United States General Accounting Office

GAO

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

May 2002

TAX ADMINISTRATION

Impact of Compliance and Collection Program Declines on Taxpayers

G A O

Accountability * Integrity * Reliability

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Contents

Abbreviations

ERIS	Enforcement Revenue Information System
GAO	General Accounting Office
IRS	Internal Revenue Service

GAO

Accountability * Integrity * Reliability

United States General Accounting Office
Washington, DC 20548

May 22, 2002

The Honorable Amo Houghton
Chairman, Subcommittee on Oversight
Committee on Ways and Means
House of Representatives

Dear Mr. Chairman:

For the last several years, Congress and others have been concerned about declines in the Internal Revenue Service's (IRS) compliance and collection programs. Many view these programs—such as audits to determine whether taxpayers have accurately reported the amount of taxes that they owe and collection follow-up with taxpayers who have not paid what is owed—as critical for maintaining the public's confidence in our tax system. Taxpayers' willingness to voluntarily comply with the tax laws depends in part on their confidence that their friends, neighbors, and business competitors are paying their share of taxes.

As we previously reported, some declines in compliance and collection programs have been dramatic.[1] For example, from fiscal year 1996 to fiscal year 2000, the number of individual tax returns audited by IRS declined by over 60 percent. Furthermore, IRS was unable to pursue many delinquent taxpayers, deferring collection action on billions of dollars in unpaid taxes.

Because of concerns about declines in IRS's compliance and collection programs, you asked us to assess the declines' overall impact on taxpayers. You asked that in making this assessment, we examine IRS's compliance and collection programs as a whole, recognizing that the amount of unpaid taxes identified by the compliance programs largely determines the workload of the collection programs. Accordingly, we agreed to

[1]See U.S. General Accounting Office, *IRS Modernization: Continued Improvement in Management Capability Needed to Support Long-Term Transformation*, GAO-01-700T (Washington, D.C.: May 8, 2001).

- describe the changes since 1996 in IRS's compliance and collection programs, including the extent of collection deferrals, and the factors contributing to the program changes;
- determine how the program changes have affected taxpayers, including their compliance with tax laws, the buildup of penalties and interest, and the length of time before collection actions are initiated; and
- determine how IRS addressed the program changes, including their effect on taxpayers, in its strategic assessments.

The preparation of strategic assessments is a first step in IRS's new strategic planning, budgeting, and performance management process. In the assessments, IRS's operating divisions are to provide the commissioner and his senior management team with information on significant trends, issues, and problems facing the divisions and present proposals for addressing them.

To measure the change in IRS's compliance and collection programs, we focused on the performance of eight major programs from fiscal years 1996 to 2001. In general, the six compliance programs were designed to (1) check for math errors and unpaid balances during returns processing, (2) determine taxes due from apparent nonfilers detected through computer matching, (3) determine taxes due from apparent underreporters detected through computer matching, (4) audit tax returns filed by individuals, (5) audit tax returns filed by corporations, and (6) audit other tax returns such as estate and gift returns. For taxpayers who are delinquent in paying taxes owed, IRS's collection programs pursue collection through (1) telephone contacts with the taxpayers and (2) personal visits with the taxpayers by IRS field staff.

To measure changes across these eight programs, we compiled data on performance indicators that were common to the programs' operations and that, in the aggregate, would provide an overview of the long-term direction of IRS's compliance and collection programs. The indicators show changes in

- **workload**, such as tax returns filed and therefore available for audit or tax delinquencies assigned to collection;
- **coverage**, such as the proportion of tax returns that were audited;
- **cases closed**, such as the number of apparent nonfiler cases in which IRS made a determination of taxes due;
- **staff time** devoted to a program;
- **productivity**, such as the number of collection cases closed per staff hour;

- **amount of unpaid taxes identified** by compliance programs or **collected** by collections programs; and
- **percentage of unpaid taxes resolved** by full payment or alternative arrangement.

Appendix I contains a detailed discussion of the scope and methodology of the assignment, including a detailed description of the performance indicators used and random samples selected to analyze taxpayer delinquencies and timing of collection actions. Although most data in the report describe changes between 1996 and 2001, we reviewed interim-year data to assure that significant changes were not overlooked. We did our work between October 2000 and April 2002 and in accordance with generally accepted government auditing standards.

Results in Brief

Our indicators showed large and pervasive declines in 5 of the 6 compliance programs (the exception was returns processing) and in both collection programs between fiscal years 1996 and 2001. For example,

- coverage for the audit and matching compliance programs declined by 29 percent to 69 percent;
- staffing and cases closed declined for the five audit and matching programs;
- unpaid taxes that were identified declined in four of the five audit and matching programs; and
- coverage by the telephone and field collection programs declined by 15 percent and 45 percent, respectively.

The decline in collection coverage reflected the collection programs' inability to work a growing proportion of the delinquent cases referred from the compliance programs. In response, by fiscal year 2001, IRS was deferring collection action on about one out of three assigned delinquencies. We estimate that by the end of fiscal year 2001, IRS had deferred collecting taxes from about 1.3 million taxpayers[2] who

[2]Because our estimates come from random samples, there is some sampling error associated with them. We express our confidence in the precision of our results as a 95 percent confidence interval around the estimate. All numerical estimates other than percentages have sampling errors of ±5 percent or less of the value of those numerical estimates, unless otherwise shown as footnotes to the report text. All percentage estimates from the samples have sampling errors of ±5 percentage points or less, unless otherwise shown as footnotes to the report text.

collectively owed about $16.1billion.[3] IRS officials said that absent significant operational change, they had little expectation of reopening many deferred collection cases.

A number of factors contributed to the declines in the programs and in collection coverage, including declines in overall IRS staffing (about 8 percent), increased workload, and increased compliance and collection procedural controls mandated by Congress to better safeguard taxpayer interests. Also, in response to congressional mandates to improve taxpayer service, IRS temporarily reassigned some compliance and collection staff to activities such as answering taxpayer questions. Additionally, IRS officials said that compliance and collection resources were constrained by the need to commit resources to process tax returns and issue refunds.

The declines in IRS's compliance and collection programs affected taxpayers in several ways.

- The likelihood that taxpayer noncompliance would be detected and pursued by IRS declined. For example, coverage in the nonfiler program declined by 69 percent by the end of fiscal year 2001.
- The length of time that taxpayers owed back taxes at the time that they were assigned to collection increased between 1996 and 2001, although IRS intended that by deferring collection action on some older collection cases, it could get to newly assigned cases more quickly.
- The amount of penalties and interest continued to accumulate on deferred collection cases, making future payment increasingly demanding if subsequently pursued by IRS.

Taken together, these changes have reduced the incentives for voluntary compliance, a concern of IRS senior managers. Also, some available, but very limited, data suggest that voluntary compliance may have begun to deteriorate. For example, the number of apparent individual nonfilers increased about three and one-half times faster than the individual tax filing population.

The strategic assessments, which were prepared to provide a basis for IRS senior managers to decide on significant program changes in IRS dealings with individual and small business taxpayers, identified the risk of

[3] The 95 percent confidence interval is $14.8 billion to $17.4 billion.

declining compliance as a major trend, issue, or problem for IRS. These assessments, part of IRS's new strategic planning, budgeting, and performance management process, also proposed a number of compliance and collection initiatives to address noncompliance. The assessments could not quantify the impact that the initiatives may have on taxpayer compliance, because IRS has not yet finished implementing a system for measuring taxpayer compliance. However, as a partial substitute for such information, the assessments could have provided quantitative estimates of the impacts of the initiatives on compliance and collection programs and the gap between them.

To better assure that the assessments promote informed strategic decision making, we are recommending that the commissioner of internal revenue reexamine the extent to which some quantitative information on the impact of proposed program changes should be included in strategic assessments.

In a letter dated May 13, 2002, the IRS commissioner agreed with our recommendations. (See p. 26 for a discussion of agency comments, which are reprinted in app. II.)

Background

Under our voluntary tax system, taxpayers are responsible for filing tax returns that report the full amount of taxes owed (referred to as self-assessment of taxes) as well as pay any taxes that are due. IRS has established eight major compliance and collection programs to check on taxpayer compliance with these responsibilities and to initiate collection action if payment is not received. A descriptive overview of these compliance and collection programs is shown in figure 1. (A detailed description appears in table 4 in app. I.)

