United States General Accounting Office

GAO

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

April 1994

TAX ADMINISTRATION

Analysis of IRS' Budget Request for Fiscal Year 1995

GAO

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

General Government Division

B-257031

April 20, 1994

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

Dear Mr. Chairman:

This report responds to your request for our analysis of the Internal Revenue Service's (IRS) fiscal year 1995 budget request. On the basis of our past and current work at IRS, we raise several questions concerning the proposed budget and compliance initiatives.

Background

IRS' budget has grown from $4.4 billion in fiscal year 1987 to $7.4 billion in 1994. Adjusted for inflation, this represents a real growth of 3.7 percent. About one-third of this growth has gone to Tax Systems Modernization (TSM)—IRS' program to update its antiquated computer systems. Over the same period, IRS' workload has grown about 10 percent. The taxpaying population has grown and with it the demands on IRS returns processing and taxpayer assistance activities. Similarly, the growth in filed returns along with a growth in the incidence of nonfiling has added to IRS' compliance workload—returns to be audited, documents to be computer matched, delinquent accounts to be collected, and delinquent returns to be secured.

IRS' budget is composed of four appropriations. They are for (1) administration and management (3 percent), (2) returns processing and taxpayer assistance (21 percent), (3) tax law enforcement (53 percent), and (4) information systems (23 percent).[1] With the need to process and service more tax accounts, the priority given to TSM, and the relatively larger size of the tax law enforcement appropriation, law enforcement has been the most susceptible to absorbing unfunded costs.

Results in Brief

IRS' fiscal year 1995 budget request totals $7.61 billion, a 3.7 percent increase over IRS' fiscal year 1994 appropriation that is primarily attributable to a growth in TSM. At the same time, the budget would reduce IRS' staffing level to 109,656 full-time equivalents (FTE)—a decrease of 5.2 percent that falls most heavily on IRS' enforcement programs. Separate

[1]Percentages reflect amounts proposed in the fiscal year 1995 budget without separately proposed compliance initiatives. They are roughly comparable to the proportions in earlier budgets.

from IRS' budget request, the President has proposed giving IRS another $405 million for several compliance initiatives that would increase IRS staffing by about 5,000 FTEs and thus reverse the decline in enforcement staff.

Our analysis of IRS' budget request and the proposed initiatives raised several questions:

- Will funding shortfalls again prevent IRS from fully implementing the proposed compliance initiatives?
- Should one of the proposed initiatives be refocused to emphasize more use of the telephone in collecting delinquent tax accounts?
- How will the proposed compliance initiatives and related revenue estimates be revised in light of the lower funding level in the Senate budget resolution?
- Is a fee for installment agreements appropriate and, if so, is there a more equitable alternative to the flat fee being proposed?
- Would it be better to do away with the direct deposit indicator on electronically filed returns rather than charge for providing the service?
- To what extent do incomplete business requirements and technical standards and guidelines increase the risks for TSM projects in the budget request?
- Are the budget requests for returns processing and taxpayer service appropriate considering filing season data on the number of returns filed and toll-free telephone accessibility?

Observations on IRS' Budget and Proposed Compliance Initiatives

We have the following observations on IRS' budget request and the proposed initiatives. Each of our observations is discussed in more detail in appendixes to this report.

Unfunded Costs

Over the past decade, IRS' annual budget requests have often been insufficient to fund IRS' base operations. IRS is projecting such a budget shortfall in fiscal year 1994, primarily because of an unfunded locality pay increase and other unfunded labor costs. Because of the shortfall, most of the $115 million Congress appropriated for compliance initiatives in fiscal year 1994 will not be used for that purpose. IRS now plans to spend only about $17 million of that money on the initiatives. (See app. I.)

IRS faces another potential shortfall of about $136 million in fiscal year 1995 because of (1) use of an inflation rate for IRS' support costs that is less than that used for other agencies, (2) a governmentwide reduction in procurement costs proposed by the President, and (3) potential federal employee pay increases beyond the amount budgeted by the President. (See app. I.)

Compliance Initiatives

The fiscal year 1995 budget resolution passed by the Senate on March 25, 1994, allows for IRS' fiscal year 1995 appropriation to be increased by up to $405 million to fund various compliance initiatives. With the one exception discussed in the next paragraph, we support those initiatives provided there is reasonable assurance that the resources will be used to increase IRS' enforcement presence. IRS' most recent statistics show a tax gap of $127 billion for tax year 1992, a gross accounts receivable workload of $150.6 billion at the end of fiscal year 1993, a voluntary compliance level for small corporations of 61 percent for tax year 1987, and a rapid growth in refund fraud. Although some of these problems might be alleviated with more efficient use of existing IRS resources or a simplification of tax laws and administrative processes, it seems clear that IRS can use additional enforcement resources. (See app. II.)

One of the proposed compliance initiatives would provide about 1,200 FTEs and $85 million to increase collection of delinquent accounts. While we agree with the objective, we do not support this initiative because it would increase the number of staff who collect delinquent taxes through face-to-face contact with taxpayers. We believe that IRS should shift its collection focus to more modern processes emphasizing early telephone contact with delinquent debtors. (See app. II.)

Funding provided for the compliance initiatives in the Senate budget resolution is significantly lower than the funding level upon which IRS based its staffing and revenue estimates. The budget resolution would provide funding of $2.025 billion over 5 years. IRS' estimates of 8,136 additional FTEs and $9.2 billion of additional revenue were based on funding of $2.5 billion over that period. With the decreased funding, IRS will have to revise its estimates. (See app. II.)

Approval of the proposed compliance initiatives should include the condition in the Senate budget resolution that the funds be available only for carrying out the initiatives. In the past decade, enforcement staffing has declined steadily since peaking in 1988. Congress has appropriated funds for many compliance initiatives since that time, but those initiatives have either been only partially implemented or totally eliminated because of IRS budget shortfalls in other areas. (See app. III.)

User Fees

IRS' budget request includes offsets related to three user fees. One is an increase in the fee IRS now charges for providing taxpayers photocopies of returns from prior years. The other two user fees—for installment agreements and direct deposit indicators on tax refunds—are new. If an installment agreement user fee is imposed, IRS might want to consider alternatives to the flat fee being proposed. We discuss two alternatives in appendix IV. As for the direct deposit indicator, we believe that it might be more appropriate for IRS to do away with the service rather than charging a fee for providing it. Financial institutions rely on the direct deposit indicator in deciding whether to make refund anticipation loans to filers of electronic tax returns. We believe that these loans, by allowing electronic filers to get their money within 2 to 3 days, foster an environment conducive to fraud. (See app. IV.)

TSM

IRS' budget request includes $989 million for TSM. IRS' computer systems must be modernized, and we believe that TSM is generally a good investment. However, IRS is not positioned to successfully build TSM systems because it has not yet defined its business requirements or completed technical standards and guidelines in such critical areas as security, data, and telecommunications. It would be helpful for the Subcommittee, in reviewing IRS' budget, if IRS would provide a written evaluation that explains the extent to which proposed fiscal year 1995 projects are subject to additional risks due to incomplete requirements, standards, and guidelines. (See app. V.)

Filing Season

Interim data on the 1994 filing season show two negative trends continuing that could have implications for the fiscal year 1995 budget. First, the number of returns filed by individual taxpayers is decreasing again this year, contrary to IRS estimates. Second, taxpayer accessibility to IRS' toll-free telephone service continues to worsen—declining from 24 percent in 1993 to 21 percent as of March 19, 1994. (See app. VI.)

Objective, Scope, and Methodology

Our objective was to analyze IRS' budget request including the compliance initiatives proposed separately by the administration. With one exception, our work was done at IRS headquarters in Washington, D.C., and involved discussions with IRS officials, reviews of budget documents and related materials, reviews of data relating to the 1994 filing season, and the compilation of information from our past work. The one exception involved work we did to assess IRS' service to taxpayers wanting copies of tax forms and publications. As described in appendix VI, that work involved visits and calls to several IRS field locations.

