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IRS' New Business Vision

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IRS' NEW BUSINESS VISION

SUMMARY STATEMENT OF
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The Internal Revenue Service (IRS) has been encouraged on several occasions to use the opportunity afforded by Tax Systems Modernization to identify alternative business practices that would provide better service to taxpayers. In 1992, IRS began to do just that. IRS has now developed its new business vision, at least conceptually.

IRS' new vision calls for (1) shifting from a paper-based to an electronic tax processing system, (2) consolidating fragmented telephone assistance into fewer centrally-managed locations that can handle almost all taxpayer calls, and (3) developing a database that will contain all pertinent account information readily available to employees who need it. GAO supports these business concepts. They hold promise for improved taxpayer service and more efficient and effective government.

IRS got a late start in developing its new vision and faces many challenges before the vision becomes a reality. One challenge is to increase significantly the number of tax returns that are filed electronically. IRS' goal is to increase the number to 80 million by 2001. To reach this goal, IRS says it needs legislation that would enable it to require electronic filing under certain conditions. Considering the time needed to pass legislation and issue regulations, GAO believes that the legal issues associated with electronic filing need to be resolved and legislative proposals submitted to Congress soon if IRS hopes to receive 80 million electronic returns 8 years from now.

In addition to legislation, IRS needs to make electronic filing more accessible to a broader range of taxpayers. GAO has recommended that IRS (1) encourage employers and financial institutions to offer electronic filing to employees and customers and (2) consider letting taxpayers file through their personal computers. IRS has developed a strategy that includes these initiatives and many others.

IRS' new business vision also poses a significant human resource challenge because it will dramatically change the work done by many IRS employees. IRS has pledged that all career and career conditional employees in jobs affected by new technology will be given the opportunity for retraining and continued employment at the same grade level. IRS will use several strategies in trying to meet the human resource challenge including retraining, the use of term appointments, and attrition. IRS may also redirect some affected employees into new tax compliance and customer service positions.

Mr. Chairman and Members of the Subcommittee:

We are pleased to be here today to discuss the status of IRS' plans to change its business operations to take advantage of the opportunities provided by Tax Systems Modernization. We have three major points:

- -- IRS' new business vision builds on organizational and work process concepts the Subcommittee has previously examined.
- -- To realize this vision, IRS needs to increase dramatically the number of tax returns filed electronically.
- -- And, IRS faces a massive challenge to retrain and redeploy staff.

You also asked that we provide information on the future role of IRS' regional offices, steps being taken by IRS to develop the menus for its new automated telephone service, and IRS' compliance with the Chief Financial Officers Act of 1990. This information is included in appendixes to our statement.

IRS' NEW BUSINESS VISION

On several occasions, we and the Subcommittee have (1) noted how IRS' business planning for its Tax Systems Modernization effort lagged behind its technical planning and (2) encouraged IRS to use the opportunity afforded by modernization to identify alternative business practices that would ultimately provide better service to taxpayers. In 1992, IRS began to do just that. IRS has now developed its new business vision, at least conceptually. Many concepts in IRS' vision will not be new to this Subcommittee.

For example, the Subcommittee has examined the concept of taxpayers resolving problems in a single contact with IRS--commonly called one-stop service. The Subcommittee also examined two options to minimize taxpayer burden in filing tax returns: expanding electronic filing and introducing return-free filing, a system in which some taxpayers do not prepare tax returns.[1]

IRS' new business vision calls for (1) shifting from a paper-based to an electronic tax processing system; (2) consolidating

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[1]GAO previously testified before the Subcommittee on these topics: Identifying Options for Organizational and Business Changes at IRS (GAO/T-GGD-91-54, July 9, 1991); Tax Administration: One Stop Service: A New Concept of Assistance For Taxpayers (GAO/T-GGD-92-33, Apr. 28, 1992); and Tax Administration: Opportunities to Reduce the Burden of Filing and Processing Tax Returns (GAO/T-GGD-92-41, May 13, 1992).

fragmented telephone assistance into fewer centrally-managed locations that can handle almost all taxpayer calls; and (3) developing a database that contains all pertinent account information, readily available to all employees who need it.[2] The vision also allows for the possibility of some form of return-free filing.

