

GAO

Testimony

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Ways and Means, House of Representatives

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**INTERNAL REVENUE  
SERVICE**

**Assessment of Fiscal Year  
2004 Budget Request and  
2003 Filing Season  
Performance to Date**

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Highlights of [GAO-03-641T](#), a testimony before the Subcommittee on Oversight, Committee on Ways and Means, House of Representatives

## INTERNAL REVENUE SERVICE

# Assessment of Fiscal Year 2004 Budget Request and 2003 Filing Season Performance to Date

### Why GAO Did This Study

The Internal Revenue Service (IRS) is responsible for collecting most of the funds that pay for the federal government. For 2003, IRS expects to process 130 million individual income tax returns, issue 99 million refunds, receive 100 million telephone calls, and assist 4 million taxpayers face-to-face at IRS and volunteer offices. Most of these interactions with taxpayers occur during the January through April tax filing season.

GAO was asked by the Subcommittee to assess the likelihood of IRS allocating more resources to a key priority, compliance; whether proposed spending on computer systems is justified; and filing season performance.

### What GAO Recommends

GAO is not making any recommendations. However, as GAO noted last year, until IRS incorporates best practices in preparing its information systems budget, it will not be able to ensure that the information system operations and maintenance request is adequately supported.

### What GAO Found

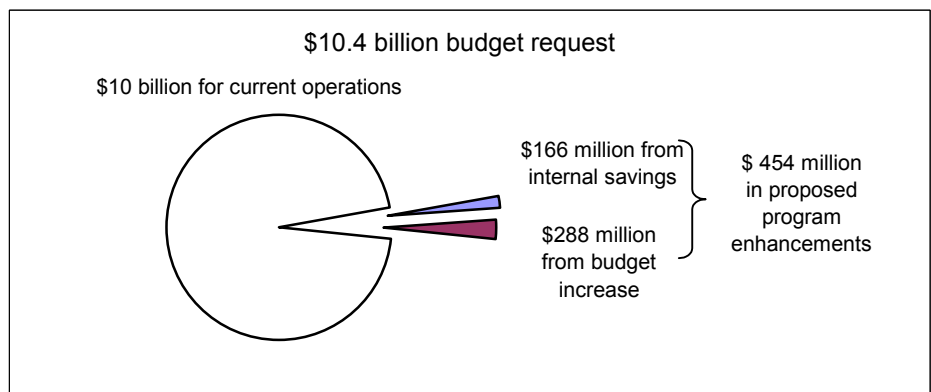
IRS is requesting \$10.4 billion and 100,043 FTEs, a dollar increase of about 5 percent over the fiscal year 2003 request. The 2004 budget request, like other recent requests, identifies compliance as one of IRS's top priorities for additional resources. As shown below, IRS intends to fund some program enhancements from the requested budget increase and internal savings. Several factors, including lowered savings projections since the budget request was prepared, raise questions about IRS's ability to achieve all the savings and shift resources to compliance as planned. IRS's recent history raises the same questions, in part, because unbudgeted expenses, such as pay raises, have absorbed budget increases.

IRS is requesting \$2.1 billion in information technology. This includes \$429 million for the agency's multiyear capital account that funds contractor costs for the Business Systems Modernization program, and \$1.67 billion for information systems, primarily for operations and maintenance. In response to GAO's recommendation last year, IRS has begun to implement an information technology management process patterned after its systems modernization program. Until the process is fully implemented, IRS will have limited ability to develop supportable information systems budget requests.

IRS's 2003 filing season performance has improved over last year. For example, IRS's telephone access has improved and the Web site has seen increased use. Such improvements represent a payoff from IRS's ongoing systems modernization investments and wider management improvements.

Although IRS has not succeeded in reallocating staff to one of its priority needs, compliance, there will likely be increased potential for such reallocation as modernization proceeds. This will present Congress, in its oversight and appropriations roles, with significant opportunities to weigh in on IRS's overall strategy for better accomplishing its mission.

IRS's Proposed Funding for Program Enhancements



Source: IRS data.

[www.gao.gov/cgi-bin/getrpt?GAO-03-641T](http://www.gao.gov/cgi-bin/getrpt?GAO-03-641T).

To view the full report, including the scope and methodology, click on the link above. For more information, contact Jim White at (202) 512-9110 or [WhiteJ@gao.gov](mailto:WhiteJ@gao.gov).

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Mr. Chairman and Members of the Subcommittee:

We are pleased to participate in the Subcommittee's inquiry into Internal Revenue Service's (IRS) fiscal year 2004 budget request and 2003 tax filing season performance.

