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GAO

Report to the Commissioner of the Internal Revenue Service

August 1988

SYSTEM INTEGRITY

IRS Can Reduce Processing Errors With Better Controls and Information

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GAO

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General Accounting Office
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Information Management and
Technology Division

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

Dear Mr. Gibbs:

This report discusses our review of IRS' system for correcting errors in processing tax returns. We reviewed this system under our basic legislative authority to evaluate federal agencies and programs. Our review assessed IRS' (1) controls for correcting errors in processing returns and in issuing taxpayer refunds and notices, and (2) efforts to identify the causes of processing errors.

This report contains recommendations to you in chapters 2 and 3. As you know, 31 U.S.C. 720 requires the head of a federal agency to submit a written statement of actions taken on our recommendations to the House Committee on Government Operations and the Senate Committee on Governmental Affairs 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 would appreciate receiving copies of these statements.

We are also sending copies of this report to the Chairman, Subcommittee on Oversight, House Committee on Ways and Means.

Sincerely yours,

Ralph V. Carlone

Ralph V. Carlone
Director

Executive Summary

Purpose

During 1987, over 100 million taxpayers filed tax returns with one of the Internal Revenue Service's (IRS) 10 service centers. These centers process tax return information and send it to IRS' National Computer Center in Martinsburg, West Virginia, to update the master files of taxpayers' accounts.

Complex, changing tax laws and high turnover of processing personnel contribute to mistakes made either by taxpayers or by IRS. About 160,000 adjustments were made during a 12-month period in order to correct these mistakes. IRS believes a high-quality processing system is essential to minimizing adjustments, correcting processing errors, and reducing erroneous refunds and balance due notices.

GAO reviewed IRS' processing system in order to assess

- controls for correcting errors in processing returns and in issuing refunds and notices; and
- efforts to identify the causes of processing errors so that corrective action can be taken.

Background

IRS refers to tax return processing in its service centers as pipeline processing. Controls are in place to ensure that complete and accurate data are prepared for input to the master files. Three important stages of pipeline processing occur when

- code and edit examiners manually review tax returns for completeness, correct certain taxpayer errors, and put codes on the returns;
- data transcribers convert data from tax returns to machine readable form for computer processing; and
- error resolution examiners correct errors identified by the computer system before sending the data to the master files.

After posting to the master file, tapes of refunds and balance due notices are sent to the service centers for further processing. Incorrect data on the master file can result in erroneous refunds or balance due notices being sent to taxpayers. Such errors can waste IRS resources, upset taxpayers, and hurt IRS' public image, thereby eroding the effectiveness of the voluntary tax system.

According to IRS reports, about 160,000 adjustments were made to correct processing errors for the 12-month period ending June 30, 1987. These adjustments corrected errors made by taxpayers or IRS. To assess

IRS' controls for correcting errors, GAO analyzed a sample consisting of 389 randomly selected adjustments from a universe of 10,501 adjustments made by four representative service centers between April and June, 1987.

Results in Brief

On the basis of its sample, GAO estimates the total dollar amount of errors in its universe of 10,501 adjustments was about $9.1 million.

GAO's random sample of IRS adjustments showed that about 72 percent of the adjustments would not have been needed if error resolution examiners and, in some cases data transcribers, had adhered to required procedures for correcting errors identified by the automated system. The majority of these errors were eventually detected through a final check by another automated system. However, as a result of not correcting the errors earlier, taxpayers received refunds and tax due notices within about 7 to 15 weeks rather than the normal 4 to 6 weeks. Correcting errors at the end of the process is also more costly than correcting them earlier.

In 21 percent of the cases, the incorrect refunds and tax due notices generated by these errors were sent to taxpayers, resulting in excess refunds up to $5,000 and incorrect tax due notices as high as $8,100.

IRS has increased its quality control to identify the causes of processing errors, but some activities are not as effective as they could be because of reporting problems.

Principal Findings

Error Resolution Controls Not Followed

In 327 of the cases, errors made by taxpayers and the IRS were identified by automated controls. However, in virtually all of these cases, error resolution examiners did not properly correct the errors. They generally accepted for later input to the master file computer calculations generated from data containing errors made by taxpayers or by other IRS processing units. They did not compare the data in the system with the data on the tax returns as required by IRS instructions. GAO estimates that at least 281, or about 72 percent, of the cases could have been corrected properly if the error examiners and, in some cases, data transcribers had simply followed specified procedures. (See ch. 2.)

Data Conversion Controls Not Followed

The GAO sample also showed that 49 cases that should have been corrected by the error resolution examiners could have been corrected even earlier in the process. These errors were detected by automated controls in the data transcription process, but the data transcribers overrode the controls and allowed the errors to proceed to the next phase of processing. (See ch. 2.)

Correcting Errors After Initial Processing Increases Time and Cost

In 306 of the 389 cases reviewed, the incorrect refunds and tax due notices were stopped and corrected by IRS employees who review selected refund and tax due notices for errors before the notices are sent to taxpayers. As a result of these actions, taxpayers received correct refunds and tax due notices, but received them in about 7 to 15 weeks rather than the 4 to 6 weeks normally required to process them.

In 83 cases, the incorrect refunds and tax due notices generated by these errors were sent to taxpayers. Some taxpayers received refunds ranging from $7 to nearly $5,000 more than they were owed; others received tax due notices requiring them to pay from $1 to over $8,100 more than they actually owed. IRS figures show that the cost to correct these errors is about $4.00 per case, but only $0.30 during the error resolution stage. (See ch. 2.)

Better Management Information Needed

A number of quality monitoring activities provide feedback on processing errors so that IRS managers can take corrective action. However, GAO found (1) the management reports generated from some of these activities have been inaccurate and untimely and (2) service center unit managers do not consider certain reports to be useful to their needs. (See ch. 3.)

Recommendations

GAO recommends that the Commissioner of the Internal Revenue Service direct his staff to:

- Implement a program to review more tax returns corrected by Error Resolution Units before sending tax return data to the master file. Service center directors should have flexibility to adjust the percentage of returns reviewed to their units' performance.
- Ensure that feedback on the nature and source of errors identified in these reviews is provided promptly to the processing units responsible for missing or creating the errors and to National Office managers, so

that both parties can take timely corrective action and thus help prevent future errors.

- Review the completeness, timeliness, and accuracy of management information produced by quality monitoring, and modify those reports that do not meet management needs.

Agency Comments

IRS agreed with GAO's conclusions and recommendations. However, IRS offered several comments to clarify details about its current error correction processes. IRS' formal comments have been considered in the preparation of this final report and are included in their entirety as the appendix.

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Abbreviations

AMIS	Adjustment Management Information System
GAO	General Accounting Office
IMTEC	Information Management and Technology Division
IRS	Internal Revenue Service
PAS	Program Analysis System

Introduction

The Internal Revenue Service (IRS) has installed a new Distributed Input System[1] for inputting tax return data and a new Error Resolution System for correcting tax return errors made by taxpayers and IRS processing units. This report addresses the effectiveness of these new systems as well as the other input control functions in place for processing tax returns.