We support these business concepts because they should lead to improved taxpayer service at less cost to the government. As described in detail in IRS' Service Center Organizational Study (SCOS), implementation of these concepts will result in several changes, including significant organizational restructuring. IRS' new business vision calls for establishing a third computing center and making all three centers responsible, among other things, for receiving electronic returns. The vision also calls for two new organizational entities--submission processing sites and customer service sites. Submission processing sites will process all paper transmissions. Customer service sites will consolidate telephone-based operations that are currently scattered in numerous locations and across several IRS functions. We recommended such a consolidation in our 1991 testimony before this Subcommittee. Additional information on these organizational changes is included in appendix I.

IRS' plans for implementing its business concepts are evolving. And they are likely to change even more as IRS implements new technology and tests its ability to turn concepts into reality.

LEGISLATION AND AGGRESSIVE MARKETING MAY BE NEEDED TO REACH ELECTRONIC FILING GOAL

Critical to IRS' new vision is IRS' plan to increase significantly the number of tax returns filed electronically. Electronic filing has been available for a number of years and was the topic of two of our recent reports.[3]

In 1993, IRS received about 12 million tax returns electronically. Without any major changes in the existing program, IRS' Research Division forecasts 28 million electronic returns by 1999. IRS' current business vision is to increase the 1993 number more than 6-fold--to 80 million by 2001.

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[2]The creation of this database involves critical security and privacy issues that will need to be resolved before implementation.

[3]Tax Administration: IRS Can Improve Controls Over Electronic Filing Fraud (GAO/GGD-93-27, Dec. 30, 1992) and Tax Administration: Opportunities to Increase the Use of Electronic Filing (GAO/GGD-93-40, Jan. 22, 1993).

Electronic filing offers two important benefits to IRS. First, the costs for processing, storing, and retrieving tax returns are lower than under a paper-based processing system. Second, IRS can process returns and refunds faster and more accurately. Accordingly, the number of returns filed electronically is a key controlling factor in IRS' plans. The more electronic returns, the less paper that submission processing sites will have to handle. The number of electronic returns will also affect workload estimates for customer service sites because paper returns involve more errors which in turn require more contacts with taxpayers.

Thus, it is very important that IRS reach its electronic filing goal. To do that, the SCOS report said that IRS needed legislation that mandated electronic filing by certain tax preparers and businesses. However, IRS recently determined that it has no legal standing with preparers because the statutory responsibility for filing tax returns lies with the taxpayer. It is our understanding, therefore, that in lieu of the mandates called for in the SCOS report, IRS is now considering legislation that would provide the Secretary of the Treasury with the broad authority to prescribe conditions under which returns will be filed electronically. IRS would then develop appropriate regulations.

We have not assessed the legal issues associated with mandated electronic filing. Considering the time needed to pass legislation and issue regulations and for the private sector to plan for such a change, we believe the legal issues need to be resolved and the proposals submitted to Congress soon if IRS hopes to receive 80 million electronic returns 8 years from now.

Another legislative change is needed if electronic filing is to become a true paperless process. It is not a paperless process today. Taxpayers must still mail IRS a paper document with their signatures. Processing these documents requires many of the same steps electronic filing is supposed to eliminate. In addition, IRS must match the electronic return with the signature document, research discrepancies, contact electronic filers to obtain missing documents, and store the documents. IRS has prepared a proposal that would authorize alternatives to paper signatures, such as signature pads. A similar proposal was included in H.R. 11, which was passed by Congress last year but vetoed for reasons unrelated to the proposal.

Yet another legislative initiative that is important to IRS' new vision would allow for payment of taxes by credit card. Although we support this initiative, which is included in H.R. 3419, IRS needs to resolve several issues before credit payments become a reality. Two such issues are the transaction fees normally charged and the characteristic of the debt in bankruptcy proceedings. Consumer indebtedness on credit cards is currently subject to discharge in bankruptcy proceedings; federal taxes are not. More information on credit card payment issues is included in appendix II.

In addition to these changes, IRS needs to make electronic filing more accessible to a broader range of taxpayers, including those who are unwilling or unable to incur the costs of a tax preparer. We have recommended that IRS (1) encourage employers and financial institutions to offer electronic filing to employees and customers, (2) consider letting taxpayers file through their personal computers, and (3) broaden access to electronic filing at IRS offices or other locations. Since our report was issued, IRS has developed a strategy that includes these initiatives and many others.