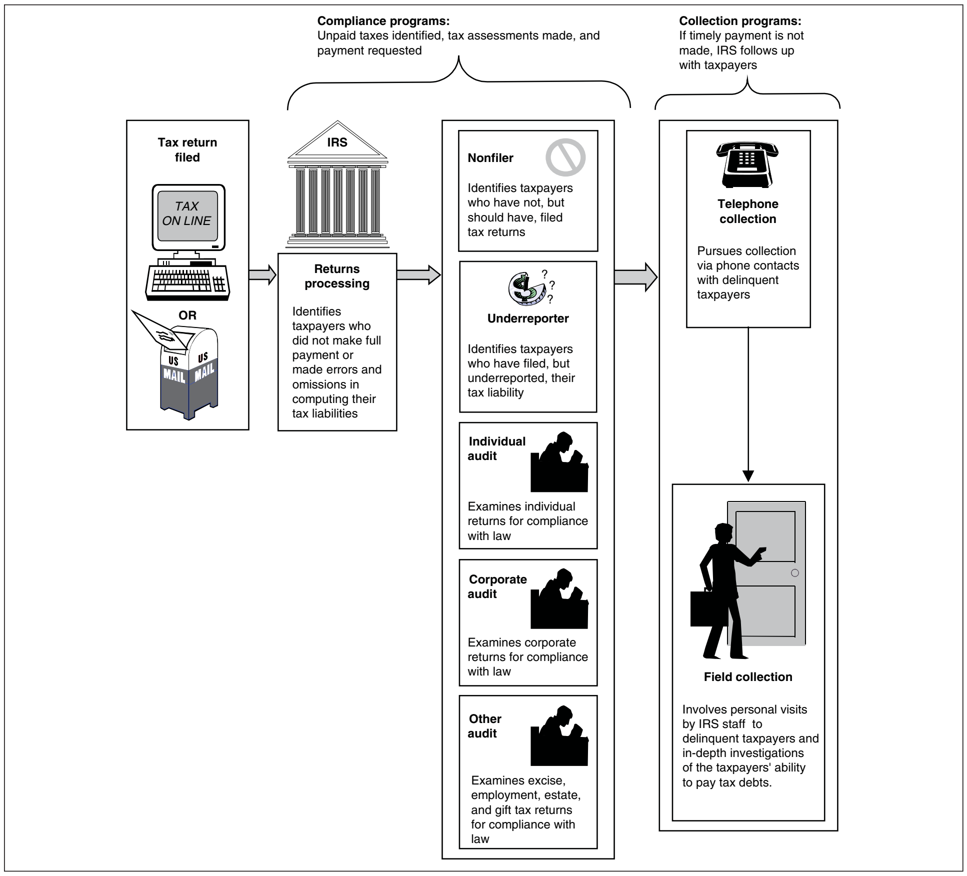
In general, the compliance programs were designed to assure that taxpayers fully and accurately report and pay the amount of taxes that they owe to IRS. As shown in figure 1, IRS's compliance checks begin when taxpayers file their tax returns. As returns are received and processed, they are checked for errors (e.g., math errors and omitted schedules) and unpaid balances. After processing, a tax return may also be selected for review by other compliance programs. Two of these compliance programs use computers to analyze information available to IRS (e.g., earnings on bank deposits) to detect taxpayers who have not filed tax returns or taxpayers who have underreported the amount of taxes owed. IRS may also audit the tax returns filed by individuals, corporations, and others, such as estates, to determine whether the correct tax has been reported and paid. At this point in the compliance process, taxpayers may be asked for records to substantiate their returns. If the compliance programs identify unpaid taxes, IRS makes the tax assessments and requests the taxpayers to make the appropriate payment.[4] If payment is not received, IRS sends a series of collection notices to taxpayers demanding payment of the assessment.

If taxpayers become delinquent—if they do not pay their taxes after being sent collection notices—IRS may initiate collection action through its telephone and field collection programs. In addition to requesting payment from delinquent taxpayers, these programs research the taxpayers' ability to pay their tax debts and may use sanctions, including levies, liens, and seizures, to obtain payment.[5] More-complex unpaid assessments are referred from telephone collection to field collection.

[4]In general, IRS sends taxpayers a written notice that additional tax will be assessed and provides 90 days for them to respond. The proposed tax is automatically assessed if the taxpayer does not respond or does not file an appeal.

[5]Under the Internal Revenue Code, "levy" is defined as the seizure of a taxpayer's assets to satisfy a tax delinquency. IRS differentiates between the levy of assets in the possession of the taxpayer (referred to as "seizure") and the levy of assets, such as bank accounts and wages, which are in the possession of third parties, such as banks or employers (referred to as a "levy"). A lien is a legal claim, filed in accordance with state property law, that attaches to property to secure payment of a debt.

Figure 1: Overview of IRS's Compliance and Collection Process



Source: GAO analysis of IRS information.

Beginning in fiscal year 2001, IRS reorganized into four operating divisions, each responsible for administering tax law for a set of taxpayers with similar needs. By reorganizing in this manner, IRS sought to establish clearer lines of responsibility and accountability for improving service to taxpayers and resolving their tax problems. Through such improvements, IRS expected to better enable taxpayers to comply with the tax laws.

The two largest divisions in terms of staff and number of taxpayers covered, and the primary focus of this report, are the small business division and the wage and investment division. The small business division is responsible for individuals who are fully or partially self-employed and for businesses with assets up to $10 million. The wage and investment division is responsible for individuals who are not self-employed (e.g., wage earners). The other two divisions are responsible for large and midsized businesses and for tax-exempt and government entities.

In general, the IRS operating divisions are responsible for managing the daily operations of the eight major compliance and collection programs, as appropriate for their taxpayers. In some instances, however, the programs are consolidated in one division or two divisions. For example, the field collection program is housed within the small business division and the telephone collection program is split between the small business division and the wage and investment division.

The operations of the compliance and collection programs differ from each other in many respects. Some of the programs (e.g., returns processing and underreporter programs) rely on automation and deal with millions of taxpayers. Some (e.g., corporate audit) are highly labor intensive and deal with far fewer taxpayers. Others (e.g., the nonfiler program) are a combination of automated programs and labor intensive investigations.

Although day-to-day management of IRS's compliance and collection programs is the responsibility of the operating divisions, the commissioner and his senior management team maintain responsibility for making decisions on major operational changes, allocating resources within IRS, and developing agencywide strategic plans. The process for making these decisions starts with the operating divisions' preparing strategic assessments that report on major trends, issues, and problems facing the divisions and proposals for dealing with them. These decisions are subject to public oversight. The IRS Restructuring and Reform Act of 1998[6] (IRS Restructuring Act) established an IRS oversight board, in part to assist Congress in reviewing and approving IRS's budget and strategic planning decisions.

[6]P.L. 105-206.

Compliance and Collection Programs Showed Declines, with Billions of Unpaid Taxes Not Pursued

Overall, our analysis showed significant and pervasive declines in IRS's compliance and collection programs, as measured by indicators such as those covering staffing, work completed, and work outcomes from fiscal year 1996 to fiscal year 2001. Moreover, an increasing gap between collection workload, stemming from assessments made by compliance programs, and collection case closures has led IRS to defer taking action to collect on billions of dollars of tax delinquencies. A number of factors have contributed to these declines. These factors include decreases in overall staffing, decreases in compliance and collection staffing, decreased productivity of the remaining compliance and collection staff, increased compliance and collection procedural controls to better safeguard taxpayer interests, temporary details of compliance and collection staff to taxpayer assistance work, and constraints imposed by the need to process returns and issue refunds.

Compliance Programs Showed Declines in Staffing and Case Outcomes

From fiscal year 1996 through fiscal year 2001, most compliance programs showed significant declines in the amount of staff time expended on compliance work, in the number of compliance cases closed, and in the proportion of the workload reviewed to determine whether additional tax assessments were warranted (i.e., coverage). About half of the programs also saw declines in the productivity of the compliance staff (i.e., case closures per hour of staff time), in the amount of unpaid taxes identified, and in the percentage of unpaid taxes resolved (i.e., the proportion of the unpaid taxes collected without involving the two collection programs). While the declines were not universal, they were pervasive, as illustrated by the shaded areas in table 1. The declines occurred over a period when the programs' workload (e.g., the number of returns filed, apparent nonfilers, or apparent underreporters) was increasing, as also shown in table 1.

Table 1: Percentage Changes in Six IRS Compliance Programs, Fiscal Years 1996–2001

Performance indicators	Returns processing	Nonfiler	Underreporter	Individual audit	Corporate audit	Other audit
Workload	+9	+34	+25[a]	+10	+14	+4
Coverage	n/a[b]	–69	–29[a]	–63	–60	–59
Cases closed	+9	–58	–10[c]	–59	–55	–58
Staff time	+7	–57	–20	–41	–14	–18
Productivity	+2	–1	+13[c]	–31	–47	–48
Dollars of unpaid taxes identified	+21	–2	+33	–43	–20	–11
Percentage of unpaid taxes resolved	—[d]	–12	–2	+68	+29	–23

Note: See appendix I for a description of the trends and data compilation.

[a]Fiscal year data were not available. The trend analysis was based on the filing year of underreporting tax returns.

[b]Since all tax returns must be processed, the coverage indicator is not applicable. However, the amount of work done per return processed has expanded. During the analysis period, returns processing was assigned additional responsibility for dealing with certain types of erroneous claims for tax credits that had previously been handled by its individual audit staff. Based on available data, we estimate that the additional responsibilities increased returns processing error–related work by about 7 percent.

[c]The analysis period covers fiscal years 1997 through 2001; data for fiscal year 1996 were not available.

[d]Less than 1 percent.

Source: GAO review of IRS data.

Compliance coverage fell notably for all compliance programs except returns processing. The declines ranged from about 29 percent to about 69 percent in the five audit and matching compliance programs. Further, the number of cases closed by these programs declined by about 55 percent or more, with the exception of the underreporter program, which declined by about 10 percent.

Also, these five compliance programs generally experienced marked declines in the staff time committed to compliance work and, with one exception, the productivity of staff in closing cases. According to the underreporter program staff, the increased use of automation enabled the program to increase productivity but not sufficiently to maintain coverage.

In general, the amount of unpaid taxes identified by these compliance programs did not decline as much as the number of cases closed. In two of the six compliance programs, the amount of unpaid taxes identified increased. The data available to us do not make clear the extent to which this increase may represent a change in the type of cases worked, increased levels of noncompliance by taxpayers, or other factors, including inflation.[7]

For this period, the data also show a mixed picture with respect to the percentage of unpaid taxes resolved—that is, the percentage of the compliance assessments that the compliance programs collect at the conclusion of their work, without referral to telephone or field collection.[8] The individual audit and corporate audit programs tended to collect a greater proportion of the tax assessments in fiscal year 2001 than in fiscal year 1996, while the nonfiler, underreporter, and other audit programs collected a somewhat reduced proportion of the assessments. In general, the table indicates that the programs that showed the biggest gains in the proportion of unpaid taxes collected also showed the largest declines in the amount of unpaid taxes identified. For example, while the individual audit program showed a 68 percent increase in its collection rate, it also experienced a 43 percent decline in the amount of unpaid taxes identified.