IRS began quality monitoring in 1982 to gather detailed data on the types and sources of tax return errors and to analyze the data at both the service center and national office levels to determine corrective actions. This report addresses IRS quality monitoring initiated since our report.

Individual Tax Return Processing at IRS

During 1987, over 100 million taxpayers filed tax returns with one of IRS' 10 service centers. The service centers process these returns and provide updated tax return information for posting to the master file of taxpayer accounts maintained at the National Computer Center in Martinsburg, West Virginia. After updating the accounts, the National Computer Center identifies taxpayers entitled to refunds and those who still owe taxes. Computer tapes of refund and tax due[2] information are then sent back to the service centers for further processing, printing, and mailing.

The service centers' computer systems play a vital role throughout this process. They provide the means to convert data from paper tax forms to computer-readable magnetic tapes and disks, check data for mathematical errors and other discrepancies, correct mistakes made on tax returns, process the data to be sent to the National Computer Center, select refund and tax due notices for review before mailing to taxpayers, and make adjustments to taxpayer accounts.

Factors That Complicate IRS' Returns Processing

The typical service center is responsible for annually processing about 10 million tax returns and providing accurate tax information for posting to the master file. The tax laws are complex and require detailed instructions and well-designed forms for taxpayers and tax preparers. Because taxpayers make errors in calculations and in filling out tax

[1]We recommended in an earlier report that IRS consider certain changes to its data transcription and error correction functions to improve the efficiency and effectiveness of tax return processing (IRS Can Do More To Identify Tax Return Processing Problems And Reduce Processing Costs (GAO/GGD-83-8, Oct. 14, 1982)).

[2]We define tax due notices to also include applicable interest and penalty charges.

forms, IRS' processing system is designed to identify and correct as many of these errors as possible. Automation plays an important role in identifying and correcting errors.

The constant changes to tax laws and regulations, and high turnover among IRS employees, further complicate tax return processing. Changes to laws and regulations may require changes to taxpayers' forms and instructions as well as changes to service center processing controls.

Importance of Internal Controls to Data Quality and Management Information

Internal controls in data processing ensure the completeness of manual and automated transactions, records, and reports, as well as the detection and correction of errors. Quality assurance controls are an integral part of IRS' internal control system for processing tax returns in the service center because they provide IRS with a means of evaluating the effectiveness of its processing. Management reports summarizing quality control activities help to identify errors being made because of misunderstood procedures, inadequate supervision and review, or poor communication. Ineffective controls result in errors, inefficient use of manpower, and adverse publicity for IRS.

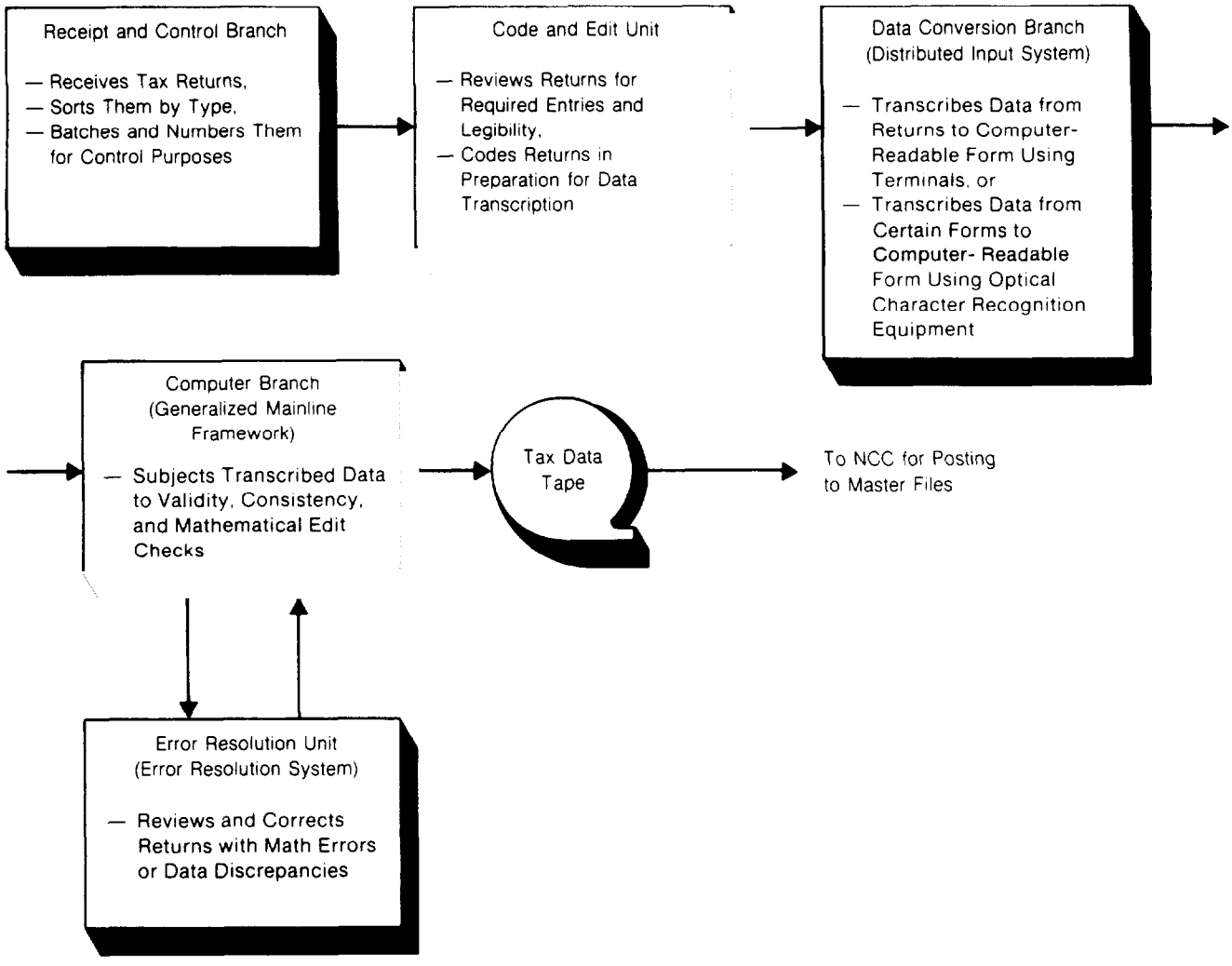
Description of IRS' Pipeline Processing System for Individual Tax Returns

IRS refers to its processing of tax returns in its service centers as pipeline processing. Pipeline processing is a data input function, and controls are in place at various processing stages to physically monitor the movement of documents through the pipeline and to ensure the accuracy of the data used to update the master files at the National Computer Center. As shown in figure 1.1, a simplified flowchart of pipeline processing operations, processing begins in the Receipt and Control Branch, and continues through the Code and Edit Unit, and the Data Conversion Branch. The return information is then processed through the automated, Generalized Mainline Framework, which prepares data for posting to the master file and rejects erroneous returns, sending them to the Error Resolution Unit for correction.