We did our work between January and April 1994 in accordance with generally accepted government auditing standards. We discussed the results of our work with the Director of IRS' Budget Division and other responsible officials on April 14, 1994. The officials generally confined their comments to the factual accuracy of our report. They suggested some changes, which we have incorporated where appropriate.

We are sending copies of this report to various congressional committees, the Secretary of the Treasury, the Commissioner of Internal Revenue, the Director of the Office of Management and Budget, and other interested parties. We will also make copies available to others on request.

The major contributors to this report are listed in appendix VII. Please contact me on (202) 512-5407 if you have any questions.

Sincerely yours,

Jennie S. Stathis

Jennie S. Stathis
Director, Tax Policy and
Administration Issues

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Abbreviations

AUR	Automated Underreporter
CFOL	Corporate Files On-Line
FTE	full-time equivalent
IRS	Internal Revenue Service
NOCC	National Office Command Center
OMB	Office of Management and Budget
RAL	refund anticipation loan
TIES	Totally Integrated Examination System
TSM	Tax Systems Modernization

IRS' Fiscal Year 1995 Budget Request

IRS' budget request for fiscal year 1995 totals $7.61 billion and provides for a staffing level of 109,656 full-time equivalents (FTEs). The budget proposes to offset $147 million of the requested funds with projected revenues from three user fees. (Our views on two of these user fees are in appendix IV.) Separate from IRS' budget request, the President has proposed giving IRS another $405 million and 5,078 FTEs to fund compliance initiatives that are estimated to produce $9.2 billion in revenues in the next 5 years. (Our views on the compliance initiatives are in appendix II.)

For fiscal year 1994, Congress appropriated IRS $7.34 billion to support 115,700 FTEs (P.L. 103-123). IRS' fiscal year 1995 budget request represents a $269 million (3.7 percent) increase over the 1994 appropriated level but a 6,044 (5.2 percent) decrease in FTEs.[2] As shown in table I.1, the funding increase is to support IRS information systems. On the other hand, table I.2 shows that most of the staff reductions (77 percent) are from IRS' enforcement programs (e.g., Examination, Collection, Document Matching, Criminal Investigation, and International). Those enforcement programs account for 53 percent of IRS' budget request for fiscal year 1995.

[2]To achieve the 109,656 FTEs provided for in the fiscal year 1995 budget, IRS anticipates having 95,821 permanent positions by the end of that year. According to IRS data, 96,753 permanent staff were on board as of January 22, 1994. Thus, to reach its goal, IRS needs a further reduction of 932 employees, or about 1 percent of its on-board staff. IRS officials told us that attrition should be enough to achieve that reduction.

Table I.1: IRS Funding Changes From 1994 Appropriation to 1995 Budget Without Proposed Compliance Initiatives

Dollars in thousands

		Appropriation[a]			
	Total IRS budget	1	2	3	4
1994 appropriation	$7,344,085	$167,822	$1,696,853	$4,007,962	$1,471,448
Adjustment for restructuring[b]	(net 0)	+69,062	-89,030	+19,507	+461
Adjusted 1994 appropriation	7,344,085	236,884	1,607,823	4,027,469	1,471,909
Reprogramming to meet 1994 labor shortfall	(net 0)	+3,266	+23,764	-41,038	+14,008
Other change[c]	+7,556			+7,556	
1994 authorized level	7,351,641	240,150	1,631,587	3,993,987	1,485,917
1995 budget request	7,612,595	233,387	1,621,408	3,998,225	1,759,575
Net change from adjusted 1994 appropriation to 1995 budget request	+268,510	-3,497	+13,585	-29,244	+287,666

[a]IRS has four appropriations. The first funds administrative and management activities; the second funds returns processing and taxpayer assistance activities; the third funds tax law enforcement activities; and the fourth funds information system activities.

[b]For fiscal year 1995, the Office of Management and Budget (OMB) approved certain revisions to IRS' appropriation accounts that resulted in some program activities being moved among accounts. In its budget request for 1995, IRS adjusted the figures for 1994 so that the 2 years could be compared.

[c]Transfer of funds from the Office of National Drug Control Policy and the Department of Justice to IRS enforcement programs.

Source: IRS fiscal year 1995 budget request.

Table I.2: Changes in IRS' FTEs From 1994 Appropriation to 1995 Budget Without Proposed Compliance Initiatives

		Appropriation[a]			
	Total	**1**	**2**	**3**	**4**
1994 appropriation	115,700	2,397	34,615	69,057	9,631
Adjustment for account restructuring[b]	(net 0)	+589	−1,223	+627	+7
Adjusted 1994 appropriation	115,700	2,986	33,392	69,684	9,638
Reprogramming to meet 1994 labor cost shortfall[c]	−2,875	−78	−241	−2,640	+84
1994 authorized level	112,825	2,908	33,151	67,044	9,722
1995 budget request	109,656	2,789	32,154	65,036	9,677
(a)Productivity savings	−1,152	−24	−393	−708	−27
(b)Changes to meet projected 1995 labor cost shortfall	−2,032	−61	−488	−1,300	−183
(c)Other	+15	−34	−116	0	+165
Net change from adjusted 1994 appropriation to 1995 budget request	−6,044	−197	−1,238	−4,648	+39

[a]IRS has four appropriations. The first funds administrative and management activities; the second funds returns processing and taxpayer assistance activities; the third funds tax law enforcement activities; and the fourth funds information system activities.

[b]For fiscal year 1995, OMB approved certain revisions to IRS' appropriation accounts that resulted in some program activities being moved among accounts. In its budget request for 1995, IRS adjusted the figures for 1994 so that the 2 years could be compared.

[c]This reprogrammed amount is net of a 3,211 reduction for labor costs and a 336 increase for other reasons.

Source: IRS fiscal year 1995 budget request.

By adding $405 million to IRS' budget, the proposed compliance initiatives would effectively give IRS a net increase of 9.2 percent over fiscal year 1994 appropriated levels. The initiatives would also restore the staff losses in IRS' enforcement programs, as most of the increase of 5,078 FTEs would be applied to these programs.

Higher Labor Costs in Fiscal Year 1994 Required Staff Reductions and Virtually Eliminated the Fiscal Year 1994 Compliance Initiatives

For 1994, IRS has projected a labor cost shortfall of $219 million. The projected shortfall is divided almost equally between an unfunded federal pay raise for locality pay and other unfunded labor costs. The locality pay raise, which amounted to $105 million in IRS, was not provided for in the President's budget request for fiscal year 1994. Other unfunded labor costs included base labor costs of about $85 million, unemployment compensation of $19 million, and administratively uncontrollable overtime of $10 million. To meet this labor cost shortfall, as can be seen in table I.2, IRS reduced its staff by 2,875 FTEs, 92 percent of which (2,640 FTEs) came from enforcement programs.

Included in IRS' fiscal year 1994 appropriation was $115 million for various compliance initiatives. Those initiatives were intended, among other things, to help IRS collect more delinquent taxes; increase audit coverage; increase international compliance efforts; and deal with various compliance issues, such as bankruptcy, independent contractors, nonfilers, and electronic filing fraud. After various adjustments to account for the 1994 labor cost shortfall, IRS now plans to spend only about $17 million on those initiatives. That money is to be used for international examinations, expert witness fees associated with large case examinations, and electronic filing fraud.

IRS' inability to deliver the fiscal year 1994 compliance initiatives is not a unique occurrence. As we discuss in appendix III, IRS has had problems delivering compliance initiatives for similar reasons for the past several years.