Collection Programs Showed Declines in Workload, Results, and Staffing

Overall, there were almost universal declines in the two collection programs' performance between fiscal years 1996 and 2001, as indicated by the shaded areas in table 2. While collection workload (i.e., the number of delinquencies assigned to collection) declined somewhat as a result of the reduced levels of compliance work, the programs' capacity to close collection cases—such as by securing payment or completing sufficient analysis to determine that payment cannot be made at that time—declined much more.

[7] If adjusted only for inflation (as measured by the price indexes for gross domestic product), for an individual underreporting income at the same rate on a tax return filed in 1996 compared with one filed in 2001, the dollar amount of the unpaid tax would increase by about 9 percent.

[8] In general, payment is requested at the time that any IRS compliance program determines that additional taxes are due.

Table 2: Percentage Changes in Two IRS Collection Programs, Fiscal Years 1996–2001.

Performance indicators	Telephone collection	Field collection
Workload[a]	–24	—[b]
Coverage	–15	–45
Cases closed	–36	–45
Direct staff time	–12	–28
Productivity	–27	–24
Dollars of unpaid taxes collected	–15	–7
Percentage of delinquencies resolved	6	—[b]

[a]Cases referred from telephone collection to field collection were included as field collection workload.

[b]Less than 1 percent.

Source: GAO review of IRS data.

Cases closed declined by over 36 percent, reflecting significant declines in both staff time and productivity, as shown in table 2. In turn, the amount of unpaid taxes collected by the two programs declined, but not as steeply as did the number of cases closed. The percentage of case closures that resulted in resolution of delinquencies, either through immediate payment or through installment arrangements, stayed roughly the same, with no change for field collections and a 6 percent increase for telephone collections

Use of Collection Enforcement Sanctions Decreased

Another indicator of the change in the telephone and field collection programs is IRS's decreasing use of enforcement sanctions, both in absolute numbers and as a proportion of closed collection cases. The number of liens, levies, and seizures dropped precipitously between fiscal years 1996 and 2000 and then increased somewhat during fiscal year 2001. Even with this change, however, table 3 shows that the number of levies and seizures remained 78 and 98 percent below 1996 levels, respectively. Also, when considered as a proportion of closed collection cases, the use of levy and seizure sanctions declined by 64 and 96 percent between fiscal years 1996 and 2001, as shown in table 3. The use of liens showed the most significant turnaround, but as of 2001, the number of lien filings was down 43 percent and as a percentage of case closures was down 6 percent.

Table 3: Number of Enforcement Sanctions and Proportion of Sanctions Used to Compel Payment of Delinquent Taxes, Fiscal Years 1996–2001

	Number of enforcement sanctions[a]			As a proportion of closed cases		
Sanction	1996	2001	Percentage change	1996	2001	Percentage change
Lien	750,225	428,376	–43	15	14	–6
Levy	3,108,926	674,080	–78	62	22	–64
Seizure	10,449	234	–98	—[b]	—[b]	–96

[a]For 2000, the number of liens, levies, and seizures were 287,516; 219,778; and 74; respectively.

[b]Less than 1 percent.

Source: GAO review of IRS compliance and collection program data.

Increasing Gap between Compliance and Collection Capacity Has Led IRS to Defer Collection Action on Billions of Dollars in Tax Delinquencies

By March 1999, collection officials recognized that changes were needed. Their case inventory of delinquent accounts was growing and aging, and the gap between their workload and their capacity to complete work was increasing. They recognized that they could not close all collection cases, and they believed that they needed to be able to deal with taxpayers more quickly, particularly taxpayers who were still in business and owed employment taxes.[9] The officials believed that getting to these delinquencies quickly, before they became unmanageable to the taxpayers, would make collection easier and faster.

In response, collection managers introduced a new collection case selection system. The selection system delivered to collection staff delinquencies that met newly established collection priorities based on delinquency amount and recency, with priority given to employment tax over income tax delinquencies and to taxpayers who contacted IRS to resolve their delinquencies. The system also periodically reviewed cases in telephone collection and field collection backlog and automatically purged those that met certain aging criteria as a result of having been passed over for more recent delinquencies. The automatic purging was accomplished by closing the collection cases as not collectible. This had the effect of

[9]IRS considers employment tax compliance to be among the most challenging issues for small business, since delinquent tax can rapidly compound beyond the employer's ability to pay. See U.S. General Accounting Office, *Tax Administration: IRS's Efforts to Improve Compliance with Employment Tax Requirements Should Be Evaluated*, GAO-02-92 (Washington, D.C.: Jan. 15, 2002).

deferring collection action, in that IRS maintained the right to reinitiate collection action.

Once collection action has been deferred, however, two conditions must be met before IRS will consider reopening a collection case, according to IRS officials. The two conditions are (1) if the taxpayer becomes delinquent again or if IRS receives information indicating that the taxpayer had additional assets that could help pay off the delinquency and (2) if IRS finds the resources to work the collection cases. The taxpayers will, however, be sent annual notices of taxes due and will be subject to having any refunds from subsequently filed tax returns offset by IRS to cover unpaid taxes. Also, IRS will continue to monitor the deferred collection accounts for possible collection action until IRS's statutory right to collect the taxes expires, generally 10 years after taxes are assessed.

Even though IRS has systems for monitoring deferred collection cases, the senior IRS officials responsible for managing collection programs indicated that, absent significant operational changes, they had little expectation that a telephone or field collection case would be reopened for these tax debts alone once collection action had been deferred.

On the basis of our random sample of unpaid tax accounts, we estimate that by the end of fiscal year 2001, after the deferral policy had been in place for about two and one-half years, IRS had deferred collection action on the tax debts of an estimated 1.3 million taxpayers. We also estimate that these 1.3 million taxpayers owed about $16.1 billion[10] in unpaid taxes, interest, and penalties that originated from assessments by all six compliance programs.[11] By fiscal year 2001, IRS was deferring collection action on tax debts at a rate equal to one of three new delinquencies assigned to the collection programs.

While the amounts owed by these taxpayers were not inconsequential, we found that, consistent with IRS's stated collection deferral priorities, these taxpayers owed less and had been delinquent longer than other delinquent taxpayers. We estimate that the median amount owed by the taxpayers for

[10]The 95 percent confidence interval is $14.8 billion to $17.4 billion.

[11]We estimate that about 34 percent of the assessments were originated by the nonfiler program, about 34 percent by the returns processing program, about 13 percent by the 3 audit programs, about 7 percent by the underreporter program, and about 11 percent by other sources, such as penalties.

whom collection action was deferred was about $4,500,[12] compared with $5,500[13] for other delinquent taxpayers in the collection population. Also, the taxpayers for whom collection action was deferred tended to have been delinquent for a longer period of time—about an estimated 5.6 years versus an estimated 3.9 years.

Declining Staff and Productivity and an Emphasis on Taxpayer Service Contributed to Compliance and Collection Declines

A number of factors contributed to the decline in compliance and collection programs. Generally, IRS faced overall staffing declines while it confronted several competing and growing workload demands. Overall,

- aggregate staffing, measured by full-time equivalents, was about 107,000 in fiscal year 1996 and about 98,000 in fiscal year 2001—about an 8 percent decline;
- individual income tax returns filed increased from about 119 million in fiscal year 1996 to about 130 million in fiscal year 2001—about a 9 percent increase; and
- business income returns (corporate and partnership), which are filed by taxpayers that have more complex dealings with IRS, increased by 17 percent, from 6.5 million returns in 1996 to 7.6 million returns in 2001.

While overall staffing declined about 8 percent, the impacts on almost all of the compliance and collection programs were generally much larger, as shown in tables 1 and 2. According to IRS senior officials, to assure that the tax returns filed by taxpayers are processed timely and that timely payments are made to taxpayers owed refunds, IRS first allocated its resources to meet the returns processing program's increasing workload before it funded the other compliance and collection programs. Also, the officials provided data that showed that at the beginning of the six-year period, IRS was adjusting down from compliance and collection staffing increases during the late 1980s and early 1990s. Comparing IRS data on professional staff levels for audit and field collection in fiscal year 2001 with data on the pre-1987 buildup shows a decline of about 21 percent.

[12] We also estimate that the average amount of the tax debts was about $12,400, with a 95 percent confidence interval of $11,400 to $13,400.

[13] We also estimate that the average amount of the tax debts was about $28,300, with a 95 percent confidence interval of $26,900 to $29,700.

Also during this period, the IRS Restructuring Act, enacted in 1998, provided additional rights for taxpayers and imposed additional administrative responsibilities on IRS's compliance and collection programs. For example, prior to IRS's using enforcement sanctions to collect unpaid taxes, additional notifications and opportunities for appeals were required to be provided to taxpayers. Also, compliance and collection staff were required to keep records of contacts with third parties and to make taxpayers aware of such contacts. Further, collection staff were required to prepare additional documentation, such as certifications that they had verified that the taxes were past due and that the sanctions were appropriate given the taxpayers' circumstances, and to submit that documentation to a higher-level manager for review and approval. Deviations from this and other requirements of the act may subject compliance and collection staff to disciplinary action, including mandatory termination of employment, for actions such as willfully not obtaining certain required approval signatures or for actions constituting taxpayer harassment.[14] According to some senior officials, the potential for disciplinary action has resulted in IRS compliance and collection staff's working more slowly and hesitantly, spending much more time documenting their actions.

In addition, the act mandated that IRS improve service to taxpayers, such as telephone assistance; following this mandate, IRS undertook a major organizational restructuring and modernization effort. In response to these demands, and with a declining pool of staff resources, IRS reallocated staff from compliance (other than returns processing) and collection programs to provide additional support to taxpayer assistance services. Some of the reallocation was accomplished by allowing attrition to occur without hiring replacement staff for compliance and collection programs, and some was accomplished by temporarily detailing compliance and collection staff to other IRS programs. For example, from fiscal year 1996 to fiscal year 2000, the percentage of field collection professional staff time detailed to supplement taxpayer assistance staff during the tax filing season—in large part assisting taxpayers who requested assistance at IRS

[14]The act required that the commissioner terminate the employment of an IRS employee if there is a final administrative or judicial determination that the employee committed any 1 of 10 acts or omissions. These acts include the willful failure to obtain the required approval signatures on documents authorizing the seizure of a taxpayer's home, personal belongings, or business assets or violations of the Internal Revenue Code, Treasury regulations, or IRS policies for the purpose of retaliating against or harassing a taxpayer, taxpayer representative, or other IRS employee.

offices—grew from about 4 percent of collection time in fiscal year 1996 to about 14 percent in fiscal year 2000 before dropping to 5 percent in 2001. Staff time charged to compliance and collection programs between fiscal years 1996 and 2001 declined in all but one program (i.e., returns processing) and in several instances by 20 percent or more, as shown in tables 1 and 2.