Pipeline Processing Controls

Processing controls are designed to ensure that tax return data are complete and accurate before sending them to the master file. These controls are intended to ensure that the data are (1) properly recorded when they enter the system, (2) converted to machine processing format without loss or addition of data, (3) corrected when errors are detected, and (4) accounted for in system output. The automated systems discussed below have controls that are important for effective processing.

Figure 1.1: Pipeline Processing Operations



The Distributed Input System is used to transcribe data from tax returns to machine readable form for subsequent computer processing. The system has a control feature called zero balancing for detecting and correcting transcription errors. The Distributed Input System computes the total of a series of figures that were entered by a data transcriber and compares this total to the total originally entered for that series of figures. If the computer-calculated total does not equal the transcribed

total, the computer will not accept any more data until the transcriber corrects any transcription errors or overrides the error message. The transcribers are responsible for assuring that the figures have been accurately transcribed, not for correcting taxpayer mathematical errors. Overriding the error message would be appropriate when transcribers confirmed there was not an actual transcription error.

The Generalized Mainline Framework is a series of software programs that subjects each return to validity, consistency, and mathematical edit checks. After completing the edits, these programs create a computer tape of all returns that pass the edits and the tape is sent daily to the National Computer Center. Any returns found to contain potential errors are sent to the Error Resolution Unit for correction.

The Error Resolution System is used to correct errors made by taxpayers and those made by IRS during processing. This system is a computer-prompted input system whereby errors are sequentially placed on the terminal's screen for correction. The system calculates and displays an answer based on the data entered; therefore, if the data entered are wrong, the computer-generated answer will also be wrong. IRS procedures require examiners to determine the correct solution on the basis of the tax return and other available information, and not just accept the answer calculated by the system.

After the returns have completed service center processing, data from the returns are stored on computer tapes and sent to the National Computer Center for further processing. The National Computer Center creates and updates taxpayer accounts on the master files. It also produces output tapes containing refund notices, tax due notices, and information about tax returns that meet certain criteria and have audit potential. Also, various accounting and operating reports are produced. After the master file posting is complete, the National Computer Center sends tapes containing refund and tax due information to the 10 service centers.

At the service centers, these tapes are processed through the Notice Review Processing System to select refund and tax due notices with a high probability for error. These are reviewed by the Output Review Units in the service centers before sending the notices to taxpayers. The system automatically requests the taxpayer documents needed by the examiners to review the notices, but their review is done manually. This process is intended to prevent erroneous notices from going to taxpayers.

Consequences of Erroneous Data in the Master File

When erroneous tax return data reach the master file, inaccurate refund and tax due notices may be generated. Incorrect notices sent to taxpayers can result in upset taxpayers and in a loss of public confidence in IRS' ability to administer the tax laws. In turn, the effectiveness of our voluntary tax system can be eroded.

When erroneous refunds and tax due notices are sent to taxpayers, they may accept refunds to which they are not entitled or pay taxes they do not owe. When taxpayers notice the errors, they may send the refunds back to IRS or protest the tax bill. These situations waste IRS resources through additional work load for IRS units that have contact with taxpayers such as the Taxpayer Relations Branch, Adjustments/Correspondence Branch, and the Problem Resolution Program Office. Notices disputed by taxpayers may take many months to resolve, and IRS' public image suffers when it has caused the error.

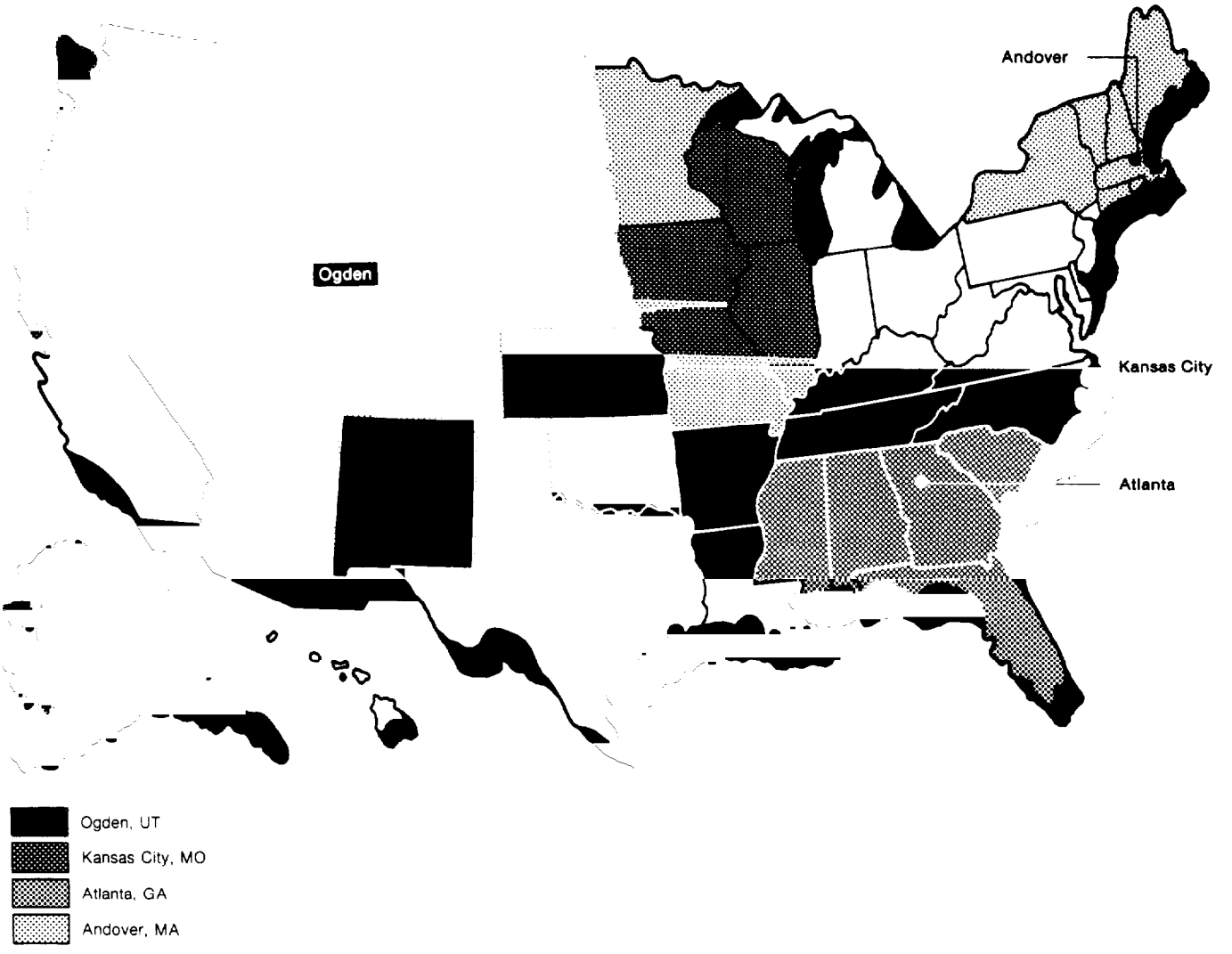
IRS data show that the cost of correcting an error during Error Resolution processing is about $0.30 compared to the $4.19 that it costs to correct it after a taxpayer receives a notice. Also, correcting errors during input processing reduces the number of erroneous notices generated, thereby reducing the work load of the Output Review Unit.

