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Report to the Commissioner, Internal
Revenue Service

June 1988

INTERNAL REVENUE SERVICE

Need to Improve the Revenue Accounting Control System



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

Information Management and
Technology Division

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June 17, 1988

The Honorable Lawrence B. Gibbs
Commissioner of Internal Revenue
Department of the Treasury

Dear Mr. Gibbs:

We have completed a review of the Internal Revenue Service's (IRS) Revenue Accounting Control System (RACS) and found that it is inefficient and susceptible to errors. Program managers at IRS agree and have initiated a two-staged approach to improve the system. First, a plan is being developed to replace the system by 1992; a decision by IRS on this plan is expected by July 1988. Second, enhancements to the replacement system will be considered as part of the agency's effort to redesign the tax processing system. To assist you in your review of these plans, we are providing the information we gathered on the shortcomings of the present system and some factors that we believe need to be addressed in any future RACS plans.

RACS is an automated system put in operation in October 1984 to replace IRS' manual accounting system. The system:

- helps IRS account for and classify tax revenues,¹ disbursements, and related financial transactions at each of IRS' 10 service centers;
- is the focal point for reporting revenue classification data to the Department of the Treasury (until revenue is classified, Treasury is not able to use the revenue to pay obligations of the government); and
- helps ensure that state and local governments, as well as other federal agencies, are properly reimbursed for such programs as child support and unemployment.

In fiscal year 1987, IRS processed 193 million tax returns and related documents, collected over \$886 billion in taxes, and made refunds totaling \$97 billion—all of which were accounted for by RACS.

Shortcomings of the Current System

In developing RACS, IRS had originally intended to fully automate what had been a completely manual accounting system; however, it did not automate the system to the extent intended. Accounting data generated

¹Major tax revenue classes include withholding, individual income, corporation income, excise, estate and gift, carriers tax, and federal unemployment tax.

by other automated IRS systems and needed by RACS still must be entered manually, which has contributed to IRS errors in classifying tax revenues. Also, the system's account files must be balanced and reconciled manually. In addition, it does not have the capability to identify categories of errors that occur repeatedly, or help analyze IRS' growing accounts receivable balance. IRS did not automate interfaces with other IRS accounting systems nor implement automated balancing or reconciling features of RACS because (1) modifications to the other automated systems would have been required and IRS was reluctant to do so, (2) some balancing functions were thought not to be needed with RACS, and (3) software for other balancing functions was not ready at the time the system was made operational and has not been added since.

IRS has had problems with accurately classifying tax revenue. For example, in 1985 IRS had problems in properly classifying and reporting federal unemployment tax revenue. An apparent windfall of tax receipts into the Federal Unemployment Tax Act Trust Fund occurred in part because some service centers had not classified tax payments correctly. Because the errors went undetected by IRS, the fund appeared to have a surplus, which caused the Department of Labor to publish an erroneous projection of the federal collections for extended unemployment benefits. The Department of Labor identified the abnormally high balance and brought it to IRS' attention. IRS conducted a review and determined that errors had occurred, and made an adjustment that reduced the fund by \$1.2 billion.

Congressional inquiries related to IRS' classification operations (resulting from the large adjustments made in 1985), prompted IRS to review individual service centers to determine the sources of classification errors. IRS found that one significant source of errors, besides errors caused by taxpayers omitting or incorrectly reporting information, was mistakes made by RACS data entry personnel while entering tax classification data from source documents. We concluded, and the national headquarters accounting branch chief agreed, that electronic interconnection of IRS' automated systems with RACS could help prevent this type of error.

In the absence of automated balancing and reconciling features, IRS employees must manually balance and reconcile RACS' account files with information in files maintained in other systems. This reliance on manual balancing and reconciling has resulted in an accounting system requiring both computer-assisted and labor-intensive manual processes to control the accuracy of accounting information.