Funding Shortfalls Possible in Fiscal Year 1995

In preparing its fiscal year 1995 budget proposal, IRS had projected a labor cost shortfall of about $90 million. According to IRS officials, they discussed with OMB officials the need to increase IRS' labor budget to get higher amounts for costs, such as within-grade increases, career ladder promotions, and other "nondiscretionary" salary increases. Rather than increase IRS' budget request by $90 million, OMB reduced IRS' FTE level for fiscal year 1995 by 2,032. By reducing FTEs, OMB was allowing IRS to use the funds normally allotted to these positions to pay the expected labor cost increases.

Even with this adjustment by OMB, IRS is facing potential shortfalls of about $136 million in fiscal year 1995 support and labor costs. Some of these potential shortfalls are the result of elements in the President's fiscal year 1995 budget relating to procurement savings and federal pay raises. Should they materialize, these shortfalls could adversely affect IRS' ability to deliver the compliance initiatives being proposed for fiscal year 1995.

Support Costs

Approximately $2.4 billion (31 percent) of the fiscal year 1995 budget is for costs unrelated to employees' salaries and benefits. For these "support costs" (e.g., rent, travel, supplies, and equipment), the budget provides for a $236 million increase over fiscal year 1994 authorized levels. Of that increase, $36 million is attributed to inflation. This increase for inflation is smaller than comparable increases in the past 4 years and is 64 percent of last year's increase and 45 percent of the increase in 1993.

To calculate the amount of support cost growth, the Department of the Treasury effectively required IRS to use a "non-pay inflation factor" of 1.6 percent, according to an official in the Office of IRS' Chief Financial Officer. This rate is 1 percentage point less than the rate applied to other government agencies and 1.1 percentage points less than last year's budgeted inflation rate. Because of the less-than-average inflation increase, IRS officials expect the fiscal year 1995 support cost budget to be "very short" and expect, at a minimum, a shortfall of $22 million.

According to IRS officials, support cost budget categories have been cut considerably in the last 2 years, particularly in fiscal year 1993. In 1993, to meet a budget shortfall, IRS not only cut FTEs but also cut about $100 million from its support budget. The officials said that recent support reductions have primarily affected supplies and services, non-automated data processing equipment, and training travel.

A governmentwide reduction proposed by the President as a result of work by the National Policy Review will also decrease the funds available for IRS support costs and could increase the potential shortfall. That reduction involves savings projected as a result of revisions to government procurement recommended by the National Policy Review. As explained by IRS officials, the procurement revisions are expected to streamline the procedures for government vendors, thereby reducing vendors' costs. These lowered costs then will be passed back to the government agencies, resulting in savings to the agencies.

These procurement savings are reflected in a line item in the President's budget entitled "reinventing Federal procurement." The total reduction shown for that line is $712 million in 1995. An IRS official told us that the portion allocated to the Department of the Treasury is $33 million and that

IRS' portion will be $26 million. If this provision in the President's budget is adopted, IRS' budget will have to be adjusted downward to reflect IRS' share of the expected savings. IRS budget officials said that even if the procurement revisions were implemented immediately, it would be difficult to realize any savings in fiscal year 1995 because of procurement lead times and the fact that the revisions would not affect existing contracts. If IRS cannot reduce costs by $26 million, IRS' support cost budget will be further depleted by reductions to amounts budgeted for computer equipment, and its potential shortfall will be that much greater.

Labor Costs

The President's fiscal year 1995 budget assumes a 1.6 percent increase in federal workers' pay effective January 1995. The budget does not say whether this amount is intended to cover a national pay raise, an increase in locality pay, or a combination of both. For IRS, a 1.6 percent pay raise equates to $57.3 million.

The President's budget proposal is an alternative to the pay adjustments otherwise required by law. Full implementation of the law would result in a substantially larger federal pay increase in fiscal year 1995.

The Federal Employees Pay Comparability Act of 1990 (5 U.S.C. 5303) requires that an annual national pay increase be paid to all federal employees based on the percentage change in the Employment Cost Index less 0.5 percent. Using the Index change during the measuring period prescribed by law, the 1995 pay increase would be 2.6 percent. That size pay raise would equal $93.1 million at IRS.

Another section of the Federal Employees Pay Comparability Act of 1990 (5 U.S.C. 5304) was designed to restore federal pay rates to competitive levels. The act established a schedule for incrementally increasing federal pay, by locality, over 9 years until federal rates are equal to 95 percent of prevailing nonfederal rates in each locality. Twenty percent of the locality pay gap was to be closed in 1994 and an additional 10 percent of the gap is to be closed in each of the succeeding 8 years. The 1994 locality pay raises granted under the law averaged about 4 percent. An OMB official said that a good estimate for fiscal year 1995 would be about one-half the fiscal year 1994 increase, if the 1995 adjustments are made. Locality pay cost IRS $105 million in fiscal year 1994. Half of that would be $52.5 million in fiscal year 1995.

The total of these two amounts—$93.1 million for a national pay raise and $52.5 million for a locality pay raise—is $88.3 million more than the amount included in IRS' budget. If federal pay for fiscal year 1995 is raised as much as the law requires, IRS and other federal agencies will need additional funds to maintain staffing levels or else will have to absorb the added costs by cutting programs.

Validity of Claimed Productivity Savings Unclear

The fiscal year 1995 budget includes decreases of 1,152 FTEs and $44.7 million attributed to estimated productivity savings associated with various systems being implemented as part of TSM. These savings were used to offset mandatory personnel reductions under Executive Order 12839.

Productivity savings represent the long-term benefits of implementing new information systems and are considered permanent reductions in IRS' budget base. Hence, reductions taken in one year carry forward to subsequent years. As of fiscal year 1995, IRS' annual base staffing will have been reduced by a total of 4,764 FTEs to reflect productivity savings from the implementation of TSM systems.

The realization of expected productivity savings is a key indicator of successful systems implementation. Because productivity savings are estimated in advance of a system's deployment, their realization depends to a great extent on how accurately IRS was able to predict how and when the system would be implemented in the field.

In an attempt to assess IRS' accuracy in estimating productivity savings, we inquired into three systems—Corporate Files On-Line (CFOL), the Totally Integrated Examination System (TIES), and Automated Underreporter (AUR)—that accounted for 76 percent of the 1,219 FTEs in productivity savings IRS claimed in fiscal year 1994. According to IRS officials, IRS assesses realized productivity savings through postimplementation reviews of individual systems. As of April 4, 1994, IRS had not completed any postimplementation reviews to determine if projected productivity savings were being realized, although reviews of CFOL and AUR were in progress as of that date. Hence, we were unable to assess the accuracy of IRS' estimates.

According to IRS, CFOL will be fully implemented in fiscal year 1994. Statistics compiled by IRS' National Office Command Center indicate that the use of CFOL during the 1994 filing season is about twice what it was during the comparable period last year. TIES implementation for fiscal year 1994 is currently on schedule.

With regard to AUR, which will eventually be installed in 6 of IRS' 10 service centers, IRS now believes that some portion of the system's projected benefits may not be realized as soon as expected. According to IRS budget documents, IRS' estimated productivity savings in the fiscal year 1995 budget were reduced during budget formulation by 145 FTEs and $4.3 million. The reduction was to compensate for revised productivity estimates for fiscal years 1993 and 1994 due to problems in implementing AUR and funding the Underreporter program.

Although they did not have a detailed cause-and-effect analysis supporting the AUR adjustment, IRS staff attributed the adjustment to three types of problems resulting in unrealized productivity savings and a decrease in IRS' Underreporter program staff. First, IRS has experienced delays in implementing AUR. IRS had expected to implement AUR in the six service centers in fiscal year 1993. Now, IRS does not expect to implement AUR in two of the six service centers until June 1994.