Objectives, Scope, and Methodology

Our objectives were to assess IRS' (1) controls for correcting errors in processing tax returns and issuing refunds and notices, and (2) efforts to identify the causes of processing errors so that corrective action can be taken.

To assess IRS' controls for correcting errors, we analyzed a random sample of adjustments made to correct IRS processing errors on tax year 1986 individual tax returns at four service centers. These IRS processing errors include mistakes made by IRS personnel as well as IRS' failure to correct certain taxpayer mistakes. By sampling these adjustments, we hoped to identify any significant trends in errors over which IRS may have some control and could take effective corrective action. The four service centers we selected have input processing functions typical of all service centers and include the one that had the highest percentage of adjustments for correcting IRS errors for the 12-month period ending June 30, 1987 (Andover, Massachusetts—14 percent); the lowest (Kansas City, Missouri—4 percent); and two in between (Atlanta, Georgia, and Ogden, Utah). These four centers process individual tax returns from the areas of the country shaded in figure 1.2.

Figure 1.2: Areas of the Country Covered by the Four Selected Service Centers



To select our sample, we developed a computer program that the four service centers matched against their daily transaction files, and identified a universe of 10,501 adjustments to correct IRS processing errors made between April 9 and June 12 of 1987. From this universe, we selected a stratified random sample of 389 of these adjustments for

detailed analysis,[3] which included (1) reviewing pertinent computer records and source documents to identify the sources and causes of the errors, (2) discussing the reasons for the adjustments with service center examiners who enter tax return data and make adjustments to taxpayer accounts, and (3) reviewing the adherence to required procedures by service center personnel.

During our review, we relied on an IRS reporting system that showed about 160,000 adjustments were made as a result of IRS processing errors for the 12-month period ending June 30, 1987. Our universe of 10,501 adjustments from the four service centers was drawn from this system within this period. We did not audit these reports to determine the numerical accuracy of the 160,000 total. However, we did note reliability problems with the system that produces the reports, which indicates that the 160,000 figure may be understated, an issue that is discussed in chapter 3.

To assess IRS' efforts to identify the causes of processing errors we:

- obtained and reviewed management reports generated by the processing system and determined how they were generated, who was using them, and for what purpose;
- discussed IRS initiatives recently implemented to identify and report on processing problems with IRS' National Office and service center personnel responsible for accumulating data, preparing reports, and implementing corrective actions;
- discussed with service center managers and supervisors the formal and informal feedback mechanisms being used in the service centers to identify processing errors and to get the information back to the appropriate processing function; and
- reviewed recent studies of the error resolution function conducted at the Fresno and Kansas City Service Centers.

This review, conducted between February and October of 1987, was performed in accordance with generally accepted government auditing standards.

[3]We projected the sample results at the 95 percent confidence level to the universe of 10,501 adjustments. (See ch.2.)

IRS Can Reduce Processing Errors Through Better Quality Controls

Our analysis disclosed that adjustments to correct tax return data stored on IRS' master files would not have been necessary in at least 281, or about 72 percent, of our sample cases, if IRS staff had simply followed prescribed error correction procedures. Automated controls had detected these errors as the data were being converted and entered into IRS' automated system and had alerted IRS staff responsible for taking corrective action.

The majority of the adjustments in our sample were made when the errors were detected later through another automated control, which selects refund and tax due notices for manual verification of their accuracy. As a result of these actions, taxpayers received correct refunds and tax due notices, but received them in about 7 to 15 weeks rather than the 4 to 6 weeks normally required to process them.

For those cases not detected through this final verification process, some taxpayers received refunds ranging from $7 to nearly $5,000 more than they were due; others received tax due notices requiring them to pay from $1 to over $8,100 more than they actually owed. IRS figures show that the cost to correct these errors is $4.19 per case, but only $0.30 during the initial processing.

Whenever incorrect refunds or tax due notices are sent to taxpayers, IRS runs the risk of hurting its public image and eroding the effectiveness of the voluntary tax system.

Sources of IRS' Processing Errors

Table 2.1 shows the sources of errors made in our 389 sample adjustment cases.

Table 2.1: Sources of Tax Return Errors[a]

Total Cases	Code and Edit	Data Conversion	Taxpayers
389 (100%)	114 (29%)	141 (36%)	220 (57%)

[a]Many cases had multiple errors. For example, 133 of the cases with taxpayer errors also had errors made by Code and Edit and/or Data Conversion. In these cases, the table shows an error in each category and, therefore, these categories total more than 100 percent.

Our analysis of the 389 sample cases disclosed that 327, or 84 percent, were detected by automated controls and sent to the Error Resolution Unit for correction. The other 16 percent of our cases did not go through

the Error Resolution Unit because the automated edit checks do not detect all errors.

Error Correction Controls Not Followed

Of the 327 sample cases that had been through the Error Resolution Units for correction:

- 281 were not properly corrected because Error Resolution examiners did not follow required procedures,
- 38 were not properly corrected, but because of inadequate information we could not determine an exact cause, and
- 8 were properly corrected by Error Resolution, but a subsequent IRS error was made during the output review or adjustments process.

The primary problem we identified occurred in the 281 cases where Error Resolution examiners did not follow Internal Revenue Manual procedures (3(12)32.2) requiring them to verify the information in the computer system with the information on the tax return. Because the data in the computer system for these cases were incorrect, the computer calculated an incorrect solution for the examiner to review. If examiners had reviewed the tax return and corrected the error rather than just accepting what was on the screen, they would have prevented erroneous data from going to the master file. In a few cases, an examiner made a mistake in trying to correct an error. We estimate that about 72 percent of our sample[1] adjustments could have been avoided if Error Resolution examiners had adhered to required procedures.

Taxpayer errors, data conversion transcription errors, and coding errors that affect calculations on the tax return (number of exemptions, filing status), are typical of the types of errors that were not corrected by examiners. While the errors involved many different lines on the tax returns, the two areas discussed below as examples illustrate how processing problems can start in one processing unit, go to Error Resolution, and not get corrected because examiners did not follow procedures. The two areas involve the earned income credit and taxable amount of social security.

Earned income credit is available to taxpayers who have a dependent child, and whose earned income and adjusted gross income are each less

[1] At a 95 percent confidence level, we project that within our universe of 10,501 the actual number of adjustments that could have been avoided is between 7,126 and 8,040.

than $11,000. These taxpayers must also meet other criteria such as filing status (for example, head of household). About 11 percent of our sample cases involved earned income credit errors.