According to IRS officials, the demands on resources also affected productivity as indicated by the number of cases closed per staff hour of compliance and collections staff time. The officials said that some of the IRS Restructuring Act requirements, such as suspending collection action to provide time for additional notifications and appeal hearings, increased the amount of staff time and calendar time required to close a case. They also noted that some of the potentially available staff time was consumed in training for the new requirements. In addition, according to IRS officials, from 1996 through 2001 the complexity of cases worked by compliance and collection staff had changed, requiring more time to complete cases. For example, many erroneous claims for tax credits that had been handled by audit prior to fiscal year 1997 were reassigned to returns processing, which could handle the claims largely on an automated basis.

IRS officials did not provide us with any quantitative analysis that distinguished between the effects of the IRS Restructuring Act and those of other factors influencing productivity. On the basis of the data available to us, we could not discern the extent to which the changes in productivity were attributable to the act or to other factors.

Taxpayers Face Reduced Sanctions for Noncompliance and Reduced Incentives to Voluntarily Comply

The declines in IRS's compliance and collection programs affected taxpayers in several ways. Our analysis showed that noncompliance was less likely to be detected by compliance programs and pursued or sanctioned by collection programs. Also, the length of time that taxpayers had owed back taxes when they were assigned to collection increased between fiscal years 1996 and 2001, although IRS intended that by deferring collection action on some older collection cases, it could get to newly assigned cases quicker. For the deferred cases, penalties and interest continue to accumulate, making future payment of those assessments increasingly demanding. Taken together, these changes have reduced the incentives for voluntary compliance, a concern of IRS senior managers. Some available, but very limited, data suggest that voluntary compliance may have begun to deteriorate.

Noncompliance Was Less Likely to Be Detected and Pursued

The data presented earlier on the changes in IRS's compliance and collection programs showed that the likelihood that taxpayer noncompliance would be detected and pursued by IRS declined between fiscal years 1996 and 2001. For example, in situations where IRS had information that a tax return was due but not filed, the rate of IRS compliance follow-up declined about 69 percent. In situations where IRS had information that a tax return understated the amount of taxes owed, the decline in follow-up was about 29 percent. Moreover, even when compliance follow-up took place and the taxpayers were found to owe back taxes, because of IRS's practice of deferring collection action, the taxpayers had about a one in three chance of not being pursued by IRS collection staff. And, if pursued, the delinquent taxpayers were about 64 percent less likely to experience an enforced collection action such as the levying of their assets. These changes reduced the incentives to comply with the tax laws.

Some Increased Time in Initiating Collection

Although IRS intended that by deferring collection action on some tax debts it would be able to initiate collection action for some higher-priority cases sooner, our random samples showed that the median length of time that taxpayers had owed back taxes at the time they were assigned to collection increased between 1996 and 2001. We estimate these increases as follows:

- Taxpayers who were assigned to collection as of the end of fiscal year 1996 had owed back taxes for about 1.2 years when they were assigned to telephone or field collections.
- Taxpayers who were assigned to collection as of the end of fiscal year 2000 had owed back taxes for about 1.3 years when they were assigned to telephone or field collections
- Taxpayers who were assigned to collection as of the end of fiscal year 2001 had owed back taxes for about 1.6 years when they were assigned to telephone or field collections.

On the basis of our analysis of randomly sampled collection case files related to taxpayers who were delinquent at the end of fiscal year 2000 (2001 case files were not available at the time of our field work), we noted that much of this timeframe was attributable to the concluding of interim matters—for example, resolving questions on the amount of the taxpayers' tax liability or providing time for the taxpayers to make periodic payments. When we factored in the time taken to conclude these interim matters, our sample showed that, on average, the taxpayers had been potentially eligible for collection actions for about 6 months[15] when they were contacted by collection staff. Also, on comparing the sampled collection cases that were initiated before and after IRS started deferring collection cases, we found no statistically significant difference in the timing of the collection action.

Accordingly, as shown by our samples, deferring some collection cases helped IRS to keep its collection caseload from ballooning but did not improve collection timeliness. According to IRS senior officials, some recent procedural changes, designed to speed up the assignment of priority cases to collection staff, should improve the timing of the collection actions that are initiated.

Taxpayers Face Buildup of Penalties and Interest When IRS Defers Taking Collection Action

As expected, our random sample of unpaid tax assessments as of the end of fiscal year 2001 showed that taxpayers for whom collection action was deferred were statistically different from taxpayers who were assigned to telephone and field collection. We estimate these differences as follows:

- Taxpayers who were assigned to telephone or field collection were about three times as likely to have made payments on their delinquencies during the previous year as those for whom collection action was deferred.
- Taxpayers for whom collection action was deferred owed about 7 times more in penalties and interest as a percentage of their income (or of payroll for businesses) than the taxpayers who were assigned to collection.[16]

Not surprisingly, these differences indicate that follow-up by telephone or field collections may have a strong impact on generating payment on tax liabilities and preventing a buildup of penalties and interest. In turn, deferring collection action to a later date would make resolution of the delinquencies more demanding on affected taxpayers.

[15]The 95 percent confidence interval is 4 to 8 months.

[16]The 95 percent confidence interval is 6.7 to 7.9 times. Analyses are based on comparisons of taxpayers whose delinquencies were at the median level and whose account data showed that a tax return had been filed within the previous two years. For individuals, income was the reported adjusted gross income. Given the differences in the ways that IRS captured business data, for consistency we used total compensation paid (i.e., payroll) as the measurement base.

Incentives to Voluntarily Comply Are Reduced

Improving voluntary compliance—the percentage of the taxes owed that taxpayers voluntarily report and pay—is a major goal of IRS's compliance and collection programs. Although the compliance and collection programs may focus on noncompliant taxpayers, IRS believes that the deterrent effect of the programs influences the compliance of all taxpayers. Currently, IRS does not have a measure of voluntary compliance.

The declines in IRS's compliance and collection programs that occurred from fiscal year 1996 through fiscal year 2001 have reduced some of the incentives useful for (1) inducing noncompliant taxpayers to become compliant and (2) reassuring compliant taxpayers that they are not being disadvantaged by voluntarily reporting and paying the full amount of taxes that they owe. Because only a little more than two years of data were available for analyzing taxpayers for whom collection action was deferred, we were not able to determine whether the deferral will have any long-term effects on the taxpayers' future payment compliance and on the amount of interest and penalties owed. If no action is taken to collect the delinquent tax, however, the motivation to pay the taxes owed is reduced.

Available, but very limited, data suggest that voluntary compliance may have deteriorated. For example, the growth in the number of apparent nonfilers (i.e., individuals who have not filed tax returns, as identified by IRS document matching over the period fiscal years 1996 to 2001) increased about three and one-half times faster than the tax filing population. Similarly, the number of apparent underreporters increased about one and one-half times faster. As discussed in the following section, compliance trends are a concern of IRS senior managers.

IRS's New Strategic Assessments Address Tax Noncompliance but Could Provide More Quantitative Information

The strategic assessments prepared by the wage and investment and small business operating divisions identified the risk of declining compliance as a major issue for IRS. These assessments, part of IRS's new strategic planning, budgeting, and performance management process, also proposed a number of compliance and collection initiatives to address noncompliance. The operating divisions could not quantify the impact that their initiatives are expected to have on compliance, because IRS is several years away from finishing a system for making compliance estimates. However, as a partial substitute for such information, the assessments could have provided quantitative information on the expected impacts of the initiatives on compliance and collection programs.

Strategic Assessments Are a Key First Step in IRS's Strategic Planning, Budgeting, and Performance Management Process

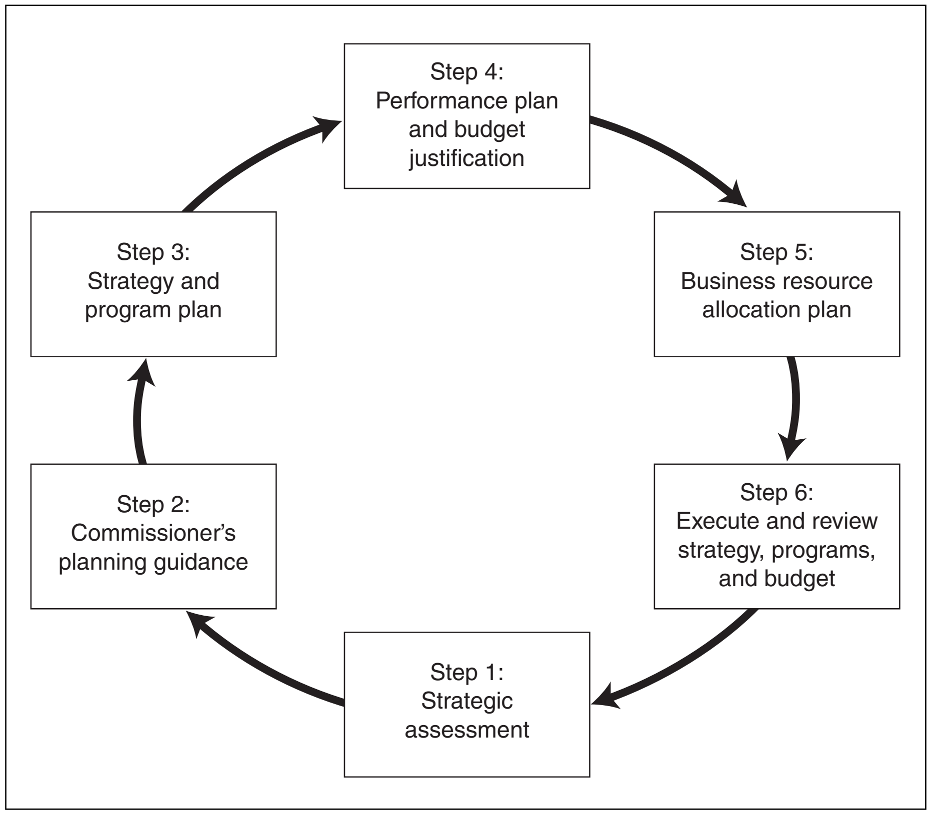
To make decisions for fiscal year 2002 and subsequent year operations, IRS implemented a new strategic planning, budgeting, and performance management process during fiscal year 2000. The process begins, as outlined in figure 2, with the operating divisions' preparing strategic assessments. After receipt and review of the strategic assessments, the commissioner provides detailed guidance (step 2) to the operating divisions for developing their strategy and program plans (step 3). These plans are then incorporated (step 4) into an IRS-wide performance plan (which sets out measurable objectives such as the number of audits to be done). These plans are, in turn, incorporated into IRS's budget justification (which sets out its resource requests to Congress). The remaining steps (5 and 6) involve allocating resources across IRS divisions and programs and monitoring division adherence to the planning and budgeting decisions.

