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TAX ADMINISTRATION

IRS' Fiscal Year 1996 and 1997 Budget Issues and the 1996 Filing Season

Lynda D. Willis
Director, Tax Policy and Administration Issues
General Government Division

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Tax Administration: IRS' Fiscal Year 1996 and 1997 Budget Issues and the 1996 Filing Season

IRS' fiscal year 1996 appropriation was $7.3 billion—$860 million less than what the President had requested and $160 million less than IRS' fiscal year 1995 appropriation. To cover the labor cost shortfall that resulted, IRS officials said that they took a number of actions. These included reducing (1) travel and overtime costs, (2) cash awards, (3) hours for seasonal staff, and (4) the number of nonpermanent staff. In making these reductions, IRS said that it wanted to ensure that it had sufficient staff to do what it saw as its most critical function—processing returns and issuing refunds. As a result, most of the cuts were absorbed by certain compliance programs.

The 1996 filing season seems to be going more smoothly than last year's in some key respects. Most importantly, IRS is delaying fewer refunds this year while it validates Social Security Numbers and Earned Income Credit claims. IRS revised its procedures this year to better target its validation efforts. Also, taxpayers appear to be having an easier time reaching IRS by telephone this year and more taxpayers are using alternative return filing methods. Despite the improvements, there are still several concerns. For example, the percent of calls IRS answers compared to the number it receives is still low. Through March 9, 1996, the accessibility rate was 20 percent compared with 11 percent for the comparable time period last year. Also, IRS closed many walk-in sites this year that had provided assistance to taxpayers in the past.

IRS is requesting almost $8 billion for fiscal year 1997, an increase of $647 million from fiscal year 1996. The largest increases are (1) $359 million for certain compliance initiatives and (2) $155 million for Tax Systems Modernization (TSM). Both of these areas have been problematic for IRS in the past. Although IRS has taken steps to address some of GAO's concerns with past compliance initiatives, there are still some questions that remain appropriate in discussing the current request.

For example, does IRS have reliable data on the revenue generated by its enforcement activities? Regarding TSM, GAO identified managerial and technical weaknesses in July 1995 that IRS has not yet corrected. As a result, GAO does not believe that IRS can make effective use of TSM systems development funds at this time.

Tax Administration: IRS' Fiscal Year 1996 and 1997 Budget Issues and the 1996 Filing Season

Madam Chairman and Members of the Subcommittee:

We are pleased to be here today to participate in the Subcommittee's inquiry into the Internal Revenue Service's (IRS) financial condition for 1996, the status of the 1996 filing season, and the administration's fiscal year 1997 budget request for IRS.

Our statement is based on work we have been doing for the Subcommittee and our past reviews of filing season activities, Tax Systems Modernization (TSM), and compliance initiatives.

In our statement, we address the following four issues:

- According to IRS officials, IRS' actions to reduce staffing through a hiring freeze and an early-out program were not sufficient to cover the labor-cost shortfall that resulted from an approximately $860-million reduction in IRS' budget request for fiscal year 1996. To further cover the shortfall, IRS reduced support costs, cut the number of hours for seasonal employees, and reduced the number of nonpermanent staff. In making these reductions, IRS wanted to ensure that it had enough staff to process tax returns and issue refunds in a timely manner. As a result, programs directed at identifying noncompliance and, to a lesser extent, assisting taxpayers, absorbed most of the cuts.
- Notwithstanding the budget cuts that affected some of IRS' taxpayer assistance programs, this year's filing season seems to be progressing more smoothly than did last year's in some key respects. Most importantly, IRS is delaying fewer refunds this year while it validates Social Security Numbers (SSN) and Earned Income Credit claims. IRS revised its procedures for 1996 in an attempt to better target its efforts and impose less of a burden on honest taxpayers. Also, telephone accessibility has improved, and more taxpayers are using alternative return-filing methods. Although this filing season appears to be going more smoothly in these respects, there are still several concerns. For example, (1) although telephone accessibility has improved, it is still very low; (2) IRS closed many walk-in sites this year that had provided assistance to taxpayers in the past; and (3) the document imaging system being used to process some individual income tax forms is still not meeting its original expectations.
- The administration is requesting almost $8 billion for IRS for fiscal year 1997, an increase of $647 million from fiscal year 1996. Of that request, $850 million is for TSM, $155 million more than in 1996. TSM is plagued by numerous managerial and technical weaknesses that we identified in a

July 1995 report.[1] Although IRS has initiated actions in response to these weaknesses, those efforts provide little assurance that the weaknesses will be corrected in the near term. As a result, we believe that additional investments in TSM are at risk.