Second, IRS was unable to reassign all excess Underreporter program employees at the four non-AUR service centers to funded positions as quickly as it anticipated primarily because of slower than expected attrition. As a result, IRS had to fund some Underreporter program employees who were assigned to other functions, such as returns processing, with Underreporter program resources. This funding of reassigned employees reduced the number of FTEs available to process Underreporter program cases in the AUR service centers, even where AUR was fully implemented.

Finally, the Underreporter program incurred budget adjustments during fiscal year 1994 that further reduced the number of FTEs available to process Underreporter program cases. The reduction in fiscal year 1995 savings is intended to bring IRS' total cumulative systems-driven productivity savings for AUR in line with revised expectations as of fiscal year 1995. Although IRS' revised estimates anticipate that full AUR productivity will be achieved in fiscal year 1995, information returns program staff said that full productivity may not be achieved until fiscal year 1996 because of continuing problems in the funding of reassigned Underreporter program employees.

Observations on Proposed Fiscal Year 1995 Compliance Initiatives

A budget resolution passed by the Senate on March 25, 1994, (S. Con. Res. 63), allows for IRS' fiscal year 1995 appropriation to be increased by up to $405 million to fund various IRS compliance initiatives.[3] IRS has said that such an increase would enable IRS to increase its enforcement presence beyond what the fiscal year 1995 budget would otherwise allow. With the increase, IRS expects, among other things, to do more audits of nonfarm small proprietors and small corporations, collect more delinquent accounts, and enhance international and criminal enforcement efforts.

IRS' most recent statistics show (1) a tax gap of $127 billion in tax year 1992, (2) a gross accounts receivable workload of $150.6 billion at the end of fiscal year 1993, (3) a drop in the voluntary compliance level for small corporations from 81 percent for tax year 1980 to 61 percent for tax year 1987, and (4) a rapid growth in refund fraud. Although some of these problems might be alleviated with more efficient use of existing IRS resources or a simplification of tax laws and administrative processes, it seems clear that IRS can use additional enforcement resources. As noted in the next section, however, not all of the initiative money will be used to increase enforcement resources. Some of the money will be used to "buy back" existing enforcement positions that would be cut under IRS' fiscal year 1995 budget request.

Except for the collection initiative discussed later in this appendix, we support the proposed compliance initiatives provided there is reasonable assurance that the resources will be used to increase IRS' enforcement presence, unlike what has happened in the past as we discuss in appendix III. The budget resolution passed by the Senate includes language that could help provide that assurance. It requires that "any funds made available pursuant to such budget authority or outlays are available only for the purpose of carrying out Internal Revenue Service compliance initiative activities."

[3] The Senate resolution makes the additional budget authority contingent on four conditions: (1) the Secretary of the Treasury, must certify that a Taxpayer Bill of Rights 2, substantially similar to that contained in the conference report to H.R. 11, 102d Congress, 2d Session, has been enacted into law; (2) the Secretary must certify that IRS will implement an educational program on Taxpayer Bill of Rights 1 and 2 for new employees hired pursuant to the budget authority; (3) the Director of the Congressional Budget Office must certify that the budget authority will not increase the federal budget deficit; and (4) funds provided pursuant to the budget authority would be available only for the purpose of carrying out IRS compliance initiative activities. The first condition applies to the budget authority for years after fiscal year 1995.

IRS' Plans for Staffing the Compliance Initiative Positions

In developing the initiative proposals and related revenue estimates, IRS officials said that they used the following assumptions about initiative staffing:

- About 2,000 positions would replace FTEs cut from IRS' 1995 budget request. IRS expects these positions to become vacant through attrition during fiscal year 1995 and expects to fill those vacancies with new hires. Salary costs for these positions were estimated at approximately $35,000 per FTE.
- About 900 positions would be filled by reassigning IRS staff already on board (e.g., a tax auditor moving into a revenue agent position). In estimating the salary costs for these 900 positions, IRS used an average salary range for the specific employment category (e.g., revenue agent or attorney). For revenue estimating purposes, IRS assumed that these reassignments would be made on April 1, 1995.
- About 2,100 positions would be filled by new hires in fiscal year 1995. IRS assumed in its estimates that these people would have an average entry-on-duty date of April 1, 1995, and would be paid entry-level salaries.

Senate Budget Resolution Would Require a Reduction in Planned Staffing Growth and Estimated Revenue From Compliance Initiatives

The Senate budget resolution, which allows for IRS' compliance initiatives, limits funding in any 1 year to no more than $405 million. This amount is the same as the cost presented in the President's budget—$405 million a year, or $2.025 billion over 5 years. However, IRS used a higher cost estimate—$2.5 billion over 5 years—to calculate its staffing and revenue estimates related to the initiatives.

As planned by IRS, the initiatives would have funded 5,078 FTEs in fiscal year 1995 and 8,136 FTEs in succeeding years. Fiscal year 1995 differs from other years because, as we discussed in the previous section, staff hired to fill many of the new positions would only be on board for part of fiscal year 1995. Thus, the number of FTEs in that year would be much less than in the succeeding years when all staff would be working a full year. On the basis of such staffing, IRS estimated that the compliance initiatives would generate revenues of $9.2 billion through 1999.

However, the provision in the Senate budget resolution would necessitate a significant reduction in these staffing figures and revenues. With the total anticipated funding of $2.025 billion, IRS will be able to support about 5,000 FTEs in the years after 1995—more than 3,000 fewer per year than IRS projected when it developed its revenue estimates.

Focus of Collection Initiative Could Be Improved

According to information provided by IRS, one of the larger compliance initiatives proposed by the administration would provide 1,222 FTEs and about $84.7 million to increase collection of delinquent accounts. IRS' information shows that about 1,000 of those FTEs are for revenue officers, who work out of IRS' district offices and attempt to collect taxes through face-to-face contact with taxpayers. The rest of the FTEs are for support and follow-on staff, such as clerks and attorneys. None of the FTEs are for staff at IRS' automated collection sites, who attempt to collect delinquencies through telephone contact with taxpayers.

We do not support an initiative that calls for more revenue officers. As we discussed in a May 1993 report and subsequent testimony,[4] we believe that the focus of IRS' collection efforts should be just the opposite—more use of the telephone and less reliance on face-to-face contacts. As we noted in our report and testimony, IRS' call site collectors were more productive than revenue officers. According to IRS data for fiscal year 1991, call site collectors averaged $1.5 million in collections, while district office staff averaged $331,000. And call site collectors are paid lower salaries than revenue officers, making the difference in return on investment even greater. Despite the differing returns on investment, IRS' data for 1991 showed that 65 percent of its collection staff worked in district office positions.

We also noted in our report and testimony that modern collection processes emphasize early telephone contact with delinquent debtors. In contrast, IRS relies heavily on visits by revenue officers—a step that private sector companies avoid because of the cost and physical dangers involved.

We recommended in our May 1993 report that IRS restructure its collection organization to support earlier telephone contact with delinquent taxpayers and determine how to use current collection staff in earlier, more productive phases of the collection cycle. The collection initiative, as presently constructed, is not consistent with that recommendation.

Number of Cases of Identified Filing Fraud Continues to Rise

One of the compliance initiatives being proposed by the administration would increase criminal investigation staff to work on refund fraud. The number of refund fraud cases has been steadily increasing, and interim results for the 1994 filing season show that trend continuing. As of February 28, 1994, IRS had identified 9,698 returns involving fraudulent

[4]Tax Administration: New Delinquent Tax Collection Methods for IRS (GAO/GGD-93-67, May 11, 1993); and Tax Administration: Collecting Delinquent Taxes and Communicating With Taxpayers (GAO/T-GGD-94-50, Nov. 9, 1993).

refunds, 229 percent more than the number that had been identified as of the same time in 1993. Of the fraudulent cases identified, 59 percent were associated with electronic returns even though only about 25 percent of the individual income tax returns received by IRS as of March 4, 1994, had been filed electronically.

