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TAX ADMINISTRATION

IRS' Fiscal Year 1997 Spending, 1997 Filing Season, and Fiscal Year 1998 Budget Request

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Tax Administration: IRS' Fiscal Year 1997 Spending, 1997 Filing Season, and Fiscal Year 1998 Budget Request

IRS' fiscal year 1997 appropriation act and accompanying conference report indicated that Congress was concerned about, among other things, the level of taxpayer service and IRS' lack of progress in modernizing its systems.

In response to congressional concerns about taxpayer service, IRS added more staff this year to answer the telephone and revised its procedures for handling more complicated calls for assistance. As a result, IRS answered 52 percent of taxpayers' call attempts during the first 2 months of this filing season, compared with 21 percent during the same period last year. This filing season has also seen a large increase in electronic filing.

To respond to congressional concerns about modernization, IRS realigned its fiscal year 1997 information system spending plans. GAO's review of eight projects showed that the spending plans appeared to be consistent with congressional direction. However, IRS (1) has since cancelled projects that it had estimated would cost a total of $36 million in fiscal year 1997 and (2) decided not to begin acquiring and developing new systems for another 12 to 18 months. Therefore, Congress should consider rescinding the $36 million.

Included in IRS' budget request for fiscal year 1998 is $131 million for developmental information systems. In addition, the administration is proposing a $1 billion capital account for information technology investments at IRS. Neither the $131 million or the $1 billion is supported by the type of analysis required by Clinger-Cohen Act, the Government Performance and Results Act, and the Office of Management and Budget. Congress should consider not funding either the $131 million request or the capital account until management and technical weaknesses in IRS' modernization program are resolved and required justifications are completed. IRS' budget request also includes $84 million for its turn of the century date conversion effort. There is reason to question the sufficiency of that amount because IRS has not yet determined its total conversion needs.

Finally, IRS expects the funding limits it faces in fiscal year 1997 and anticipates for fiscal year 1998 to continue until at least 2002. Fiscal constraints as well as longstanding concerns about the efficiency of IRS operations make consensus on IRS strategic goals and the measures for assessing progress against those goals critically important. In recent years, Congress has put in place a statutory framework for accomplishing this. This framework includes as its essential elements the Chief Financial

Officers Act; the Clinger-Cohen Act; and the Government Performance and Results Act.

Tax Administration: IRS' Fiscal Year 1997 Spending, 1997 Filing Season, and Fiscal Year 1998 Budget Request

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) actions to implement its fiscal year 1997 appropriation, the status of the 1997 tax return filing season, and the administration's fiscal year 1998 budget request for IRS.

This statement is based on our review of the administration's fiscal year 1998 budget request, the interim results of our review of the 1997 tax return filing season, a review of IRS' fiscal year 1997 spending plans for information systems, and our past work on Tax Systems Modernization (TSM).

Our statement makes the following points:

- IRS' fiscal year 1997 appropriation act and accompanying conference report indicated that Congress was concerned about, among other things, the level of taxpayer service and the lack of progress in implementing TSM. In response to congressional concerns and direction, IRS allocated about 1,000 additional full-time equivalent (FTE) staff to taxpayer service activities and realigned its fiscal year 1997 information system spending plans. IRS has since cancelled some of the projects that were included in those plans and that it had estimated would cost a total of $36 million in fiscal year 1997.
- The 1997 filing season has seen significant increases in two areas where we have criticized IRS' performance in the past—electronic filing and telephone accessibility. To help achieve those increases, IRS (1) revised the tax package sent to persons eligible to file by telephone, hoping, as a result, to encourage them to file by phone; (2) assigned more staff to answer the phone; and (3) revised its procedures for handling more complicated telephone requests for assistance.
- IRS' basic budget request for fiscal year 1998 is for $7.4 billion and 102,385 FTEs. Included in that request is $131 million for developmental information systems, the same amount that was provided in fiscal year 1997. In addition to that basic request, the administration is proposing a capital account for information technology investments at IRS—$500 million for fiscal year 1998 and another $500 million for 1999. Neither the $131 million or the $1 billion is supported by the type of analysis required by the Clinger-Cohen Act, the Government Performance and Results Act (GPRA), and the Office of Management and Budget (OMB).
- The budget request also includes $84 million for IRS' turn of the century date change effort. IRS has already determined that it will need several

million dollars more for this effort in fiscal year 1997 than had been allocated. Given that and because IRS' overall conversion needs are still being determined, it seems reasonable to question whether the amount requested for this effort in fiscal year 1998 will be sufficient.

