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IRS' Implementation of Certain Compliance Initiatives

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The Honorable Jim Sasser, Chairman
The Honorable Pete Domenici, Ranking Minority Member
Committee on the Budget
United States Senate

You asked us to monitor the Internal Revenue Service's (IRS) tracking of the results of three fiscal year 1991 compliance initiatives. The three initiatives were designed to (1) revise IRS' training program for revenue agents so that experienced staff would spend less time training new staff and, as a result, more time doing audits; (2) increase examination staff so that IRS could audit more returns; and (3) increase collection staff so that IRS could collect more delinquent accounts.

This fact sheet documents a briefing given earlier this month to Committee staff on the results of our work to date and our remaining work. In the event that IRS' fiscal year 1993 budget request may contain compliance initiatives, our interim results may be of use to the Committee in its deliberations on the fiscal year 1993 budget request. Thus far, we have (1) reviewed IRS' monthly compliance initiative tracking reports for fiscal year 1991, (2) reviewed documents explaining how IRS developed its revenue estimates for the three initiatives, and (3) discussed the initiatives' results with IRS National Office officials in the Budget Division and in the Examination and Collection functions.

While we were preparing this fact sheet, we received IRS' revisions to its 5-year revenue estimates for the compliance initiatives. As part of our continuing work, we plan to determine the appropriateness of these revisions for the three initiatives that we reviewed.

BACKGROUND

IRS' fiscal year 1991 appropriation included $191 million for 3,476 additional staff years to implement nine compliance initiatives. These initiatives were intended to produce direct enforcement revenue and promote more voluntary compliance. Because of the budget reallocations described next, however, the staff years and funds for those initiatives were reduced.

IRS allocated about $15 million of the initiative funds to cover unbudgeted fiscal year 1991 costs, such as a portion of the fiscal year 1991 pay increase. In addition, because IRS' fiscal year 1991 appropriation was not enacted until October 27, 1990, IRS was unable to begin hiring new staff at the start of the fiscal year. As a result, the administration revised the staffing and funding targets for the initiatives to reflect levels that could be achieved if hiring had begun in January 1991. As a result of these changes, the fiscal year 1991 initiative funding was reduced to $134 million, and the staffing target was decreased to 2,236 additional staff years.

At the original funding level of $191 million, IRS estimated that the nine initiatives would raise $0.5 billion in additional revenue in fiscal year 1991 and $5.7 billion through fiscal year 1995. The revenue targets were revised to $0.2 billion and $6.2 billion, respectively. Appendix I shows the original funding and revenue projections as well as the subsequent revisions for the three initiatives that we reviewed.

IRS' Assistant Commissioner (Finance)/Controller is responsible for tracking the results of the fiscal year 1991 compliance initiatives. To track the results, IRS developed revenue and staffing targets for each initiative by adding the initiative staffing increase to baseline levels. IRS then monitored progress against the targets. The results of this monitoring were documented in monthly reports and a year-end summary.

RESULTS OF EFFORTS

Fiscal year 1991 results were mixed for the following three compliance initiatives that we reviewed.

-- IRS used contract instructors less extensively than expected. Nevertheless, IRS reported that its opportunity cost savings from its training initiative were $4 million more than it had originally estimated. These additional savings resulted from the conservative approach IRS used in estimating first-year opportunity cost savings from this initiative.

-- The examination initiative exceeded its staffing goal by 46 staff years, but it lost almost $9 million more than IRS initially estimated. This additional loss occurred because the opportunity costs associated with training new revenue agents were higher than anticipated.

-- IRS did not meet its target for the total dollars collected from delinquent accounts in fiscal year 1991. Yet, IRS has said that the collection initiative achieved its revenue target of $38.7 million. IRS reached this conclusion by reducing the baseline against which initiative results were measured.

1991 OPPORTUNITY COST SAVINGS TARGET FOR TRAINING INITIATIVE EXCEEDED

Before 1991, IRS' training program for new revenue agents involved 55 weeks of classroom and on-the-job training. As we reported to the Committee in April 1990, that training involved a significant amount of opportunity costs--potential audit revenues that went unrealized because experienced revenue agents were used to do the training.[1] Before 1991, IRS was using three experienced revenue agents as instructors for each training class.

The examination training initiative involved two revisions to the revenue agent training program that were intended to reduce the opportunity costs associated with that training. The first change to the training program involved replacing some of the revenue agent instructors with contract trainers. The second change involved restructuring the training program to reduce the amount of time new revenue agents and revenue agent instructors spend in training.

