⁷All CFO Act agencies and non-CFO Act agencies with nontax ending debt balances of \$50 million or greater are required to report quarterly.

Scope and Methodology

To address our objectives, we interviewed FMS officials and reviewed pertinent FMS documents and reports to obtain an understanding of FMS's policies and procedures for nontax debts that are returned uncollected to FMS by its PCA contractors and for closing out uncollectible nontax debts and reporting such debts to IRS as income to the debtor. We also reviewed applicable federal regulations and guidance for federal nontax debt collection, close-out, and IRS reporting, including the Federal Claims Collection Standards, OMB Circular A-129, and IRS instructions for reporting closed-out debts. In addition, we obtained and analyzed FMS's cross-servicing database for the period from inception of the cross-servicing program in fiscal year 1996 through February 28, 2003, to determine what collection actions in-house FMS collectors performed on debts that had been returned uncollected from its PCA contractors and whether the in-house FMS collectors properly identified all uncollected debts that could be reported to IRS, including amounts that had been forgiven through compromise.

A scope limitation prevented us from using statistical sampling techniques to determine whether compromises made by in-house FMS collectors were justified, supported, and reported to IRS. FMS's cross-servicing database did not identify all forgiven amounts resulting from compromise agreements made by in-house FMS collectors; the database identified forgiven amounts only for in-house FMS agreements if the compromised amount had been paid in full and the debt settled.¹⁸ The database did not include the forgiven amounts for in-house compromise agreements that were active but had not yet been settled. We did use statistical sampling techniques to select from FMS's PCA cross-servicing database 54 debts that had been compromised by FMS's PCA contractors from October 1, 2002, through February 28, 2003.¹⁹ Using electronic and hard-copy information provided by FMS for the selected compromised debts, we determined whether the compromises were justified, supported, and reported to IRS. We projected the results from our sample of compromises to the population from which the sampled items were drawn. (App. I contains additional information on the sampling method.)

¹⁸If the debtor defaults on the compromise agreement, the debtor owes the full balance of the debt prior to compromise, less any amounts paid.

¹⁹We selected October 1, 2002, through February 28, 2003, as our testing period because FMS had performed reviews of compromises made by its PCA contractors for prior periods and found problems.

In addition, we interviewed FMS and OMB officials about the extent to which their respective agencies monitor and report on federal agencies governmentwide regarding identification and reporting of closed-out debts to IRS. We also obtained and analyzed TRORs for all 24 CFO Act agencies to determine the nontax debt close-out and IRS reporting information for calendar year 2002.

To determine whether information in FMS's cross-servicing database was reliable, we reviewed documentation provided by FMS supporting reliability testing performed by FMS and its contractors on the database. In addition, we performed electronic testing of specific data elements in the database that we used to perform our work. Based on our review of FMS's documents and our own testing, we concluded that the data elements used for this report are sufficiently reliable for the purpose of the report.

We performed our work from October 2002 through August 2003 in accordance with U.S. generally accepted government auditing standards.

We requested comments on a draft of this report from the Secretary of the Treasury and the Director of OMB or their designees. The Commissioner of FMS provided Treasury's comments, which are reprinted in appendix II. On October 21, 2003, staff from OMB provided us with OMB's oral comments on the draft. Treasury's and OMB's comments are discussed in the Agency Comments and Our Evaluation section of this report and are incorporated in the report as applicable.

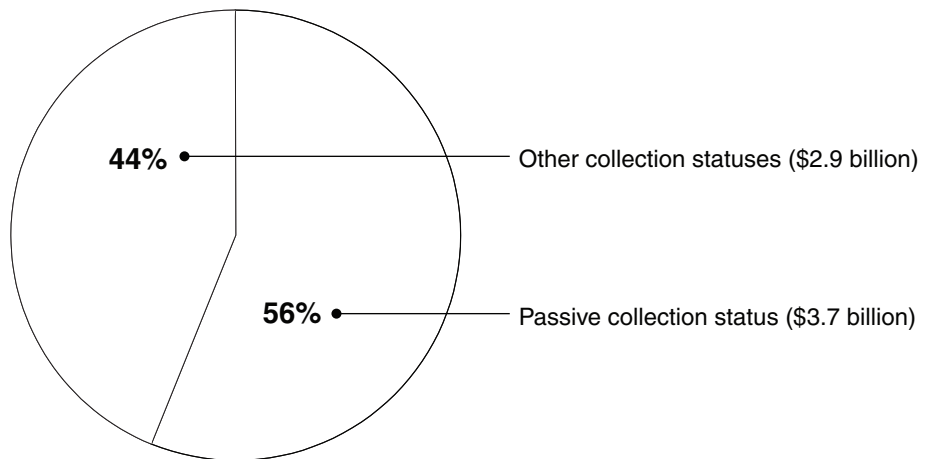
Collection Opportunities Were Lost on Uncollected Debts Returned from PCA Contractors

As of February 28, 2003, FMS had approximately \$6.6 billion of debts in cross-servicing. More than half of these debts had been returned uncollected by FMS's secondary PCA contractors and were being kept in TOP for passive collection. Passive collection entailed no further collection action other than minimal efforts through offsets, and certain debts in passive collection were not eligible for such offsets. In addition, FMS did not review certain uncollected debts that FMS returned to the referring agencies to determine whether all collection activity had been performed on the debts, including whether FMS should close out and report the debts to IRS on behalf of the agencies. Further, certain debts that were not in passive collection or returned to referring agencies were kept in inactive status where no collection activities, including referral to TOP, were performed. Consequently, opportunities for maximizing collections or other recoveries were lost.

FMS Did Not Review Uncollected Debts Left in TOP for Passive Collection

When debts were returned from secondary PCA contractors, FMS simply kept most of them in TOP, where they largely lay dormant without any review to determine the next best course of action to improve collections. For fiscal years 2000, 2001, and 2002, FMS kept about \$2.6 billion of uncollected nontax debts returned from its secondary PCA contractors in TOP for passive collection. As of February 28, 2003, debts retained in TOP for passive collection totaled about \$3.7 billion and, as shown in figure 1, represented 56 percent of the approximately \$6.6 billion of debts that were at FMS for cross-servicing at that time.²⁰ Through February 28, 2003, FMS had collected only about \$9 million on debts in passive collection through offsets, which was the only collection tool being used to collect these returned debts.

Figure 1: Percentage of Cross-Serviced Debts in Passive Collection as of February 28, 2003



Source: GAO.

Note: Derived from analysis of FMS's cross-servicing database as of February 28, 2003.

FMS did not have written procedures for reviewing debts kept in TOP for passive collection. It is important to note that FMS officials stated that

²⁰In addition to the approximately \$2.6 billion of debts returned from secondary PCA contractors in fiscal years 2000 through 2002, about \$1.1 billion were retained in TOP for passive collection on debts that were returned from secondary PCA contractors either prior to fiscal year 2000 or in fiscal year 2003.

because of system limitations, FMS did not identify specific debts that were in TOP for passive collection. However, we were able to identify debts in TOP for passive collection using off-the-shelf database analysis software.

Certain nontax debts kept in TOP for passive collection warrant additional review to determine the next best course of action to maximize collections or other recoveries, such as those possible through administrative wage garnishment (AWG) or reporting closed-out debts to IRS. For example, DCIA authorized federal agencies to use AWG to collect delinquent nontax debts.²¹ FMS can perform AWG on behalf of other federal agencies as part of cross-servicing, although only on behalf of agencies that have authorized FMS to do so. FMS began using AWG with the assistance of its PCA contractors during fiscal year 2002. Because most of the debts in TOP for passive collection were returned to FMS from PCA contractors before any agencies had authorized FMS to use AWG on their behalf, most debts in TOP for passive collection have not yet been assessed for AWG collection opportunities. Further, as of our fieldwork completion date, only four federal agencies had authorized FMS to perform AWG on their behalf.²² However, FMS expects additional agencies to provide such authorization in the future.

In addition, about \$449 million of nontax debts in TOP for passive collection as of February 28, 2003, will not be collected through offset because the statutory and regulatory 10-year limitations for offsets has expired for those debts.²³ According to FMS officials, FMS's cross-servicing system did not remove debts from TOP when the debts reached the 10-year limitation, so such debts were not evaluated for possible close-out and reporting to IRS.²⁴

²¹AWG, as authorized by DCIA, is an administrative process that allows an agency to issue an order requiring the debtor's employer to withhold up to 15 percent of the debtor's disposable pay for payment of the debt.

²²The four agencies that have authorized FMS to perform AWG on their behalf are the Department of Housing and Urban Development, the Securities and Exchange Commission, the James Madison Foundation, and the Railroad Retirement Board.

²³Judgment debts and student loans are not subject to the statutory and regulatory 10-year limitations. None of the approximately \$449 million of debts were judgment debts or student loans.

²⁴According to FMS officials, the debts are removed only if they are subsequently matched to payments in TOP.