- IRS is also requesting funds to replace two old systems used to process paper returns and remittances. Because extra money is being spent on those replacement systems in 1997, all of the funding being requested for 1998 may not be needed.
- The largest staffing increase in IRS' budget request is for 195 FTEs (with an associated cost of $11 million) to process a projected increase in the number of tax returns filed in 1998. IRS expects that most of the additional returns will be filed electronically. Data IRS used to determine how much more money and staff it needed to process those additional returns show only a small difference between the number of FTEs needed to process a million electronic returns and the number needed to process a million paper returns. That small difference is inconsistent with what we would have expected and may reflect, at least in part, the fact that electronic filing is not truly paperless.
- Finally, IRS and Congress face many challenges in moving the nation's tax system into the next millennium. Funding limits faced by IRS in fiscal year 1997 and anticipated for fiscal year 1998 are projected to continue until at least 2002. Fiscal constraints as well as longstanding concerns about the operations and management of IRS make consensus on IRS performance goals and measuring progress in achieving those goals critically important. The provisions and requirements of the Chief Financial Officers Act, Clinger-Cohen Act, and Government Performance and Results Act provide a mechanism for accomplishing this.

Overview of 1997 Appropriation Issues

IRS' fiscal year 1997 appropriation act[1] and accompanying conference report[2] indicated that Congress was concerned about various aspects of IRS' operations. Among other things, Congress expressed concern about (1) TSM and the need to direct more systems development work to the private sector; (2) TSM funds being directed at "feeding the beast" rather than at true modernization; (3) the ability of taxpayers to reach IRS over the telephone; (4) the need to maintain taxpayer service at fiscal year 1995

[1]The Omnibus Consolidated Appropriations Act (P.L. 104-208, Sept. 30, 1996).

[2]H.R. Report No. 863, 104th Cong., 2d sess. (1996).

levels, at a minimum;[3] and (5) the need to develop a strategic plan and performance measures for inclusion in IRS' fiscal year 1998 budget request.

As shown in table 1, IRS' final appropriation for fiscal year 1997 was $7.2 billion—$142 million less than its fiscal year 1996 appropriation. The fiscal year 1997 appropriation also rescinded about $174 million in information systems funds. Table 1 also shows that the fiscal year 1997 appropriation provided (1) all of what IRS requested for processing, assistance, and management; (2) $424 million less than requested for tax law enforcement; and (3) $365 million less than requested for information systems.

Table 1: IRS' Fiscal Year 1997 Appropriation Compared to Its Fiscal Year 1997 Budget Request and Fiscal Year 1996 Appropriation

In billions

Appropriation account	Fiscal year 1996 appropriation	Fiscal year 1997 budget request	Fiscal year 1997 appropriation
Processing, assistance, and management	$1.724	$1.780	$1.780
Tax law enforcement	4.097	4.528	4.104
Information systems	1.527	1.688	1.323
Total[a]	**$7.348**	**$7.995**	**$7.206**

[a]Totals may not add due to rounding.

Source: P.L. 104-52, fiscal year 1997 President's budget request for IRS, and P.L. 104-208.

In response to its fiscal year 1997 appropriation and the congressional direction specified therein, IRS (1) revised its spending plans for information systems; (2) reallocated resources within the processing, assistance, and management account to direct more resources to taxpayer service activities; and (3) reduced the number of compliance staff.

IRS' Fiscal Year 1997 Systems Spending Plans Are Consistent With Congressional Direction, but $36 Million May No Longer Be Needed

For fiscal year 1997, IRS was appropriated about $1.3 billion to fund its information systems. The appropriation act specified that the $1.3 billion be spent as follows:

- $758.4 million for legacy systems,
- $206.2 million for TSM operational systems,
- $130.1 million for TSM development and deployment,
- $83.4 million for program infrastructure,
- $62.1 million for "stay-in-business" projects,

[3]Congress added this requirement because it was concerned that IRS' pending reorganization of certain field activities would adversely affect taxpayer service.