- The largest program increase in IRS' fiscal year 1997 budget request is $359 million for certain compliance programs. Our past work on compliance initiatives identified several problem areas, including (1) IRS' inability to fully implement past initiatives, (2) the inaccuracy of IRS' tracking of the revenue from such initiatives, and (3) the focus of past collection initiatives on hiring revenue officers instead of more productive collection staff. Although IRS has taken some actions to address our concerns, some issues remain, particularly in terms of the reliability of IRS' data.

Overview of IRS' Financial Condition in Fiscal Year 1996

IRS' fiscal year 1996 appropriation was $7.3 billion. That amount was about $860 million less than the President requested for fiscal year 1996 and about $160 million less than IRS' fiscal year 1995 appropriation.

In June 1995, anticipating possible reductions from the amount the President had requested for fiscal year 1996, IRS began taking steps to reduce its staffing levels. On June 30, 1995, IRS announced a hiring freeze. Earlier in 1995, IRS had announced an early-out program without incentives for employees affected by its district office and regional office consolidations. After enactment of its final appropriation, IRS reopened the early-out program through February 3, 1996, and made it available to all employees. About 1,690 staff retired as a result of this program.

To further cut costs, IRS officials said that IRS (1) reduced employee cash awards by 20 percent, for a savings of $11 million;[2] (2) reduced travel and overtime costs by $49 million; (3) reduced the workhours of seasonal employees[3] by as much as 40 percent; and (4) cut back on the use of nonpermanent staff, such as term employees.[4] IRS officials also said that the above actions enabled them to avert a reduction-in-force (RIF). According to IRS officials, by the time IRS would have been able to

[1] Tax Systems Modernization: Management and Technical Weaknesses Must Be Corrected If Modernization Is To Succeed (GAO/AIMD-95-156, July 26, 1995).

[2] According to IRS officials, IRS considered eliminating all cash awards but decided against that option.

[3] Although IRS' seasonal staff work less than a traditional 40-hour week, 52-week schedule, they are permanent employees.

[4] Term employees are hired for a finite period of time. During that time, they have employment rights similar to those of permanent employees. However, they can be released once their term expires.

implement a RIF for fiscal year 1996, the cost would have exceed the savings.

As of March 1, 1996, according to IRS officials, IRS had about $140 million in unfunded mandatory nonlabor costs for fiscal year 1996. Some of those unfunded costs were for telecommunications, postage, and rent. IRS officials said that they are hoping to resolve these unfunded costs without having to resort to furloughs.

Part of the $140 million shortfall stems from lower user-fee receipts than expected. IRS' fiscal year 1996 appropriation assumed a receipt of $119 million from user fees. IRS now expects to receive from $60 to $70 million in such fees for fiscal year 1996.

Staffing Cuts in the Document Matching Program and at Automated Collection System Call Sites

As noted earlier, IRS' actions to reduce labor costs involved steps directed at seasonal and nonpermanent staff. Most of IRS' seasonal and non-permanent staff (1) help process tax returns during the filing season, (2) assist taxpayers either at walk-in offices or over the telephone, and (3) work in compliance programs that do not require face-to-face interaction with taxpayers. IRS officials told us that in deciding which areas to cut, IRS wanted to ensure that it could process tax returns and issue refunds in a timely manner. As a result, most of IRS' staffing cuts affected its compliance programs, with some cuts in the taxpayer service area.

According to IRS officials, the two compliance programs that employ the largest number of seasonal and term staff are (1) the Document Matching program, through which IRS identifies taxpayers that either underreport their income or do not file required tax returns, and (2) the Automated Collection System (ACS), through which IRS staff try to contact delinquent taxpayers or nonfilers by telephone and resolve the delinquency. Because IRS' cost-cutting measures for fiscal year 1996 focused on seasonal and nonpermanent staff, these two programs were significantly affected.