With IRS' vision dependent on electronic filing, it is essential that IRS effectively deal with electronic filing fraud. We reported on this problem in our December 1992 report. Since then, the numbers have gotten worse. Through the first 8 months of 1993, IRS had identified more than 23,000 fraudulent electronic returns--100 percent more than during the same period last year. At least some of the growth in identified fraud may be due to the fact that IRS took steps in 1993 to improve its detection of fraud. Whatever the reason, it seems clear that the harder IRS looks for fraud, the more it finds. And no one knows how much is not being found.

NEW BUSINESS VISION POSES A SIGNIFICANT HUMAN RESOURCE CHALLENGE FOR IRS

IRS staff will need vastly different skills in the future. IRS employs as many as 130,000 persons at the peak of the filing season, many of whom will see dramatic changes in their work. More electronic returns, automated systems to read paper returns, more telephone contacts with taxpayers, and online access to data files will change the tasks to be done. The full impact of these changes on IRS' workforce will not be fully known until IRS decides on the number of submission processing and customer service sites and determines, through prototyping, how those sites should best be organized and staffed.

In October 1990, IRS announced a policy which pledged that all career and career conditional employees in jobs affected by new technology would be given the opportunity for retraining and continued employment at the same grade level. One important purpose of this promise is to maintain employee morale and secure employee cooperation in transitioning to a modernized workplace. But the pledge was made before IRS developed its new business vision. With significant organizational and work process changes now contemplated, IRS has a much greater challenge to meet its commitment. And IRS has to administer the current tax system while transitioning to the new one.

Among the strategies IRS will use in trying to meet the human resource challenge are the following:

- -- The major effort will be to retrain current employees to do new work.
- -- Some employees will leave through normal turnover, although attrition has declined considerably since 1988.
- -- IRS has begun to use term appointments--2,000 so far--to fill positions needed currently but not in the future. OPM regulations allow term appointments when the employment need is longer than 1 year but not more than 4 years.
- -- IRS may also redirect some affected employees into new tax compliance and customer service positions.

IRS' experiences in implementing the Automated Underreporter System provide a clear example of the problems that can be encountered without effective human resources planning. Implementation of that system involved a consolidation in 6 service centers of underreporter work that IRS had been doing in 10. Consistent with IRS' policy, work had to be found for staff in the other four service centers who would no longer be doing underreporter work. As of August 1993, 1 year after this process began, about one-third of those employees had still not been redeployed.

CONCLUSIONS

IRS' business vision holds great promise for improved taxpayer service and more efficient and effective government. We look forward to the day when taxpayers can get the kind of service they deserve and when IRS employees have the tools they need to do their jobs right. IRS got a late start in developing its vision and faces many challenges before the vision will become a reality. But it must persevere. Continuing oversight by this Subcommittee will help ensure that it does.

This concludes my statement. We welcome any questions you may have.

STATUS OF RECOMMENDATIONS FROM IRS' SERVICE CENTER ORGANIZATION STUDY

In 1992, IRS began a study, referred to as the Service Center Organization Study (SCOS), to improve (1) the way IRS collects and processes tax return data and (2) the quality and content of its non-face-to-face contacts with taxpayers. The scope of this study included all work currently done at the 10 service centers, 2 computing centers, 32 taxpayer service call sites, 23 automated collection system (ACS) sites, and 3 Centralized Inventory Distribution System (CIDS) sites that handle requests for forms and publications.

SCOS recommended two new organizational entities and clarified the role of computing centers. One new entity, submission processing sites, will handle all paper transmissions--tax returns, information documents, W-2s, and correspondence--and will resolve errors that do not require customer contact. The paper transmissions will be scanned and imaged and will be stored in a Document Processing System. The scanned images will then be transferred to computing centers. SCOS recommended having four submission processing sites.

The second new entity, customer service sites, will consolidate current telephone-based operations at taxpayer service call sites, ACS sites, CIDS sites, service centers, and computing centers. We recommended such a consolidation in our 1991 testimony before the Subcommittee.[4] These customer service sites are expected to resolve all taxpayer questions and problems that do not require face-to-face contact. Face-to-face contacts will continue to take place in IRS' district offices. IRS' vision is that most non-face-to-face dealings with taxpayers will be over the telephone, although the customer service sites will also handle correspondence.