- $61.0 million for staff downsizing, and
- $21.9 million for telecommunication network conversion.

IRS' plans for spending its fiscal year 1997 information systems appropriation and IRS' obligations through December 31, 1996, appear consistent with the act's direction. Specifically, at the beginning of fiscal year 1997, we judgmentally selected eight projects, totaling approximately $197 million, that IRS planned to fund with its information systems appropriation and analyzed each relative to the categories and amounts specified in the act. Our analysis showed that IRS identified its projects in accordance with the legislative categories and that all of the projects we reviewed appeared to be consistent with the act's categories and spending levels.

In analyzing IRS' spending, we also found that IRS has ongoing or completed over one-half of the projects (with fiscal year 1997 costs totaling about $87.3 million) that were used to justify the allocation of $130.1 million for systems development and deployment. IRS is reviewing one other project for $7 million and has canceled the remaining projects, which had projected fiscal year 1997 costs totaling about $36 million.

According to IRS' Chief Information Officer (CIO), IRS canceled these systems because business case analyses did not justify continued development. The canceled projects include the Corporate Accounts Processing System, the Integrated Case Processing System, and the Workload Management System.

The CIO also stated that IRS does not plan to start any new system development projects until it has developed the internal capability needed to effectively manage system development projects, which includes developing a modernization systems architecture and a systems deployment plan. The CIO said that it would be 12 to 18 months before IRS begins acquiring and developing new systems. Therefore, Congress should consider rescinding the $36 million that IRS will not be using for systems development and deployment in fiscal year 1997.

As noted earlier, $61 million of IRS' fiscal year 1997 information systems appropriation was allocated for staff downsizing. We question whether all of the $61 million will be needed for that purpose. IRS had requested those funds to downsize its information systems staff by 819 positions. According to IRS' Chief for Management and Administration, however, attrition among information systems staff has been higher than expected and IRS' current downsizing plans include only 228 information systems positions.

Increased Resources Provided for Taxpayer Service in 1997

Given congressional concerns about the level of taxpayer service and the low level of telephone accessibility documented in our annual filing season reports,[4] IRS decided that its highest priority in 1997, other than processing returns and refunds, would be to improve taxpayer service, especially the ability of taxpayers to reach IRS on the phone. One important step IRS took to achieve that end was to increase the number of FTEs devoted to taxpayer service. According to IRS estimates, the number of taxpayer service FTEs will increase from 8,031 in fiscal year 1996 to 9,091 in fiscal year 1997. The estimated number of FTEs for fiscal year 1997 is also higher than in fiscal year 1995, which is in accord with congressional direction in IRS' fiscal year 1997 appropriation. According to IRS budget officials, some of these additional FTEs were achieved by reallocating resources originally targeted for submission processing; the rest were funded with user fees that IRS is authorized to retain.

The bulk of the staffing increase for taxpayer service is directed at helping taxpayers reach IRS by telephone. To augment that increase, IRS has also been detailing staff from other functions to help answer the phone, including staff who would normally be doing compliance work. As discussed later, this increased staffing, along with other steps IRS took, seem to have succeeded in significantly improving telephone accessibility this filing season.

IRS Reduced Compliance Staff in 1997 to Accommodate Roll-Over of 1996 Funding

The fiscal year 1997 appropriation for tax law enforcement was essentially a roll-over of the 1996 appropriation. However, IRS, in its budget request for 1997, said that it needed an increase of $116 million just to "maintain current levels" for enforcement. According to IRS, getting a roll-over in funding for 1997 rather than an increase forced it to reduce staffing levels for compliance activities so it could pay on-board staff. Specifically, IRS reduced certain compliance positions (i.e., revenue agents and revenue officers) by more than 1,000. As one result of this reduction, IRS estimates that audit coverage will drop from 1.6 percent to 1.2 percent. We should note, however, that these reductions were directed at those enforcement

[4] Tax Administration: Continuing Problems Affect Otherwise Successful 1994 Filing Season (GAO/GGD-95-5, Oct. 7, 1994); The 1995 Tax Filing Season: IRS Performance Indicators Provide Incomplete Information About Some Problems (GAO/GGD-96-48, Dec. 29, 1995); and IRS' 1996 Tax Filing Season: Performance Goals Generally Met; Efforts to Modernize Had Mixed Results (GAO/GGD-97-25, Dec. 18, 1996).

staff that IRS has characterized as "representing the least efficient use of IRS resources on the margin."