According to IRS senior management, the strategic assessments are intended to provide "big picture" information for making decisions on significant operational changes. To obtain that decision-making information, senior management instructed the operating divisions to prepare brief strategic assessment documents that summarize

- important trends, issues, and problems facing the operating divisions and IRS and
- proposals for dealing with those trends, issues, and problems.

The operating divisions were instructed to describe the trends, issues, and problems, using quantifiable, measurable data when possible. Also, in proposing changes, the operating divisions were to determine the most critical trends requiring attention by considering their impact on the achievement of IRS's goals. These goals included increasing taxpayer compliance and increasing the fairness of the compliance programs.

Figure 2: IRS's Strategic Planning Process



Source: GAO review of IRS planning documentation.

The planning process helps IRS to implement the Government Performance and Results Act (Results Act).[17] The act's goal was to improve the management of federal programs by having federal agency decision making focus on impacts (i.e., the measurable results achieved by their programs). The agencies were required to periodically develop strategic plans, identify measures for assessing progress in achieving plan goals, and use the measures to report on the progress in meeting plan goals. Operationalizing the act's mandate was left to the agencies. We have reported in the past that IRS's approach, designed to reconcile competing

[17]P.L. 103-62.

priorities and initiatives with the realities of available resources, has helped it to make progress in defining its strategic direction.[18]

In addition, IRS's strategic plans and budgets are reviewed by an oversight board before they are submitted to the Congress. The board was established by the IRS Restructuring Act as a means of providing Congress with advice on IRS's strategic plans and budget.

Strategic Assessments Proposed Initiatives to Address Noncompliance but Provided No Quantitative Information on the Expected Impact

In the strategic assessments that we reviewed, both the wage and investment and small business operating divisions recognized that declines in their compliance and collection activities created a risk that taxpayer compliance could be negatively affected. Some of the identified risks included the potential for decreased tax collections, potential for increased numbers of nonfilers, and potential for increased underreporting of taxes owed.

To counter declines in both compliance and collection activities and to deal with the potential risks, the IRS operating divisions identified a number of changes warranting priority attention, including the need to

- reengineer the audit process,
- reengineer the collection process,
- reevaluate the telephone collection selection criteria for individuals,
- use more document matching to identify underreporters,[19] and
- increase audit and underreporter program resources.

The proposed initiatives have the potential both to increase compliance and collection activities and to rebalance those activities. For example, if productivity gains result from collection process reengineering, the collection staff will be able to close additional delinquency cases. Also, according to IRS officials, additional delinquencies could possibly be closed by outsourcing some collection activities. The officials indicated that outsourcing is an issue being studied by the collection reengineering team.

[18]See U.S. General Accounting Office, *IRS Modernization: Continued Improvement in Management Capability Needed to Support Long-Term Transformation*, GAO-01-700T (Washington, D.C.: May 8, 2001).

[19]IRS has embarked on a program to match information on income distributions from partnerships and certain corporations to their owners.

Because of a lack of information, the operating divisions' strategic assessments could not quantify the impact that their changes may have on taxpayer compliance. Currently, IRS lacks reliable data on the voluntary compliance rate and information on how IRS's compliance and collection programs influence that rate. In May 2000, IRS established a research office to develop a new approach for measuring compliance. However, IRS will not have new data on the compliance rate for individuals and businesses for several years and could take longer to develop estimates of how compliance and collection programs influence the rate.[20]

The assessments that we reviewed, however, missed opportunities to at least partially compensate for the lack of quantitative estimates of the impact that the proposed changes would have on compliance. Some examples of the type of quantitative estimates that could be provided are suggested by the information that we presented in the first two sections of this report. Such quantitative estimates might include the impact on compliance and collection workload, coverage, cases closed, staffing, productivity, dollars of unpaid taxes identified, and percentage of taxes resolved. Other quantitative estimates could address the benefits and costs associated with the proposed changes. Although such estimates would be only a partial substitute for an estimate of the impact on the ultimate result, compliance, they would provide quantitative information about the expected impact on the declines in compliance and collection programs and the growing gap between them.

Senior managers told us that the strategic assessments were important, providing the starting point in the management decision-making chain for rationing IRS's limited resources to the most important priorities. The officials also said that even if the basis for some aspects of strategic decision making, such as the balance between compliance and collection programs, were not explicitly addressed in the strategic assessments, they believed that sound decisions had been made as a result of IRS's implementing the new strategic planning process. For example, they indicated that the collection reengineering effort had the potential to

[20]During October 2002, IRS expects to begin a study on the extent to which individual taxpayers voluntarily report the full amount of taxes that they owe. IRS expects the final report in April 2004. This report will be supplemented with an analysis of IRS data on (1) the extent to which currently filed returns are accompanied by full payment and (2) the extent to which individuals who are required to file tax returns actually do so. IRS has already produced data on nonfilers and expects to complete a payment analysis shortly, according to IRS senior officials.

affect the balance between collection and compliance activities. They said that as managers gained more experience with the process, their strategic assessment reports would improve.

Estimating the impacts of proposed initiatives would have some costs and could lengthen a document intended to be "strategic" and therefore brief. However, both IRS guidance and the Results Act emphasize the value of quantitative information related to performance, especially the impact or results that programs were achieving. Some quantitative information about the expected impacts of proposed program changes could provide IRS senior managers a fuller understanding of the trade-offs involved in planning the allocation of IRS resources to compliance and collections programs.

In addition, quantitative information might have other benefits. Internally, it might provide lower-level managers not directly involved in strategic decision making a better understanding of the reasons for decisions and expected results. Externally, quantitative information from the strategic assessments might facilitate decision making by Congress, the oversight board, and others. For example, quantitative information from the strategic assessments could be incorporated into documents going to Congress, such as the annual budget request.

Conclusions

The commissioner and senior managers recognize that the declines in IRS's compliance and collection programs are a strategic problem that puts a major part of the agency's mission, ensuring compliance with the tax laws, at risk. Problems of this magnitude, involving the level of IRS resources and the allocation of those resources within the agency, must be dealt with by top management and external stakeholders including Congress and the oversight board. To facilitate such decision making, IRS has implemented its new strategic planning, budgeting, and performance management process. Strategic assessments are the basis for the process and, by extension, are also part of the basis for decisions about IRS's budget and strategy made by Congress and others.

We support IRS's new approach to strategic planning, an approach that seeks to integrate planning and budgeting based on quantifiable information with management decision making. We also recognize that IRS's strategic assessments, and thus strategic planning, are constrained by the absence of data on the impact that IRS operations have on taxpayer compliance. Nonetheless, opportunities exist to make the strategic assessments more informative. How much quantitative information should be provided in strategic assessments is a decision for the primary users of the assessments, IRS's top managers. Making the strategic assessments more quantitative will not resolve IRS's strategic problems but could contribute more information to the decision-making process.

Recommendation

Based on experience to date using strategic assessments, we recommend that the commissioner of internal revenue reexamine the extent to which some quantitative information on the impact of proposed program changes should be included in strategic assessments.

Agency Comments

The commissioner of internal revenue provided written comments on a draft of this report in a May 13, 2002, letter, which is reprinted in appendix II. The commissioner agreed with our findings and recommendation and described some ongoing efforts to improve productivity and to reverse declines in compliance and collection programs. He said that steps were being taken to increase the use of quantitative data in strategic decision making, including the development of a methodology for assessing costs and benefits that will be refined as IRS proceeds through future planning cycles.

As arranged with your office, we plan no further distribution of this report until 30 days from its date of issue, unless you publicly announce its contents earlier. After that period, we will send copies to Representative William M. Thomas, chairman, and Representative Charles B. Rangel, ranking minority member, House Committee on Ways and Means; Representative William J. Coyne, ranking minority member, Subcommittee on Oversight, House Committee on Ways and Means; and Senator Max Baucus, chairman, and Senator Charles E. Grassley, ranking republican member, Senate Committee on Finance. We will also send copies to the Honorable Paul H. O'Neil, secretary of the treasury; the Honorable Charles O. Rossotti, commissioner of internal revenue; the Honorable Mitchell E. Daniels, Jr., director, Office of Management and Budget; and other interested parties. Copies of this report will be made available to others on request. In addition, the report will be available at no charge on the GAO Web site (www.gao.gov).