The computer will calculate an incorrect amount of earned income credit if Code and Edit examiners miscode a taxpayer's filing status or if Data Conversion does not properly transcribe amounts from the income lines. In one of our cases, for example, Code and Edit neglected to code that the taxpayer was not eligible for the earned income credit. Although the taxpayer was a head of household with a dependent, the taxpayer was not eligible for the credit because the dependent was not a child but the taxpayer's grandparent. Even though the taxpayer did not claim the credit, the computer automatically generated one because the miscoded information was transcribed and input to the system. The Error Resolution examiner should have checked the return, noticed the coding error, determined that the taxpayer was not eligible for the earned income credit, and disallowed the computer-generated earned income credit. Instead, the examiner accepted the computer calculation, thereby increasing the taxpayer's refund by $296, the amount of the erroneous earned income credit. The Output Review Unit corrected the refund before it went to the taxpayer, but this process delayed the taxpayer's rightful refund by about 10 weeks.

Taxable amount of social security benefits is another example of IRS processing errors resulting from Error Resolution examiners accepting computer calculations without following IRS procedures. Our sample included cases from all four service centers where the computer calculated an incorrect amount of taxable social security benefits that were not corrected by Error Resolution examiners.

In one of our cases, a data transcriber erroneously entered social security benefits as $6,804 instead of the $9,804 that the taxpayer clearly entered on the return. As a result of this transcription error, the return was sent to the Error Resolution Unit. The Error Resolution examiner did not follow procedures that require comparing the transcribed data with the tax return to make necessary corrections. Because the examiner accepted the computer's calculation, erroneous data went forward to the master files and increased the taxpayer's expected refund from $975 to $1,545. Output Review corrected the error and sent the correct refund of $975; however, the taxpayer received the refund 6 weeks later than normal.

Proper Use of Zero Balancing Would Help

One hundred of our sample cases went to the Error Resolution Unit because Data Conversion Unit operators made a transcription error. Forty-nine of these transcription errors were caused by data transcribers overriding the zero balancing controls described on page 10; the other 51 were transcription errors that could not have been detected by zero balancing controls. When the Distributed Input System indicates a potential transcription error and the zero balancing control stops the system from accepting further data, transcribers are required by the Internal Revenue Manual (3(24)33.1) to verify that all items have been transcribed correctly and then press the release key.

Discussions with IRS personnel who helped us analyze our cases indicate transcribers could have pressed the release key without verifying the accuracy of their transcription. IRS officials explained that one reason transcribers skip this step is to increase their production and thereby be eligible for increased incentive pay. Tax returns with transcription errors that could be corrected were instead sent to the Error Resolution Unit. As noted previously, examiners did not follow the required procedures to compare the transcribed data with the tax return and inaccurate data went to the master file. On the basis of our analysis, we found that 49, or about 13 percent, of the cases in our sample[2] would not have gone to the Error Resolution Unit for correction if the Data Conversion Unit had complied with the zero balancing controls.

In one of our cases, a Data Conversion Unit transcriber entered the taxpayer's interest income as $7,898 instead of $2,898. This transcription error caused the total income line to differ with the total of the income entries, but the transcriber overrode the zero balance message rather than correcting the transcription error. When the return went to the Error Resolution Unit, the examiner accepted the computer generated total income calculated with incorrect data. This resulted in the taxpayer receiving a tax bill for $1,161 instead of an expected $489 refund. After contacting IRS to correct the problem, the taxpayer received his refund about 11 weeks later than normal.

Supervisors at the service centers told us that they expect their transcribers to use zero balancing properly in order to correct transcription errors as early as possible and prevent returns from going to Error Resolution. Nevertheless, officials in the National Office and at two service

[2]At the 95 percent confidence level, we project the actual number of transcription error cases within our universe of 10,501 that should have been corrected by data transcribers is between 990 and 1,676.

centers we visited suspect that the release key is being misused. Also, Andover's director told us that because of suspected transcription problems, Andover will be increasing its quality review of data transcribers by 50 percent for processing year 1988.

Code and Edit Errors Can Be Reduced

Within our sample, 114 cases involved Code and Edit examiners not following required processing procedures, and 92 of these cases went to the Error Resolution Units for correction. Coding mistakes can affect computations on many different parts of a tax return including Schedule A, tax computations, and earned income credit. The earned income credit example discussed earlier is typical of IRS processing errors we noted, which start with a code and edit mistake that is not properly corrected in Error Resolution.

Of the 22 code and edit cases that did not go through Error Resolution, 16 occurred when examiners did not follow required IRS procedures in editing the withholding and estimated payments lines. The tax examiners are required to move the withholding amount claimed to the estimated payment line when a return shows income received but no wages earned, and withholding is claimed, but there is no supporting document, such as a W-2. We found that the Code and Edit examiners erroneously moved the claimed withholding to the estimated payment line when supporting documentation was attached.

For example, in one of our cases, a Code and Edit examiner moved a $193 amount from the withholding line to the estimated payment line, even though the taxpayer's attached withholding statement showed $193 in withholdings. Data entry transcribers properly entered the erroneously edited returns, the data went to the master file, and an erroneous tax due notice was generated. The Output Review Unit caught the error during the notice review process, and the taxpayer received his refund about 3 weeks late.

Consequences of Processing Errors in Our Sample

When inaccurate data reach the master file at the National Computer Center, erroneous refund notices and tax due notices are generated. Tapes of all refund and tax due notices are sent to the service centers. Prior to sending notices to taxpayers, the Notice Review Processing System selects notices with a high probability for error. Output Review Units check the accuracy of these selected notices by comparing them with supporting taxpayer documents. When Output Review examiners

find erroneous notices, they make an adjustment to the taxpayers' accounts.

Table 2.2 shows the number of cases that had either a refund or a tax due notice generated, the number with notices stopped and corrected by the Output Review Units, and the number sent to taxpayers with incorrect amounts.

Table 2.2: Disposition of Notices in Our Sample Cases

Disposition	Refund notices	Tax due notices	Total cases
Stopped and corrected[a]	119	70	189
Stopped, corrected, and partial refund sent taxpayer	117	•	117
Subtotal	**236**	**70**	**306**
Sent to taxpayers uncorrected	65	18	83
Total notices generated	**301**	**88**	**389**

[a]One case was stopped but did not need correction. We could not determine the reason for the delay.

As the table shows, 306 notices were stopped by the Output Review Unit and corrected; in several of these cases, however, only a partial refund was sent to the taxpayer with a notice that the remainder of the refund would be sent later. Another 83 notices[3] were not stopped by Output Review and were sent to taxpayers with incorrect amounts. When projected to our universe of 10,501 cases, we estimate the total dollar amount of all errors was about $9.1 million.[4]

Analysis of Refund Notices

Further analysis of the 301 refund notices generated by our sample cases indicates that:

- 98 were delayed at least 3 weeks when the Output Review Unit stopped and corrected erroneous refunds caused by IRS processing errors.
- 20 were stopped and delayed from 5 to 11 weeks because IRS had either processed the taxpayer's prior year return incorrectly as a 1986 return (16 cases) or had processed a return under an incorrectly transcribed social security number (4 cases). Consequently, the taxpayer's actual

[3]At the 95 percent confidence level, we project that within our universe of 10,501 the actual number of notices sent to taxpayers with incorrect amounts is between 1,847 and 2,687.