The 1997 Filing Season

By various statistical measures traditionally used to assess a filing season, the 1997 filing season is going well. Especially noteworthy are significant increases in electronic filing and telephone accessibility. One major change this year involves a new procedure IRS is using to deal with returns that have missing or incorrect Social Security Numbers (SSN). However, the impact of this procedure will not be evident until after the filing season. Another area that we cannot address at this time is refund fraud. IRS had not compiled data on the number of fraudulent returns and refunds identified this year as of the time we prepared this testimony.

Significant Increases in Electronic Filing and Telephone Accessibility

As of March 7, 1997, the number of returns filed electronically, including those filed over the telephone, was 24.7 percent more than at the same time last year. This increase is even more significant considering, as shown in table 2, that the total number of individual income tax returns filed as of March 7, 1997, was 1.5 percent less than at the same time last year.

Table 2: Individual Income Tax Returns Received

Type of filing	March 7, 1997	March 8, 1996	Percent of change
Traditional paper	28,057,000	31,980,000	–12.3
1040PC[a]	2,746,000	2,373,000	15.7
Total Paper	**30,803,000**	**34,353,000**	**–10.3**
Traditional electronic[b]	10,921,000	9,273,000	17.8
TeleFile	3,495,000	2,284,000	53.0
Total Electronic	**14,416,000**	**11,557,000**	**24.7**
Total	**45,219,000**	**45,910,000**	**–1.5**

[a]Under the Form 1040PC method of filing, taxpayers or tax return preparers use personal computer software that produces paper tax returns in answer-sheet format. The Form 1040PC shows the tax return line and the data on that line. Only lines on which the taxpayer has made an entry are included on the Form 1040PC.

[b]Traditional electronic returns are those that are filed through third parties, such as tax return preparers.

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

As table 2 shows, the largest percentage increase is in the number of returns filed by telephone (i.e., TeleFile). That increase may be due, in large part, to a change in the tax package IRS sent eligible TeleFile users this year. In past years, IRS sent taxpayers who appeared eligible to use TeleFile a package that included not only TeleFile materials but also a Form 1040EZ and related instructions. Thus, taxpayers who could not or did not want to use TeleFile had the materials they needed to file on paper, assuming they were still eligible to file a Form 1040EZ. This year, IRS eliminated the Form 1040EZ and related instructions from the package sent eligible TeleFile users—hoping that more taxpayers would be inclined to use TeleFile if they only received the TeleFile materials.

A second noteworthy trend this year is an increase in the ability of taxpayers who have questions about the tax law, their refunds, or their account to reach IRS by telephone. As shown in table 3, the accessibility of IRS' telephone assistance, as we have defined it in the past, has increased substantially.[5]

Table 3: Accessibility of IRS' Telephone Assistance[a]

Filing season	Number of call attempts (in millions)	Number of calls answered (in millions)	Percent accessibility
1997	21.6	11.3	52.3
1996	42.3	9.0	21.3

[a]These data are for January 1 through February 22, 1997, and January 1 through February 24, 1996.

Source: IRS data.

As table 3 indicates, the increase in accessibility is due to a combination of fewer calls coming in and more calls being answered. The two factors are not unrelated. The more successful IRS is in answering the phone, the fewer times taxpayers should have to call in an attempt to get through.

IRS has another way of measuring accessibility, called "level of access", which tracks the percentage of callers who were eventually able to get through to IRS rather than the number of call attempts. As of February 22, 1997, according to IRS data, the level of access was 71 percent, a substantial increase over the 52-percent level of access as of the same time last year.

[5]Accessibility, as we have traditionally defined it, is the total number of calls answered divided by the number of call attempts, which is the sum of the following: (1) calls answered, (2) busy signals, and (3) calls abandoned by the caller before an IRS assistor got on the line.

There are several factors that appear to have contributed to IRS' increased telephone service: (1) an increase in the number of staff assigned to answer the phone, some of which was achieved by detailing staff from other IRS functions;[6] (2) an attempt to reduce the need for persons to call IRS by eliminating certain notices that IRS deemed to be unnecessary; and (3) revisions to IRS' procedures for handling calls.