In estimating the opportunity cost savings from this initiative, IRS determined what it would have cost to train new revenue agents under the old training program and compared it to the cost of training them under the new program. In doing so, IRS assumed it would train 1,500 new revenue agents with a combination of contract trainers and GS-12 revenue agent classroom instructors and that the total training time would be reduced from 55 weeks to 43 weeks. Using those assumptions, IRS estimated that opportunity costs would decrease by $21 million for fiscal year 1991. IRS then reduced that estimate to $10.5 million, according to IRS officials, because of anticipated start-up problems. IRS reported that the training initiative actually reduced opportunity costs by $14.3 million in fiscal year 1991.

IRS also estimated that this initiative would reduce opportunity costs by $492.0 million through fiscal year 1995. However, that 5-year target was based on assumptions that are not consistent with IRS' first-year experience with this initiative. For

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[1] Tax Administration: Potential Audit Revenues Lost While Training New Revenue Agents (GAO/GGD-90-77, Apr. 6, 1990).

example, classroom and on-the-job training time was actually reduced by 21 weeks rather than 12 weeks--a difference that could cause IRS' 5-year target to be understated. The following other differences from the assumptions could cause IRS' 5-year target to be overstated:

-- IRS assumed that two of three instructors per class would be contract instructors, but, in 1991, less than one of three instructors were contractors.

-- IRS assumed that all of the revenue agent classroom instructors would be GS-12s, but in 1991 35 percent of the revenue agent instructors were GS-13s. According to IRS statistics, GS-13s are more productive than GS-12s.

-- Revenue agent productivity, in terms of the dollars recommended per hour, was higher than IRS assumed.

IRS recently revised its 5-year opportunity cost savings estimate for this initiative from $492.0 million to $408.5 million. According to an IRS budget official, the revision was made in light of the fiscal year 1991 experience, including the four factors listed above, and because no significant hiring will occur in fiscal year 1992. We plan to review IRS' methodology for developing this estimate.

REVENUE LOSS FOR FIRST YEAR OF EXAMINATION INITIATIVE HIGHER THAN EXPECTED

The examination initiative provided for adding almost 900 examination staff, 572 of whom were to be revenue agents, to do more audits. IRS estimated that this initiative would result in an $18.3 million loss in the first year but would generate $818.8 million through fiscal year 1995.

IRS' projection of additional revenue from an increase in examination staff is the net of three separate projections--(1) the revenue arising from the examinations done by the new staff, (2) the revenue lost because experienced revenue agents temporarily stop auditing returns while they train new revenue agents, and (3) the net additional revenue gained by redirecting experienced staff to higher-yield examinations.

In an August 1988 report,[2] we concluded that although an increase in revenue agents will eventually have a positive revenue impact, it is unreasonable to expect much additional revenue in the first year of a major staff increase. This conclusion was based on the amount of time it takes to hire new staff and the time and effort involved in training them. We recommended that IRS reexamine and validate its examination revenue estimation methodology.

After we issued that report, IRS reassessed its methodology and concluded that increases in examination staff result in decreased revenue in the first year and that revenue would not be generated until the second year. Incorporating this conclusion into its revised methodology, IRS estimated that it would lose $18.3 million in fiscal year 1991 from hiring the new revenue agents authorized by the examination initiative.

At the end of fiscal year 1991, IRS reported that it had realized 15,808 revenue agent staff years--46 more than its target. It also reported that it lost $27 million instead of the $18 million it had projected. IRS officials told us that the additional loss --almost $9 million--can be attributed to higher-than-expected opportunity costs associated with training new revenue agents. Those higher opportunity costs arose because, as discussed in the training initiative section, more and higher-graded revenue agents had to be used as instructors than expected.

IRS recently revised its 5-year revenue estimate for this initiative from $818.8 million to $854.2 million. According to an IRS budget official, the revision was made to reflect IRS' experience with opportunity cost savings in fiscal year 1991. We will review the assumptions IRS used to develop this estimate.

COLLECTION INITIATIVE FALLS SHORT OF TARGET FOR TOTAL DOLLARS COLLECTED

The collection initiative called for hiring an additional 687 collection staff, of which 332 were to be revenue officers. These staff were expected to close an additional 17,000 taxpayer delinquent accounts and collect an additional $38.7 million in fiscal year 1991 and $1.1 billion through fiscal year 1995.