If you have any questions, please contact me or Thomas Richards at (202) 512-9110. Key contributors to this report are acknowledged in appendix III.

Sincerely yours,

James R. White
Director, Tax Issues

Appendix I: Objectives, Scope, and Methodology

As requested, the objectives of GAO's review were to

- describe the changes since 1996 in IRS's compliance and collection programs, including the extent of collection deferrals, and the factors contributing to the program changes;
- determine how the program changes have affected taxpayers, including their compliance with tax laws, the buildup of penalties and interest, and the length of time before collection actions are initiated; and
- determine how IRS addressed the program changes, including their effect on taxpayers, in its strategic assessments.

Scope and Methodology

We first identified IRS's major compliance and collection programs. On the basis of our analysis of IRS data system reports and discussions with IRS officials, we identified 8 such programs. In general, compliance programs are designed to assure that taxpayers fairly and accurately report and pay the amount of taxes that they owe. Collection programs are to follow up with taxpayers to obtain payment and initiate enforcement action if taxpayers become delinquent by not paying their tax after being sent notices. Descriptions of the compliance and collection programs appear in table 4.

Table 4: Description of IRS Compliance and Collection Programs

Program	Description
Compliance programs	
Returns processing	Designed to identify and correspond with taxpayers who did not make full payment with their tax return filing ("balance-due returns") or who filed returns with errors or certain other omissions ("math errors").
Nonfiler	Designed to correspond and, if necessary, make telephone or field contacts with taxpayers who according to IRS records have not, but should have, filed tax returns. IRS identifies these apparent nonfilers by computer-matching information returns, such as those filed by banks reporting earnings by taxpayers, with the tax returns that are filed with IRS and IRS's masterfile records on taxpayers.
Underreporter	Designed to correspond with taxpayers whose tax returns, according to IRS records, have underreported the amount of taxes owed. IRS identifies these apparent underreporters by computer-matching information returns, such as those filed by banks reporting earnings by taxpayers, with the taxpayers' tax returns that are filed with IRS.
Individual audits	Designed to examine individual income tax returns for compliance with tax law.
Corporate audits	Designed to examine corporate income tax returns for compliance with tax law.
Other audits	Designed to examine other tax returns such as those for partnerships, estate and trust income, estate tax, employment, and excise taxes for compliance with tax law.
Collection programs	
Telephone collection	If taxpayers become delinquent (i.e., do not pay their taxes after being notified of the amount past due), the IRS staff assigned to the telephone collection program may initiate collection action over the phone or in writing. If the contacted taxpayers are not responsive to attempts to resolve their delinquencies, the collection staff is authorized, under certain circumstances, to initiate enforced collection action. These actions include recording liens on taxpayer property and sending notices to levy taxpayer wages, bank accounts, and other financial assets held by third parties.[a] If more in-depth analyses are required, telephone collections may refer the case to field collections.
Field collection	To collect delinquent taxes, IRS field collection staff may visit delinquent taxpayers at their homes or businesses as well as contact them by telephone and mail. The staff are responsible for making in-depth investigations of taxpayers' ability to pay their tax debts. To compel compliance, the staff are authorized, under certain circumstances, to record liens on taxpayer property or levy taxpayer wages, bank accounts, and other financial assets held by third parties and to seize other assets owned by the taxpayer.[a]

[a]Under the Internal Revenue Code, "levy" is defined as the seizure of a taxpayer's assets to satisfy a tax delinquency. IRS differentiates between the levy of assets in the possession of the taxpayer (referred to as "seizure") and the levy of assets, such as bank accounts and wages, that are in the possession of third parties, such as banks or employers (referred to as "levy"). A lien is a legal claim, filed in accordance with state property law, that attaches to property to secure payment of a debt.

Source: GAO review of IRS data.

As indicated by table 4, the separation point between compliance and collection programs is the point at which a taxpayer is determined to be delinquent. At that point, the taxpayer has not paid taxes after being notified by the compliance component of the amount due and after being sent collection notices—usually three or more to individuals and two to businesses.

Changes in Compliance and Collection Programs

To measure changes across the eight programs, now managed by four divisions, we identified performance indicators that would be common to their operations and that, in the aggregate, would provide an overview of the long-term direction of IRS's compliance and collection programs. The indicators were not intended to provide a comprehensive evaluation of program performance. Rather, the indicators were to provide a general overview of changes in compliance and collection workload, staff resources committed to dealing with the workload, productivity of the resources, work completed, extent of the workload addressed, and work outcomes in terms of unpaid taxes identified and unpaid taxes resolved. Table 5 provides a general description of the seven performance indicators, together with a more detailed description of the indicators as they apply to the eight compliance or collection programs.

Table 5: Definitions of Performance Indicators

Performance indicator	Program-specific performance indicator
Workload: Comparison of the number of work units that were available to be worked in fiscal year 1996 with comparable data for fiscal year 2001.	**Returns processing**: Comparison of the numbers of tax returns filed (individual income, individual estimated tax, corporation income, partnership, estate and trust income, estate tax, employment, excise tax, exempt organizations, employee plans, and supplemental filings) for fiscal year 1996 with comparable data for fiscal year 2001.
	Nonfiler: Comparison of the total number of apparent individual nonfilers available for compliance follow-up in fiscal year 1996 with comparable data for fiscal year 2001. IRS identified the population of apparent nonfilers by matching information returns against individual return filings on a tax year basis. Given that the nonfiler program worked tax year 1994 cases in fiscal year 1996 and tax year 1999 cases in fiscal year 2001, this tax year data is reported as fiscal years 1996 and 2001 workload data. Data on apparent business nonfilers was not available for 1996 and therefore cannot be compared with data for fiscal year 2001. Accordingly, business nonfilers have not been included as part of potential workload.
	Underreporter: Comparison of the total number of apparent individual underreporters available for compliance follow-up in fiscal year 1996 with comparable data for fiscal year 2001. IRS identified the population of apparent underreporters through matching information returns against individual return filings on a tax year basis. Most of the underreporter program for fiscal year 1996 involved reviewing tax year 1992 and 1993 returns, and most of fiscal year 2001 data involved reviewing tax year 1998 and 1999 tax returns
	Individual audit: Comparison of the number of individual income tax returns available for examination in fiscal year 1996 with comparable data for fiscal year 2001. We used IRS's method for determining the number of individual income tax returns available for examination, which considers tax returns filed in the previous year as those available for examination. For fiscal year 1996 workload, we used tax returns filed in calendar year 1995, and for fiscal year 2001 workload, we used tax returns filed in calendar year 2000.
	Corporate audit: Comparison of the number of corporate tax returns available for examination in fiscal year 1996 with comparable data for fiscal year 2001. We used IRS's method for determining the total number of corporation income tax returns available for examination, which considers tax returns filed in the previous year as those available for examination. For fiscal year 1996 workload, we used tax returns filed in calendar year 1995, and for fiscal year 2001 workload, we used tax returns filed in calendar year 2000.

Performance indicator	Program-specific performance indicator
	Other audit: Comparison of the number of partnership, estate and trust income, estate tax, employment, and excise for tax returns available for examination in fiscal year 1996 with comparable data for fiscal year 2001. We used IRS's method for determining the total number of tax returns available for examination, which considers tax returns filed in the previous year as those available for examination. For fiscal year 1996 workload, we used tax returns filed in calendar year 1995, and for fiscal year 2001 workload, we used tax returns filed in calendar year 2000.
	Telephone collection: Comparison of the number of delinquent accounts assigned (issued) to the telephone collection program during fiscal year 1996 with comparable data for fiscal year 2001. The totals were adjusted to account for the number of modules referred from the telephone program to field collection and from field collection to the telephone program during the year.
	Field collection: Comparison of the number of delinquent accounts assigned (issued) to field collection, including support components (a backlog holding area referred to as the queue and service center collection branch) during fiscal year 1996 with comparable data for fiscal year 2001. The totals were adjusted to account for the number of modules referred from the telephone program to field collection and from field collection to the telephone program during the year.
Cases closed: Comparison of the number of compliance and collection work units closed (i.e., closure represents a compliance decision as to the accuracy of the reported tax liability or a collection decision on collection of a liability) in fiscal year 1996 with comparable data for fiscal year 2001.	**Returns processing**: Comparison of the total tax returns processed during fiscal year 1996 with comparable data for fiscal year 2001.
	Nonfiler: Comparison of the number of apparent nonfiler cases closed in fiscal year 1996 with comparable data for fiscal year 2001. Nonfiler program case closures include dispositions such as those made through correspondence, investigations, or examinations but exclude cases closed without being worked to a conclusion, such as case deferrals. To avoid double-counting closures, collection referrals to audit were subtracted from collection dispositions because audit closures had been added to the total.
	Underreporter: Comparison of the number of apparent underreporter cases that were closed (a determination made as to whether additional taxes were owed) in fiscal year 1997 with data for fiscal year 2001. Fiscal year 1997 data were used because fiscal year 1996 data on case closures was not available.
	Individual audit: Comparison of the number of individual examinations closed in fiscal year 1996 with comparable data for fiscal year 2001.
	Corporate audit: Comparison of the number of corporate examinations closed in fiscal year 1996 with comparable data for fiscal year 2001.
	Other audit: Comparison of the number of partnership, estate and trust income, estate tax, employment, and excise tax return examinations closed in fiscal year 1996 with comparable data for fiscal year 2001.
	Telephone collection: Comparison of the number of delinquent accounts worked to closure (i.e., excludes deferrals) in fiscal year 1996 with comparable data for fiscal year 2001.
	Field collection: Comparison of the number of delinquent accounts worked to closure (i.e., excludes deferrals) in fiscal year 1996 with comparable data for fiscal year 2001. These data include closures by supporting components, such as the service center collections branch.
Coverage: Comparison of the proportion of workload reviewed in fiscal year 1996 (i.e., cases closed during the year as a percentage of cases available to be worked during the year) with comparable data for fiscal year 2001.	**Returns processing**: Comparison of the proportion of filed tax returns that are processed by returns processing in fiscal year 1996 with comparable data for fiscal year 2001. Processing all income tax returns in the same year that they are received for both fiscal year 1996 and fiscal year 2001 would constitute 100 percent coverage in each year and a 0 percent change in coverage.