As an example of the latter, this year, unlike past years, callers who indicate, through the choices they select on the automated telephone menu, that they have a question in a complex tax area (such as "sale of residence") are to be connected to a voice messaging system. Those callers are asked to leave their name, telephone number, and best time for IRS to call back, and they are told that someone will be calling back within 2 working days. Those return calls are being made by staff detailed from IRS' Examination function. According to IRS, it made this change after a study showed that several areas of complicated tax law involved 20 to 30 minute telephone conversations and that an assistor could answer about 5 simpler calls within the same amount of time.

Too Soon to Assess Impact of IRS' New SSN Procedure

One important change this filing season involves the way IRS is handling returns filed with missing or incorrect SSNs. Over the last few years, when IRS identified a missing or invalid SSN, it delayed the taxpayer's refund and corresponded with the taxpayer to resolve the issue. As we noted in our report to the Subcommittee on the 1996 filing season, IRS was unable to pursue many of the problem SSNs it identified under those procedures.[7]

Effective with this filing season, IRS was given the legislative authority to treat missing or invalid SSNs as an error made by the taxpayer, similar to the way IRS handles math errors. Under that new authority, when IRS detects a missing or invalid SSN, it is to disallow any related deductions and credits and adjust the taxpayer's tax liability.

For example, if a taxpayer claims one dependent and the child care credit, but lists an invalid SSN for the dependent, IRS is to increase the taxable income by the personal exemption amount claimed for the dependent and not allow the child care credit. IRS is then to adjust the taxpayer's tax

[6]In one service center, for example, 26 staff from the Collection area were detailed on an as-needed basis to answer the phones, 45 staff from that center's Adjustment/Correspondence Branch have been detailed to answer phone calls during the filing season, and another 24 staff from that Branch have been detailed to answer calls for 2 hours each afternoon.

[7]IRS' 1996 Tax Filing Season: Performance Goals Generally Met; Efforts to Modernize Had Mixed Results (GAO/GGD-97-25, Dec. 18, 1996).

liability and reduce the taxpayer's refund, if any. The taxpayer is to receive a notice explaining the changes to his or her tax liability and refund. The standard notice IRS is using provides a special toll-free telephone number that taxpayers can call if they want to discuss the changes and/or provide corrected information to support their claims. Taxpayers can also write to IRS to resolve the issue.

IRS estimated that about 2.4 million taxpayers will receive these "SSN-math error" notices in 1997. According to an IRS official, IRS had issued about 70,000 such notices as of February 21, 1997. At the time we prepared this testimony, officials at three IRS customer service centers, which are responsible for answering taxpayers' inquiries, told us that assistors were not yet getting many calls or letters from taxpayers who received the notices. Thus, it is too early to assess the impact of this new procedure.

Data Not Yet Available on Refund Fraud

As we noted in our report on the 1996 filing season, IRS identified many fewer fraudulent returns last year than it did in 1995. According to IRS, the decline was due to a 31-percent staffing decrease in IRS' Questionable Refund Program. Program officials told us that the reduced level of staffing has continued in 1997. However, we do not know how the reduced staffing has affected the number of fraudulent returns and refunds identified this year because IRS had not compiled that data as of the time we prepared this testimony.

Fiscal Year 1998 Budget Request for Information Systems Raises Several Questions

IRS' fiscal year 1998 budget request includes $1.27 billion and 7,162 FTEs for information systems. Of the $1.27 billion, $1.14 billion is for operational systems, including funds for IRS' century data change effort and for replacing two old processing systems. The rest of the request ($131 million) is for developmental systems. In addition to the $1.27 billion, the administration is requesting $1 billion over 2 years to fund a multi-year capital account, referred to as the Information Technology Investments Account, for new modernization projects at IRS.

Our analysis of the information systems request raised several questions: (1) Should Congress approve the $131 million for developmental systems and the $1 billion capital account given the absence of the kind of supporting analyses required by the Clinger-Cohen Act, GPRA, and OMB? (2) Is the money being requested for IRS' century date conversion effort sufficient? and (3) Will IRS need all of the money requested for replacing two processing systems?