Document Matching

Through the Document Matching program, IRS matches income reported on tax returns with information provided by third parties, such as wage information from employers and interest and dividend information from financial institutions. Those matches are to identify taxpayers that underreported their income (underreporters) and those that did not file required tax returns (nonfilers).

According to IRS, it spent about 1,950 staff years on underreporter activities in fiscal year 1995 and closed 4.1 million cases with recommended tax assessments of $1.7 billion. Because of staff reductions, IRS estimates that it will spend about 1,300 staff years on underreporter activities in 1996—about a 33-percent reduction—and close about 1.5 million fewer cases. IRS estimates that its assessments from closed cases will be $1.4 billion, $300 million less than in 1995. IRS' matching program also identifies taxpayers who have not claimed refunds to which they are entitled. In fiscal year 1995, IRS issued $120 million in refunds through that program. IRS expects that amount to drop to $95 million in 1996 because of staff reductions.

Also under the Document Matching program, IRS creates returns for nonfilers using information documents provided by third parties. According to IRS, it spent about 600 staff years on that effort in fiscal year 1995, closed about 810,000 cases, and assessed $1.9 billion. Because of staff reductions, IRS estimates that it will spend about 370 staff years on this effort in fiscal year 1996—about a 38-percent reduction—and close about 180,000 fewer cases. IRS estimates that assessments from closed cases will be $1.3 billion, $650 million less than in 1995.

Automated Collection System

Once a tax delinquency or delinquent return is identified, IRS uses a three-stage process to collect the tax or secure the return. In the first stage, taxpayers are mailed a series of notices. If the case is not resolved at this point and meets certain criteria, it is transferred to ACS. At this stage, IRS staff in call sites contact the taxpayer or nonfiler by telephone. If the case remains unresolved at this point and meets certain criteria, it is transferred to a revenue officer, who is to visit the taxpayer or nonfiler or take other steps to secure the delinquent return and/or collect the delinquent tax.

Because of various factors discussed in the appendix, ACS had a significant number of seasonal, term, and other than full-time permanent staff at the end of fiscal year 1995—66 percent more than it had at the end of fiscal year 1994. As a result, ACS was targeted for a significant staff reduction when IRS decided to reduce the number of hours for seasonal staff and not extend appointments for term employees.

IRS officials subsequently decided that the budget impact on ACS was too severe. To mitigate the impact, IRS negotiated with the National Treasury Employees Union to allow the detail of about 300 revenue officers and other compliance staff to ACS. These details are to remain in effect for at least 1 year. IRS officials said that they plan to revisit this agreement with the union once IRS knows its budget situation for fiscal year 1997.

The 1996 Filing Season Seems to Be Going More Smoothly Than Last Year's in Certain Key Respects

On the basis of our past filing season reviews, we had several questions going into the 1996 filing season:

- How will IRS' staffing reductions for fiscal year 1996 affect its ability to process returns and assist taxpayers?
- Will last year's drop in the number of electronic filings be reversed?
- What can taxpayers expect in the way of refund delays in 1996?
- Will the steady decline in the accessibility of IRS' telephone assistance over the past several years continue?
- Has the performance of IRS' Service Center Recognition/Image Processing System (SCRIPS) improved?

As discussed below, preliminary information addressing these questions indicates that, in certain key respects, the 1996 filing season is progressing more smoothly than did the 1995 season. As also discussed below, however, there are still several concerns that we will be monitoring during our continuing assessment of filing season activities. Specifically, (1) although telephone accessibility is up, it is still very low; (2) IRS closed many walk-in sites this year that had provided assistance to taxpayers in the past; and (3) SCRIPS is still not meeting its original expectations.

Effect of Staffing Cuts on Filing Season

In deciding where to make the staffing cuts for fiscal year 1996, IRS wanted to make sure it had enough staff to do its most critical functions—process returns and issue refunds—in a timely manner. Available data indicate that IRS has been successful in that regard. As of March 15, 1996, IRS' 10 service centers had processed 71 percent of the paper individual income tax returns they had received (the same percent as last year), and the centers were processing that workload in about the same cycle time as last year (within an average of 8 to 13 days, depending on the type of individual income tax return filed).