As in past years, most of the identified fraud cases involved returns on which the person was claiming an earned income tax credit. Recent legislative changes expanded eligibility for the earned income tax credit and increased the maximum credit amount. Those changes will first affect tax returns filed in 1995 and could encourage even more attempts to defraud the system. With that in mind and considering the continuing upward trend in identified filing fraud, we support the proposed initiative.

But we also believe that the long-term solution to the fraud problem requires something beyond an infusion of more staff. As we have stated in the past, we believe that the use of manual labor is the least efficient way to deal with electronic filing fraud. It would be more efficient, for example, if IRS improved the criteria its computers use to screen electronic returns for potential fraud after the returns have been filed. An even more efficient way to combat such fraud is to implement controls at the front of the process to help keep fraudulent returns from being filed in the first place. IRS has implemented several such controls. One that has not been implemented—a match of wage information received from employers with wage information on the electronic returns—would be beneficial because fraudulent refund schemes generally involve the preparation of false W-2s and the fabrication of wage and withholding information. Currently, employer wage information other than that provided by taxpayers is not available to IRS until after it processes taxpayers' returns because of the time it takes to verify the information and correct any errors.

IRS' History in Delivering Compliance Initiatives

As shown in table III.1, staffing in three of IRS' major compliance programs (Examination, Collection, and Document Matching) has shown the same trend since 1986—peaking in 1988 and steadily declining thereafter—to the point that the proposed fiscal year 1995 staffing, without the proposed compliance initiatives, is below the 1986 level in two of those programs. Table III.2 shows staffing trends for three important enforcement positions—revenue agent, tax auditor, and revenue officer. The reduction in enforcement staffing has occurred despite several compliance initiatives in past IRS appropriations that were intended to increase IRS' enforcement presence.

Table III.1: Staffing in Three IRS Enforcement Programs Since Fiscal Year 1986

	FTEs			
Fiscal year	**Examination**	**Collection**	**Document matching**	**Total**
1986	26,120	15,571	4,844	**46,535**
1987	29,243	16,265	5,259	**50,767**
1988	31,895	18,546	7,029	**57,470**
1989	31,315	18,470	5,691	**55,476**
1990	28,788	18,034	5,683	**52,505**
1991	28,592	18,605	5,609	**52,806**
1992	28,393	18,518	4,394	**51,305**
1993	27,490	18,214	4,165	**49,869**
1994[a]	27,037	17,463	3,674	**48,174**
1995[a] without compliance initiatives	26,044	17,125	3,469	**46,638**
1995 with compliance initiatives[b]	28,296	18,241	3,700	**50,237**

[a]To approximate the FTEs that will be applied to the specific programs in fiscal years 1994 and 1995, we used budget estimates and supporting IRS data.

[b]Fiscal year 1995 budget estimates increased using IRS data relating to the proposed compliance initiatives.

Source: Data for 1986 through 1991 came from Tax Administration: Trends for Certain IRS Programs (GAO/GGD-93-102FS, May 26, 1993). Data for 1992 through 1995 came from IRS annual reports, IRS budget requests, and IRS data relating to the proposed compliance initiatives for fiscal year 1995.

Table III.2: Staffing for Specific IRS Enforcement Positions Since Fiscal Year 1986

	FTEs		
Fiscal year	Revenue agent	Tax auditor	Revenue officer
1986	13,619	3,292	7,247
1987	14,944	3,105	7,229
1988	16,559	3,242	8,238
1989	16,486	3,327	8,105
1990	15,526	3,003	7,601
1991	15,738	2,842	7,929
1992	15,947	2,704	8,054
1993	15,541	2,556	7,666
1994[a]	15,304	2,505	7,471
1995[b] without compliance initiatives	14,644	2,435	7,317
1995[c] with compliance initiatives	15,730	2,782	8,336

[a]Authorized levels.

[b]Budget estimates.

[c]Budget estimates increased using IRS data relating to the proposed compliance initiatives.

Source: Data for 1986 through 1993 came from IRS annual reports. Data for 1994 and 1995 came from IRS budgets and IRS data relating to the proposed compliance initiatives for fiscal year 1995.

IRS' inability to deliver past compliance initiatives and the staffing reductions reflected in tables III.1 and III.2 resulted, in large part, from shortfalls (i.e., unfunded costs) that caused IRS to reprogram funds appropriated for the compliance initiatives. IRS had shortfalls of $360 million in fiscal year 1989 and $465 million in fiscal year 1990. Shortfalls have continued throughout the 1990s, amounting to at least $80 million each year. In 1993, for example, the shortfall was over $200 million.

Some of the shortfalls were because of circumstances, such as unfunded pay raises, that were beyond IRS' control, while others were because of IRS' problems in accurately estimating labor costs. To deal with the shortfalls, IRS froze most hiring, curtailed programmatic activities, and cut expenditures in such areas as supplemental training.

Enforcement staffing and initiatives to increase enforcement staffing have not fared well in the face of persistent budgetary shortfalls. In the past decade, enforcement staffing peaked in 1988 after partial implementation of a 1987 staffing initiative. But those gains were eroded by a hiring freeze in 1989 and 1990. In 1990, IRS received funding for nine compliance initiatives but implemented only two. In 1991, Congress appropriated $191 million for initiatives, and IRS used $134 million for that purpose. Even after partial implementation of the 1991 initiatives, staffing in the three major enforcement programs remained 4,664 FTEs less than in fiscal year 1988 and showed a modest increase of 301 FTEs over fiscal year 1990.

Since 1991, enforcement staffing has continued to decrease. No compliance initiatives were authorized in 1992, and shortfalls in the fiscal year 1992 budget were partially addressed by a significant cut to the Document Matching program. As can be seen in table III.1, this program lost 1,215 FTEs (a 22 percent reduction) in 1992.

In 1993 and 1994, Congress authorized initiatives of $43 million and $115 million, respectively. IRS was unable to fully implement the initiatives in either year because of unbudgeted labor costs. As noted in appendix I, IRS now plans to spend only about $17 million on the fiscal year 1994 initiatives.

IRS Enforcement Indicators Show Effect of Reduced Staffing

As can be seen in tables III.3 through III.9, several IRS enforcement indicators show the effect of IRS' inability to deliver the staffing increases authorized by Congress in past initiatives.

Table III.3: Number of Audits Completed by IRS

Fiscal year	Number
1986	1,310,000
1987	1,296,000
1988	1,198,000
1989	1,144,000
1990	1,085,000
1991[a]	1,322,000
1992	1,284,000
1993	1,300,000

[a]The 1991 figure has not been changed to reflect IRS' reported error in including data from another enforcement program.

Source: IRS budgets.

Table III.4: Audit Coverage of Individual and Corporate Returns

Fiscal year	Individual returns	Corporate returns
1986	1.12%	2.25%
1987	1.09	1.58
1988	1.03	1.32
1989	0.92	2.02
1990	0.80	2.59
1991	1.00[a]	2.36
1992	0.91	2.99
1993	0.92	3.05

Note: Audit coverage is the number of returns examined divided by the number of returns filed in the previous calendar year.

[a]The 1991 figure for individual returns has not been changed to reflect IRS' reported error in including data from another enforcement program.

Source: IRS annual reports.

Table III.5: Recommended Additional Tax and Penalties From IRS Examinations

Dollars in billions

Fiscal year	Dollar amount
1986	$23.3
1987	23.6
1988	22.5
1989	22.1
1990	23.0
1991[a]	31.2
1992	26.7
1993	23.1

Note: Because of changes made upon taxpayer appeal or factors, such as taxpayer hardship, that affect collectibility, recommended taxes and penalties are not always collected.

