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Report to the Chairman, Subcommittee on Oversight, Committee on Ways and Means, House of Representatives

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TAX ADMINISTRATION

Results of IRS' Mid-Fiscal Year 1989 Financial Review

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The Honorable J.J. Pickle
Chairman, Subcommittee on Oversight
Committee on Ways and Means
House of Representatives

Dear Mr. Chairman:

On April 25, 1989, as a follow-up to our April 4 testimony on the Internal Revenue Service's (IRS) budget request for fiscal year 1990,[1] you asked us to provide an analysis of IRS' mid-fiscal year 1989 financial review. On July 6, 1989, we briefed your staff on the results of our analysis. This letter documents the information provided at that briefing, supplemented by some additional data.

Results in Brief

Because cost-cutting measures taken earlier in fiscal year 1989 had proven insufficient to offset a $360 million budget shortfall, IRS, in May 1989, imposed additional cuts that were expected to make up the difference. According to IRS statistics and other information obtained from IRS officials, those cuts

- have affected IRS' service to the public by making it more difficult for taxpayers to reach IRS over the telephone and by decreasing the manageability of certain service center correspondence inventories and
- are expected to decrease the revenues derived from IRS' document-matching activities.

Other effects may become apparent next year depending on the extent to which (1) furloughed employees decide not to return to IRS (which could adversely affect the quality of IRS' returns processing activities) and/or (2) IRS is unable to fund items, such as space alterations, that were deferred until next year.

Background

As noted in our April testimony, IRS had identified a fiscal year 1989 budget shortfall of about $360 million and had taken various actions in an attempt to offset that shortfall. Included among those actions were a hiring freeze and restrictions on travel, training, and equipment acquisitions. Those actions proved insufficient, however, primarily because the

[1] Administration's Fiscal Year 1990 Budget Proposals for IRS and the Tax Court (GAO/T-GGD-89-16, Apr. 4, 1989).

hiring freeze had not had its intended effect. As discussed in our testimony, for example, IRS' Examination function had originally expected to reduce its staffing by 1,000 positions but had to significantly reduce its estimate when it later realized that the level of attrition was much lower than expected.

During the mid-year review, IRS decided on additional actions that had to be taken to offset the remaining shortfall. As officially announced in a May 12, 1989, memorandum to IRS executives from the Deputy Commissioner for Planning and Resources, IRS decided to (1) make additional cuts to support services, equipment, training, and space alterations, (2) reduce various service center programs by furloughing temporary staff, and (3) limit the level of taxpayer service provided after the filing season.

Objective, Scope, and Methodology

Our objective was to assess the results of IRS' mid-year review in terms of their effect or potential effect on IRS' operations. To do that, we analyzed documentation relevant to the mid-year review and talked with officials in IRS' Finance Office and in various program areas, such as taxpayer service and returns processing, affected by decisions made at the mid-year review. We also analyzed IRS statistics on the level of taxpayer service being provided and on the size and manageability of service center correspondence inventories.

We did our work from April to July 1989 and in accordance with generally accepted government auditing standards. We sought the views of officials responsible for the activities discussed in this report and incorporated their comments where appropriate. They generally agreed with the facts presented.

Effects of IRS' Cutbacks

The full effect of IRS' cutbacks will not be apparent until after fiscal year 1989. Some degradation in IRS' service to the public is already discernible, however, and IRS expects some reduction in revenues as a result of cutbacks in the Underreporter Program. We believe that two additional issues are associated with the cutbacks, the effects of which, if any, will not surface until next year. Those issues involve whether (1) work quality in the service centers will be adversely affected by the unstable work environment created by furloughs and (2) sufficient money will be available in fiscal year 1990 to fund various activities, such as space alterations and equipment purchases, that IRS deferred from this year to next.

Service to the Public

As a result of IRS' cutbacks, the level of service to taxpayers over the telephone and through correspondence has been reduced.

According to IRS' statistics, for example, IRS had achieved a 72-percent level of telephone service[2] for the week ending July 29, 1989, compared with an 84.1-percent level of service during the same week last year. This year's level of service is lower than IRS had planned when it made its mid-year cuts in May. At that time, IRS expected the cuts to cause the level of service to drop to 75 percent. A drop in the level of service means that taxpayers are having a more difficult time contacting IRS over the phone. At this time of year, most taxpayers are calling IRS with questions not about the tax law, which is the case during the filing season, but about their individual accounts.

As a further indication of the increasing difficulty taxpayers are having in getting through to IRS over the telephone, IRS' statistics showed that 64.2 percent of the callers during the week ending July 29 got through on the first attempt. That rate of accessibility was down from 80.3 percent during the week ending May 13—the week the National Office advised the field of the decision to reduce the level of service.

Another of IRS' decisions at the mid-year review was to cut 141 staff years from the Service Center Correspondence Program. It is under this program that the service centers respond to taxpayer inquiries about their accounts and notify taxpayers of IRS-initiated adjustments to their accounts. According to IRS' statistics, the 10 service centers had 695,619 correspondence cases in their inventories on July 28, 1989, compared with 585,125 at that same time last year—an increase of about 19 percent. More important than the absolute size of the correspondence inventory, however, is the inventory's manageability. A comparison of manageability on July 28 with manageability at the time the mid-year cuts were announced (May 12) would seem to reflect the effect of those cuts in the correspondence area.