Taxpayers wanting to call IRS would use one toll-free number no matter what their problem or question. SCOS assumed that through the use of voice response units and various interactive systems, 45 percent of the callers would be able to take care of their problem or question without talking to a human being (a discussion of what IRS is doing to develop the menus associated with the voice response units is in app. IV). Taxpayers who cannot resolve their issues through this system will be routed to an IRS employee for assistance. SCOS recommended that there be from 10 to 28 customer service sites.

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[4]Identifying Options for Organizational and Business Changes at IRS (GAO/T-GGD-91-54, July 9, 1991).

SCOS also clarified the roles of computing centers. When we testified in July 1991, IRS was planning to maintain computerized taxpayer account data at all 10 service centers. We questioned that plan. SCOS subsequently recommended that those activities be centralized in three computing centers. As described in the SCOS report, the computing centers, among other things, will directly receive from taxpayers all electronic and magnetic transmissions of tax returns, payments, information returns, etc., and use that information along with data transferred from submission sites to update taxpayer databases and identify issues for further analysis and taxpayer contact.

IRS' Executive Committee has approved the basic concept of operations for submission processing sites, customer service sites, and computing centers, as described above. The only site-specific recommendations that IRS has announced were for the three computing centers. They will be in Martinsburg, West Virginia, and Detroit, Michigan (the sites of IRS' two existing computing centers), and Memphis, Tennessee.

After SCOS was completed, IRS senior executives identified a need for a more detailed analysis of the transition and implementation issues associated with the new business vision. As a result of this analysis, changes were made to some of the key assumptions upon which the SCOS recommendations were based. For example, IRS lowered the number of electronically-filed returns it expects to receive in 2001 from 91 million to 80 million.

IRS further revised its assumptions for purposes of sizing the submission processing sites that will be operational in 1996. For example, as part of its vision for reducing the amount of paper associated with returns processing, SCOS assumed that all returns not filed electronically would be filed on answer sheets. To size the submission processing sites, however, IRS decided to assume that only 50 percent of the nonelectronic returns would be received on answer sheets. IRS also used a more conservative estimate of about 60 million electronic returns (rather than its goal of 80 million) to allow for the possibility that some proposed legislation will not be enacted. And IRS decided that it should plan on continuing to receive quarterly employment and excise tax returns--SCOS had assumed that these returns would be filed annually.

By assuming less electronic returns and fewer answer sheets than anticipated by SCOS and by assuming continuation of quarterly filings, IRS increased its estimate of the amount of paper that would have to be processed. That increase will most likely result in an increase in the number of submission processing sites from the four recommended in SCOS. At the time we prepared this statement, IRS was considering increasing the number to five or six. The revised assumptions will also affect the workload estimates for customer service sites because paper returns involve more errors than electronically-filed returns, which, in turn, will require more correspondence with taxpayers. However, it is uncertain how, if at all, this increased workload will affect IRS' decision on the number of customer service sites.

CREDIT CARD TAX PAYMENT ISSUES

One legislative proposal mentioned in SCOS would allow for payment of taxes by credit card. That provision is included in H.R. 3419. The use of credit cards would offer taxpayers an easy payment option and might possibly facilitate tax payment under IRS' electronic filing program. Currently, taxpayers who file electronically and owe additional taxes must send their payment to IRS separate from the tax return.

It is likely that authorization for credit card federal tax payments would be extended to debit cards as well. IRS staff have been working on policy issues surrounding credit and debit card payments and ways to implement a credit card tax payment program once legislation is enacted. Even if legislation were enacted to authorize federal tax payment by credit card, IRS would need to resolve important issues before accepting such payments.[5]

For Visa and MasterCard--the two most widely used credit cards in the nation and therefore likely to be used to pay taxes--the treatment of federal taxes paid with a credit card in bankruptcy proceedings is the single most important unresolved issue. Under current law, federal taxes are generally not dischargeable in bankruptcy. However, consumer indebtedness owed on credit cards is subject to discharge in bankruptcy proceedings. According to data we obtained from Visa, bankruptcy losses are one of their largest write-offs annually.