IRS has not developed an automated error-tracking system for RACS to provide managers with information on the types of errors entering the system and their frequency so that causes of errors can be identified and corrected. As a result, service centers cannot readily identify categories of errors that occur repeatedly and then take action to prevent them. Consequently, IRS may be needlessly dealing with the same types of errors and higher volumes of errors than necessary. We concluded, and the national headquarters accounting branch chief agreed, that an automated RACS error-tracking system would help managers to identify errors in RACS as well as other systems, and help managers take steps to prevent their repetition, thereby conserving IRS' resources.

Another example of RACS' limited analysis and reporting capability involves IRS' growing accounts receivable balance. The accounts receivable balance increased from \$18.4 billion in fiscal year 1981 to \$53.7 billion in fiscal year 1987. IRS believes part of this increase may be attributable to population growth, new programs for detecting underreported taxes, and service center processing problems. However, IRS does not know to what extent each of these causes or other causes may have increased accounts receivable, because information that could help identify causes cannot be captured on RACS.

Accounts receivable balances are supplied to RACS primarily from the master and non-master files.² The master file contains the majority of accounts receivable, and so the detailed information needed to analyze accounts receivable balances must be extracted from this file. However, obtaining detailed information from the master file is difficult because of its large size and because it is kept on magnetic tape that requires the slow, sequential reading of the files.

Concerned with the growth in accounts receivable, IRS formed two task forces. One task force is identifying the causes of the increase in accounts receivable, while the other is reviewing how IRS accounts for receivables. IRS has employed a private firm to research the growth in the accounts receivable balance and make recommendations for improving accounting and reporting procedures for accounts receivable.

²The master file, maintained at IRS' National Computer Center, contains information regarding taxpayers' filing of tax returns and return-related documents. The non-master files are maintained at IRS' 10 service centers and contain taxpayer information not contained in the master file, such as penalty assessments.

IRS' Efforts to Improve Revenue Accounting

IRS recognizes the need to further automate its revenue accounting operations and has taken steps to do so. For example, computer tape interfaces have been established between RACS and another automated system to record transactions from portions of two major files—the unidentified remittance file and the dishonored checks file—that affect revenue receipts. Also, additional tape interfaces are planned to reduce the need for manual data input to RACS, according to IRS' national headquarters accounting branch chief.

In October 1987, IRS drafted a proposal for replacing RACS, which was revised in March 1988. According to IRS' March 1988 proposal, a fully automated replacement system could be operational in 1992. Additionally, in 1995, all aspects of the non-master file tax processing functions might be included in the proposed replacement system. This would allow IRS to consolidate and automate all manual subsidiary files into one computer system.

The proposed replacement system is intended to allow financial information to pass from one IRS computer system to another. Accounts would automatically be updated, eliminating labor-intensive manual processes. Other planned benefits include providing faster, more detailed financial reporting to Treasury and the Congress; increased data integrity; expanded management information; faster response to and analysis of financial status questions; faster identification of service center operational accounting problems; and on-line monitoring of the fiscal process. IRS has not formally approved the replacement proposal, but expects to have a decision on it by July 1988.

IRS is also planning to redesign its entire tax processing system, including revenue accounting functions. However, the planning process has not progressed far enough to determine how these functions will fit into the overall redesign scheme.

According to IRS national headquarters accounting branch officials, some of RACS' analysis and report generation limitations could be resolved through the redesign effort. For example, thorough analysis of the accounts receivable balance requires access to information in the master file. As part of the redesigned tax system, IRS plans to place master file data on a direct access media, such as magnetic disc, to allow easier and faster access to information in the master file and therefore facilitate analysis.

For both the RACS replacement effort and tax system redesign, the conceptual planning has only begun. IRS has not made a final decision on whether to proceed with a RACS replacement system and will not prepare detailed plans until the RACS proposal has been approved. The tax system redesign management plan was approved in March 1988, but IRS has not yet decided on a new design for the tax processing system. Detailed redesign planning will take place over the next 2 years.