[a]The 1991 figure has not been changed to reflect IRS' reported error in including data from another enforcement program.

Source: Data for 1986 through 1991 came from Tax Administration: Trends for Certain IRS Programs (GAO/GGD-93-102FS, May 26, 1993). Data for 1992 and 1993 came from IRS budgets.

Table III.6: Delinquent Tax Collections by IRS

Dollars in billions

Fiscal year	Current dollars	1993 dollars
1986	$19.6	$25.1
1987	22.9	28.4
1988	23.3	27.8
1989	23.5	26.9
1990	25.5	27.9
1991	24.3	28.6
1992	24.2	24.8
1993	22.8	22.8

Source: Current dollars for 1986 through 1991 came from Tax Administration: Trends for Certain IRS Programs (GAO/GGD-93-102FS, May 26, 1993). Current dollars for 1992 and 1993 came from IRS' Delinquent Accounts Receivable Yield reports. The 1993 dollars are GAO computations using data from IRS' yield reports and gross domestic product indexes.

Table III.7: Number of Accounts in IRS' Gross Accounts Receivable Inventory

In millions

Fiscal year	Number of accounts
1988	13.6
1989	15.1
1990	15.5
1991	17.4
1992	19.1
1993	22.0

Source: Data for 1988 through 1991 came from Tax Administration: Trends for Certain IRS Programs (GAO/GGD-93-102FS, May 26, 1993). Data for 1992 and 1993 came from IRS' Accounts Receivable Management Information System Report.

Table III.8: Underreporter Assessments

Dollars in millions

Fiscal year	Dollar amount
1986	$1,808
1987	1,201
1988	1,944
1989	2,075
1990	1,520
1991	1,860
1992	1,799
1993	1,527

Source: Data for 1986 through 1991 came from Tax Administration: Trends for Certain IRS Programs (GAO/GGD-93-102FS, May 26, 1993). Data for 1992 and 1993 came from IRS reports.

Table III.9: Delinquent Returns Secured

Fiscal year	Number of returns
1987	4,154,430
1988	3,824,951
1989	4,535,996
1990	3,877,624
1991	3,720,963
1992	4,607,482
1993	4,048,767

Source: Data for 1987 through 1991 came from Tax Administration: Trends for Certain IRS Programs (GAO/GGD-93-102FS, May 26, 1993). Data for 1992 and 1993 came from IRS' Delinquent Return Activity Report.

Proposed User Fees

The administration's fiscal year 1995 budget request for IRS includes offsets related to three user fees. One of those user fees involves an increase in the fee IRS now charges for providing taxpayers photocopies of returns from prior years. The other two user fees—charging taxpayers for installment agreements and charging electronic return transmitters for direct deposit indicators on tax refunds—are new. Our comments on those two fees follow.

Installment Agreements

The administration is proposing that a fee be charged for installment agreements. The fee would be $18 if an agreement is entered into when the return is filed and $20 if it is entered into after the return is filed.

The first policy question is whether to impose such a fee. Precedents for a fee exist in the private sector (e.g., loan fees charged by financial institutions) and in IRS (e.g., fees charged for the cost of lien filings). IRS does incur additional costs in establishing, monitoring, and managing installment agreements; but we do not know if the proposed fees fairly reflect those costs. And it is impossible to predict how taxpayers will react to this fee. Taxpayers already pay interest and a failure-to-pay penalty that cumulate to about a 13 percent annual interest rate. Adding a fee to that cost may discourage some taxpayers from seeking installment agreements at a time when IRS is encouraging the use of these agreements and could ultimately affect the collectibility of some delinquent accounts. On the other hand, the fee may encourage some taxpayers to pay their liabilities in full rather than incur the additional cost.

If such a fee is imposed, the second question would relate to its structure and size. A flat fee, as proposed by the administration, might be construed as inequitable because it would fall heaviest on taxpayers with smaller balances or those who pay their agreements off quickly. Also, because IRS has to obtain more financial information for taxpayers requesting agreements of more than $10,000, it could be argued that IRS' costs for establishing such agreements are higher and that those taxpayers should pay a larger fee. A flat fee also does not recognize that IRS' costs increase each time IRS sends out monthly billing notices and when it renegotiates an existing agreement or reinstates a defaulted agreement.

Following are two possible alternatives to the administration's flat fee. The first alternative would place an interest surcharge based on the unpaid balance of the agreement. Based on IRS-reported installment agreement collections of about $3 billion in fiscal year 1993, a 1.8 percent surcharge would have raised $54 million (the revenue IRS has estimated will derive from the $18 and $20 fees). Calculated another way, a taxpayer with an installment agreement for $1,065 (the average amount of agreements paid off in fiscal year 1993) would pay about $10.80 more over a 12-month payoff period with a 1.8 percent surcharge.

This alternative should cause taxpayers with longer payoff periods and larger balances to pay more and thus would seem more equitable than a flat fee. On the other hand, the amount being charged would be based, in part, on the dollar amount of the agreement and thus would not be totally related to IRS' costs. According to IRS budget officials, this alternative may be unacceptable because, under the budget scoring rules, an interest surcharge is treated like a tax and thus would increase receipts. The administration's objective was to construct the proposed user fees in a manner that could be used to offset expenditures.

A second alternative that seems more compatible with the administration's objective would be to retain an initial flat fee but add recurring annual fees and a fee for reinstating or renegotiating agreements. The initial fee would be based on IRS' "set up" costs plus first year maintenance costs. The annual fee would be based on subsequent maintenance costs. This alternative also seems more equitable than the administration's proposal because taxpayers with longer payoff periods would pay more. The annual fee would be analogous to annual fees charged by credit card issuers, and the renegotiation and reinstatement fees would target taxpayers who cause IRS additional costs. On the negative side, such a fee structure would be more difficult to administer than a flat fee and would not reflect the additional costs of setting up agreements larger than $10,000.

Direct Deposit Indicator

Many banks make refund anticipation loans (RAL) to taxpayers who file their returns electronically. RALs enable electronic filers, for a fee, to get money in 2 to 3 days instead of waiting 2 to 3 weeks to get their refund from IRS. Over 90 percent of the electronic filers in 1993 applied for RALs.

To be eligible for RALs, taxpayers have to arrange for IRS to deposit their refunds directly in the bank, thereby pledging the refunds as collateral for the RALs. This process begins when the tax return preparer electronically transmits the return to IRS along with a request that the refund be directly deposited in the taxpayer's bank account. IRS then informs the preparer, through what is known as a "direct deposit indicator," whether it will honor the request. IRS will not honor a direct deposit request if the taxpayer has a federal debt, such as unpaid child support or unpaid federal taxes, that will be offset against the taxpayer's refund. Financial institutions rely on the direct deposit indicator in deciding whether to make RALS.

The administration is proposing that a fee of $8 be charged for each direct deposit indictor provided. We have two observations on this proposal.

First, we believe that RALS, by shortening the time between the filing of a fraudulent electronic return and the receipt of the financial payoff from that act, foster an environment conducive to fraud. Information provided by IRS showing how the $8 fee was computed seems to acknowledge the relationship between RALS and fraud. The information shows that almost $2 of the proposed fee is to cover costs incurred by IRS' Criminal Investigation Division to address electronic filing fraud.

In late 1992, in an effort to disassociate itself from RALS, IRS announced plans to discontinue issuing the direct deposit indicator. IRS' hope was that financial institutions would be more careful in approving RALS and thus make it more difficult for persons to reap financial gains from fraudulent electronic filings. Tax return preparers and the financial community lobbied to keep the indicator and warned that a reduction in the availability of RALS, which was sure to result if IRS implemented its decision, could have a negative effect on public acceptance of electronic filing. IRS subsequently reversed its decision.