[4]At the 95 percent confidence level, we project the actual dollar amount of all errors in our universe is between $6.2 million and $12.0 million.

1986 return appeared to be a duplicate to the computer, and was rejected for review and subsequent correction.

- A $6,078 refund was stopped and delayed by Output Review for 10 weeks before it was sent to the taxpayer, but we could not determine the exact reason for this delay.
- 117 were stopped by Output Review but sent to taxpayers because the erroneous refund was for an amount less than the taxpayer was due. When Output Review detects such an error, IRS' procedure is to send the partial refund with a notice saying the rest of the refund will be forthcoming.
- 65 refunds were not stopped by Output Review and sent to taxpayers. Of these, 63 were for amounts ranging from $7 to $4,960 more than the taxpayer claimed; the other 2 were for $50 and $271 less than claimed. The total amount of errors on these refunds was $29,693.

Analysis of Tax Due Notices

Analysis of the 88 erroneous tax due notices generated by our sample indicates that:

- 70 were stopped by Output Review and corrected, and
- 18 were sent to taxpayers requesting them to pay from $1 to $8,142 in additional taxes. Most of these taxpayers expected refunds. The additional taxes requested totaled $16,690 and the refunds eliminated totaled $9,159.

Reducing Errors Made by Error Resolution Units

Our results show that about 72 percent of the errors in our sample could have been prevented if Error Resolution examiners had followed prescribed procedures. Service center managers told us they believe that high personnel turnover in Error Resolution Units is a factor contributing to the number of errors being made by these examiners. At one of the service centers we visited, 57 percent of Error Resolution examiners were new hires for the 1987 processing season, while in another about 50 percent were new hires. New hires receive 3 weeks of training, but the managers believe that the new hires depend too much on the automated system and do not analyze and correct errors as effectively as the more experienced examiners.

The managers told us that more examiners would remain in the Error Resolution Unit if the Error Resolution examiner position was returned to its previous higher grade level. The position was downgraded with the advent of the automated Error Resolution System because the new system was expected to simplify error correction. As a result, many

experienced examiners leave the unit for promotion in other service center units.

Error Resolution processing errors could also be reduced if Data Conversion Unit transcribers followed zero balancing procedures more closely. Following these procedures would reduce the number of returns going to Error Resolution for correction and lessen the likelihood of Error Resolution examiners missing the error because they accept computer calculations generated by incorrect data inputs.

Fresno Service Center's Review of All Error Resolution System Notice Codes

The Fresno Service Center, which was not one of the four centers at which we did detailed analysis of adjustments, instituted an additional control in 1987 to reduce the number of errors coming out of Error Resolution. A quality review team reviewed all tax returns processed through the Error Resolution Unit in 1987 for which a notice would have been sent to a taxpayer.

The service center team reviewed 331,412 returns, and found 42,832, or almost 13 percent, had errors that they corrected before sending data on the returns to the master file. They also provided immediate feedback to the Error Resolution examiners on the errors being made, and the review team concluded that this feedback improved the performance of the examiners. They also concluded (1) the additional cost of reviewing all tax returns processed through the Error Resolution System was less than the cost of making the correction in the Adjustments Branch—$3.70 compared to $4.06 per correction; (2) additional savings were realized by reducing the work loads in the Output Review Unit, the Collections Branch, and Problem Resolution Office; and (3) the review prevented thousands of erroneous notices from being generated from the master file and sent to taxpayers. The Fresno Service Center repeated its 100 percent review of notices generated by the Error Resolution Unit during the 1988 processing season.

We discussed the Fresno Service Center's project with National Office officials responsible for the Error Resolution System program policies and procedures. While they agreed that Fresno's project helped to prevent erroneous notices, they had not received any formal feedback, because the project was a local Fresno initiative. They stated that such feedback is important for them to make the changes necessary to address the causes of system errors, such as changes in Error Resolution computer programs and procedures.

Kansas City Service Center's Review of Error Resolution System Notice Codes

Kansas City Service Center's Error Resolution Unit conducted a study similar to Fresno's by reviewing 21 percent of the tax returns processed by its Error Resolution Unit for which a notice would be sent to a taxpayer. This project team reviewed 77,518 returns and found 7,646, or almost 10 percent of the returns, had errors that they corrected before the data were sent to the master file. The cost of preventing the 7,646 erroneous notices was $22,674, or $2.97 per correction, somewhat less than the IRS average cost of $4.19 per adjustment after a taxpayer receives a notice. The unit manager intends to continue this review because of the positive impact it will have in decreasing the number of adjustments, the number of notices requiring output review, and the number of unhappy taxpayers.

Conclusions

While the Error Resolution System is detecting errors, Error Resolution examiners are not always correcting the errors, with the result that thousands of erroneous refunds and tax due notices are generated and sent to taxpayers.

On the basis of these results from our sample, we believe a substantial number of IRS and taxpayer errors detected by the automated system would have been corrected if Error Resolution examiners had routinely verified information on the tax returns with information previously entered into the automated system. Also, proper use of the zero balancing controls by data entry operators could reduce the number of returns going to Error Resolution for correction. Increased review of tax returns corrected by Error Resolution examiners, as was done by the Fresno and Kansas City Service Centers, could reduce the number of erroneous notices being generated as well as identify specific problem areas needing improvement. Timely correction of errors and their systemic or procedural causes would lead to the prevention of future errors. Thus, subsequent quality reviews may require fewer resources to address processing problems. We believe the effectiveness of the voluntary tax system would be enhanced by efforts to minimize IRS' own errors in the early stages of processing, thereby reducing the need to contact taxpayers in order to resolve erroneous refunds or tax due notices.

Recommendations

We recommend that the Commissioner

- Require service center directors to implement a program to review tax returns corrected by the Error Resolution Units before sending them to the master files, as is being done by the Fresno and Kansas City Service

Centers. Service center directors should have flexibility to adjust the percentage of returns reviewed to their units' performance.

- Ensure that feedback on the nature and source of errors identified in these reviews is provided promptly to the processing units responsible for missing or creating the errors, and to National Office managers, so that both parties can take timely corrective action and thus help prevent future errors.

Agency Comments and Our Evaluation

In responding to our draft report, the IRS agreed with our conclusions and recommendations but expressed concern that the wording of our recommendations gave the impression that there are no systems currently in place to monitor and evaluate the effectiveness of the error correction process prior to release of information to the master file. Specifically, IRS cited its quality reviews of selected output from all processing units in the service centers and the weekly feedback provided by the Program Analysis System reports. (See app. I.)

It was not our intention to imply that IRS had no such systems in place. In fact, we discuss the service centers' quality assurance activities and IRS' Program Analysis Systems in some depth in chapter 3. However, the high percentage of IRS processing errors attributable to Error Resolution examiners is an indication that more returns should be reviewed than is accomplished under the current quality review system. Also, as discussed in the next chapter, feedback received from the Program Analysis System reviews is not always timely enough to correct data before these data leave the processing unit.