Performance indicator	Program-specific performance indicator
	Nonfiler: Comparison of the proportion of apparent nonfiler cases that were worked to resolution in fiscal year 1996 (i.e., fiscal year 1996 nonfiler closures as a percentage of apparent nonfilers cases available to be worked in fiscal year 1996) with comparable data for fiscal year 2001.
	Underreporter: Comparison of the proportion of apparent underreporter cases that were closed in fiscal year 1996 with comparable data for fiscal year 2001. IRS identified the population of apparent underreporters through matching information returns against individual return filings on a tax year basis. Most of the underreporter program for fiscal year 1996 involved reviewing tax years 1992 and 1993 returns, and most of fiscal year 2001 data involved reviewing tax years 1998 and 1999 tax returns. Coverage for fiscal year 1996 is measured by comparing the number of closed returns for tax years 1992 and 1993 with the workload. Coverage for fiscal year 2001 is measured by comparing the number of closed returns for tax years 1998 and 1999 with the workload.
	Individual audit: Comparison of the proportion of individual income tax return filings that were examined in fiscal year 1996 with comparable data for fiscal year 2001. Consistent with IRS's practice in computing audit rates, the comparison involved relating audit closures in fiscal years 1996 and 2001 with returns filed in calendar years 1995 and 2000, respectively.
	Corporation audit: Comparison of the proportion of corporation income tax return filings that were examined in fiscal year 1996 with comparable data for fiscal year 2001. Consistent with IRS's practice in computing audit rates, the comparison involved relating audit closures in fiscal years 1996 and 2001 with returns filed in calendar years 1995 and 2000, respectively.
	Other audit: Comparison of the proportion of partnership, estate and trust income, estate tax, employment, and excise tax returns filings that were examined in fiscal year 1996 to comparable data for fiscal year 2001. Consistent with IRS's practice in computing audit rates, the comparison involved relating audit closures in fiscal years 1996 and 2001 with returns filed in calendar year 1995 and 2000, respectively.
	Telephone collection: Comparison of the proportion of delinquencies assigned to telephone collection that were worked to conclusion in fiscal year 1996 with comparable data for fiscal year 2001. The comparison involved relating the number of delinquencies worked to closure (i.e., excludes deferrals) during each fiscal year to the number of new delinquencies assigned as workload during the fiscal year.
	Field collection: Comparison of the proportion of delinquencies assigned to field collection (including support units) that were worked to conclusion in fiscal year 1996 with comparable data for fiscal year 2001. The comparison involved relating the number of delinquencies worked to closure (i.e., excludes deferrals) during each fiscal year to the number of new delinquencies assigned as workload during the fiscal year.
Staff time: Comparison of staff time charged to compliance programs for fiscal year 1996 with comparable data for fiscal year 2001.	**Returns processing**: Comparison of program staff years for core services needed to process tax returns and balance-due and math error notices (processing center receipt and control branch, document perfection branch, data conversion branch, and data processing division) for which consistent data were available for fiscal year 1996 with comparable data for fiscal year 2001.
	Nonfiler: Comparison of program staff hours charged by compliance program staff in service centers, telephone collections, field collection, and audit programs to carry out nonfiler programs in fiscal year 1996 with comparable data for fiscal year 2001.
	Underreporter: Comparison of program staff years used for the underreporter program in fiscal year 1996 with comparable data for fiscal year 2001.
	Individual audit: Comparison of the number of staff hours charged by examination staff to complete audits closed in fiscal year 1996 with comparable data obtained from IRS's Audit Information Management System for fiscal year 2001.

Performance indicator	Program-specific performance indicator
	Corporate audit: Comparison of the number of staff hours charged by examination staff to complete audits closed in fiscal year 1996 with comparable data obtained from IRS's Audit Information Management System for fiscal year 2001.
	Other audit: Comparison of the number of staff hours charged by examination staff to complete audits closed in fiscal year 1996 with comparable data obtained from IRS's Audit Information Management System for fiscal year 2001.
	Telephone collection: Comparison of the number of staff hours (including administrative overhead) charged to delinquent account activities in fiscal year 1996 with comparable data for fiscal year 2001.
	Field collection: Comparison of the number of staff hours charged by collection staff to delinquent account activities in fiscal year 1996 with comparable data for fiscal year 2001.
Productivity: Comparison of the number of compliance and collection work units (e.g., audits) closed in fiscal year 1996 per staff time available that year for compliance work with comparable data for fiscal year 2001.	**Returns processing**: Comparison of the number of tax return filings processed and math error and balance-due notices issued per staff year that were used to process that workload in fiscal year 1996 with comparable data for fiscal year 2001. Math error and balance-due notices were added to return filings to match work outputs to the resources used to process that output. The number of math error and balance-due notices processed included available data for calendar years 1996 and 2001.
	Nonfiler: Comparison of the number of case closures per staff hour charged by compliance program staff in IRS service centers, telephone and field collection, and audit programs to carry the out the nonfiler program in fiscal year 1996 with comparable data for fiscal year 2001.
	Underreporter: Comparison of the number of underreporter cases closed per staff year used for the underreporter program in fiscal year 1997 with comparable data for fiscal year 2001. Fiscal year 1997 data was used because fiscal year 1996 data on case closures was not available.
	Individual audit: Comparison of the number of individual examinations closed per staff hour charged by examination staff to complete audits closed in fiscal year 1996 with comparable data for fiscal year 2001.
	Corporate audit: Comparison of the number of corporation examinations closed per staff hour charged by examination staff to complete audits closed in fiscal year 1996 with comparable data for fiscal year 2001.
	Other audit: Comparison of the number of partnership, estate and trust income, estate tax, employment, and excise tax return examinations closed per staff hour charged by examination staff to complete audits that were closed in fiscal year 1996 with comparable data for fiscal year 2001.
	Telephone collection: Comparison of the number of delinquent accounts closed (excluding deferrals) per staff hour charged to taxpayer delinquent account activities in fiscal year 1996 with comparable data for fiscal year 2001.
	Field collection: Comparison of the number of delinquent accounts closed (excluding deferrals) per staff hour charged to taxpayer delinquent account activities in fiscal year 1996 with comparable data for fiscal year 2001.

Dollars of unpaid taxes identified (compliance programs) or collected (collection programs): • For compliance programs, a comparison of the total amount of tax assessments (including assessed interest and penalties) generated by the compliance programs in fiscal year 1996 with comparable data for fiscal year 2001 • For collection programs, a comparison of the amounts collected by collection programs in fiscal year 1996 with comparable data for fiscal year 2001.	**Returns processing**: Comparison of the amount of tax assessments related to unpaid taxes on balance-due and math error returns made by returns processing in fiscal year 1996 with comparable data for fiscal year 2001.
	Nonfiler: Comparison of the amount of tax assessments made by the nonfiler program in fiscal year 1996 with comparable data for fiscal year 2001.
	Underreporter: Comparison of the amount of tax assessments made by the underreporter program in fiscal year 1996 with comparable data for fiscal year 2001.
	Individual audit: Comparison of the amount of tax assessments made by the individual audit program in fiscal year 1996 with comparable data for fiscal year 2001. Data include assessments that may be subsequently appealed.
	Corporate audit: Comparison of the amount of tax assessments made by the corporation audit program in fiscal year 1996 with comparable data for fiscal year 2001. Data include assessments that may be subsequently appealed.
	Other audit: Comparison of tax assessments related to the audit of estate and trust income, estate tax, employment, and excise tax returns in fiscal year 1996 with comparable data for fiscal year 2001. Data include assessments that may be subsequently appealed. Assessments related to the audit of partnership returns are excluded to eliminate double-counting for pass-throughs to the partners' returns.
	Telephone collection: Comparison of the amount of delinquent taxes collected by telephone collection in fiscal year 1996 with comparable data for fiscal year 2001.
	Field collection: Comparison of the amount of delinquent taxes collected by field collection in fiscal year 1996 with comparable data for fiscal year 2001.
Percentage of unpaid taxes resolved: • For compliance programs, a comparison of the percentage of the fiscal year 1996 tax assessments (including assessed interest and penalties) that were collected by the compliance components through collection notices during the year with comparable data for fiscal year 2001. • For collection programs, a comparison of the percentage of delinquent assessments fully resolved in fiscal year 1996 with comparable data for fiscal year 2001.	**Returns processing**: Comparison of the percentage of unpaid taxes assessed during fiscal year 1996 that were collected in the year of assessment without involving telephone or field collections with comparable data for fiscal year 2001.
	Nonfiler: Comparison of the percentage of unpaid taxes assessed during fiscal year 1996 that were collected in the year of assessment without involving telephone or field collections with comparable data for fiscal year 2001.
	Underreporter: Comparison of the percentage of unpaid taxes assessed during fiscal year 1996 that were collected in the year of assessment without involving telephone or field collections with comparable data for fiscal year 2001.
	Individual audit: Comparison of the percentage of unpaid taxes assessed during fiscal year 1996 that were collected in the year of assessment without involving telephone or field collections with comparable data for fiscal year 2001.
	Corporate audit: Comparison of the percentage of unpaid taxes assessed during fiscal year 1996 that were collected in the year of assessment without involving telephone or field collections with comparable data for fiscal year 2001.
	Other audit: Comparison of the percentage of unpaid taxes assessed during fiscal year 1996 that were collected in the year of assessment without involving telephone or field collections with comparable data for fiscal year 2001.
	Telephone collection: Comparison of the percentage of closures from the telephone collection program that fully resolved the tax delinquencies (i.e., full payment received or installment agreement arranged) in fiscal year 1996 with comparable data for fiscal year 2001.
	Field collection: Comparison of the percentage of closures from the field collection program that fully resolved the tax delinquencies (i.e., full payment received or installment agreement arranged) in fiscal year 1996 with comparable data for fiscal year 2001.