Officials representing Visa and MasterCard have expressed reservations to IRS about allowing credit card tax payments unless federal tax debts paid with a credit or debit card remain a nondischargeable item in bankruptcy. Their position is that a federal credit or debit card tax payment program should not create new risk for either IRS or the credit card system. It is important to note that taxpayers can currently pay their taxes with credit cards if they obtain cash advances or use the convenience checks associated with some credit cards.

There are additional issues that IRS must address in order to administer a credit card tax payment program. One issue is treatment of the discount fees typically incurred on traditional charge transactions. A merchant accepting a credit card pays a discount fee, which reduces the amount of the proceeds for sales made by credit card. The potential problem is that credit card

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[5]The material that follows came from our report entitled Tax Administration: New Delinquent Tax Collection Methods for IRS (GAO/GGD-93-67, May 11, 1993).

issuers prohibit merchants from passing the discount fees on to customers and IRS typically does not discount taxes (other than in circumstances where an offer in compromise is involved).[6]

Several states currently allow taxpayers to pay taxes by credit card. Generally, to not discount taxes owed the states, the states have contracted with an intermediary company which actually accepts the credit card payment from the taxpayer. The state is paid the full amount of the tax and the taxpayers agree to pay a transaction fee over and above the amount of taxes owed the state. Because of the transaction fee, these types of credit card transactions are under review by VISA and MasterCard.

One solution for IRS in dealing with discount and transaction fee issues would be to join the Financial Management Service's (FMS) Credit Card Collection Network.[7] FMS has made arrangements with banks that allow federal agencies to accept credit cards for sales without discounting them. Under FMS' arrangement, the federal government maintains noninterest-bearing accounts at the banks instead of paying discount fees.

Another matter for IRS to consider involves the resolution of credit card billing errors. Credit card billing errors are governed by the Truth in Lending Act (15 U.S.C. 1666) and similar state laws. Debit card billing error resolution guidelines are covered by the Electronic Funds Transfer Act (15 U.S.C. 1693f). Additional guidance would be needed to clarify when and how IRS should be involved in resolving billing disputes associated with paying taxes with credit and debit cards.

Yet another issue was raised by Bankcard Holders of America, a credit card consumer group concerned about taxpayers' privacy. That group has suggested that tax preparers and others be prohibited from marketing information relating to taxpayers who pay taxes with credit cards. There has also been some opposition to the credit card tax payment proposal because of concerns about encouraging more consumer indebtedness.

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[6]An offer in compromise is a situation wherein IRS considers accepting less than the full amount of taxes owed to resolve the liability in full.

[7]FMS, an agency of the Department of the Treasury, is responsible for, among other things, operating and maintaining systems for collecting government funds.

IRS PLANS CHANGES TO ITS REGIONAL OFFICES

In 1992, IRS began a study of its National and regional offices. As a result of that study, IRS has tentatively decided to (1) reduce the number of regions from 7 to 5 by December 1995; (2) reduce the number of regional employees so that each region eventually has a core of about 50 employees devoted to compliance and customer service research and analysis, with some additonal support positions; and (3) establish consolidated sites (the number yet to be determined) to provide resources management and information services.

The results of the National Office/Regional Office study were not formally documented. According to IRS officials, three guiding principles were used in making these decisions: (1) reducing the number of executives, (2) reducing the number of management layers in IRS, and (3) reducing regional and National Office positions by 2,000 and redeploying staff to the front-line to improve customer service.

The seven regional offices, each under the direction of a Regional Commissioner, execute National Office policy and oversee the functions and activities of the district offices and service centers within their geographical boundaries. The regional offices help reduce the National Office's span of control over a field structure that includes 10 service centers and 63 district offices.

We are assessing the roles and responsibilities of IRS' regional offices for the Subcommittee on Oversight, House Committee on Ways and Means, and expect to issue a report early next year. In April 1993, we told the Subcommittee that although we had identified several positive aspects of regional office operations, we had also identified opportunities for increasing operational efficiency.[8] For example:

-- While span of control is a valid consideration in managing 63 district offices, it seems less valid when considering the 10 service centers and 3 forms distribution sites.

[8]Tax Adminstration: IRS' Budget Request for Fiscal Year 1994 (GAO/T-GGD-93-23, Apr. 28, 1993).

-- Span of control could also become less of a concern once IRS consolidates its various telephone operations. Currently, telephone-based operations report through district and regional offices to the National Office. A consolidated telephone operation could report directly to the National Office.