In our opinion, the Kansas City and Fresno program efforts achieved greater benefits than the other quality assurance activities, specifically in (1) the increased number of returns reviewed; (2) the daily feedback to examiners making the errors, thereby improving the Error Resolution System units' performance early on; and (3) the correction of all identified processing mistakes before sending tax data to the master file, thereby decreasing the number of incorrect notices and refunds being generated and sent to taxpayers.

IRS' letter to us stated that it will be performing an in-depth analysis of the results at Fresno and Kansas City, including the feedback to examiners who caused the errors, for possible nationwide implementation. We believe that this is a positive step in improving IRS' error correction system during tax return processing.

Better Management Information Needed From IRS' Quality Monitoring

In our 1982 report, we concluded that IRS' quality monitoring did not produce the detailed data necessary to determine the systemic and procedural causes of errors. In response, IRS' Commissioner committed the IRS to securing better program evaluation data.

IRS initiated a number of quality monitoring activities to improve its ability to identify processing problems. These activities include: (1) improving the notice review process, (2) implementing the Program Analysis System (PAS), and (3) establishing an Adjustment Management Information System (AMIS). While these activities resulted in some improvements, actions can still be taken to ensure that management data are complete, accurate, timely, and useful to IRS managers.

Quality Assurance Initiatives

To improve quality, IRS has established in the service centers the Quality Assurance Branch, which is responsible for implementing programs designed to identify errors and invalid notices and to evaluate the performance of employees and processing units. These programs provide feedback on processing problems to service center managers. While service center line managers depend on this feedback in managing their units, other systems can also provide feedback to them and to higher level managers in the service centers and in the National Office. These systems are the Notice Review Processing System, the Program Analysis System, and the Adjustment Management Information System.

IRS has recently increased its efforts to improve quality agencywide by implementing a Quality Improvement Process program. Through this problem-solving process, quality improvement teams conduct projects to address chronic problems in order to reduce waste and errors. Managers from the IRS National Office, regional offices, district offices, and service centers are participating in these projects. According to IRS, the following events and concerns led to this approach:

- the 1984-1985 filing season problems and the resources expended to correct the problems,
- decreasing public confidence in IRS,
- decreasing employee pride in the organization,
- frequent technological and organizational changes, and
- a growing interest in quality improvement principles within IRS.

Notice Review Processing System Data Are Not Timely or Complete

IRS has a goal to stop every erroneous notice from being sent to taxpayers. The Quality Assurance Branch's Output Review Unit is responsible for stopping erroneous notices by using the automated Notice Review Processing System, which became operational in all 10 service centers in March 1987. The unit is also responsible for providing formal feedback to the service center processing units to prevent errors from recurring. The system was designed to select notices with a high probability for error by applying certain selection criteria to refund and tax due notices generated from the master file at the National Computer Center. In the opinion of the supervisors of the Output Review Units at the four service centers we visited, the Notice Review Processing System is a significant improvement over the prior system in identifying potential erroneous notices.

In order to provide feedback during the 1987 processing season, the Output Review Units were to accumulate data on errors causing bad notices, interpret these data, and provide weekly feedback to processing units causing the errors and to service center management. Also, Output Review was to provide the accumulated data to the National Office coordinator of the Notice Review Processing System on a monthly basis, to be consolidated into a nationwide report. This report was intended to provide service center and National Office management with information on the effectiveness of the processing units and the Notice Review Processing System.

During 1987, however, the weekly and monthly reports were delayed or not submitted and an overall national summary was not prepared. The Notice Review Processing System coordinator told us that service centers did not always provide the weekly and monthly reports because the service centers did not take the time to manually prepare the data as a result of higher priority work. In addition, there was no software program to format the data into a consistent monthly report. Officials in all four of the centers we visited told us that, while the detailed information for the reports was being recorded on data collection sheets by Output Review Unit staff, entering these data for reporting purposes is a time-consuming process, and other work took priority.

National Office officials recognize the data input problem and the reporting software problem. IRS intended to input the data by optically scanning the data collection sheets. Also, a new software program was to be developed to provide a consistent format for the monthly reports. While IRS had planned to have these two improvements operational for the 1988 Notice Review peak processing season in March, it experienced

problems implementing the optical scanning procedure and was continuing to work on these improvements as of June 1988.

Usefulness of PAS Data to IRS Managers

PAS was developed by IRS in response to our 1982 report, and is a recent addition to the Quality Assurance Branch's programs. As a quality monitoring system, PAS analyzes service center functions such as error resolution, adjustments, and notice review, in order to (1) identify both taxpayer errors and processing errors; (2) analyze why the errors occurred; and (3) recommend improvements, such as revising procedures and forms, service center training, and taxpayer education to prevent recurring errors. The first PAS reviews were conducted in all service centers during the 1986 processing season.

Data from the system are intended to be used by managers at all levels in the service centers and at some levels in the National Office as a tool to identify and correct future processing problem areas. The National Office issued a national summary for the 1986 PAS review of the Error Resolution System. The summary included a total of 16 findings for improving the quality of IRS' operations. Eight of these findings resulted in changes to the Internal Revenue Manual's instructions and procedures for pipeline processing units, 7 resulted in no changes, and 1 was no longer applicable for the 1987 tax year. While the 1987 PAS national summary for the Error Resolution System did not contain specific findings for changing the Internal Revenue Manual, IRS plans to use the information to strengthen taxpayer education and service center training programs, and to assist quality improvement projects.

At the service centers, we found general agreement by managers we interviewed at the division chief level and above that PAS information is useful in terms of reviewing errors found during the processing season and making periodic processing improvements. However, certain unit managers below the division chief level in the four service centers we visited did not find PAS information useful because it was too late to correct the errors before the data left their units. According to National Office officials, however, the Program Analysis data were not intended for this purpose. Other concerns expressed to us by unit managers in the centers we visited were that the PAS sample is too small to be valid and the reports are misleading, do not contain enough information, or are not received weekly as scheduled. Table 3.1 summarizes these opinions.

Table 3.1: Unit Manager Concerns About PAS Reports

	Service centers visited			
	1	2	3	4
Data not current	X	X	X	X
Sample too small		X		X
Reports misleading	X	X		
Need more information	X	X	X	
Not received weekly	X	X		X

We discussed the unit managers' perceptions about PAS with the Chief, National Office Quality Assurance and Program Development Branch, and other National Office officials. They stated that data from the system are intended for use by unit managers. However, the unit managers probably do not fully understand the PAS reports because they have not received uniform training on how to use the report data. To date, PAS training has been given to the Quality Assurance staff at the service centers who collect and report the Program Analysis data. National Office officials intended that the Quality Assurance staff would instruct the unit managers on the usefulness of the system and the reports available. Other headquarters officials told us that it would be beneficial to provide PAS training to unit managers. In preparing for the 1988 filing season, headquarters officials incorporated some training into their visits to service centers.

AMIS Reports Are Unreliable

In describing AMIS, the Internal Revenue Manual states that with proper use IRS hopes to reduce eventually the number of adjustments by identifying the causes of errors.