To compile the performance data related to these performance indicators, we substantially relied on the data output from various IRS information systems. For example, IRS uniformly collects data on resources, typically staff hours or staff years used, as program input. We did not evaluate the internal controls over the collection and processing of this IRS information system data. Because IRS managers routinely use the information from these systems to manage program operations, we believe that the information is appropriate for use in compiling an overview of program changes.

The routine output from the IRS data systems alone, however, was not sufficient to provide data on the following:

1. **The nonfiler program**. Because IRS's nonfiler program involved cases managed by several IRS divisions, we worked with IRS managers to consolidate data from a number of different sources to compile the trend data. In doing this, we obtained data from IRS's Audit Management Information System, collection reports prepared through IRS's Integrated Data Retrieval System, and supplemental data prepared by IRS's Nonfiler Program office in response to internal IRS requirements.

2. **The amount of additional tax assessments made by the returns processing program**. To develop data on compliance assessments made by returns processing, we obtained a data extract from IRS's Enforcement Revenue Information System (ERIS). That system was designed by IRS to accumulate collection data for assessments that result from IRS's compliance work.

   From the ERIS data extract, we first derived data to indicate the amount of additional tax assessments made by returns processing compliance work, such as identifying returns with a balance due or making assessments to correct errors or omissions identified on the tax returns. To do this, given the manner in which IRS accounts for the assessments, we

   - identified the total assessments made by returns processing, other than returns that were filed with full payment or with no errors requiring an IRS notice;
   - identified the amount of payment made on the accounts prior to IRS's notifying the taxpayer of the amount due; and
   - subtracted the prenotification payments from the total assessments.

   We subtracted the prenotification payments from the total assessments in order to eliminate taxes that were voluntarily reported and paid by taxpayers.

3. **The amount of unpaid tax assessments resolved by the five compliance programs**. From the ERIS data, we also derived data to compute the percentage of unpaid tax assessments that were collected by the five compliance programs.[1] We included as collections any payments made by the taxpayers in response to written notices sent to the taxpayers. Data were not available to extend the analysis period for collections for fiscal years beyond 2001. Therefore, to ensure comparable collection data on the proportion of fiscal year 1996 and 2001 assessments collected by the assessing compliance program, we limited the collection period to the fiscal year of the assessment.

We also interviewed officials from IRS's operational divisions responsible for wage earners, small businesses, and large and midsized businesses to obtain an understanding of compliance and collection programs and to discuss reasons for compliance and collection trends. We provided our performance trends and supporting computations to IRS staff, who reviewed and commented on our analyses.

Effect of Compliance and Collection Program Changes on Taxpayers

To determine how these changes have affected taxpayers, we examined two samples of IRS data. The first sample from IRS's automated masterfile records of unpaid tax accounts provided the data to examine overall changes in the number of accounts with unpaid balances; changes in the characteristics of delinquent taxpayers, such as the amounts of interest and penalties owed; and the age of the accounts. In order to examine contacts between taxpayers and the IRS and events affecting the timeliness of resolution, we examined a sample of taxpayer collection case files.

Accounts Receivable Sample

To analyze the delinquent taxpayer characteristics, we selected a random sample of taxpayers who had an unpaid tax assessment outstanding at the end of fiscal years 1996, 1998, 2000, and 2001. In developing this sample, we partitioned the population into different groups, or strata, based on the collection status of their modules on September 30 of each year and by type of taxpayer (i.e., individuals and businesses). We stratified this sample to ensure that taxpayers at different stages in IRS's collection process were represented. Once we had selected a sample of taxpayers, we also obtained information on recent payments made to IRS by those taxpayers and information from recent tax returns filed by the taxpayers

[1]Data exclude amounts collected by Appeals, because the source of assessments was not identified in IRS's data system.

and posted to IRS data systems. To review this sample, we used analysis software to produce statistically reliable estimates of the characteristics of the population of taxpayers whom IRS had identified as not having paid their taxes as of the end of the four fiscal years.

Taxpayer Case File Sample

To examine data on collection actions taken with respect to taxpayers—such as the length of time from when the delinquencies became available for assignment to telephone or field collection staff to when the taxpayers were contacted by the collection staff—we used a random sample that was taken as part of our audit of IRS's financial statement for fiscal year 2000. This sample consisted of randomly selected unpaid tax assessments that were owed by 520 taxpayers.

From this sample, we reviewed IRS collection case file documentation on 108 taxpayers, that is, those taxpayers who had been assigned to either telephone or field collection and about whom IRS had sufficient collection case file documentation for us to analyze. IRS had limited the accumulation of case files to those relevant to estimation of the collectibility of its accounts receivable.

We analyzed these cases with two different data collection instruments. The first captured (1) dates that distinct field collection phases started and ended, (2) occurrences of IRS collection contacts or attempted contacts with taxpayers, and (3) the disposition of cases when the collection phases ended. The second data collection instrument captured information from IRS's masterfile records on these taxpayers. This information described the number of delinquencies, type of taxes owed, and dollar amounts. It also provided a history of the collection-related transactions (i.e., payments, defaults on installment agreements, or litigation pending) for the taxpayer.

Sampling Error

Because our estimates come from random samples, there is some sampling error associated with them. We express our confidence in the precision of our results as a 95 percent confidence interval around the estimate. For example, for the estimate of 1.3 million taxpayers, the actual value would be between 1.25 million and 1.35 million taxpayers. All percentage estimates from the samples have sampling errors of ±5 percentage points or less, unless otherwise shown in footnotes to the report text. All numerical estimates other than percentages have sampling errors of ±5 percent or less of the value of those numerical estimates, unless otherwise shown in footnotes to the report text.

Strategic Planning

With respect to objective 3, we reviewed the strategic assessments made by the IRS operating division responsible for individual taxpayers other than the self-employed and by the operating division responsible for small businesses and self-employed individuals. The assessments were made during the first half of fiscal year 2001 for consideration by senior management in developing strategy and program plans for fiscal year 2002 and 2003. We reviewed the strategic assessments along with IRS instructions for preparation of the assessments. Our review of these documents focused on identifying how the strategic assessments addressed the compliance and collection trends and taxpayer impacts that we identified in response to objectives 1 and 2. We also interviewed IRS strategic planning, small business, and wage and investment officials responsible for developing and monitoring strategic plans. We did not evaluate the strategic assessment's selection of IRS's priorities, proposed improvement projects, and resources needed to implement the projects. Evaluating the operating division's plans would require an assessment of IRS's entire strategic planning process, which was outside the scope of this assignment.

We performed our work at IRS's national office in Washington, D.C.; IRS's Kansas City Submissions Processing Center, Missouri; and IRS's Oakland, California, area office between October 2000 and April 2002 and in accordance with generally accepted government auditing standards.

We requested comments on a draft of this report from the commissioner of internal revenue. We received written comments from the commissioner on May 14, 2002. The comments are reprinted in appendix II and discussed in our report.

Appendix II: Comments from the Internal Revenue Service

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

COMMISSIONER

MAY 13 2002

Mr. James R. White
Director, Tax Issues
United States General Accounting Office
Washington, D.C. 20548

Dear Mr. White:

I reviewed your draft report titled "Tax Administration: Impact of Compliance and Collection Program Declines on Taxpayers" and agree with your overall assessment and recommendation. Many factors contributed to program declines including an overall reduction in staffing, loss of the 1995 Compliance Initiative and the resulting staffing reduction to Compliance, and the shift of resources from Compliance programs to customer service. These factors, as well as the legislative changes mandated by the Restructuring and Reform Act of 1998 that increased administrative and procedural responsibilities, have impacted our overall productivity.

Your report indicates that although there has been a 28% decline in direct staff time there was only a 7% drop in dollars collected. This is a result of our continuing efforts to provide focus to the most productive cases in our inventory. We are hopeful that this focus as well as our reengineering efforts will help improve productivity and reverse some of the declines.

Your report also discusses the lack of quantitative information used to support the Trends, Issues, and Problems (TIPs) and the subsequent operational priorities identified as part of our strategic assessment process. We acknowledge the necessity for making use of quantitative data in our decision-making processes. Your analysis was based on last year's FY 2002-2003 Strategic Assessment Process. I would like to share some of our ongoing efforts to develop quantitative data that will help with our future strategic assessments.

For the FY 2003-2004 process, we developed a methodology to include costs and benefits as part of the assessment. We used this methodology to quantify costs for the proposed operational priorities and improvement projects. We also attempted to describe quantifiable benefits that would result if the priorities and projects were implemented. We will continue to refine this methodology for use in future strategic assessment cycles.

2

Your report also indicates that we are hampered by the lack of data on taxpayer compliance. I have charged the National Research Program (NRP) with developing Compliance measures that will be valid at the Servicewide and operating division level.

These efforts will provide senior management with cost and benefit data for proposed programs. They will also provide a method for determining the effectiveness of existing and newly implemented programs.

If you have any questions, please contact me or your staff may contact Brady Bennett, Director, Strategy, Research and Performance Management, Small Business/Self-Employed, at (202) 283-2250 or Joseph R. Brimacombe, Deputy Director, Compliance Policy, Small Business/Self Employed, at (202) 283-2150.

Sincerely,

Charles O. Rossotti

Charles O. Rossotti

Appendix III: GAO Contacts and Staff Acknowledgments

GAO Contacts

James R. White, (202) 512-9110
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Acknowledgments

In addition to those named above, Leon Green, Mary Jankowski, John Mingus, Sam Scrutchins, Anjali Tekchandani, Thom Venezia, Wendy Ahmed, Cheryl Peterson, Susan Baker, Anne Laffoon, Kristina Boughton, and Avram Ashery made key contributions to this product.

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