Budget Request for Systems Development Not Justified

The Clinger-Cohen Act, GPRA, and OMB Circular No. A-11 and supporting memoranda require that information technology investments be supported by accurate cost data and convincing cost-benefit analyses. For fiscal year 1998, IRS is requesting $131 million for system development. However, IRS' request does not include a credible, verifiable justification. The budget request states that IRS does not know how it plans to spend these funds because its modernization systems architecture and system deployment plan have not yet been finalized. These efforts are scheduled for completion in May 1997 and are intended to guide future systems development. According to IRS budget officials, $131 million was requested for fiscal year 1998 because it was approximately the same amount IRS received in fiscal year 1997 for system development.

No Justification to Support Billion Dollar Information Technology Investments Account

The administration is proposing to establish an Information Technology Investments Account to fund future modernization investments at IRS. It is seeking $1 billion—$500 million in fiscal year 1998 and another $500 million in fiscal year 1999—for "yet-to-be-specified" development efforts. According to IRS' request, the funds are to support acquisition of new information systems, expenditures from the account will be reviewed and approved by Treasury's Modernization Management Board, and no funds will be obligated before July 1, 1998.

The Clinger-Cohen Act, GPRA, and OMB Circular No. A-11 and supporting memoranda require that, prior to requesting multi-year funding for capital asset acquisitions, agencies develop accurate, complete cost data and perform thorough analyses to justify the business need for the investment. For example, agencies need to show that needed investments (1) support a critical agency mission; (2) are justified by a life cycle based cost-benefit analysis; and (3) have cost, schedule, and performance goals.

IRS has not prepared such analyses for its fiscal year 1998 and 1999 investment account request. Instead, IRS and Treasury officials stated that, during executive-level discussions, they estimated that they would need about $2 billion over the next 5 years. This estimate was not based on analytical data or derived using formal cost estimating techniques. According to OMB officials responsible for IRS' budget submission, the request was reduced to $1 billion over 2 years because they perceived the lesser amount as more palatable to Congress. These officials also told us that they were not concerned about the precision of the estimate because their first priority is to "earmark funds" in the fiscal year 1998 and 1999 budgets so funds will be available when IRS eventually determines how it wants to modernize its systems.

In 1995 we made over a dozen recommendations to the Commissioner of Internal Revenue to address systems modernization management and technical weaknesses.[8] We reported in 1996 that IRS had initiated many activities to improve its modernization efforts but had not yet fully implemented any of our recommendations.[9] Since then, IRS has continued to address our recommendations and respond to congressional direction. But, there is still no evidence that any of the recommendations have been fully implemented and, as we reported in February 1997, IRS' systems modernization effort continues to be at risk.[10] Much remains to be done to implement essential improvements in IRS' modernization efforts. IRS has not yet instituted disciplined processes for designing and developing new systems and has not yet completed its systems architecture.

Given IRS' poor track record delivering cost-beneficial TSM systems, persisting weaknesses in both software development and acquisition capabilities, and the lack of justification and analyses for proposed system expenditures, Congress should consider not funding either the $131 million request for systems development or the $1 billion capital account until the management and technical weaknesses in IRS' modernization program are resolved and the required justifications are completed.

Funding Needs for Century Date Change Are Uncertain

IRS, like other federal agencies, is in the midst of a major project aimed at making its computer systems "century date compliant." Currently, IRS' computer systems can not distinguish between the years 1900 and 2000 because the systems year is represented by two-digit date fields (i.e., 00 in both cases). IRS estimates that the failure to correct this situation before 2000 could result in millions of erroneous tax notices, refunds, and bills. Accordingly, IRS' CIO has designated this effort as a top priority. The CIO established a year 2000 project office to coordinate work among the various IRS organizations with responsibility for assessing, converting, and testing IRS systems.

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

[9] Tax Systems Modernization: Actions Underway But IRS Has Not Yet Corrected Management and Technical Weaknesses (GAO/AIMD-96-106, June 7, 1996).

[10] GAO High-Risk Series, IRS Management (GAO/HR-97-8, Feb. 1997).