With AMIS, tax examiners use various codes to categorize each adjustment made to an individual taxpayer's account. One of eight source codes is assigned to identify why the adjustment was made (for example, a taxpayer request or IRS error) and a reason code is assigned to identify the section of the tax return affected by the adjustment (for example, the total income line or federal tax withholding line). These codes also determine the message printed on a notice sent to taxpayers.

The AMIS reports, which are produced monthly, provide IRS managers with nationwide adjustments data intended to help them focus on potential problems in tax return preparation and service center processing. Our review showed that the monthly AMIS reports are sent to the Tax Accounts and Underreporter Branch in the National Office and to the

Adjustment/Correspondence Branch and the Management Support Branch at each service center. The AMIS report for the 12-month period ending June 30, 1987, stated that of 2 million total adjustments, 160,000 were made to correct IRS processing errors.

AMIS reports were not being used by the National Office Tax Accounts and Underreporter Branch or by the four service centers in our review, according to IRS officials in these units. The Adjustments Team Leader of the National Office Tax Accounts and Underreporter Branch who is responsible for the AMIS system informed us that AMIS has never provided the feedback for which it was originally intended. For example, the AMIS reports do not provide data for all eight source codes. Other National Office and service center officials told us the AMIS reports were unreliable because examiners were improperly assigning source and reason codes.

We also noted this latter situation when discussing cases in our sample with examiners at two of the four service centers we visited. Examiners can choose from a number of valid source and reason codes in order to make an adjustment, but the accuracy of the AMIS report data depends on these examiners' ability to choose the correct codes. Examiners in one service center told us that in certain situations they would use a source code that prevents a notice from being sent to a taxpayer instead of first using a source code that records the adjustment as an IRS processing error and then another code that stops the notice. The examiners' intent was to stop the notice, but by using only one source code, the number of adjustments attributable to IRS error is understated on the AMIS report.

At a second service center, supervisors of different shifts process similar cases differently. One supervisor used the source code that prevents the notice, while the second supervisor used the code that recognizes the IRS error along with the second code that stops the notice. While we could not determine the frequency of the miscodings or their effect on the AMIS reports, the information suggests that the 160,000 adjustments made to correct IRS processing errors may be understated.

Conclusions

Since our 1982 report, IRS has increased its quality monitoring activities for identifying the types and causes of processing errors. We found that specific improvements could be made to each of these initiatives to assure that complete, timely, and accurate data are available for management's use in devising strategies for minimizing IRS processing errors.

Recommendation

We recommend that the Commissioner direct his staff to review the completeness, timeliness, and accuracy of management information produced by IRS' quality monitoring and modify those reports that do not meet management needs.

Agency Comments and Our Evaluation

In responding to our draft report, IRS stated that AMIS is the principal management information reporting system for monitoring the quality of adjustments being made by IRS employees to taxpayer accounts and that IRS is: (1) planning to issue a memorandum to field officials stressing the importance of using appropriate source and reason codes, (2) considering additional validity checks to ensure the proper use of source codes and reason codes, and (3) reformatting the quick reference chart used by employees making adjustments.

We believe that the AMIS system can be a useful management tool for IRS. An effective AMIS system would help IRS to better identify problem areas to be addressed by PAS reviews or by means of special projects. We also believe that IRS should consider improvements to the management information produced by the Notice Review Processing System and PAS systems as well.

Comments From the Internal Revenue Service

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

COMMISSIONER

JUN 8 1988

Mr. Ralph V. Carlone
Director, Information Management
and Technology Division
United States General Accounting Office
Washington, DC 20548

Dear Mr. Carlone:

We have reviewed your recent draft report entitled "System Integrity: Better Controls and Management Can Reduce Processing Errors" and agree with the report's conclusions and recommendations.

As you know, the IRS is placing new emphasis on improving the quality of our products and services to the taxpaying public, including reducing the volume of incorrect notices and refunds that are issued to taxpayers. One indicator of our efforts to improve the quality of our service center operations is the decrease thus far this year in the volume of subsequent correspondence and adjustment requests from taxpayers. Furthermore, we are encouraged by the results of the 1988 filing season. Although we originally had projected that tax reform would cause an increase in the Error Resolution System workload, based on further analysis of the most recent filing season data, we have lowered our estimate by over 40 percent.

Detailed comments on the report recommendations are enclosed.

We hope you find these comments useful.

With kind regards,

Sincerely,

Enclosure

Recommendation 2 (Page 37):

Ensure that feedback on the nature and source of errors identified in these reviews is provided promptly to the processing units responsible for missing or creating the errors, and to National Office managers, so that both parties can take timely corrective action and thus help prevent future errors.

Comment:

The Program Analysis System (PAS) reports are provided to service center and National Office management for early identification of trends in taxpayer errors, deficiencies in processing procedures and training, as well as systemic problems. These updates are provided weekly. This data should be used by the service center to determine the percentage and types of documents they should review.

The systems in Fresno and Kansas City require that the errors that are detected are given back to the employee who caused the error for correction. This aspect will also be reviewed for possible nationwide implementation.

Recommendation 3 (Page 47):

We recommend that the Commissioner direct his staff to review the completeness, timeliness, and accuracy of management information produced by IRS' quality monitoring and modify those reports that do not meet management needs.

Comment:

The principal management information reports to monitor the quality of completeness, timeliness and accuracy of adjustments are produced by the Adjustment Management Information System (AMIS). Several initiatives are underway to improve AMIS. Additional validity checks to ensure the proper use of the source codes and reason codes which identify why the adjustment was made and the section of the return affected by the adjustment are under consideration. In addition, a memorandum stressing the importance of using the appropriate source codes and reason codes will be issued to field officials. The source codes and reason codes will also be revised to reflect the Tax Reform Act changes and the chart used by employees for quick reference will be reformatted.

IRS COMMENTS ON RECOMMENDATIONS
CONTAINED IN GAO DRAFT REPORT ENTITLED
"SYSTEM INTEGRITY: BETTER CONTROLS AND MANAGEMENT
CAN REDUCE PROCESSING ERRORS"

We would like to mention that the wording of all three recommendations is misleading in that it gives the impression that there are no systems currently in place to monitor and evaluate the effectiveness of the corrective process prior to release of information to the master file. We strongly recommend that the wording in each recommendation be changed to properly reflect current processes.

Recommendation 1 (Page 37):

Require service center directors to implement a review of tax returns corrected by the Error Resolution Units before sending them to the master files. Service center directors should have flexibility to adjust the percentage of returns reviewed on the basis of their units performance.

Comment:

A quality review system is in place to review selected output from all processing functions including Error Resolution prior to sending the tax return information to the master file. Quality review feedback is provided to the individual employees as well as service center management. Since the selection of Error Resolution cases for review is performed by the computer system, service center directors can increase or decrease the percentage to be sampled. The quality review system focuses only on errors detected in that particular function being reviewed.

As cited in the report, two service centers, Fresno and Kansas City, are experimenting with performing a 100% review of the tax returns processed by Error Resolution prior to sending the tax information to the master file. The results thus far are encouraging. We will be performing an indepth analysis of the test results from both centers with consideration given to nationwide implementation.

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