While it is true that taxpayer interest in electronic filing may wane if RALS become less available, we are more concerned about the significant growth in electronic filing fraud and the role of RALS in fostering that growth. We have expressed our concern with fraud in several recent products on electronic filing.[5] Considering the fraud problem, it might be more appropriate for IRS to disassociate itself from RALS by doing away with the direct deposit indicator as originally planned rather than charging a fee for providing it.

Second, if the fee is enacted, it is possible that at least a portion of it will be passed on to the taxpayer through an increase in the cost of obtaining RALS. RALS are already very costly. In 1991, according to our survey of

[5]Tax Administration: IRS Can Improve Controls Over Electronic Filing Fraud (GAO/GGD-93-27, Dec. 30, 1992); Tax Administration: Opportunities to Increase the Use of Electronic Filing (GAO/GGD-93-40, Jan. 22, 1993); Tax Administration: Increased Fraud and Poor Taxpayer Access to IRS Cloud 1993 Filing Season (GAO/GGD-94-65, Dec. 22, 1993); and Tax Administration: Electronic Filing Fraud (GAO/T-GGD-94-89, Feb. 10, 1994).

electronic filing preparers and transmitters, the median loan fee was between $29 and $35 depending on the type of tax return being filed. Such a fee, when considering the loan's short term, represents a high interest rate. Adding all or part of the $8 user fee to that cost will make the interest rate even higher.

Appendix V

The Tax Systems Modernization Budget

Modernization of IRS' information systems is critical if IRS is to effectively process tax returns, administer the tax laws, and assist taxpayers. Therefore, we believe that Tax Systems Modernization (TSM) is generally a good investment. According to IRS, fiscal year 1995 will be the year that the agency moves beyond planning and organizational decisions to the implementation of TSM systems. In its fiscal year 1995 budget, IRS is requesting $1.76 billion for information systems, about 23 percent of its total 1995 request. Of this amount, $989 million, or 56 percent, is for TSM. This amount brings the total expended or requested for TSM in fiscal years 1990 through 1995 to $2.9 billion, or about one-third of the total estimated investment to develop TSM systems.[6] TSM accounts for almost all of the $311 million requested increase in the information systems budget compared to fiscal year 1994.

IRS' budget documents and plans justify each of the TSM projects in terms of their goals and objectives. However, IRS' request for 1995 project funds cannot be properly evaluated without considering how the projects support TSM requirements, how they fit into the overall master plan for TSM, and whether the available technical standards and guidelines are adequate to support each of them.

We have said that IRS is not yet positioned to successfully build TSM systems because it has not completed key TSM guidance.[7] Critical gaps include the following:

- Business requirements to define TSM's operational capability. IRS plans to have approved business requirements by fiscal year 1995, but they may require further refinement before specific projects can use them.
- A business master plan, management approach, and management procedures to guide, monitor, and control the overall implementation of TSM. IRS plans to complete these efforts in May 1994.
- Data, security, and telecommunications standards and guidelines for the design and construction of TSM systems. Although work on these guidelines is in progress, IRS had not, as of February 1994, established specific schedules for completing these efforts.

[6]According to IRS, the $2.9 billion includes some funds for operations and maintenance of systems during the prototype and pilot stages that were not included in IRS' estimate of TSM development costs. In its economic analysis of TSM as of October 1992, IRS estimated operation and maintenance costs of $675 million through fiscal year 1995.

[7]Tax Systems Modernization: Status of Planning and Technical Foundation (GAO/T-AIMD-GGD-94-104, Mar. 2, 1994); Tax Administration: Achieving Business and Technical Goals in Tax Systems Modernization (GAO/T-GGD-93-24, Apr. 27, 1993); Tax Administration: Status of Tax Systems Modernization, Tax Delinquencies, and the Tax Gap (GAO/T-GGD-93-04, Feb. 3, 1993).

IRS incurs added risk of cost overruns and schedule delay when it acquires a system before the business requirements for that system have been defined or builds a system before the technical standards and guidelines are available in critical areas, such as security, data, and telecommunications. We have suggested that IRS set specific and aggressive schedules for completing and disseminating this guidance. We also suggested that IRS defer any hardware acquisitions or software development that might be affected substantially by the unfinished business requirements and technical standards and guidelines.

Only IRS has the detailed information needed to assess whether the proposed fiscal year 1995 projects are subject to additional risks because of unfinished guidance. It would be helpful for the Subcommittee, in reviewing IRS' budget, if IRS would provide a written evaluation that explains the extent to which the risks for each project increase due to incomplete business requirements and technical standards and guidelines. Such an evaluation should: (1) describe the relationship between each project and the business master plan; (2) identify specific activities of each project such as software design, coding, or equipment purchase; and (3) determine how the project activity fits with the business master plan and whether critical business requirements and technical standards and guidelines will be available.

Interim Results of the 1994 Filing Season May Have Budgetary Implications

Interim results of the 1994 filing season indicate that two negative trends discussed in our report on the 1993 filing season are continuing:[8] (1) the number of individual income tax returns filed as of April 8, 1994, was less than at the same time last year and (2) the accessibility of IRS' toll-free telephone assistance continues to worsen. Both of these trends are important in assessing the appropriateness of IRS' budget request for fiscal year 1995. A third continuing negative trend, refund fraud, was discussed in appendix II as it relates to the administration's proposed compliance initiatives for fiscal year 1995.

At the Subcommittee's request, we are also including information in this appendix on (1) the results of our limited tests of the level of service IRS provides taxpayers who want copies of tax forms and publications and (2) the performance of IRS' computer systems during the filing season.

Returns Filed Continue to Decrease

IRS' budget request for fiscal year 1995 includes an increase of 322 FTEs and about $11.6 million to cover the estimated increase in service center workload resulting from an expected growth in the number of tax returns filed. However, recent trends in the filing of individual income tax returns, which have accounted for more than half of all returns filed in past years, raise some doubts about the reliability of IRS' workload estimate and the need for the requested increase in staff and dollars.

The first year in the past decade in which the number of individual income tax returns decreased from the number filed the previous year was 1993. As shown in table VI.1, that downward trend appears to be continuing in 1994.

[8] Tax Administration: Increased Fraud and Poor Taxpayer Access to IRS Cloud 1993 Filing Season (GAO/GGD-94-65, Dec. 22, 1993).

Table VI.1: Number of Individual Income Tax Returns Filed by Early April 1992, 1993, and 1994

Type of individual income tax return	Received by IRS as of April 10, 1992	Received by IRS as of April 9, 1993	Received by IRS as of April 8, 1994	Percentage increase (decrease) from 1993 to 1994	Percentage increase expected by IRS for 1994
Paper	64,488,000	58,282,000	54,969,000	(5.7)	0.6
Electronic	10,380,000	11,683,000	12,683,000	8.6	14.4
TeleFile[a]	121,000	141,000	490,000	247.5[b]	271.0
Total	**74,989,000**	**70,106,000**	**68,142,000**	**(2.8)**	**2.5**

[a]TeleFile is an alternative filing method being tested by IRS. With TeleFile, certain taxpayers are able to file simple tax returns using touch-tone telephones and a toll-free number.

[b]This increase results from the expansion of TeleFile from one state (Ohio) in 1992 and 1993 to seven states (Florida, Indiana, Kentucky, Michigan, Ohio, South Carolina, and West Virginia) in 1994.

Source: Receipts came from IRS' Management Information System for Top Level Executives. Expected increases came from data provided by the office of IRS' Chief for Taxpayer Services.