A delinquent account occurs when a taxpayer who files a return fails to pay the required tax. IRS attempts to collect the money owed by sending a series of notices to the taxpayer, or, if that

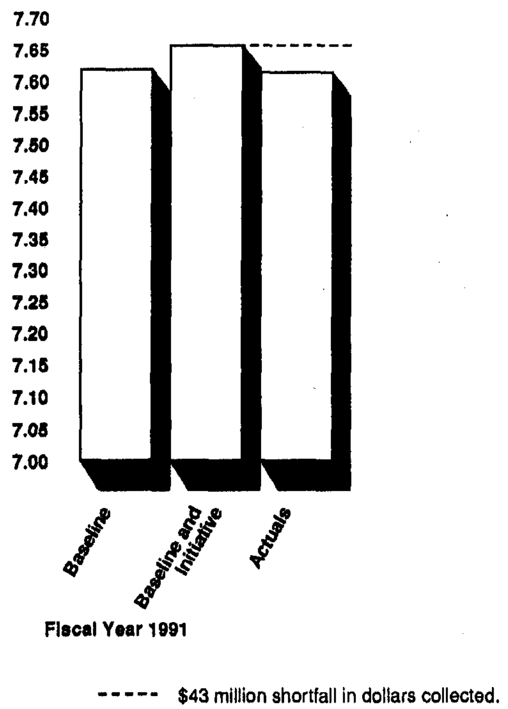
[2] Tax Administration: Difficulties in Accurately Estimating Tax Examination Yield (GAO/GGD-88-119, Aug. 8, 1988).

approach fails, levying cash assets and/or calling the taxpayer. If this fails, the case is sent to a revenue officer in one of IRS' district offices. The revenue officer personally visits the taxpayer in an attempt to secure payment.

In projecting how much revenue the additional 687 collection staff would bring in, IRS estimated the number of cases it expected new staff to close and the dollar amount associated with each closure. Because of the learning experience for new hires and the time spent in training, IRS estimated that new hire productivity would be 50 percent of that of experienced staff. Once IRS had estimated the revenue to be generated by the new hires, it subtracted the opportunity costs associated with using experienced staff to train the new hires. Using this methodology, IRS concluded that it would collect an additional $38.7 million in fiscal year 1991. Applying the additional dollars that would be collected by these new hires to an estimate of base level collections from collection staff, IRS estimated that at the end of fiscal year 1991 it would have collected $7.656 billion.

In its year-end compliance initiative tracking report, IRS said it collected $7.613 billion--$43 million less than originally projected. (See fig. 1.) However, the report also concluded that IRS had "achieved the goal [of the initiative] by collecting $38 million." IRS reached that conclusion by reducing the fiscal year 1991 baseline collections. According to IRS officials, they reduced the baseline because IRS used 26 fewer staff years than expected and because staff on board experienced a lower-than-expected productivity (dollars collected per staff year).

<u>Figure 1: Taxpayer Delinquent Dollars Collected in Fiscal Year 1991</u> (Dollars in billions)



Source: IRS' September 1991 compliance initiative tracking report.

Many factors may contribute to the lower-than-expected productivity. For example, the public's reduced ability to pay as a result of the recession may affect IRS' ability to collect taxes owed. Underestimates of either new hire productivity or the opportunity costs associated with training new staff would be other explanations.

IRS made a slight revision to its 5-year revenue target for this initiative, reducing it by less than $1 million. We plan to review the appropriateness of this revision in light of the first year's experience.

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Copies of this fact sheet are being sent to the Secretary of the Treasury, the Commissioner of Internal Revenue, and the Director, Office of Management and Budget. We will also make copies available to others upon request.

Major contributors to this fact sheet are listed in Appendix II. Please contact me on (202) 275-6407 if you or your staff have any questions concerning the information in this fact sheet or our continuing work for the Committee.

Jennie S. Stathis

Jennie S. Stathis
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CHANGES IN FUNDING AND REVENUE ESTIMATES FOR THREE FISCAL YEAR 1991 INITIATIVES

Table I.1: Compliance Initiatives as Approved by Congress
(Dollars in millions)

Initiative	Funding	Estimated FY 91 revenue	Estimated FY 91-FY 95 revenue
Training	$7.5	$13.8	$517.6
Examination	77.1	(18.2)	1,081.7
Collection	55.5	150.2	1,608.4
Total	$140.1	$145.8	$3,207.7

Source: IRS data.

Table I.2: Compliance Initiatives After Reallocations
(Dollars in millions)

Initiative	Funding	Estimated FY 91 revenue	Estimated FY 91-FY 95 revenue
Training	$5.7	$10.5	$492.0
Examination	58.7	(18.3)	818.8
Collection	42.3	38.7	1,113.6
Total	$106.7	$30.9	$2,424.4

Source: IRS data.

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