Certain other debts in TOP for passive collection are also unlikely to yield any collections through offsets—those for which we determined the debtors' Taxpayer Identification Numbers (TIN) were invalid or belonged to deceased individuals or cases in which the debtors were bankrupt. Specifically, we identified about \$24 million of delinquent nontax debts for which the debtors' TINs were invalid.²⁵ In addition, using the Social Security Administration's (SSA) Death Master File, we identified over 2,500 nontax debts totaling about \$18 million with TINs that belonged to reportedly deceased debtors, including one with a referred balance of approximately \$4 million.²⁶ This debt had been in TOP since November 2001 with no collections through offsets. We also identified 69 delinquent Medicare debts belonging to the Department of Health and Human Services (HHS) totaling about \$12 million that were being held in TOP after return from secondary PCA contractors for which FMS's cross-servicing database indicated that the debtors were in bankruptcy.²⁷ According to FMS officials, when a bankruptcy is recorded in the cross-servicing database for a particular debt, the cross-servicing system marks the debtor as bankrupt for all debts associated with that debtor but does not remove them from TOP. In-house FMS collectors typically removed from TOP only the specific debt that they were working even though others had been flagged as belonging to the same bankrupt debtor.

As a result of our analyses and inquiries, FMS has initiated a review of debts in TOP to identify those beyond the statutory and regulatory 10-year limitations for offsets. As of April 2003, FMS had identified over 7,300 such debts, totaling about \$463 million (an increase of \$14 million over the

²⁵IRS periodically provides a list of prefix numbers for valid Employer Identification Numbers on its Web site. The Social Security Administration (SSA) provides a description of invalid Social Security numbers on its Web site. We used these Web sites to identify invalid TINs. There may be other debts with invalid TINs that we could not identify using the information from IRS and SSA Web sites.

²⁶SSA stores death information for each individual who has been issued a Social Security number and whose death has been reported to SSA. SSA periodically extracts the death information and makes this information, called the Death Master File, available for sale to the public by the Department of Commerce.

²⁷In total, FMS's cross-servicing database showed that about \$110 million of HHS's Medicare debts, including the approximately \$12 million in passive collection, were in TOP and available for liquidation by offsets even though the debtors were in bankruptcy. The automatic stay mandated by 11 U.S.C. 362 prevents the government from pursuing collection action against debtors in bankruptcy for certain debts that arise prior to the commencement of the bankruptcy litigation.

\$449 million of debts we identified as of February 28, 2003). An FMS official stated that these debts would be removed from TOP and evaluated for possible close-out and reporting to IRS as income to the debtors. The official also stated that FMS would develop a process for routinely identifying such debts. In addition, FMS officials stated that FMS will revise its policies and procedures so that collectors will be instructed to review the debtor and all associated nontax debts whenever a bankruptcy is discovered for a debt and determine debts that should be removed from TOP. Finally, FMS officials stated that FMS is in the process of developing a new automated cross-servicing system, called FedDebt. According to FMS officials, once FedDebt is implemented in January 2005, FMS will be able to routinely identify individual debts that are in passive collection.

FMS Did Not Perform Collection and Close-Out Reviews for All Debts Returned to Referring Agencies and Debts in Inactive Status

Through February 28, 2003, FMS returned to referring agencies about \$1.1 billion of delinquent nontax debts that had been returned uncollected to FMS by secondary PCA contractors during fiscal years 2000, 2001, and 2002. FMS's cross-servicing procedures require that in-house FMS collectors, prior to returning debts to referring agencies, review the collection activity on the debts to determine whether they are eligible to be returned to the referring federal agencies. As part of this review, the cross-servicing procedures require collectors to determine whether the debts should be closed out and reported to IRS by FMS. We found, however, that FMS had summarily returned about 40 percent of the \$1.1 billion to referring agencies without first ensuring that the required collection activities had been performed.

According to information in FMS's cross-servicing database, in April 2002 FMS had a substantial backlog of debts that had been returned to FMS by secondary PCA contractors over the past several years that were primarily in inactive status, meaning that no collection action was taking place. To eliminate this backlog, FMS used its automated system to summarily return about 41,000 debts totaling approximately \$446 million to the referring agencies in April 2002. According to agency procedures and as confirmed by an FMS official, prior to the April 2002 return of the debts to the referring agencies, FMS should have first evaluated these debts to determine whether close-out was appropriate and whether the debts should be reported to IRS. Our analysis showed that about \$97 million of these returned debts met two criteria for being reported by FMS to IRS as income to the debtor: (1) the debts had TINs and (2) the referring agencies had granted FMS authority to report the debts to IRS.

Our review of the cross-servicing database showed that FMS continues to face challenges in reviewing uncollected debts returned from secondary PCA contractors. Specifically, as of February 28, 2003, FMS had approximately \$80 million of debts in inactive status even though its PCA contractors returned these uncollected debts to FMS during fiscal year 2002. According to an FMS official, the backlog occurred because the automated cross-servicing system did not always identify debts returned to FMS by secondary PCA contractors that required further collection review by in-house FMS collectors. The FMS official stated that FedDebt, when implemented in January 2005, would correct this problem.

Inadequate Monitoring and Reporting of Closed-Out Debts to IRS

DCIA gives OMB responsibility for annual reporting to the Congress on any problems regarding federal agency progress in improving policies and standards for closing out debts,²⁸ and FMS is responsible for the form and content of the TROR, which FMS uses to monitor federal agencies' implementation of DCIA. Neither OMB nor FMS monitored or reported on the extent to which agencies governmentwide closed out debts and reported them to IRS. The TRORs for 24 CFO Act agencies showed that the agencies reported that about \$1 billion of the approximately \$3.2 billion of nontax debts that were reported closed out by those agencies were reported to IRS as income to the debtors for calendar year 2002.²⁹ Additionally, the TRORs that the agencies used to report did not disclose why closed-out debts were not reported to IRS and did not include closed-

²⁸Specifically, DCIA requires OMB to (1) review the standards and policies of each federal agency for compromising, writing down, forgiving, or discharging indebtedness arising from programs of the agency; (2) determine whether those standards and policies are consistent and protect the interests of the United States; (3) direct the head of the agency to make appropriate modifications to any federal agency's standards or policies that the OMB Director determines are not consistent or do not protect the interests of the United States, and (4) report annually to the Congress on deficiencies in the standards and policies of federal agencies for compromising, writing down, forgiving, or discharging indebtedness, and progress made in improving those standards and policies.

²⁹In previous work, we found that certain federal agencies may not be properly reporting closed-out debts to IRS. For example, in fiscal year 2002, we reported that the Centers for Medicare & Medicaid Services was not reporting certain closed-out Medicare debts to IRS as income to debtors. U.S. General Accounting Office, *Debt Collection Improvement Act of 1996: HHS's Centers for Medicare & Medicaid Services Faces Challenges to Fully Implement Certain Key Provisions*, GAO-02-307 (Washington, D.C.: Feb. 22, 2002). In addition, we found that Farm Services Agency officials were unaware of the requirement to report closed-out debts to IRS as income for secondary debtors. U.S. General Accounting Office, *Debt Collection: Agriculture Making Progress in Addressing Key Challenges*, GAO-03-202T (Washington, D.C.: Nov. 13, 2002).

out debts that had been previously classified as currently not collectible (CNC). These are significant reporting deficiencies because without such information, the TRORs cannot be used to determine the extent to which all eligible debts are closed out and reported to IRS. As a result of inadequate monitoring and reporting of closed-out debts to IRS, opportunities for recovery by reporting closed-out debts to IRS as income to debtors may have been lost.

Neither OMB nor FMS officials could specifically explain why certain agencies had reported different amounts for debts closed out and debts reported to IRS. According to an OMB official, OMB does not have a formal process in place to review federal agencies' standards and policies regarding debt collection, including reporting closed-out debts to IRS, and does not monitor the extent to which agencies close out debts and report them to IRS. The OMB official stated that OMB examiners, at their own discretion, might look at how federal agencies are closing out debts as part of the examiners' overall evaluation of the agencies' implementation of the President's Management Agenda.³⁰ According to the official, OMB has not submitted any reports to the Congress regarding problems with agencies' standards and policies for closing out debts and reporting them to IRS.

FMS officials stated that the large difference on the agencies' TRORs between closed-out debts and debts reported to IRS may be attributable to situations involving debts that are not required to be reported to IRS.³¹ However, FMS does not require federal agencies to disclose such information in their TRORs. Without such disclosures in the TRORs, it is not possible for FMS, OMB, or any other interested party to determine whether federal agencies are reporting their closed-out debts to IRS accurately and completely.

Moreover, the agency TRORs understated the amount of debt closed out during calendar year 2002. Specifically, we determined and FMS officials acknowledged that the \$3.2 billion of debts that were reported closed out

³⁰The President's Management Agenda, announced in the summer of 2001, is a strategy for improving the management of the federal government. The President's Management Agenda includes an emphasis on strategic management of human capital, competitive sourcing, improved financial performance, expanded electronic government, and budget and performance integration.

³¹For example, 26 U.S.C. 6050P and 26 C.F.R. 1.6050P-1 exclude certain debts that are discharged in bankruptcy and debts less than \$600 from IRS reporting requirements.

by the 24 CFO Act agencies did not include debts previously classified as CNC that were subsequently closed out. This is a significant deficiency in the TROR because CNC debts that are eventually closed out can be substantial. For example, the 24 CFO Act agencies reported about \$10.1 billion of CNC debts at the end of calendar year 2002. Without information on whether CNC debts are closed out, the TRORs cannot be used to fully determine the extent to which all debts are closed out and reported to IRS. In spite of these reporting deficiencies, FMS officials stated that FMS does not have any plans to revise the TROR.

FMS Missed Certain Opportunities to Improve Overall Collections

In addition to taking little action to improve collections for debts that were returned uncollected by PCA contractors, FMS missed certain opportunities to improve overall cross-servicing collections. FMS did not establish effective processes or procedures for identifying debts to forward to DOJ. As a result, FMS had relatively few debts (about \$30 million as of February 28, 2003) at DOJ for enforced collection action even though DOJ has been successful in collecting debts through civil litigation in the past. In addition, FMS did not report all eligible debts that had been referred for cross-servicing to TOP, as required by its cross-servicing procedures, and did not report secondary debtors, such as cosigners, to TOP.