-- Efficiencies could be achieved by consolidating administrative services (such as processing travel vouchers), resource management activities (such as training and personnel management), and automated data processing activities.

IRS is working on the issues associated with having fewer regional office staff. Specifically, IRS senior executives are deciding on the appropriate roles and responsibilities for regional offices given the recommended staffing levels. Those roles and responsibilities have already been altered as a result of IRS' recently-announced plans to reorganize its criminal investigation function. That reorganization, among other things, will reduce to 34 the number of districts having a chief of criminal investigation. Also, in lieu of having an assistant regional commissioner for criminal investigations in each region responsible for overseeing district office activities, the new structure calls for four directors of investigation based in separate geographic areas. The four directors will report directly to the National Office, thus eliminating the regional offices from any management role.

IRS' PLANS TO DEVELOP A MENU-DRIVEN TELEPHONE SERVICE

A key feature of IRS' business vision is increased reliance on the telephone to interact with taxpayers. An important element in accomplishing this is the use of voice response units that employ menus allowing taxpayers to route themselves to various information sources, depending on the nature of their problem or question. The Subcommittee asked about the steps IRS is taking to make these menus "friendly to the taxpayers."

Cognizant IRS officials told us that IRS is taking several actions to try to make the menus user friendly. These actions include (1) seeking advice from private industry users, (2) contracting with the American Institutes for Research for development of standards to guide menu development, and (3) pilot testing the Taxpayer Service/Automated Collection System call routing application in the Cleveland call site in 1993. As part of this process, IRS has sought taxpayers' comments about the menus.

IRS has had some successful experiences with telephone menus. IRS' test of telephone filing of tax returns, for example, involves the use of a menu that leads taxpayers through the filing of a simple tax return. Our assessment of that test in 1992 showed that the process, including the menu, worked very well and was well received by taxpayers who used it.[9] We used the menu ourselves and found it user friendly.

IRS is installing new voice response unit menus, based on its Cleveland test, at 16 other call sites and has said that it will continue to collect taxpayers' comments and modify the menus as needed. We believe that the process IRS is using to develop the menus, and the steps being taken in that process, are reasonable. However, we have not done enough work to say whether taxpayers who have used those menus found them easy to use.

We informally tested the menus by having several of our staff members make calls to the Atlanta, Cleveland, and Phoenix call sites. In general, we found the menus easy to follow, although we thought some were too lengthy and detailed. Some of our staff said that they were hesitant to make menu selections because of the large number of detailed options from which to choose. This factor may have played a part in the fact that only 55 percent of the taxpayers in the Cleveland test chose to route themselves. IRS is working to resolve such problems as it continues to test these menus and receive taxpayer feedback.

[9]Tax Administration: IRS' Test of Tax Return Filing by Telephone (GAO/GGD-93-91BR, Apr. 26, 1993).

STATUS OF IRS' EFFORTS TO COMPLY WITH THE CFO ACT

On June 30, 1993, we reported on the first year financial audit of IRS, stating that IRS' existing systems were not designed to provide the meaningful and reliable financial management information needed to effectively manage and report on IRS' operations. Accordingly, we were unable to express an opinion on the reliability of the fiscal year 1992 Principal Financial Statements of IRS because critical supporting information was not available and we were unable to perform the audit procedures we considered necessary. Where supporting information was available, we found that such information was generally unreliable because of material weaknesses in internal controls.

As highlighted below, IRS has taken action to correct many of the problems in time for the audit of its fiscal year 1993 financial statements, particularly those where needed supporting data was not available for our fiscal year 1992 audit. We are now doing the fiscal year 1993 audit and anticipate completing our work no later than June 1994. We plan to assess the effectiveness of IRS corrective actions during the current audit.[10]

TAX ACCOUNTS RECEIVABLE

After performing a detailed analysis of IRS' receivables as of June 30, 1991, we estimated that only $65 billion of about $105 billion in gross reported receivables that we reviewed were valid and that only $19 billion were collectible. At the time, IRS reported that $66 billion of the $105 billion were collectible.