Manageability of Correspondence Inventory

In assessing manageability, IRS uses three criteria. The first criterion is that the center's inventory not contain any uncontrolled cases that are older than 14 days. (If a service center expects to take longer than 14 calendar days to resolve a case, it is to control that case by entering it into a computerized database; otherwise the case is considered "uncontrolled.") The National Office considers a center to have exceeded this

[2]IRS computes its level of telephone service by comparing the number of taxpayers' calls answered at its toll-free telephone sites with its estimate of the total number of taxpayers who tried to call.

criterion if its uncontrolled inventory at the end of a week exceeds the total of its receipts for that week and the previous week. Using that measure, we determined that no center's inventory was in excess of the first criterion on either May 12 or July 28, 1989.

The second criterion for manageability is that not more than 20 percent of a center's inventory be older than 45 days (referred to as the overage rate). On May 12, 1989, the overage rate nationwide was 7.7 percent, no center had a rate that exceeded the 20-percent criterion, and one center (Kansas City, Missouri) had a rate over 10 percent. As of July 28, that situation has changed considerably. According to IRS' statistics, the overage rate nationwide had increased to 16.2 percent, 9 of the 10 centers had overage rates above 10 percent, and the rates for Kansas City and Philadelphia had grown past 20 percent. Kansas City's rate on July 28 was 29.9 percent; Philadelphia's was 20.2.

The third criterion for manageability is that a center's total inventory not exceed the equivalent of 3 weeks' production. To measure against that criterion, IRS divides a center's average production for the last 4 weeks into its ending inventory. If the result exceeds "3," the inventory is considered unmanageable. Using IRS' formula, we determined that three centers (Kansas City, Memphis, and Philadelphia) exceeded that criterion as of July 28. As of May 12, only Memphis' inventory had exceeded the criterion.

The National Office branch chief responsible for the correspondence program said that all centers had been instructed to redirect any resource savings in other programs to the correspondence area. He said that his office has been monitoring the situation in Kansas City and, as part of that monitoring, is tracking the center's daily receipts and closures. He also said that Kansas City developed an action plan and that the situation is improving. The branch chief said that he has also talked with Memphis and Philadelphia, but is not overly concerned about their inventory levels.

Revenues

The cut of 141 staff years in the correspondence program was one of several cuts to service center programs resulting from the mid-year review. In total, IRS decided to reduce service center staffing by about 750 staff years with an expected savings of about $12.5 million. The biggest service center staffing reduction was in the Underreporter Program, which sustained a cut of 469 staff years. Under that program, service centers follow up on cases identified through document matching in which taxpayers appear to have underreported their income. According to the headquarters branch chief responsible for that program, the reduction will cause service centers to work fewer cases, which, he estimated, will ultimately result in a total revenue loss of about $100 million, most of which will occur after fiscal year 1989.

As a result of its mid-year review, IRS had also intended to reduce staffing in another aspect of the document-matching effort—that which involves converting data to tape from information documents submitted on paper (as opposed to those submitted on magnetic media). Because paper information cannot be matched until it is converted, this cut, according to IRS officials, would have excluded certain information from the matching process. The potential impact on taxpayer equity and revenues caused IRS to rethink its decision. By restoring some staff years to the conversion effort and extending the time frame in which that conversion had to be done, IRS now expects to use all of the paper information.

IRS also cut some staff in the Automated Collection System. According to a Collection official in the National Office, that cut will have no impact on revenues because it involved clerical positions.

Service Center Quality

Many service center employees are classified as seasonal or temporary workers. They work for only part of the work year, and many return to work at the center in succeeding years. IRS officials told us that many temporary staff in the service centers work several months a year and move from one area of the center to another depending on the time of year. Staff who help process returns during the filing season, for example, might move to the correspondence or underreporters area once the filing season winds down.

Cuts to the correspondence and underreporter programs, as discussed above, were accomplished by furloughing some of that staff. To the extent furloughed staff choose to seek a more stable employment and thus not return to the service center next year, IRS will be forced to hire inexperienced staff. The more IRS has to rely on inexperienced staff, the more it has to spend on training and the greater the probability that work quality will decline. The extent to which furloughed employees choose not to return to IRS and the effect, if any, on quality will not be known until the 1990 filing season. We intend to pursue the issue as part of our annual assessment of filing season activities for the Subcommittee.

Deferrals

Some of the cuts made by IRS in an attempt to deal with this year's shortfall involved the deferral of expenditures until next year. The Southwest Region, for example, planned to save about $2.3 million by deferring a major office relocation in Houston, Texas. Training was another area affected by deferrals. To help the regions make funding decisions in that area, the National Office provided them with guidelines for identifying mandatory courses. As explained to us by an Examination official, for example, each region was expected to provide the mandatory examination training. The extent to which any nonmandatory examination training was provided, if at all, was left to the individual region, depending on its particular fiscal situation. Among the many training courses that the Central Region considered deferring, for example, was Phase IV of the revenue agent training program. During that phase of their training, agents learn about examining partnership returns.

Deferring such things as space alterations, relocations, equipment purchases, and training may help IRS make it through fiscal year 1989. The need to pay for those items in 1990, however, could cause funding problems next year.

As agreed with the Subcommittee, unless you publicly announce its contents earlier, we plan no further distribution of this report until 10 days from the date of issuance. At that time, we will send copies to the Secretary of the Treasury, Commissioner of Internal Revenue, Director of the Office of Management and Budget, and other interested congressional committees.

David Attianese and Sharon Paris of my staff contributed to the preparation of this report. If you or your staff have any questions concerning the report, please call me on 272-7904.

Sincerely yours,

Paul L. Posner

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Issues

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