FMS Missed Enforced Collection Opportunities

DOJ serves as the federal government's "collector of last resort." When a federal agency, including FMS, cannot collect certain debts administratively, DOJ can litigate the claims and, with judicial oversight, enforce collections by seizing bank, stock, and similar accounts from debtors; seizing and selling debtor-owned real estate and other property; and garnishing a higher percentage of debtors' wages than AWG under DCIA allows.³² The benefits of enforced collection are reflected in past DOJ recoveries. In its fiscal year 2002 report to the Congress, FMS noted that DOJ collected about \$10.9 billion in cash recoveries through civil litigation from fiscal year 1998 through fiscal year 2002.

³²Federal agencies, in cases where there is no evidence of assets, can also refer delinquent debts to DOJ for judgment liens only rather than for enforced collection.

The Federal Claims Collection Standards require federal agencies to promptly refer debts that have a principal balance of at least \$2,500 to DOJ when the debts cannot be collected through either compromise or aggressive collection action and do not meet criteria for suspending or terminating collection action.³³ Accordingly, OMB Circular A-129 requires federal agencies, including FMS as the federal government's central debt collection agency, to refer delinquent debts to DOJ as soon as there is sufficient reason to conclude that full or partial recovery of the debts can best be achieved through litigation.

FMS acknowledges that DOJ referrals are an important part of cross-servicing. In its annual report to the Congress on federal agencies' debt collection activities, FMS reported that referrals to DOJ for civil litigation governmentwide decreased significantly over the last 3 fiscal years, from 50,572 debts in fiscal year 2000 to 8,443 debts in fiscal year 2002. As federal agencies continue to implement DCIA and make progress in promptly referring eligible debts that are over 180 days delinquent to FMS for collection action in accordance with the act's requirements, reported decreases in federal agency referrals to DOJ for enforced collection can be expected as would increases in FMS referrals due to the shift in collection responsibilities from the agencies to FMS. Generally, a determination that a debt should be referred to DOJ cannot reasonably be made until appropriate cross-servicing collection action has taken place. In working with federal agencies to facilitate implementation of DCIA, FMS emphasizes that referral of a debt to DOJ for enforced collection is a key cross-servicing tool. FMS makes clear to agencies that it will (1) prepare the forms necessary for referring debts to DOJ,³⁴ (2) work with DOJ to obtain necessary information from the agencies to litigate the claims, (3) monitor the debts while they are at DOJ, and (4) apply DOJ collections to the debts.

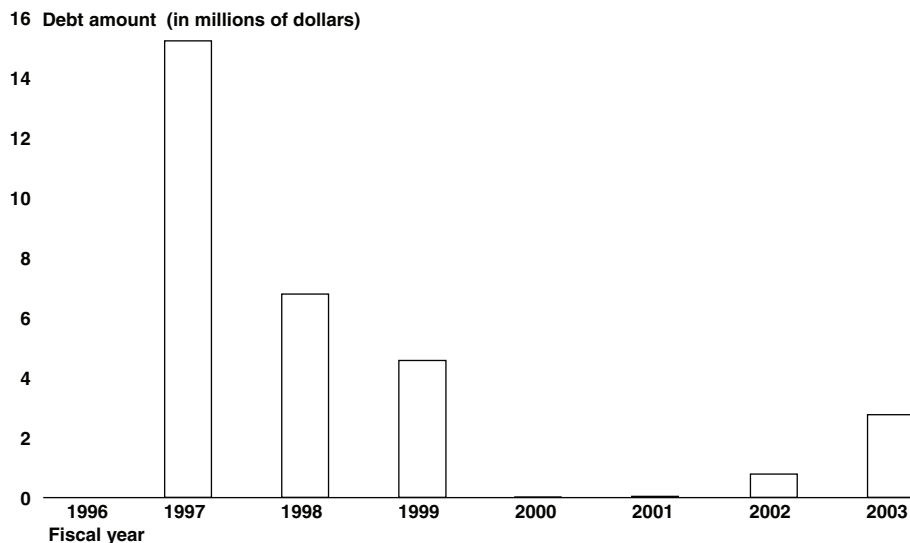
³³According to the Federal Claims Collection Standards, federal agencies may refer debts to DOJ less than \$2,500 in certain situations, such as debts for which litigation is important to ensure compliance with the federal agency's policies or programs. The Federal Claims Collection Standards also state that federal agencies may terminate collection action on a claim when, among other things, the agency is unable to locate the debtor and/or the costs of collection are anticipated to exceed the amount recoverable. Federal agencies may suspend collection action on a claim when the agency cannot locate the debtor, the debtor's financial condition is expected to improve, and/or the debtor has requested a waiver or review of the claim.

³⁴Unless excepted by DOJ, claims referred to DOJ should be accompanied by a Claims Collection Litigation Report, a Certificate of Indebtedness, and other information that may be required.

FMS, based on consultations with DOJ, established the following conditions for its referral of agency debts to DOJ: (1) the federal creditor agency has authorized FMS to refer its debts to DOJ, (2) the principal amount of the debt is \$25,000 or more, (3) there is at least 1 year before the statute of limitations expires, (4) FMS has a debtor address (or other debtor contact information for service-of-process purposes), and (5) FMS has evidence that the debtor has assets or a source of income. As appropriate, FMS also expects to refer debts to DOJ when some, but not all, of the criteria are met. For example, FMS might refer debts less than \$25,000 when bank accounts have been identified.

In spite of FMS's key role in determining whether debts referred for cross-servicing should be referred to DOJ for enforced collection, only a nominal amount of cross-serviced debt was at DOJ. Specifically, as of February 28, 2003, only about \$30 million of the approximately \$6.6 billion of debts with FMS for cross-servicing were at DOJ. Moreover, as shown in figure 2, all but about \$4 million of the debts FMS had referred to DOJ were referred prior to fiscal year 2000, suggesting that FMS had not emphasized adjudication as a collection tool.

Figure 2: FMS-Referred Debts at DOJ as of February 28, 2003, by Fiscal Year Referred



Source: GAO.

Note: Derived from analysis of FMS's cross-servicing database.

According to an FMS official, prior to fiscal year 2002, FMS had no specific process to evaluate cross-serviced debts to determine whether recovery could best be achieved by DOJ. Rather, the FMS official stated, FMS relied on the referring agencies to identify delinquent debts to refer to DOJ. In addition, FMS's in-house collectors, using their own discretion during the normal course of their collection activities, could identify specific debts for referral to DOJ.

In fiscal year 2002, FMS, in an effort to increase referrals to DOJ, began performing quarterly queries of its cross-servicing database to identify uncollected debts for referral to DOJ. The queries, while conceptually good, did not cover most of FMS's cross-servicing portfolio. Rather, they were limited to debts with principal balances \$25,000 or over that were classified as inactive or "special handling." As of February 28, 2003, FMS had identified nine debts totaling about \$4 million for DOJ referral using this smaller segment of its cross-servicing database.

Reviewing only debts classified as inactive or "special handling" with principal balances over \$25,000 is unlikely to result in many candidates for FMS referral to DOJ because of the nature of these debts and the amounts covered. Specifically, for many of the debts in inactive status, FMS does not have TINs, which are required for DOJ referral, or the debtors are in bankruptcy.³⁵ Debts classified as "special handling" are debts that collectors have identified as needing special processing because they want to keep the cases at the debt collection center. For example, a collector may place a debt in "special handling" if the collector is in negotiations with the debtor over a payment plan. We applied FMS's database query method to debts classified as inactive and "special handling." Our query identified about \$198 million of uncollected debts, which represented about 3 percent of the amount in cross-servicing. We determined that the majority of these debts were not good candidates for DOJ referral. Specifically, about \$106 million of such debts either (1) lacked agency authorization for referral to DOJ, (2) were involved in bankruptcy proceedings, (3) were beyond the general 6-year statute of limitations for litigation of nonjudgment debts, or (4) lacked TINs.

³⁵FMS's policy is to return all debts found to be in bankruptcy to referring agencies unless it has been stipulated by the referring agency that such cases will not be returned or that the bankruptcy proceedings have been completed and the debts were not discharged.

We would consider it reasonable for FMS to query a larger segment of its cross-servicing database. In particular, debts held in TOP for passive collection would seem to be better candidates for DOJ referral because they should have valid TINs and are not supposed to be in bankruptcy. This segment of the cross-servicing debt portfolio is rather large. We determined that FMS had approximately \$2.2 billion of debts in TOP with principal balances of at least \$2,500 that had been returned from its secondary PCA contractors and that were within the 6-year statute of limitations for litigating nonjudgment debt.³⁶ Unless FMS starts expanding the scope of its reviews for potential referrals to DOJ, the statute of limitations for these debts will likely expire without any opportunity for enforced collection action. Our assessment of FMS's database as of February 28, 2003, showed that about \$449 million of debts with principal balances of at least \$2,500 likely had their statute of limitations expire while they were held in TOP for passive collection. We determined that all of these debts would have been possible candidates for referral to DOJ, since they had been returned from FMS's secondary PCA contractors with at least 1 year remaining before the statute of limitations expired.

³⁶Using a \$25,000 principal balance as the threshold for DOJ referral, FMS's database showed about \$2.1 billion of debts in TOP that were within the 6-year statute of limitations.