IRS' fiscal year 1998 budget request includes $84 million for the century date change effort, an increase of $39 million over the $45 million included for that effort in IRS' fiscal year 1997 budget. However, the fiscal year 1998 request was based on September 1996 cost estimates that, in turn, were based on an estimate of lines of computer code for IRS' main tax processing systems. The request did not include estimates for IRS' secondary tax processing systems that are also critical to the tax administration process. It also did not factor in many other activities related to the century date change effort that have since been identified, such as the need for additional hardware and software for testing, operating system upgrades, and possibly additional storage capacity due to expanded date fields.

Thus far in fiscal year 1997, IRS has identified requirements for the century date conversion that would exceed its fiscal year 1997 budget by as much as $49.5 million. Of this amount, $13.5 million is for additional labor costs and the remaining $36 million is for nonlabor costs (i.e., the purchase of updated operating system environments, contractor support for software conversion and testing, and additional hardware for expected capacity increases). IRS' Investment Review Board recently approved a request for these additional funds. However, according to IRS budget officials, a funding source has not been identified. Once that source is identified, they said they plan to notify the Appropriations Committees.

IRS is currently assessing what it needs to do to make its main tax processing systems century date compliant and what that will cost. However, there are other potentially significant project costs, including those associated with converting and testing secondary tax processing systems. IRS project officials told us that they hope to have a complete cost estimate for the century date conversion effort by this summer. In the meantime, given the status of IRS' needs assessment, it seems reasonable to question whether the amount requested for this effort in fiscal year 1998 will be sufficient.

Replacement of Systems That Process Paper Tax Returns and Remittances

Also as part of its information systems request, IRS is asking for a $35 million increase over the $9 million it received in fiscal year 1997 to replace two systems—the Distributed Input System (a 12-year old system used to process paper returns)and the Remittance Processing System (an 18-year old system used to process tax payments). IRS reports that the systems are unreliable, costly to operate and maintain, and not year 2000 compliant. IRS is requesting $44 million for fiscal year 1998 to develop a replacement for these two systems and begin pilot testing in January 1998.

Project officials told us that to meet the January 1998 milestone for piloting the new systems, they accelerated the project schedule. As a result, they requested and the Investment Review Board approved, on March 4, 1997, an additional $11.8 million—$5.7 million for fiscal year 1997 requirements and $6.1 million for fiscal year 1998 requirements. Consequently, the project will not need this $6.1 million in fiscal year 1998. Accordingly, Congress should consider reducing the fiscal year 1998 request for this project by $6.1 million.

Request for Additional Returns Processing Staff Raises Questions About Benefits of Electronic Filing

IRS' largest requested budget increase is for $214 million and 195 FTEs to maintain its fiscal year 1997 program levels in fiscal year 1998. According to IRS, most of the $214 million is needed to cover pay and benefits for the employees it has on board. However, $11 million and all 195 FTEs are intended to cover "mandatory workload increases" in its returns processing function. More specifically, IRS has projected that the number of primary tax returns filed will increase from 197.9 million in 1997 to 200 million in 1998. IRS has also projected that 91 percent of the increase in primary tax returns (or 1.9 million returns) will be filed electronically.

The data IRS used to determine its need for $11 million and 195 FTEs indicated that IRS only saves about 5 FTEs for every 1 million returns that are filed electronically. This is contrary to what we would have expected. Because up-front filters keep certain taxpayer errors that are common on paper returns from contaminating electronic returns and because electronic returns bypass the labor intensive and error prone key punching process IRS uses for paper returns, we would expect that the labor and related costs to process electronically-filed returns would be substantially lower than the labor and costs associated with processing paper returns.

Part of the explanation for the smaller-than-expected savings is that electronic filing is not truly paperless. Taxpayers filing electronically, other than through TeleFile, must submit a paper signature document to authenticate the electronic portion of their return. And IRS has to process that document. In January 1993, we reported that IRS needs to resolve various issues that adversely affect the appeal of electronic filing.[11] One of

[11] Tax Administration: Opportunities to Increase the Use of Electronic Filing (GAO/GGD-93-40, Jan. 22, 1993).

those issues is the need to submit paper documents with an electronic return.