IRS service center officials told us that refunds may be going out a couple of days slower than last year but still within the 40 days that IRS promises taxpayers in its customer service standards. Service center officials told us that IRS had decided to focus on meeting the 40-day standard in 1996 rather than incur the extra costs associated with trying to beat it. However, we were unable to verify whether the refund cycle time has changed because the data we use to track refund timeliness were not available at the time we prepared this statement.

Although IRS has apparently been able to process returns and issue refunds this year without any significant problems, staffing cuts in other areas could be affecting its ability to serve taxpayers and identify questionable refund claims.

Taxpayer Service

In the taxpayer service area, IRS closed 93 walk-in assistance sites, reduced the operating hours of some of the 442 sites that remained open, and eliminated free electronic filing at 195 of the sites. According to IRS, the closed sites were selected on the basis of their historical volume of work and their proximity to other walk-in sites. As an indication of the effect of these closures and cutbacks, IRS data show that walk-in sites served about 1.7 million taxpayers from January 1 through March 9, 1996—about 16 percent fewer taxpayers than were served at the same time last year.

Walk-in sites provide various free services, including copies of the more commonly used forms and publications, help in preparing returns, and answers to tax law questions. There are other ways taxpayers can obtain those services free, although maybe not as easily.

Taxpayers needing forms and publications, for example, might find them at their local library or can get them by calling IRS' toll-free forms-ordering number. Our reviews of past filing seasons showed that taxpayers were generally able to get through to IRS when they called the forms-ordering number, and the forms distribution centers did a good job accurately filling orders. However, according to IRS, it will generally take from 7 to 15 workdays to receive what you order, if it is in stock. Taxpayers with access to a computer can download forms from Internet or the FedWorld computer bulletin board. Forms are also available on CD-ROM and through IRS' "fax on demand" service.

Taxpayers who need help preparing their returns and do not want to pay for that help might be able to take advantage of the tax preparation services offered at sites around the country that are part of the Volunteer Income Tax Assistance and Tax Counseling for the Elderly programs.

Taxpayers who need answers to tax law questions could call IRS' toll-free tax assistance number (which we discuss later) or IRS' TeleTax system, which has prerecorded information on about 150 topics. As of March 16, 1996, the number of tax law calls to TeleTax had increased by about 10 percent over last year (4.5 million this year compared with 4.1 million last year).

Still another option for free assistance is IRS' World Wide Web site on the Internet. Among other things, IRS' site includes copies of forms, information similar to that on TeleTax, and some interactive scenarios that taxpayers can use to help them answer some commonly asked questions. IRS reported on March 18, 1996, that its World Wide Web site had been accessed more than 25 million times since January 8, 1996.

Questionable Refund Program

IRS' primary program for detecting questionable refund claims also absorbed staffing cuts in 1996. According to IRS data, the 10 service centers have been allocated a total of about 379 full-time equivalents for that program in fiscal year 1996 compared with 551 full-time equivalents in 1995—a decrease of 31 percent. IRS officials told us that, because of the staff reduction, program procedures were changed in an attempt to better target the staffs' efforts. We do not know the initial impact of these changes because we have not yet seen any statistics on the number of questionable refund claims detected in 1996. In an attempt to recoup most of those staff reductions, IRS' budget request for fiscal year 1997 includes $21 million and 230 full-time equivalent positions for the questionable refund detection program. That request is part of the revenue protection initiative discussed later.

Alternative Ways of Filing

As of March 15, 1996, the number of individual income tax returns filed in ways other than the traditional paper format has increased substantially compared to the same time last year. That is true even though the overall number of returns filed as of March 15 was down slightly from last year. As shown in table 1, most of the growth in alternative filings is due to 1040PC and TeleFile.[5]

[5]Under TeleFile, certain taxpayers who are eligible to file a Form 1040EZ are allowed to file using a toll-free number on touch-tone telephones. Under the 1040PC method, a taxpayer or tax return preparer uses computer software that produces tax returns in an answer-sheet format. The 1040PC shows the tax return line number and the data (dollar amount, name, etc.) on that line. Only lines on which the taxpayer or preparer has made an entry are included on the 1040PC. Under the third alternative filing method, electronic filing, returns are transmitted over communication lines to an IRS service center, where they are automatically edited and processed.