FMS also did not routinely consider or act on advice from its PCA contractors regarding referrals to DOJ. Because PCA contractors' responsibilities include locating debtors and determining whether they have incomes or assets to repay delinquent debts, the PCA contractors would have a reasonable basis for identifying uncooperative debtors who could repay their debts but had refused. FMS's *PCA Operations and Procedures Manual* requires FMS's PCA contractors to provide recommendations to FMS on the next collection actions that should be taken on individual debts, such as referral to DOJ for litigation.³⁷ According to the manual, litigation should be recommended when the PCA contractor believes that the debtor has sufficient assets for debt repayment and that no less costly method of collection would be effective. Our analysis showed that FMS was holding debts totaling about \$47 million in TOP for passive collection that had principal balances over \$2,500 for which PCA contractors had recommended litigation.³⁸ We noted that FMS's cross-servicing database showed that these debts were within the general 6-year statute of limitations for litigating nonjudgment debts and had no apparent barriers to litigation, such as debtor bankruptcy or a deceased debtor.

FMS officials stated that FMS does not routinely review recommendations made by its PCA contractors because FMS does not believe such recommendations are reliable. In this regard, we noted that FMS's *PCA Operations and Procedures Manual* does not set forth the specific FMS criteria for selecting debts for DOJ referral. In addition, FMS does not tell PCA contractors which creditor agencies have authorized FMS to refer debts to DOJ on the agency's behalf. It is important to note that only about \$3 million, or less than one-tenth of 1 percent, of the approximately \$3.9 billion of uncollected debts that were returned to FMS from its secondary PCA contractors during fiscal years 2000, 2001, and 2002 were at DOJ.

Moreover, while FMS had referred only limited amounts of cross-serviced debt to DOJ for litigation, FMS lacked a history of its prior referral activity and knowledge of the results of such referrals. FMS officials stated that

³⁷In addition to litigation, PCA contractors can recommend that collection action be continued, the debt be returned to the referring agency, or the debt be written off and closed out.

³⁸Using a \$25,000 principal balance as the threshold for DOJ referral, FMS's database had about \$45 million of debts in TOP for passive collection for which PCA contractors had recommended litigation.

FMS does not use the cross-servicing database to track DOJ referrals; however, we found that the database has status and collection activity codes capable of being used for such tracking. FMS officials acknowledged the need to track all DOJ referrals and stated that FMS will ensure that FedDebt will be able to track all debts that FMS has referred to DOJ.

FMS Did Not Fully Use TOP

FMS's policies and procedures require in-house FMS collectors to report all eligible debts to TOP early in the cross-servicing process, before sending them to FMS's PCA contractors. In fiscal year 2000, we reported that FMS did not promptly report eligible debts to TOP as its procedures required. Computer interface problems and errors by in-house FMS collectors were cited as reasons for not promptly reporting all eligible debts to TOP.³⁹ Problems regarding TOP referrals continue as FMS's cross-servicing database as of February 28, 2003, showed that about 1,800 debts that were eligible for TOP, with referred balances totaling about \$356 million, were at PCA contractors but had never been put into TOP by FMS's collectors. We did not identify any apparent factors that would have precluded FMS's collectors from reporting these debts to TOP. The database showed that the debts were eligible for TOP in that the referring agencies had authorized FMS to report the debts to TOP, the debtors had TINs, the debtors were not in bankruptcy or deceased, and the debts were not over 10 years delinquent.

The delays in reporting these debts to TOP were extensive. As of February 28, 2003, about \$215 million of these debts with an average of approximately 320 days in cross-servicing were at the secondary PCA contractor without having been sent to TOP. One of the more egregious delays involved a debt referred by an agency in October 2001 for about \$43 million that had been in cross-servicing for over 500 days without ever having been reported to TOP.

FMS officials stated that they are aware that eligible debts are not always being reported to TOP. They told us that debts might not be reported to TOP because the cross-servicing automated system does not always identify debts that should be reported. For example, FMS officials stated that if the system failed during its nightly batch processing, the debts that

³⁹[GAO/AIMD-00-234](#).

would otherwise have been flagged for reporting to TOP would be missed. FMS officials stated that the cross-servicing system could not go back and routinely identify debts that were missed. Thus, as acknowledged by FMS officials, FMS would have to perform a periodic sweep of the entire database to identify eligible debts that were missed for reporting to TOP. In response to our inquiries, FMS officials stated that FMS will take action to ensure that FedDebt includes features to correct this problem when it is implemented in January 2005.

FMS is also not seizing the opportunity to report secondary debtors to TOP. Our analysis of FMS's cross-servicing database as of February 28, 2003, showed that about \$144 million of the approximately \$5 billion of cross-serviced debts in TOP had secondary debtors with TINs. According to FMS officials, both the TOP and cross-servicing automated systems are debt-based, rather than based on both debt and debtor. As such, TOP cannot be used to identify all debtors associated with a debt, a problem we noted to FMS about 5 years ago. Even if TOP would accept these data, the cross-servicing system cannot provide them, since it is now capable of sending only one debtor per debt to TOP. FMS officials stated that FMS is in the process of enhancing TOP to accept multiple debtors for a single debt and that the TOP enhancement should be implemented in fiscal year 2004. The officials also stated that FMS will ensure that FedDebt will be capable of referring multiple debtors to TOP when it is implemented in January 2005.

Problems Identified with Debt Compromises and a Key Performance Measure

FMS did not sufficiently ensure that nontax debts that were forgiven through compromises with debtors by its in-house collectors or its PCA contractors were done so in an operationally sound manner. FMS's cross-servicing database as of February 28, 2003, showed that FMS and its PCA contractors forgave a total of at least \$51 million of delinquent nontax debts through compromises with debtors during fiscal years 2000, 2001, and 2002. For FMS in-house compromises, this included only those compromise agreements that had been settled and paid in full. The cross-servicing database did not identify forgiven amounts for agreements that were still active or defaulted. In addition, it is unclear whether certain forgiven amounts should have been forgiven or by how much, since FMS's PCA contractors often did not document why they compromised debts and often did not obtain sufficient support and justification for the compromises. Further, FMS overstated federal agencies' progress in referring eligible nontax debts for cross-servicing. Specifically, FMS incorrectly reported that agencies had referred 96 percent of their eligible debts for cross-servicing for fiscal year 2002, rather than the actual rate of

79 percent based on our analysis of information provided by FMS. This discrepancy occurred because FMS did not include any debts that were reported as having become eligible for referral for cross-servicing during fiscal year 2002 and did not deduct the amounts of certain debts that it returned to referring agencies during fiscal year 2002.

Information Regarding Debt Compromises Was Not Sufficient

The soundness of FMS's cross-servicing program can be undermined if certain debtors receive more generous treatment as a result of compromise agreements than other similarly situated debtors. While the amount of debt forgiven as noted above was not substantial, the consistency with which delinquent debts are forgiven and the extent to which federal requirements are adhered to in arriving at such decisions are vital. Therefore, it is critically important for FMS to (1) accurately track debt amounts forgiven, (2) obtain documented support for the compromise agreements, and (3) obtain TINs for the debtors. In August 2000, as part of our overall report on FMS's cross-servicing program, we reported that the majority of FMS compromise agreements we reviewed, including those made by PCA contractors, did not include support for the forgiven amounts.⁴⁰ In following up on FMS's compromise activity, we found that FMS's cross-servicing system did not track the forgiven amounts for all debts that had been compromised during fiscal years 2000, 2001, and 2002. In addition, FMS's PCA contractors often did not document why they compromised debts and often did not obtain sufficient support for the compromise agreements, including debtors' TINs, which are needed to report the forgiven amounts to IRS.

The Federal Claims Collection Standards state that federal agencies may compromise debts if (1) the debtor is unable to pay the full amount in a reasonable time, as verified through credit reports or other financial information; (2) collection in full cannot be achieved within a reasonable time by enforced collection proceedings; (3) the cost of collection does not justify the enforced collection of the full amount; or (4) there is significant doubt concerning the government's ability to prove its case in court. According to the standards, in determining the debtor's inability to pay, agencies should consider a number of factors as verified by the debtor's credit report and other financial information, including financial statements that show the debtor's assets, liabilities, income, and expenses.

⁴⁰GAO/AIMD-00-234.

In addition, FMS's PCA contract requires its PCA contractors to document their attempts to collect the full amount of delinquent debts and provide justification for compromises. In the absence of adequate documentation supporting the PCA contractor's determination to compromise a debt for a specific amount, FMS cannot determine whether the compromise is reasonable under the Federal Claims Collection Standards. Thus, FMS has no basis to determine whether the government suffered a loss that should not have been incurred as a result of such a compromise. We also determined that the PCA contract does not establish liquidated damages or penalties for a PCA contractor's failure to document a compromise.

As part of our review, we attempted to obtain the forgiven amount for each compromise agreement established by in-house FMS collectors during fiscal years 2000, 2001, and 2002, to determine whether the bases for the forgiven amounts had been supported and documented by FMS's in-house collectors. However, FMS could not provide us the forgiven amount for each compromise agreement because the cross-servicing system only identifies the forgiven amount for compromise agreements that have been settled in full. Thus, FMS could not provide us the forgiven amounts for compromise agreements that were active or in default.

Absent information on forgiven amounts for all compromise agreements, FMS cannot track the extent to which its collectors are compromising agency-referred debts and the bases for the compromises. According to an FMS official, FMS acknowledges that such information is critical to sound cross-servicing operations and, as a result of our inquiries, plans to incorporate the ability to identify and track all forgiven amounts in the FedDebt system.