Challenges for the Future

Probably the most noteworthy part of IRS' performance during the 1997 filing season to date is the dramatic increase in telephone accessibility. The improvement, however, is not without cost. IRS is using various strategies to improve accessibility, one of which involves detailing staff from other functions to answer the phone. The funding limits and program tradeoffs faced by IRS in fiscal year 1997 and anticipated for fiscal year 1998 are likely to continue for the foreseeable future. The administration's outyear projections actually reflect a decline in IRS funding when inflation is considered.

At the same time, IRS is faced with competing demands and pressure from external stakeholders, including Congress, to improve its operations and resolve longstanding concerns. Modernization of IRS' processes and systems is critical to doing this. So is reaching consensus on IRS' strategic goals and performance measures.

In recent years, Congress has put in place a statutory framework for addressing these challenges and helping Congress and the executive branch make the difficult trade-offs that the current budget environment demands. This framework includes as its essential elements the Chief Financial Officers Act; information technology reform legislation, including the Paperwork Reduction Act of 1995 and the Clinger-Cohen Act; and GPRA.

In crafting these acts, Congress recognized that congressional and executive branch decisionmaking had been severely handicapped by the absence in many agencies of the basic underpinnings of well managed organizations. Our work has found numerous examples across government of management-related challenges stemming from unclear missions accompanied by the lack of results-oriented performance goals, the absence of detailed business strategies to meet those goals, and the failure to gather and use accurate, reliable, and timely program performance and cost information to measure progress in achieving results. All of these problems exist at IRS. To effectively bridge the gap between IRS' current operations and its future vision while living within the budget constraints of the federal government, these challenges must be met.

Under GPRA, every major federal agency must ask itself some basic questions: What is our mission? What are our goals and how will we achieve them? How can we measure performance? How will we use that information to make improvements? GPRA forces a focus on results. GPRA has the potential for adding greatly to IRS performance—a vital goal when resources are limited and public demands are high.

GPRA requires each agency to develop a strategic plan that lays out its mission, long-term goals, and strategies for achieving those goals. The strategic plans are to take into account the views of Congress and other stakeholders. To ensure that these views are considered, GPRA requires agencies to consult with Congress as they develop their strategic plans.

Congress and the administration have both demonstrated that they recognize that successful consultations are key to the success of GPRA and therefore to sustained improvements in federal management. For IRS, these consultations provide an important opportunity for Congress, IRS, and Treasury to work together to ensure that IRS' mission is focused, goals are specific and results oriented, and strategies and funding expectations are appropriate and reasonable. The consultations may prove difficult because they entail a different working relationship between agencies and Congress than has generally prevailed in the past. The consultations are likely to underscore the competing and conflicting goals of IRS programs, as well as the sometimes different expectations of the numerous parties involved.

As a GPRA pilot agency, IRS should be ahead of many federal agencies in the strategic planning and performance measurement process. Nonetheless, IRS remains a long way from being able to ensure that its budget funds the programs that will contribute the most towards achieving its mission goals. While IRS needs more outcome-oriented indicators, it also has difficulty in measuring its performance with the indicators it has. For example, IRS' top indicator is its Mission Effectiveness Indicator. This is calculated by subtracting from the revenue collected the cost of IRS programs and taxpayer burden and dividing that result by true total tax liability. While this approach may be conceptually sound, IRS does not have reliable data to calculate taxpayer burden nor can it calculate true total tax liability.

In summary, IRS' 1997 filing season is going very well in two areas that we have criticized in the past. Telephone accessibility is much higher and more taxpayers are filing electronically.

Regarding IRS' fiscal year 1997 spending and IRS' fiscal year 1998 budget request, there are several questions that Congress may wish to consider as it continues its oversight and appropriations activities. Among these are:

- Should the $36 million that IRS will not be using for systems development and deployment in fiscal year 1997 be rescinded?
- What level of funding will IRS need to make its information systems century date compliant, and will those changes be made in time?
- Does IRS need all of the fiscal year 1998 funding it is requesting for the Distributed Input System/Remittance Processing System replacement project?
- What level of funding should Congress provide for developing new information systems, given the lack of any justification for the $131 million requested for fiscal year 1998 and the $1 billion investment account for fiscal years 1998 and 1999?
- What reliable, outcome-oriented performance measures should be put in place to guide IRS and Congress in deciding how many resources should be given to IRS and how best to allocate those resources among IRS' functional activities?

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

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