Table 1: Individual Income Tax Returns Received, 1994-1996

Type of filing	March 15, 1996	March 17, 1995	March 18, 1994
Traditional paper	36,258,000	40,787,000	38,333,000
Electronic	9,811,000	9,259,000	11,647,000
TeleFile	2,379,000	592,000	459,000
1040PC	2,767,000	673,000	1,723,000
Total	**51,215,000**	**51,311,000**	**52,162,000**

Source: IRS' Management Information System for Top Level Executives.

Growth in the use of 1040PC is due, in part, to the largest user rejoining the program after dropping out in 1995.[6] The growth in TeleFile is due primarily to its expanded availability. It is now available nationwide; it was only available to taxpayers in 10 states in 1995. IRS' budget request for fiscal year 1997 includes $7 million to allow expansion of TeleFile to other forms and taxpayers. Although IRS has made substantial progress in expanding the use of TeleFile and further expansion seems logical, it is important to note that only about 12 percent of the more than 20 million 1040EZ taxpayers who IRS estimated would be eligible to use the system in 1996 had actually used it as of March 15. In past reports, we have discussed the benefits of TeleFile to taxpayers (e.g., reduced filing time, fewer errors, and quicker refunds) and the presumed benefit to IRS in reduced processing costs. In addition to expanding TeleFile, it seems that IRS could increase participation in the program by (1) determining why many currently eligible users are not participating and (2) taking steps to address any identified barriers to their fuller participation.

Last year was the first year since electronic filing started in 1986 that the number of returns received electronically decreased from the number received the prior year. Although the number of electronic returns is on the rise this year compared with last, the number filed as of March 15 was still about 16 percent fewer than the number filed at the same time 2 years ago. As we recommended in October 1995, if IRS is to reach its goal of 80 million electronic returns in 2001, it needs to (1) identify those groups of taxpayers who offer the greatest opportunity to reduce IRS' paper processing workload and operating costs if they were to file electronically and (2) develop strategies that focus resources on eliminating or

[6]For the 1995 filing season, IRS required that preparers provide taxpayers with some type of descriptive printout or legend that explained each line on the taxpayer's 1040PC return. According to an official of a private tax preparation firm that had been the largest user of 1040PCs, the firm chose to stop participating in 1995 rather than incur the extra cost associated with providing the legend.

alleviating impediments, such as the program's cost, that inhibit those groups from participating.[7]

Refund Delays

Last year, IRS took several steps in an attempt to better ensure that persons were entitled to the refunds, dependents, and Earned Income Credits they were claiming. The most visible of those efforts involved the delay of millions of refunds to allow IRS time to verify SSNs and do compliance checks. Although those efforts appeared to have had a significant deterrent effect (e.g., preliminary information indicates that 1.9 million fewer dependents were claimed in 1995 than were in 1994), they were not without problems.

IRS (1) identified many more missing, invalid, and duplicate SSNs than it was able to pursue and ended up releasing the refunds without resolving the problems and (2) delayed millions of refunds for taxpayers whose returns had valid SSNs to check for duplicate SSNs but ended up releasing those refunds after several weeks without doing the checks. Many taxpayers and practitioners were surprised that IRS delayed some refunds even if all of the SSNs on the return were good. They were also upset that IRS split some refunds—issuing part of the refund and delaying the rest—but only honored a taxpayer's direct deposit request for the first part of the refund.

As we noted in our report to the Subcommittee on the 1995 filing season, IRS identified fewer fraudulent returns during the first 9 months of 1995 than it did during the same period in 1994, and the percentage of fraudulent refunds it stopped before issuance declined.[8] Neither we nor IRS know whether those decreases were due to a decline in the incidence of fraud or a decline in the effectiveness of IRS' detection efforts. The Director of IRS' Office of Refund Fraud expressed the belief that there were fewer fraudulent returns to be identified in 1995. He opined that the additional controls IRS implemented in 1995 and knowledge of those actions had deterred persons from filing fraudulent returns.

IRS took steps this year to address some of the problems it encountered in implementing its new procedures in 1995. For example, IRS has said that it is being more selective in deciding which cases to investigate and which

[7] Tax Administration: Electronic Filing Falling Short of Expectations (GAO/GGD-96-12, Oct. 31, 1995).