Historically, IRS reports have significantly overstated receivables primarily because IRS included duplicate and insufficiently supported assessments that it had recorded as part of efforts to identify and collect taxes due. While IRS has a need to maintain such records for enforcement purposes, many assessments were not valid receivables for financial reporting purposes and should not have been included in the reported balances. In addition, IRS' estimates of the collectibility of its receivables have been unreliable because, in addition to including invalid receivables, IRS relied solely on collection experience and did not group assessments according to their collection risk or consider the taxpayer's current ability to pay. This unreliable information on IRS' accounts receivable has affected decisions on the (1) impact of increased collections on the deficit, (2) evaluation of enforcement and collection

[10]Financial Audit: Examination of IRS' Fiscal Year 1992 Financial Statements (GAO/AIMD-93-2, June 30, 1993).

performance, (3) determination of staffing levels, and (4) allocation of resources.

Based on methods that we recommended in our May 1993 report on accounts receivable,[11] IRS developed an estimate of $22 billion for collectible receivables as of September 30, 1992, based on a sample of such accounts. However, we were unable to audit this information during our fiscal year 1992 audit because IRS completed its analysis too late. We are in the process of examining IRS' detailed analysis to determine the reliability of its estimate. IRS is planning to use similar methods to estimate collectible receivables as of September 30, 1993. Ultimately, though, systems must be developed to routinely maintain an accurate record of IRS' receivables.

REVENUE

We were able to determine that IRS' total reported revenues of about $1.1 trillion were actually collected and deposited into Treasury accounts. However, we were unable to audit the components of revenue because IRS' systems could not provide the detailed transactions supporting the revenue balance.

IRS has developed programs to provide the detailed data needed to audit the revenue components for fiscal year 1993. Through these programs, IRS recently provided us with detailed revenue transactions for a test period. We are reviewing this information to determine its adequacy for our tests and to ensure that the information agrees with IRS' accounting records. IRS has committed to providing us with detailed revenue transactions for the entire fiscal year, which we plan to audit for reliability. Such information would be useful to IRS in managing its collection and enforcement activities.

MANAGEMENT OF OPERATING FUNDS

We were unable to audit approximately $4.3 billion, or 64 percent, of the reported spending of $6.7 billion from IRS' operating appropriations because IRS could not reconcile the total of detailed spending information in its outdated systems with summary amounts reported in such systems. The remaining $2.4 billion of reported spending in fiscal year 1992, which we audited, was processed by a new system installed in fiscal year 1992 in IRS' National Office and one region. The new system was implemented throughout IRS on October 1, 1992. IRS believes that

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[11] Financial Audit: IRS Significantly Overstated Its Accounts Receivable Balance (GAO/AFMD-93-42, May 6, 1993).

the new system will provide the needed support for our current audit.

PROPERTY AND EQUIPMENT

We were unable to audit IRS' property and equipment because IRS did not maintain complete and reliable detailed inventory records for its computer equipment and software (ADP assets). IRS is in the process of manually compiling detailed lists of all of its ADP assets as of September 30, 1993, which it expects to complete by the end of calendar year 1993.

SEIZED ASSETS

We were unable to audit the $797 million IRS reported for seized assets because IRS had not yet completed compiling its physical inventory of these assets as of September 30, 1992. IRS has since completed that inventory and is in the process of completing its inventory as of September 30, 1993.

We also found that IRS had not instituted basic systems and controls to provide reasonable assurance that asset seizures and disposals were accurately recorded on a timely basis. To provide complete and reliable records of asset seizures, IRS plans to implement a new property tracking system for assets seized for collection purposes and have a professional management company manage assets seized through criminal investigations.

CRITICAL FINANCIAL MANAGEMENT PROBLEMS EXIST

In addition to the unavailability of supporting information, our audit identified critical financial management problems that demand attention. We found material weaknesses in internal controls in the areas of revenue, tax accounts receivable, property and equipment, management of operating funds, computer controls, seized assets, and reports required by the Federal Managers' Financial Integrity Act (FMFIA). IRS is either considering, planning, or taking corrective actions with respect to these problems. As part of our fiscal year 1993 audit, we are assessing the status and effectiveness of these actions.

We believe that there is a high potential return on investment in the financial management function. IRS has made important strides in addressing long-standing financial management problems. But the process of change has just begun. IRS continues to face major challenges in developing meaningful and reliable financial management information and providing effective internal controls, as envisioned by the CFO Act. It will take a significant and sustained commitment by IRS, particularly by the CFO and his staff, to build on efforts now underway to develop such information and put proper controls in place.

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