According to FMS officials, in fiscal year 2002, FMS began to review repayment and compromise agreements made by its PCA contractors as part of its annual PCA contractor compliance reviews. During these reviews, FMS generally found that all PCA contractors failed to consistently document in their respective debt collection systems the justification for accepting installment payments and compromise agreements.⁴¹ As a result of FMS's findings, each PCA contractor agreed to conduct training sessions for its collectors or take other corrective actions

⁴¹FMS found that the contractor error rates resulting from failure to provide justification for the acceptance of installment and compromise agreements ranged from 26 percent at one contractor to 88 percent at another contractor.

to help ensure that the collectors properly obtain and document support for forgiven amounts.

In spite of FMS's reviews of the compromise activity of its PCA contractors and related findings pertaining to the lack of documented support for the compromises, we found that PCA contractors were still not providing sufficient support for compromises during the first 5 months of fiscal year 2003. Specifically, we found that 22 percent of the sampled compromised debts had no evidence that the PCA contractor had attempted to obtain a lump sum payment in full or a repayment agreement for the full amount prior to compromising the debt.⁴² For example, one debt involved a debtor who offered to pay the full debt balance of approximately \$14,000 in installments. However, without explanation, the PCA contractor offered to compromise the debt by 20 percent if the debtor would pay right away. The debtor accepted the compromise offer. Moreover, this PCA contractor encouraged compromise activity prior to exhausting attempts to collect debts in full by sending out pro forma letters to debtors stating that the contractor may be authorized to compromise a portion of their debt should the debtor be in a position to pay the remaining balance.

⁴²We estimate that 22 percent of the debt compromises in the population were made without the PCA contractor attempting to obtain payment in full prior to compromise. We are 95 percent confident that the percentage of debt compromises for which the PCA contractor did not attempt to obtain payment in full is from 12 percent to 34 percent.

In addition, 72 percent of the compromised debts in our sample did not have supporting documentation indicating why the PCA contractors compromised the debts or the bases used to determine how these debts met Federal Claims Collection Standards criteria for compromise.⁴³ For 81 percent of the compromised debts in our sample, PCA contractors did not have complete financial statements, and for 30 percent of the compromised debts, PCA contractors did not have credit bureau reports to support the compromises.⁴⁴

It should be noted that a PCA contractor is required to submit to FMS the debtor's financial statement and credit bureau report for review only if the compromise percentage of the debt exceeds the compromise percentage that is authorized by FMS or the referring agency. We found that for 36 of the 54 compromised debts in our sample, the PCA contractors compromised up to the amount that was allowed by FMS or the referring agencies. For example, one PCA contractor allowed a debtor to pay approximately \$46,000 to settle a debt that had an outstanding balance of about \$58,000. The forgiven amount fell within the compromise parameter that had been established by the referring agency. However, the PCA contractor did not (1) attempt to collect payment in full, (2) provide any explanation to justify the compromise, or (3) obtain the debtor's complete financial statement and credit report. Because the PCA contractor did not exceed the compromise parameter established by the referring agency, it was able to compromise the debt without submitting the debtor's financial statements and credit report to FMS for review.

FMS officials stated that PCA contractors are required to document their attempts to obtain payment in full and justification for offering or accepting a compromise even when the compromise is within agency parameters. According to FMS officials, FMS discussed this issue with its PCA

⁴³We estimate that 72 percent of the debt compromises in the population were made without the PCA contractor providing an explanation for the compromises. We are 95 percent confident that the percentage of debt compromises for which no explanation was provided by the PCA contractor is from 59 percent to 83 percent.

⁴⁴We estimate that 81 percent of the debt compromises in the population were made without the PCA contractor obtaining a complete financial statement for the debtor. We are 95 percent confident that the percentage of debt compromises for which PCA contractors did not obtain complete financial statements is from 69 percent to 91 percent. We estimate that 30 percent of the debt compromises in the population were made without the PCA contractor obtaining a credit bureau report. We are 95 percent confident that the percentage of debt compromises for which the PCA contractor did not obtain credit bureau reports is from 18 percent to 43 percent.

contractors in October 2002 and reiterated the importance of documenting the justification for compromising debts and obtaining financial statements and credit bureau reports to support the compromises. FMS officials stated that FMS would continue to look at compromise agreements in future PCA compliance reviews to help ensure that PCA contractors are providing justification and obtaining the financial statements and credit bureau reports necessary for entering into a compromise agreement.

Moreover, FMS's PCA contractors did not always attempt to obtain or report to FMS the TINs of debtors who were granted compromises. Specifically, we found that 17 percent of the compromised debts in our sample did not have TINs because the PCA contractors either did not request the TINs from the debtors or did not report the TINs to FMS.⁴⁵ Without TINs for debtors, neither FMS nor the referring agencies were able to report the forgiven amounts of the compromised debts to IRS as income to the debtors. In addition, without a TIN, if the debtor defaults on the compromise agreement, the debt cannot be reported to TOP. According to FMS officials, FMS is continuing to monitor the compromise agreements made by its PCA contractors to help ensure that the contractors obtain and report TINs to FMS. In addition, as a result of our inquiries, FMS plans to issue a technical bulletin to its PCA contractors to remind them of the need to obtain and report TINs.

⁴⁵We estimate that 17 percent of the debt compromises in the population were made without the PCA contractor obtaining a TIN from the debtor or reporting the TIN to FMS. We are 95 percent confident that the percentage of debt compromises for which no TIN was obtained by the PCA contractor or reported to FMS is from 9 percent to 29 percent.

FMS Overstated Progress in a Key Performance Measure

DCIA requires Treasury to report to the Congress each year on the debt collection activities of federal agencies, including FMS as the government's central debt collection agency. A key performance measure that FMS reports each year is the percentage of debt eligible for cross-servicing that has been referred by federal agencies. In fiscal year 2000, we reported that FMS did not properly calculate this key performance measure because the reported amount of debt referred for cross-servicing was not comparable to the reported amount of eligible debt. Specifically, FMS overstated the debt referral amount by accumulating the referred amount for about 3 and a half years. We recommended that FMS revise its reporting of debt amounts referred for cross-servicing to reflect the extent to which eligible debts reported by agencies as of a specific date have been referred to FMS.⁴⁶

In its fiscal year 2002 report to the Congress, FMS reported that \$7.9 billion, or 96 percent, of the \$8.2 billion of eligible debt had been referred for cross-servicing as of fiscal year-end and cited the high referral rate as a notable accomplishment. However, FMS's reports continue to overstate the progress made in this highly touted cross-servicing performance measure. Specifically, FMS understated debts that were eligible for cross-servicing and overstated debts that had been referred for cross-servicing, which significantly overstated the reported extent to which agencies had referred eligible debts for cross-servicing. As shown in table 1, the governmentwide cross-servicing referral rate at the end of fiscal year 2002 was about 79 percent, rather than 96 percent as reported by FMS. This is a significant difference given that FMS officials consider the cross-servicing program to be fully mature and federal agencies should be referring eligible debts when they are over 180 days delinquent.

⁴⁶[GAO/AIMD-00-234](#).

Table 1: Debt Referral Rate of Cross-Serviced Debts for Fiscal Year 2002

Dollars in billions

	FMS-reported amounts	Adjusted amounts
Eligible for referral for cross-servicing	\$8.2	\$8.5
Referred for cross-servicing	\$7.9	\$6.7
Referral rate for cross-servicing	96%	79%

Source: FMS.

According to the TRORs for the fourth quarter of fiscal year 2002, federal agencies governmentwide had about \$8.5 billion, not \$8.2 billion, of debt eligible for referral at the end of the fiscal year. In determining the amount of eligible debt for referral for cross-servicing, FMS inappropriately used the amount of debt eligible for cross-servicing referral at the end of fiscal year 2001. As such, FMS did not include any of the approximately \$300 million of debts that were reported as having become eligible for referral for cross-servicing during fiscal year 2002. Thus, FMS understated the amount of eligible debt for fiscal year 2002 by about \$300 million.

In addition, FMS noted in its fiscal year 2002 report to the Congress that the debts reported as referred for cross-servicing did not include those that were no longer being actively collected by FMS. However, FMS generally did not deduct from its reported referral amounts debts that were returned to the referring agencies during fiscal year 2002. According to FMS officials, FMS calculated the referral amount by adding debts that agencies referred to FMS during fiscal year 2002 to the amount of referred debt that FMS held for cross-servicing at the end of fiscal year 2001. FMS officials stated that they typically only reduced the referred debt amount when a debt was returned to the referring agency in the same month that the agency referred the debt to FMS. However, by not deducting the amount for all referred debts that were returned to agencies, the referred debt amount did not reflect the amount of debt that had been referred by agencies and was held by FMS for cross-servicing at fiscal year-end.⁴⁷ According to FMS's cross-servicing database, at the end of fiscal year 2002,

⁴⁷For example, in February 2002, an agency erroneously referred to FMS about \$263 million of debts that were exempted from cross-servicing. FMS returned these debts to the agency in March 2002. However, because these debts were returned 1 month after they had been referred, FMS inappropriately included them in the amounts reported as referred to FMS for cross-servicing as of the end of fiscal year 2002.

FMS held about \$6.7 billion of debts that had been referred by federal agencies for cross-servicing. In contrast, FMS reported \$7.9 billion of debts referred for cross-servicing in its report to the Congress, an overstatement of about \$1.2 billion.