[8] We limited our comparison to the first 9 months because IRS had not compiled data for the last quarter of 1995.

refunds to delay this year—trying to focus its resources on the most egregious cases and minimize the burden on honest taxpayers.

Statistics on the number of notices sent to taxpayers in 1996 concerning SSN problems and refund delays indicate that IRS is indeed delaying fewer refunds. As of March 9, 1996, IRS had mailed about 56-percent fewer refund-delay notices than at the same time last year. Another indicator that fewer refunds are being delayed in 1996 is the decrease in the number of "where is my refund" calls to IRS. Taxpayers wanting to know the status of their refunds can call TeleTax and get information through the use of an interactive telephone menu. This filing season, as of March 16, 1996, IRS reported receiving 26.5 million such calls—a decrease of about 15 percent from the 31.0 million it reported receiving as of the same time last year.

Telephone Accessibility

For the past several years, taxpayers have had difficulty reaching IRS by telephone. As we reported to the Subcommittee in December 1995, IRS data showed that (1) an estimated 46.9 million callers made 236 million call attempts to IRS for tax assistance between January 1 and April 15, 1995 and (2) IRS was able to respond to only 19.2 million of those attempts—an accessibility rate of 8 percent.[9]

Accessibility has improved this year, although it is still low. IRS data for January 1 through March 9, 1996, showed 63.3 million call attempts, of which 12.7 million were answered—an accessibility rate of about 20 percent. As of the same time last year, IRS reported receiving about 107 million call attempts, of which 11.7 million were answered—an accessibility rate of about 11 percent. As the data indicate, a major reason for the improved accessibility is the significant drop in call attempts. IRS attributed that drop to (1) fewer refund delay notices being issued, as discussed earlier; (2) a slippage in the number of returns filed; and (3) IRS efforts to publicize other information sources, such as Internet.

SCRIPS

In our report to the Subcommittee on the 1995 filing season, we noted that IRS' new document imaging system—SCRIPS—did not perform as expected, leading to increased returns processing costs and lower-than-expected productivity.[10] For example, SCRIPS had such significant downtime that two of the five service centers that were using SCRIPS stopped using it to

[9]The 1995 Tax Filing Season: IRS Performance Indicators Provide Incomplete Information About Some Problems (GAO/GGD-96-48, Dec. 29, 1995).

[10]GAO/GGD-96-48.

process Forms 1040EZ. As a result, IRS had to redirect more of the Form 1040EZ processing workload to its manual data entry system. After the 1995 filing season, IRS identified hardware and software upgrades that would be needed to correct the SCRIPS performance problems. IRS made some of those changes for the 1996 filing season.

Our discussions with IRS officials and our review of processing rate data indicate that SCRIPS' performance has improved in 1996. Specifically, SCRIPS is processing at faster rates in three of the five centers and operating with less system downtime in all five centers. However, the two centers that stopped using SCRIPS to process Forms 1040EZ last year are experiencing slower processing rates than those of last year. Despite the improved performance, SCRIPS is far from the level of performance IRS had originally expected. For example, IRS originally planned to be processing all Forms 1040EZ on SCRIPS by 1996; it now expects to process about 50 percent of the Forms 1040EZ received in 1996 on SCRIPS. The remaining forms are being processed through IRS' manual data entry system.

Although IRS made changes to SCRIPS and performance has improved, we are concerned that IRS did not establish more specific performance expectations for SCRIPS this filing season. IRS specified volume expectations by form type, but it did not establish expectations for improvements in processing rates or reductions in system down time that should result from the enhancements made for the 1996 filing season. Without those expectations, it will be difficult for IRS to determine which enhancements were cost beneficial. We are currently reviewing SCRIPS and plan to report our results later this year.

Additional Investments in TSM Are at Risk Given Current Managerial and Technical Weaknesses

TSM, which began in 1986, is key to IRS' vision of a virtually paper-free work environment in which taxpayer account updates are rapid and taxpayer information is readily available to IRS employees to respond to taxpayer inquiries. IRS' fiscal year 1997 request for TSM is $850 million, a $155 million increase from IRS' proposed operating level for fiscal year 1996. We continue to believe that TSM is a high risk and are concerned about how effectively IRS can use the requested funds until it corrects some fundamental technical and managerial weaknesses.