Because IRS' plans were not finalized at the time we completed our fieldwork in April 1988, we could not determine the extent to which IRS' plans for improving RACS spell out actions for reducing the amount of manual data transfer that occurs between RACS and other IRS automated systems, reducing the amount of manual balancing and reconciling, and providing the capability to identify and track errors. In addition, we could not determine the extent to which plans will be supported by a thorough analysis of requirements for data interchange, balancing and reconciling, and reporting; or identify changes needed to ensure compatibility between the RACS replacement system and the other systems with which it interacts.

Conclusions

The Revenue Accounting Control System is essential for helping IRS carry out its responsibility to account for and classify tax revenues, disbursements, and related financial transactions. This system accounts for the billions of dollars of revenue received by IRS annually and for large sums of receivables and payables. Because IRS did not follow through on its intention to fully automate its revenue accounting procedures, it must rely on a revenue accounting system that is inefficient and susceptible to errors.

Automation of data entry procedures could help to reduce IRS errors in classifying tax revenues. An automated error-tracking system would provide managers with information on the types of errors entering RACS and their frequency so that causes of errors can be identified and corrected. Further, electronic interconnection of IRS' automated systems with RACS would reduce the need for manual data input. In addition, increased automation would improve IRS' analysis capability in areas such as accounts receivable.

During our review, IRS officials began developing plans to address the system's shortcomings. In our opinion, it is important that as these plans are formulated, they spell out actions for (1) reducing the amount of manual data transfer that occurs between RACS and other IRS automated

systems, (2) reducing the amount of manual balancing and reconciling, (3) providing the capability to identify and track errors, and (4) ensuring compatibility between RACS and other automated systems with which it interacts.

Recommendations

We recommend that in reviewing IRS' plan for replacing RACS, you ensure that it is supported by a thorough requirements and compatibility analysis that (1) clearly specifies actions to reduce manual data input, reduce manual balancing and reconciliation, and improve RACS's capability to identify and track errors; and (2) identifies changes needed to ensure compatibility between RACS and other automated systems with which it interacts.

Objectives, Scope, and Methodology

The objectives of our review, conducted between January 1987 and April 1988, were to determine the extent to which IRS has automated its revenue accounting procedures and to assess the Revenue Accounting Control System's analysis and reporting capability. To accomplish our objectives, we reviewed operations at three service centers located in Ogden, Utah; Austin, Texas; and Andover, Massachusetts; and at IRS' national headquarters in Washington, D.C. We reviewed IRS manuals and documents related to RACS and other IRS systems; documented RACS interfaces (automated and manual) with other systems; obtained and reviewed reports and other data produced by RACS; and interviewed national headquarters accounting branch officials responsible for the operation of RACS and officials in the Department of the Treasury's Financial Management Service who receive RACS-generated reports and data. We also obtained IRS' plans for improving RACS. Because IRS' plans were not finalized at the time we completed our fieldwork, we could not assess their feasibility. Except as noted above, we conducted our work between January 1987 and April 1988 in accordance with generally accepted government auditing standards.

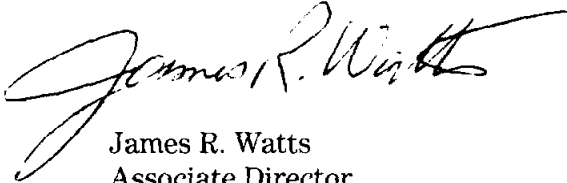
Agency Comments

We discussed the contents of this report with the Assistant Commissioner for Taxpayer Service and Returns Processing. The Assistant Commissioner agreed with the report's facts, conclusions, and recommendations and provided some additional technical information, which has been incorporated where appropriate.

This report contains recommendations to you on page 6. 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 Operations not later than 60 days after the date of the report and to the House and Senate Committees on Appropriations with the agency's first request for appropriations made more than 60 days after the date of the report.

We are sending copies of this report to the Joint Committee on Taxation, House Committee on Ways and Means, and other congressional committees; the Director, Office of Management and Budget; the Secretary of the Treasury; and other interested parties. If you have any questions or desire additional information, please contact me at 275-3455.

Sincerely yours,



James R. Watts
Associate Director

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