Conclusions

FMS continues to have opportunities for enhancing the effectiveness of its cross-servicing of delinquent nontax debt. Efficient and effective processes are needed for timely determining the next appropriate steps for debts that are not collected by FMS's PCA contractors. As noted in our report, lack of adequate processes and systems weaknesses led to missed opportunities to refer cases to DOJ for enforced collection, failure to use payment offset tools for a large block of debt, and delays in decisions to stop collection efforts on old debt and report it to IRS as income for those who had not paid outstanding amounts. In addition, due to the lack of monitoring by FMS and OMB, there is no assurance that all eligible closed-out nontax debt is reported to IRS. These lapses in oversight and systematic administration of unpaid debts, combined with continuing problems in FMS's PCA contractors' administration of offers to forgive a portion of outstanding amounts as inducements to pay the remainder, perpetuate our concerns about FMS's efforts to pursue and collect unpaid nontax debts.

Recommendations for Executive Action

To help ensure that all appropriate collection action is taken on debts returned from FMS's PCA contractors, we recommend that the Secretary of the Treasury direct the Commissioner of FMS to take the following actions:

- Identify debts kept in TOP for passive collection through the implementation of FedDebt and, in the interim, utilize appropriate analytical database software to identify such debts.
- Establish and implement procedures to periodically review debts that are kept in TOP for passive collection to determine the next best course of action for the debts to maximize collections or other recoveries.
- After all collection activities have been exercised, determine whether debts should be closed out and reported to IRS by FMS, and, if not, promptly return them to the referring agencies.

-
- Establish and implement procedures to periodically review debts that are kept in TOP for passive collection to determine whether the statute of limitations has expired or any other conditions, such as bankruptcy, exist that would prevent offset of the debts in TOP.
 - Remove debts from TOP that are not eligible for offset and determine whether the debts should be closed out and reported to IRS or returned to the referring agency.
 - Establish and implement procedures to periodically monitor debts that are held in inactive status to avoid debt backlogs and to help ensure that all debts are promptly reviewed to determine whether additional collection action or close-out and reporting to IRS is warranted. Monthly may be a reasonable interval for performing such monitoring.

To help ensure that all federal agencies are appropriately reporting closed-out debts to IRS, we recommend that the Secretary of the Treasury direct the Commissioner of FMS to take the following actions:

- Require all federal agencies to disclose in their TRORs any significant differences between the amount of debt reported as closed out and the amount of debt reported to IRS and the reasons for those differences.
- Revise information requirements for the TROR to include the amount of CNC debts that are closed out.

We also recommend that the Director of OMB direct the Controller of OMB's Office of Federal Financial Management to

- remind agencies of their obligation to comply with the standards and policies of individual agencies for writing off and closing out debts, as required by the DCIA and OMB Circular A-129;
- require agencies to initiate actions to review and correct any deficiencies they find during their review;
- require agencies to report to OMB on their policies, deficiencies, and corrective actions, if any; and
- report annually to the Congress on the deficiencies, if any, found at the agencies and the progress in resolving any deficiencies found.

To increase opportunities for collecting debts, we recommend that the Secretary of the Treasury direct the Commissioner of FMS to take the following actions:

- Revise the database query methodology FMS uses to identify cross-serviced debts for DOJ referral. The methodology should include debts kept in TOP for passive collection and should also incorporate information from FMS's PCA contractors.
- Incorporate FMS's criteria for selecting debts for DOJ referral in FMS's *PCA Operations and Procedures Manual*.
- Remind PCA contractors of the importance of enforced collection and that their recommendation for next collection action, including litigation, is a critical part of their responsibilities, and inform the PCA contractors of the agencies that have authorized FMS to refer debts to DOJ on the agencies' behalf.
- Establish and implement procedures to track all debts FMS has referred to DOJ and ensure that the FedDebt system is capable of tracking all debts that FMS refers to DOJ.
- Establish and implement procedures to monitor all debts in cross-servicing to help ensure that debts are promptly reported to TOP, including periodically sweeping the portfolio to send debts to TOP.
- Implement enhancements to the TOP system so that it can accept multiple debtors for a single debt, and ensure that the FedDebt system will be capable of being used to report secondary debtors to TOP.

To help maximize the soundness of the cross-servicing program, we recommend that the Secretary of the Treasury direct the Commissioner of FMS to take the following actions:

- Establish procedures to monitor and track all debt amounts forgiven by in-house FMS collectors and ensure that the FedDebt system identifies the forgiven amounts for all compromise agreements established by in-house FMS collectors.
- Reinforce PCA contractors' adherence to the compromise requirements set forth in the PCA contract for documenting the attempt to collect the full amount of a debt prior to its compromise.

-
- Reinforce PCA contractors' adherence to the compromise requirements set forth in the Federal Claims Collection Standards for obtaining a debtor's financial information, such as credit reports and complete financial statements, to determine the debtor's inability to pay the full amount of the debt.
 - Reinforce PCA contractors' adherence to the compromise requirements set forth in the PCA contract for documenting the justification for the compromise of a debt.
 - Incorporate liquidated damages or a penalty provision in the next PCA contract for failure of PCA contractors to document a compromise in accordance with contract requirements.
 - Remind PCA contractors, through a technical bulletin or other means, of the importance of obtaining debtors' TINs when compromising debts.
 - Fully implement our recommendation made in fiscal year 2000 to revise FMS's key performance measure on cross-servicing referrals so that the extent to which federal agencies have referred debts to cross-servicing directly corresponds to the eligible debts as of fiscal year-end. Specifically, the debt-eligible amount should reflect the amount reported by federal agencies as of fiscal year-end, and the debt-referred amount should reflect the amount in cross-servicing as of fiscal year-end.

Agency Comments and Our Evaluation

In written comments on a draft of this report, reprinted in appendix II, Treasury's FMS said that it concurred with most of the findings and that many of the findings and recommendations had already been addressed. FMS stated that enhancements to the systems that serve cross-servicing and PCA functions have resolved a number of issues and that the advent of FedDebt will further improve cross-servicing operations. However, FMS raised a number of points regarding certain of our findings and recommendations that missed the central concerns conveyed in our report and tended to downplay the significance of these concerns. The following discussion highlights and responds to the points FMS raised.

FMS stated that the findings in the report did not reflect critical operational issues and only affected a very small percentage of its cross-servicing portfolio. FMS expressed concern that we greatly expanded the scope of our work beyond the parameters that we originally set and focused on a

range of opportunities to improve the cross-servicing program that had little or no relation to the reporting of uncollectible debt.

We disagree. Specifically, referral of debts to DOJ for litigation and TOP for offset, monitoring of the compromise of debts by FMS and its PCA contractors, and identification and reporting of uncollectible debt amounts to IRS are all critical operational issues. Moreover, as discussed in the report, we found several problems related to FMS's identification and monitoring of debts held in TOP for passive collection, which represented over half the debts in FMS's \$6.6 billion cross-servicing portfolio as of February 28, 2003. These issues, when considered in conjunction with issues we have cited in previous reports, such as limited implementation of administrative wage garnishment (AWG)⁴⁸ and lack of independent verification of the accuracy, completeness, and validity of debts reported by agencies as eligible for or excluded from DCIA cross-servicing provisions,⁴⁹ raise serious concerns about FMS's progress in addressing the challenges it faces in implementing the cross-servicing program.

We also disagree with FMS's assertion that we expanded the scope of our review beyond what we conveyed to Treasury at the beginning of the assignment. In our August 2002 letter to the Secretary of the Treasury and our subsequent entrance conference with FMS officials in October 2002, we stated that our objectives were to evaluate (1) actions taken by FMS on uncollected nontax debts returned from its PCA contractors; (2) FMS's efforts to ensure that eligible uncollectible nontax debts, which federal agencies rely on FMS to report on their behalf to IRS as income to the debtors, are promptly identified and accurately reported; and (3) actions taken, if any, by FMS to ensure that federal agencies are reporting their eligible uncollectible nontax debts to IRS as income to the debtors. As stated in our report, our review addressed these objectives. In addition, in performing our work to address these objectives, we identified opportunities for FMS to improve collection of nontax debts through cross-servicing and enhance the soundness of certain operational and reporting facets of its cross-servicing program. In meeting our audit responsibilities, we must inform management of any significant issues identified during our work.

⁴⁸See, for example, U.S. General Accounting Office, *Debt Collection Improvement Act of 1996: Status of Selected Agencies' Implementation of Administrative Wage Garnishment*, [GAO-02-313](#) (Washington, D.C.: Feb. 28, 2002).

⁴⁹GAO/AIMD-00-234.

FMS suggests that our report unfairly characterizes FMS's efforts to collect debts through offset as "minimal" and that it criticizes FMS for collection activities that agencies have not delegated to it. FMS stated that TOP is its most effective collection tool, many agencies rely on TOP for the bulk of their collections, and significant collection opportunities could be lost if debts were removed from TOP prematurely. FMS stated that since the cost to collect through TOP is low, it is generally in the best interest of the government to attempt offset for as long as statutorily authorized before terminating collections and discharging the debt. FMS said that it is at creditor agencies' discretion to leave debts returned from PCA contractors in TOP for passive collection.