The Treasury, Postal Service and General Government Appropriations Act for 1996 "fenced" $100 million in TSM funding until the Secretary of the Treasury reports to the Senate and House Appropriations Committees on

IRS' progress in responding to the recommendations we made in a July 1995 report on TSM.[11]

Many of our recommendations were intended to correct critical IRS management and technical weaknesses by December 31, 1995. Without these corrections, IRS will not have the sound management and technical practices it needs to successfully meet TSM objectives in a cost effective and expeditious manner. A recent National Research Council report on TSM had a similar message.[12] The Council's recommendations parallel the recommendations we made involving IRS' (1) business strategy to reduce reliance on paper, (2) strategic information management practices, (3) software development capabilities, (4) technical infrastructures, and (5) organizational controls.

In our March 14, 1996, testimony before the Subcommittee on Treasury, Postal Service and General Government, House Committee on Appropriations, we assessed IRS' progress in responding to our recommendations.[13] Because IRS' progress report on implementing our recommendations was not finalized, our assessment was based on several follow-up meetings with IRS officials and a review of various planning documents. According to the Deputy Secretary of the Treasury, the Department is currently reviewing IRS' progress report and plans to submit it to Congress "as soon as possible."

IRS has initiated a number of activities and made some progress in addressing our recommendations to improve management of information systems; enhance its software development capability; and better define, perform, and manage TSM's technical activities. However, none of these steps, either individually or in the aggregate, has fully satisfied any of our recommendations.

As a result, we do not believe that IRS can make effective use of TSM systems development funds at this time. Our concern is heightened by the fact that IRS would not give us specific information on its plans for spending the $850 million being requested for TSM in fiscal year 1997. IRS' budget request contains some general information on its plans for the $155 million increase over the proposed operating level for fiscal year

[11]GAO/AIMD-95-156.

[12]Continued Review of the Tax Systems Modernization of the Internal Revenue Service—Final Report, Computer Science and Telecommunications Board, National Research Council, 1996.

[13]Tax Systems Modernization: Status of Tax Systems Modernization, Tax Delinquencies, and the Potential for Return Free Filing (GAO/T-GGD/AIMD-96-88, Mar. 14, 1996).

1996. However, the information provided raises additional concerns. In this regard, IRS is requesting an additional $29 million for Cyberfile, an electronic filing system. Earlier this week, we testified that Cyberfile is a poorly developed system that does not adequately address the security requirements needed to protect taxpayer data.[14]

Fiscal Year 1997 Budget Request Includes $359 Million for Revenue Protection Initiatives

In every year but one from 1990 through 1995, Congress has appropriated IRS funds for various compliance initiatives aimed at increasing IRS' enforcement staff with the expectation that the increase would produce more revenue. For fiscal year 1995, Congress appropriated $405 million for compliance initiatives. In estimating the revenue that would be generated from those initiatives—$9.2 billion—IRS assumed that Congress would continue to provide $405 million for the additional staffing over the next 4 years. However, Congress did not provide the second-year funding installment for fiscal year 1996.

IRS' fiscal year 1997 budget request includes $359 million for "revenue protection initiatives". Although the name has changed, these initiatives are directed toward achieving the same goal as were previous compliance initiatives—to increase revenue. To help Congress deliberate on this portion of IRS' budget request, you asked that we summarize our past work on compliance initiatives. That work focused on the following issues:

- Before fiscal year 1995, IRS consistently used at least some of the compliance initiative funds for purposes other than those that Congress intended. Specifically, IRS used these funds to cover budget shortfalls in base operations. As a result, many of the past compliance initiatives were never fully implemented. To ensure that IRS spent fiscal year 1995 compliance initiative funds as intended, the Appropriation Committees restricted IRS' ability to use those funds for other purposes.
- Before fiscal year 1995, IRS only tracked the staffing and revenue associated with an initiative. Using this approach, IRS could claim that compliance initiatives had met their revenue goal even if IRS' base staffing had declined, which was often the case. We recommended that IRS provide Congress with information on the total revenue achieved—from both base staffing and compliance initiative staffing—to ensure that Congress had a

[14] Tax Systems Modernization: Management and Technical Weaknesses Must Be Overcome to Achieve Success (GAO/T-AIMD-96-75, Mar. 26, 1996).

more accurate picture of IRS' total compliance program.[15] IRS revised its tracking approach for fiscal year 1995.