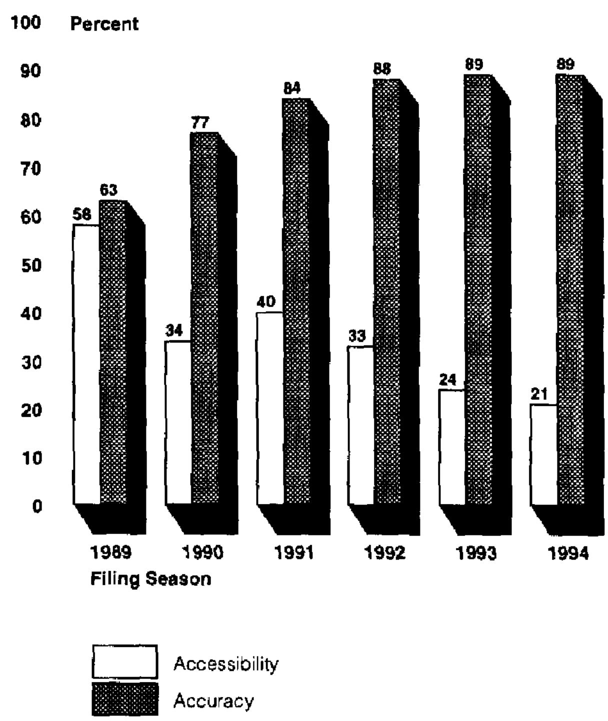
Before the 1994 filing season began, IRS projected that it would receive 117.5 million individual income tax returns in 1994—about 2.8 million (or 2.5 percent) more than it did in 1993. Unless filings increase significantly during the rest of the year, IRS will again fall far short of its estimate. That possibility raises questions as to the need for the 322 additional FTEs and $11.6 million requested by IRS.

Toll-Free Accessibility Continues to Decline

The administration's budget request includes 8,057 FTEs and about $421.1 million for taxpayer services—a decrease of 249 FTEs and $7.8 million from the amounts authorized for fiscal year 1994. It is our understanding that about 40 of the 249 FTEs would affect staffing at the toll-free call sites. That decrease comes at a time of continuing decline in the accessibility of IRS' toll-free telephone assistance. Since 1989, as shown in figure VI.1, the quality of IRS' answers to tax law questions has steadily risen while accessibility—the ability of taxpayers to get through to IRS to ask their questions—has dropped significantly.[9] Accessibility decreased primarily because of an increase in the number of calls received, while the number of calls answered remained fairly constant.

[9]We computed accessibility using information on calls from IRS' Telephone Data Report. We divided the total number of calls answered by the total number of calls received, which we defined as the sum of (1) calls answered, (2) busy signals, and (3) calls abandoned by the caller before an assistor got on the line.

Figure VI.1: Comparison of Toll-Free Telephone Accessibility and Accuracy During the 1989 Through 1994 Filing Seasons



Note: The data for 1994 are as of March 19.

Source: Data for 1989 through 1993 came from Tax Administration: Increased Fraud and Poor Taxpayer Access to IRS Cloud 1993 Filing Season (GAO/GGD-94-65, Dec. 22, 1993). Data for 1994 came from IRS' Management Information System for Top Level Executives and IRS Telephone Data Reports.

It is unclear whether and to what extent improved accessibility requires additional resources as opposed to a better use of existing resources, such as changing the hours and days of telephone site operations to better match customer demand. Despite that uncertainty, we question the plan to reduce staffing and funding for taxpayer services when IRS' capacity to answer telephone calls falls so far below the demand.

As we discuss in the next section, our tests of IRS' system for distributing forms and publications also disclosed some telephone accessibility problems, but not of the same magnitude as those of toll-free telephone assistance.

Our Tests of IRS' System for Distributing Forms and Publications Also Disclosed Telephone Accessibility Problems

In 1994, we conducted two limited tests of the level of service IRS provides to taxpayers seeking copies of tax forms and publications. The test results reflect conditions during selected periods in March 1994 and cannot be projected.

In one test, we placed calls to each of IRS' three area distribution centers that warehouse tax materials and fill taxpayers' telephone and mail orders.[10] These were toll-free telephone calls but the toll-free telephone number for ordering forms is different from the toll-free number taxpayers call when they have a tax law question. Each day, except Sunday, during a 2-week period in March, we placed calls to the distribution centers from Washington, D.C., Mission, Kansas, and San Francisco. We did not order any materials; our only intent was to test the accessibility of the telephone order system. If we received a busy signal when making a call, we waited 1 minute after hanging up and then redialed. If after nine redials we had not gotten through, we considered the attempt unsuccessful.

Of 100 attempts to contact a distribution center, 75 were successful on the first try; 9 were successful after one redial; 11 were successful after 2 or more redials; 3 were aborted after 9 unsuccessful redials; and 2 (both placed from Washington, D.C., on a Saturday) were aborted after we let the telephone ring for 2 minutes without receiving either a busy signal or an answer. Our 100 attempts to contact a distribution center required a total of 175 telephone calls. Of those 175 calls, we succeeded in getting through to an IRS representative 95 times—a 54 percent accessibility rate.

In the second test, we visited 10 IRS walk-in sites in 6 states and Washington, D.C., during the week of March 21, 1994, to see whether they had the 101 tax forms, instructions, and publications that all walk-in sites were required to stock for the 1994 filing season. Of the 10 sites, 5 had all of the required items; 4 were missing 1 item each; and 1 was missing 4 items. We made follow-up visits the next week to the five sites that were missing items and found that the site missing four items and three of the sites missing one item had received a new stock of those items. The other site missing one item was still missing that item. These results were better than the results from our last test of walk-in sites in February 1992. At that time, we visited 10 different sites and found that no site had all required items; 4 sites were missing 1 item; and 6 sites were missing between 2 and 5 items.

[10]The three area distribution centers are in Richmond, Virginia; Bloomington, Illinois; and Sacramento, California.

Few Systems Problems Identified

IRS' computer systems have generally performed well during the 1994 filing season. However, some systems problems occurred that had operational impacts such as delayed refunds and downtime for IRS employees.

Various IRS indicators show that as of March 21, 1994, IRS' computer systems for processing tax returns and adjusting taxpayers' accounts were performing as expected. Two performance indicators that IRS considers important are account updates and availability of the Integrated Data Retrieval System, which is used by IRS employees to access and adjust taxpayer accounts.

IRS data as of March 21, 1994, showed that three service centers had missed one weekend update target time. The three instances of missed targets had no adverse effect on service center operations. Likewise, service centers had met their daily update targets with only 14 exceptions. According to IRS, the missed targets had only a minor effect on system availability. In addition, the Integrated Data Retrieval System had been available 98 percent of the time.

IRS experienced some systems problems that affected taxpayers. For example, because of a communications problem, tax returns that were electronically filed at the Memphis Service Center on February 1, 1994, were not processed on time. IRS estimated that the problem caused about a 1-week delay in refunds. In another instance, taxpayers who filed electronically at the Memphis Service Center during the first week in February did not receive timely acknowledgment that their returns were filed because of a software problem in the electronic filing system.

Systems problems also caused computer systems at various locations to be unavailable to IRS personnel for short periods of time. According to IRS problem assessments, limited downtime usually has a minimal impact on IRS' overall operations. However, in one instance, a problem with the Automated Underreporter System at the service center in Brookhaven, New York, caused IRS to lay off 270 temporary employees for about a week.

All computer systems are susceptible to problems and downtime. Therefore, it is important to be able to adequately monitor and fix the problems in a timely manner. In response to serious computer problems in 1985, IRS established the National Office Command Center (NOCC) in 1986 to coordinate and monitor the resolution of hardware and software problems. NOCC ensures that problems are addressed in a timely manner and helps identify problems involving multiple locations. NOCC officials believe that the NOCC's involvement has minimized the operational impact of systems problems experienced during the 1994 filing season.

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