We agree that for certain debts, TOP can be an effective mechanism for collection, especially when used in conjunction with other debt collection activities. However, passive collection does not entail any collection action other than minimal efforts through TOP. As stated in the report, for debts held in passive collection, TOP is the only collection tool in use. Therefore, collection opportunities from the use of other collection tools, such as litigation and AWG, are lost for these debts. As we state in this report, FMS had collected only about \$9 million, or about two-tenths of 1 percent, of the \$3.7 billion of debts held in TOP for passive collection as of February 28, 2003. To increase the opportunities to collect these debts, we recommended that FMS periodically review debts kept in TOP for passive collection to determine the next best course of action for the debts, such as AWG or litigation, to maximize collections or other recoveries.

Moreover we did not recommend in our report that FMS remove debts from TOP prematurely. Rather, we stated that many of the debts kept in TOP for passive collection were unlikely to yield any collections through offsets because they were beyond the 10-year statutory and regulatory limitations applicable to offset or had other barriers, such as bankruptcy, that would prevent offset of the debts. Thus, we recommended that FMS establish and implement procedures to periodically review debts that are kept in TOP for passive collection to determine whether the statute of limitations has expired or any other conditions exist that would prevent offset of the debts and remove debts from TOP that are not eligible for offset and determine whether the debts should be closed out and reported to IRS or returned to the referring agency.

We also disagree with FMS's implication that we unfairly criticized FMS for not undertaking Form 1099C reporting activities that agencies have not delegated to it. Our review indicated that it would be highly unlikely for

creditor agencies to be able to identify specific debts in cross-servicing that are kept in TOP for passive collection. FMS advised us that because of system limitations, it could not identify specific debts that are merely being held in passive collection after being returned from PCA contractors. However, we were able to readily identify debts in TOP for passive collection through use of off-the-shelf database analysis software. Without the ability to identify specific debts for which passive collection is the only current ongoing effort, creditor agencies that have not delegated authority to FMS to report uncollectible debts to IRS on their behalf cannot fulfill their responsibility to determine whether a debt should be closed out and reported to IRS or whether other collection action should be taken on it. We consider this to also be the responsibility of FMS. This view is embodied in our recommendations that FMS establish and implement procedures to periodically review debts that are kept in TOP for passive collection to determine the next best course of action and after all collection activities have been exercised, determine whether debts should be closed out and reported to IRS by FMS, and, if not, promptly return them to the referring agencies.

In particular and as noted in our report, we would like to reemphasize that our analysis considered only those debts for which federal agencies had given FMS the authority to report uncollectible debt amounts to IRS on the agency's behalf. For such debts, FMS procedures require its collectors to evaluate them to determine whether close-out would be appropriate and whether the debt amounts should be reported to IRS.

FMS agreed with our finding that it had referred only a small amount of debt to DOJ. FMS stated that because of workload constraints, it has attempted to focus its DOJ referral efforts on cases most likely to be successfully collected through litigation. As stated in our report, in an effort to increase referrals to DOJ, FMS did begin to perform quarterly queries of its cross-servicing database to identify uncollected debts for referral to DOJ. However, we found that many of the debts identified through these queries would not be good candidates for referral to DOJ because, among other things, they lacked TINs and were involved in bankruptcy proceedings. In addition, these queries did not cover most debts in cross-servicing, including those held in TOP for passive collection that would seem to be better candidates for DOJ referral because they should have valid TINs and are not supposed to be in bankruptcy. In addition, FMS did not routinely consider or act on advice from its PCA contractors regarding referrals to DOJ. Because PCA contractors' responsibilities include locating debtors and determining whether they

have incomes or assets to repay delinquent debts, the PCA contractors would have a reasonable basis for identifying uncooperative debtors who could repay their debts but had refused.

FMS did not agree with our recommendation to incorporate liquidated damages in the next PCA contract for failure of PCA contractors to document compromises in accordance with contract requirements. FMS stated that there is no incentive for a PCA contractor to accept a compromise agreement when the debtor has the capability to pay the full amount of the debt. We disagree with FMS's contention that a PCA contractor would not accept a compromise agreement when the debtor has the capability to pay the full amount of the debt. For example, as stated in our report, we noted that one debtor offered to pay the full debt balance of approximately \$14,000 in installments. However, without explanation, the PCA contractor offered to compromise the debt by 20 percent if the debtor would pay right away. Moreover, this PCA contractor encouraged compromise activity prior to exhausting attempts to collect debts in full by sending out pro forma letters to debtors stating that the contractor may be authorized to compromise a portion of their debt should the debtor be in a position to pay the remaining balance. Further, FMS stated that it is questionable whether liquidated damages or a penalty provision in the contract would be legally enforceable. For many of the debts that we reviewed, we found that the PCA contractors often did not have documentation to justify their rationale for concluding that debtors could not pay the full debt amount or to support the amounts forgiven. In the absence of adequate documentation supporting the PCA contractor's determination to compromise a debt for a specific amount, FMS cannot determine whether the compromise is reasonable under the Federal Claims Collection Standards. Thus, FMS has no basis to determine whether the government suffered a loss that should not have been incurred as a result of such a compromise. To encourage PCA contractors to obtain adequate documentation supporting their compromises, we continue to believe that FMS should incorporate liquidated damages or a penalty provision in the next PCA contract for failure of PCA contractors to document compromises in accordance with contract requirements. FMS did not offer any legal analysis to support its assertion that a liquidated damage or penalty provision, presumably properly drafted and applied, may not be legally enforceable. Of course, the enforceability of liquidated damages or a penalty provision (e.g., reduction in the number of cases or amount of debt referred to the PCA contractor) would depend on the nature of the provision and the facts of the individual cases.

FMS did not agree with our finding related to the cross-servicing referral performance measure. FMS stated that it considered many approaches for reporting agency performance and believed that the method it chose is fair and equitable. FMS said that using only the active balance on a given date (e.g., the end of the fiscal year) would not recognize debts that are paid off, administratively resolved, or determined to be uncollectible and closed out. FMS further stated that because CFO Act agencies were required to update their TRORs on a quarterly basis beginning in fiscal year 2003, eligible amounts of debt for calculating the percentages referred are now updated every quarter.

This performance indicator⁵⁰ is a snapshot of the percentage of debt eligible for referral to cross-servicing that has been referred at a given point in time, such as at year-end. In calculating its debt referral measure for fiscal year 2002, FMS made an unreasonable determination in computing this key performance measure even though it had all the appropriate information to properly calculate this figure. A fundamental premise in calculating this performance indicator is that debts that are paid off, administratively resolved, or determined to be uncollectible and closed out are no longer eligible for referral for cross-servicing and are not subject to further federal collection efforts. As such, FMS should not include these debts in the amount referred for cross-servicing in its annual fiscal year report to the Congress. In addition, as stated in the report, in its fiscal year 2002 report to the Congress, FMS inappropriately used the amount of debt eligible for cross-servicing referral at the end of fiscal year 2001 instead of the end of fiscal year 2002. The net effect of these errors on the calculation was to overstate the amount referred (the numerator of the fraction) by \$1.2 billion and to understate the amount available for referral (the denominator of the fraction) by approximately \$300 million. Both of these errors had the effect of overstating federal agencies' progress in referring eligible nontax debts for cross-servicing.

In its oral comments, OMB agreed with the report's findings. In drafting the recommendation, we proposed that OMB review the standards and policies of individual agencies for writing off and closing out debts. In its oral response, OMB was concerned that it did not have the resources to review all federal agencies' policies and procedures. As such, OMB suggested that we modify our proposed recommendation to instead require OMB to have

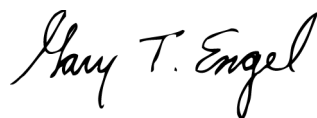
⁵⁰This performance indicator is represented as a fraction. The numerator is reported amounts referred, and the denominator is reported amounts eligible for referral.

individual federal agencies review their own policies and procedures for writing off and closing out debts and report to OMB on their policies, deficiencies, and corrective actions, if any, based on such reviews. OMB stated that it will then use these reports from the individual agencies to report to the Congress on the deficiencies, if any, found at the agencies and the progress in resolving such deficiencies. OMB's suggested approach in resolving this finding is reasonable and fully meets the intent of our proposed recommendation. As such, we have modified our recommendation to OMB accordingly.

This report contains recommendations to you. The head of a federal agency is required by 31 U.S.C. 720 to submit a written statement on actions taken on these recommendations to the Senate Committee on Governmental Affairs and the House Committee on Government Reform within 60 days of the date of this report. You must also send a written statement to the House and Senate Committees on Appropriations with the agency's first request for appropriations made over 60 days after the date of this report.

We are sending copies of this report to the Chairmen and Ranking Minority Members of the Senate Committee on Governmental Affairs; the Subcommittee on Financial Management, the Budget and International Security, Senate Committee on Governmental Affairs; the House Committee on Government Reform; the Subcommittee on Government Efficiency and Financial Management, House Committee on Government Reform; and the Commissioner of FMS. Copies will be made available to others upon request. The report is also available at no charge on GAO's Web site, at <http://www.gao.gov>.

If you have any questions regarding this report, please contact me on (202) 512-3406 or Kenneth Rupar, Assistant Director, on (214) 777-5714. Other key contributors to this report are listed in appendix III.



Gary T. Engel
Director
Financial Management and Assurance

Sampling Method

To test debts compromised by the Financial Management Service's (FMS) private collection agency (PCA) contractors from October 1, 2002, to February 28, 2003, we selected a stratified random sample of 54 debts that the PCA contractors compromised from a population of 358 debts in the cross-servicing database with forgiven dollar amounts of at least \$2,000 but less than \$100,000.¹ We did not review debts with forgiven dollar amounts under \$2,000 because they were deemed immaterial. In total, we selected 54 debts to review. (See table 2).