- Although IRS revised its tracking approach, we cannot yet comment on the accuracy of the revenue figures in IRS' tracking reports. Until recently, IRS had to estimate the amount of revenue derived from its compliance efforts because it was unable to track actual revenue—regardless of whether it was generated from compliance initiative staff or base staff. For the last several years, IRS has been implementing an Enforcement Revenue Information System (ERIS) that is intended to report the actual revenue from various compliance programs. In the past, we have discussed concerns about the reliability of ERIS data, and IRS has been working to resolve those problems. We plan to test the reliability of ERIS data as part of our audit of IRS' fiscal year 1996 financial statements.
- Although we generally supported the fiscal year 1995 compliance initiatives, we did not support hiring more revenue officers. For several years, we have encouraged IRS to shift its collection focus from revenue officers, who generally collect delinquent taxes through face-to-face contact with taxpayers, to more productive processes like ACS, that emphasize early telephone contact. Although IRS subsequently reduced the number of revenue officers for that initiative, it still planned to hire about 750 in fiscal year 1995. As noted earlier, IRS is now diverting some revenue officers —who are paid at higher rates than ACS staff—to ACS to mitigate the impact of ACS staffing reductions.

The $359 million included in IRS' fiscal year budget request for the revenue protection initiatives is expected to fund 3,820 additional compliance staff. According to IRS, most of those staff are for areas, such as ACS and Document Matching, that were significantly affected by fiscal year 1996 staffing cuts.

Despite the 3,820 additional staff associated with the revenue protection initiatives, IRS budget shows that total compliance staffing is expected to increase by only 2,390 positions in fiscal year 1997. Almost all of that difference is because IRS' budget also includes a decrease of 1,341 full-time equivalents for tax law enforcement. That decrease is part of IRS' contribution to reductions in base programs to reduce the federal deficit. According to IRS, the decrease of 1,341 positions will come from the more traditional enforcement job categories—those, such as revenue officers and revenue agents, that engage in face-to-face audit and collection activities. IRS' budget states that although "these positions still comprise

[15] Tax Administration: Congress Needs More Information on Compliance Initiative Results (GAO/GGD-92-118, July 31, 1992).

the lion's share of IRS enforcement efforts, they also represent, on the margin, the least efficient use of IRS resources." According to IRS officials, these staff reductions will be achieved through attrition.

Thus, one effect of the increases and decreases in IRS' compliance staffing for fiscal year 1997, if IRS' budget request is approved and is implemented as IRS has described, would be to alter the mix of that staffing. IRS would have fewer revenue officers, for example, and more ACS staff—the kind of mix that we have advocated in the past.

In conclusion, although IRS has made some changes, there are certain questions that remain appropriate in discussing the revenue protection initiatives: (1) will IRS spend the additional funds for additional compliance staff? (2) does IRS have reliable data on the revenue generated by its enforcement activities? and (3) will IRS be able to achieve the new staffing mix?

That concludes my statement. We welcome any questions that you may have.

Factors Affecting ACS Staffing for Fiscal Year 1996

Factors surrounding IRS' organizational and business restructuring led to ACS having a large number of seasonal, term and other than full-time permanent staff at the end of fiscal year 1995. As a result, ACS was targeted for a significant staff reduction given IRS' cost-cutting approach for fiscal year 1996.

IRS' customer service vision calls for combining into 23 customer service sites the work of at least 70 organizational units that employ staff who do not have face-to-face interactions with taxpayers. These centers are to employ staff who will work primarily by telephone to assist taxpayers, collect delinquent taxes, and adjust taxpayer accounts. As part of this consolidation, IRS is to close 10 of its 20 ACS sites.

After IRS announced which 10 sites would be closed, two things happened. First, ACS employees who could find other positions left ACS. Some of these employees were hired for revenue officer positions that became available as part of the fiscal year 1995 compliance initiatives. Second, the 10 ACS sites that were scheduled to close could hire only term and seasonal staff, according to an IRS official. Therefore, at the end of fiscal year 1995, ACS had 448 seasonal, term, and other than full-time permanent staff—66 percent higher than the number at the end of fiscal year 1994.

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