Table 2: Details of Cases Selected

Forgiven amount for each debt	Number of debts per stratum	Forgiven amount per stratum	Items tested in each stratum	Justification for number of items tested in each stratum
\$2,000 or greater but less than \$100,000	358	\$2,946,711.88	54	To provide coverage of the population of compromised debts.
Less than \$2,000	706	479,309.38	None	Average amount of strata (about \$680) was deemed to be immaterial.
Total	1,064	\$3,426,021.26	54	

Source: GAO.

Note: Data derived from analysis of FMS's cross-servicing database.

¹We identified one debt in the cross-servicing database for which the forgiven amount was at least \$100,000. We found that the referring agency rather than FMS's PCA contractor had initiated the compromise for this debt. As such, this debt was not included in our review.

Comments from the Department of the Treasury

Note: GAO comments supplementing those in the report text appear at the end of this appendix.



DEPARTMENT OF THE TREASURY
FINANCIAL MANAGEMENT SERVICE
WASHINGTON, D.C. 20227

October 20, 2003

Mr. Gary T. Engle
Director, Financial Management and Assurance
General Accounting Office
441 G Street, N.W.
Washington, DC 20548

Dear Mr. Engle:

The Financial Management Service (FMS) has received for comment a copy of the General Accounting Office's (GAO) recent draft audit report (GAO-04-47), entitled *Debt Collection: Opportunities Exist for Improving FMS's Cross-Servicing Program*. As the draft report has not been fully reviewed within GAO and is subject to change, we will address the report's specific findings and recommendations once it is finalized. I would like to address here several broad issues related to the conduct of the audit and its findings.

See comment 1.

When it initiated its audit in August 2002, GAO notified the Secretary of the Treasury that it was reviewing the process for ensuring that appropriate uncollectible debts are reported to the Internal Revenue Service (IRS), and that the focus of the review would be on the Department of the Treasury's (Treasury) handling of debts returned by private collection contractors, Treasury's role in reporting uncollectible debts to the IRS, and Treasury's monitoring of agencies' reporting of uncollectible debts to the IRS. During the course of the audit, GAO greatly expanded the scope of the work beyond the parameters it originally set, and focused instead on a range of "opportunities...for improving FMS's Cross-Servicing Program" many of which bear little or no relation to the reporting of uncollectible debt.

See comment 2.

We appreciate GAO's efforts to identify opportunities for improvement in the Cross-Servicing Program. We are gratified, given the breadth and complexity of the program, that the findings reported do not reflect critical operational issues and only affect a very small percentage of our portfolio. Our Cross-Servicing Program, like the rest of our Debt Collection Program, has continued to grow significantly over the last several years -- both in terms of referrals and collections. We recognize that the areas identified in this report require our attention, and we are already working to address these and other opportunities for improvement.

See comment 3.

We concur with most of the findings in the draft report. FMS has come a long way in improving its Cross-Servicing Program, and many of the findings and recommendations in the Report have already been addressed. Enhancements to the systems that serve cross-servicing and private collection agency functions have resolved a number of issues; and the advent of FedDebt, a new comprehensive cross-servicing system, will further improve cross-servicing operations.

See comment 4.

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See comment 5.

Return of Uncollectible Debt to Agencies – GAO’s report found that by keeping returned uncollectible debts in the offset program rather than taking other collection action or recommending close-out, FMS lost collection opportunities. We have repeatedly stated to GAO auditors Treasury’s role in handling uncollectible debts returned by PCAs: when we return debts to an agency as uncollectible, it is the agency’s responsibility to close those debts out and report the debt amounts to IRS as income to the debtor. FMS will, if requested by an agency, and as a service to it, report to the IRS via Form 1099-C on the agency’s behalf. Nonetheless, while debts are referred to Treasury for collection action, the receivables are never transferred -- they remain on the agency’s books, and the agency is responsible for discharging them.

See comment 6.

Passive Collection in TOP – GAO found that “passive collection entailed no further collection action other than minimal efforts through offsets.” The decision to leave returned debts in the Treasury Offset Program (TOP) for “passive collection” is at the creditor agency’s discretion. It is misleading to characterize efforts to collect debts through offsets as “minimal.” TOP is our most effective collection tool; many agencies rely on it for the bulk of their collection, and significant collection opportunities could be lost if debts were removed from TOP prematurely. We believe that it is appropriate for those debts to remain in TOP.

See comment 7.

The report also points out that offsets for debts left in TOP after return from private collection agencies totaled "only" about \$9 million. Since active attempts to recover the debts have been unsuccessful, it is important to note that these collections represent recoveries that probably would not have been realized without the offset program. One of the many benefits of TOP is that the cost to collect is low. Therefore, it is generally in the best interest of the government to attempt offset for as long as statutorily authorized before terminating collections and discharging the debt. As to the finding that some debts were left in TOP (less than 7 % of the cross-servicing debts active in TOP) after the 10 year statute for offset has expired, FMS acknowledges that this is a system limitation; however, the TOP system has sufficient edits and safeguards in place to ensure that no offset is taken after the 10 year point.

See comment 8.

Referrals to the Department of Justice - GAO’s finding that FMS had referred only a small amount of debt to the DOJ is true. Cross-Servicing management and representatives from the DOJ have been working closely to develop mutually agreed-upon procedures and criteria for DOJ referrals. Referral for litigation is an extremely labor-intensive process, as is the litigation process itself. Because of workload constraints both at DOJ and within the Cross-Servicing Program, we have attempted to focus on those cases most likely to be successfully collected through litigation, and we are diligently working to increase the number of cases referred to DOJ. Finally, we have initiated several actions to improve referrals to DOJ.

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See comment 9.

Compromise Requirements - GAO recommended that FMS reinforce the PCA contractors' adherence to various compromise requirements set forth in the PCA contract and Federal Claims Collection Standards. FMS will issue a technical bulletin to the PCA contractors reminding them of these requirements, as well as the fact that adherence to these requirements is included in the annual PCA compliance reviews conducted by FMS. Further, we recognize that our current cross-servicing system does not track the forgiven amount of a compromise agreement until the compromise is satisfied. This system limitation will be addressed by the FedDebt implementation. In the new system, the amount to be forgiven will be captured as soon as the compromise agreement is recorded. It is also important to note that our Treasury collectors have implemented compromise documentation procedures in accordance with recommendations from the previous GAO study on cross-servicing.

See comment 10.

FMS does not agree with GAO's recommendation to incorporate liquidated damages in the next PCA contract for PCA failure to document a compromise in accordance with contract requirements. The PCA contract is a performance-based contract. The PCA contractors are paid based on collections and receive additional accounts and monetary bonuses based on their ability to collect and resolve debt. There is no incentive for a PCA contractor to accept a compromise agreement when the debtor has the capability to pay the full amount of the debt. Additionally, it is questionable whether or not liquidated damages or a penalty provision in the contract would be legally enforceable.

See comment 11.

Agency Referral Performance - Concerning the finding that FMS overstated agencies' progress in referring eligible nontax debts for cross-servicing, we considered many approaches for reporting agency performance and believe that the method we chose is fair and equitable in a very dynamic debt environment. Reporting the amount that was referred during the year, regardless of the disposition of the debt, provides an appropriate measure of referral performance. Using only the active balance on a given date would not recognize those debts that are paid off, administratively resolved, or determined to be uncollectible and closed out. In the past, agencies were not required to report changes to the Treasury Report on Receivables (TROR) until forty-five days after the end of the present fiscal year. In FY 2003, all Chief Financial Officer Act agencies were required to update the TROR on a quarterly basis. The draft report does not note that, based on this requirement, eligible amounts for calculating the percentages referred are now updated every quarter.

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Thank you for the opportunity to comment on this draft GAO report. If you have any questions or wish to discuss these comments further, I can be reached at (202) 874-7000, or you may contact Martin Mills, Assistant Commissioner, Debt Management Services, on (202) 874-3810.

Sincerely,



Richard L. Gregg

cc: Donald V. Hammond
Fiscal Assistant Secretary
U. S. Department of the Treasury

The following are GAO's comments on the Department of the Treasury's letter dated October 20, 2003.

GAO Comments

1. In conformity with generally accepted government auditing standards, we provide responsible agency officials and other directly affected parties with an opportunity to review and provide comments on a draft report before it is issued. The language referred to by FMS concerning the report's status as a draft has been the standard language included on the cover page of GAO reports when they are sent for agency comment. After receiving agency comments, we consider their substance, revise the draft report as appropriate, state in the report whether the agency agreed or disagreed with our findings, conclusions, and recommendations, and issue the report.
2. See our discussion in the Agency Comments and Our Evaluation section.
3. See comment 2.
4. See comment 2.
5. See comment 2.
6. See comment 2.
7. The scope of our work did not include determining whether FMS's TOP system has sufficient edits and safeguards in place to ensure that no offset is taken for debts over 10 years delinquent.
8. See comment 2.
9. As stated in our report, a scope limitation prevented us from using statistical sampling techniques to determine whether compromises made by in-house FMS collectors were justified, supported, and reported to IRS. As such, we cannot comment on whether FMS collectors have implemented compromise documentation procedures in accordance with previous GAO recommendations.
10. See comment 2.
11. See comment 2.

Staff Acknowledgments

Other key contributors to this assignment were Richard Cambosos, Matthew Valenta, Ronald Haun, Michelle Philpott, Evan Gilman, and Cathy Hurley.

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