With its mission to "provide America's taxpayers with top quality service by helping them understand and meet their tax responsibilities and by applying the tax law with integrity and fairness to all," IRS is responsible for collecting most of the funds that pay for the federal government. To carry out its mission, IRS has a budget of about \$10 billion and staff of about 100,000 full time equivalents (FTE). For 2003, IRS expects to process 130 million individual income tax returns, issue 99 million refunds, receive 100 million telephone calls, and assist 4 million taxpayers face-to-face at IRS and volunteer<sup>1</sup> offices.

As you requested, our statement discusses both IRS's 2004 budget request and its 2003 filing season performance. With respect to the budget, we assessed the likelihood that IRS will be able to allocate more resources to one of its key priorities, compliance, and whether the proposed spending on some computer systems is justified. With respect to the filing season, we assessed IRS's performance in processing returns and providing assistance to taxpayers.

Our assessment of the budget request is based on a comparative analysis of IRS's fiscal year 2003 and 2004 budget requests, supporting documentation, and interviews with IRS officials. Our assessment of the filing season is based on a comparison of IRS's performance this year to last, site visits to IRS processing centers and walk-in sites, and interviews with IRS and Treasury Inspector General for Tax Administration (TIGTA) officials, tax preparers, and other external stakeholders. We also reviewed IRS's Web site for usability and accessibility.

In summary, our assessment of IRS's 2004 budget request shows that:

- IRS is requesting 100,043 FTEs and \$10.4 billion, an increase of about 5 percent over its fiscal year 2003 request. The 2004 budget request is one of many that have identified compliance activities as among IRS's top

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<sup>1</sup>These offices use IRS-trained volunteers to help prepare basic tax returns for taxpayers with special needs.

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priorities for receiving additional resources. These additional resources were to be funded from budget increases, internally generated savings, or both. Savings projections have been revised downward since the 2004 budget request was prepared, which raises questions about IRS's ability to achieve all the savings and shift resources to compliance as planned. Further, IRS's recent history shows that it has been unable to increase resources in compliance, despite having made it a priority in budget requests. In fact, for the most recent three full fiscal years—2000, 2001 and 2002—compliance resources have declined slightly. Reasons for this include unfunded expenses consuming budget increases.

- Another priority area for IRS is Information Technology (IT). IRS is requesting about \$2.1 billion and 7,986 staff years in information technology resources for fiscal year 2004. This includes (1) \$429 million for the agency's multiyear capital account that funds contractor costs for the BSM program and (2) about \$1.67 billion and 7,735 staff years for information systems, of which \$1.62 billion is for operations and maintenance. In preparing its fiscal year 2004 budget request for the operations and maintenance of information systems, IRS began to implement an information technology portfolio management process patterned after the one used for the BSM program. However, until IRS fully implements planned process improvements, its ability to develop supportable information systems budget requests will remain limited.

Our assessment of the 2003 filing season to date shows that:

- IRS's 2003 filing season performance has improved over last year, based on the data we reviewed in key filing season activities—paper and electronic processing, telephone assistance, IRS's Web site, and walk-in assistance. In particular, access to IRS's telephone assistors has improved and Web site usage has increased. While we cannot quantify the connection between these results and IRS's ongoing systems modernization efforts, the improvement in filing season performance, in part, represents a payoff from systems modernization.

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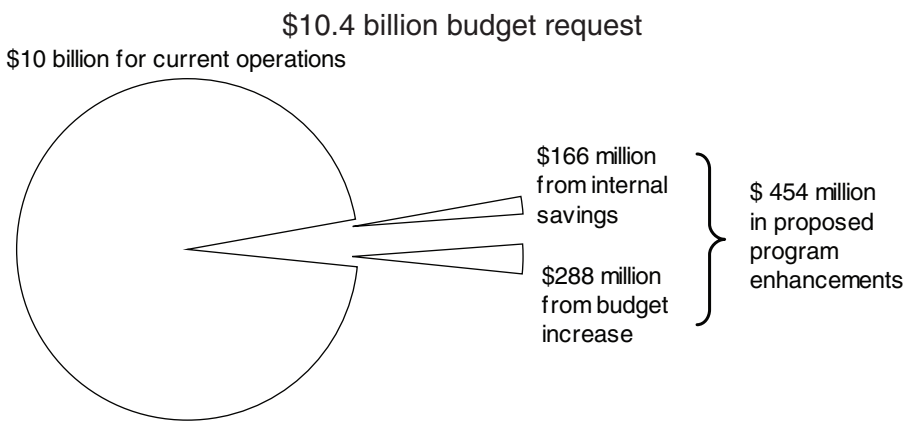
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## IRS's Fiscal Year 2004 Budget Request Includes Compliance, Taxpayer Service, and Information Systems as Priorities

For fiscal year 2004, IRS is requesting \$10.4 billion, an increase of 5.3 percent over fiscal year 2003 requested levels, and 100,043 FTEs. IRS's 2004 budget request is its second in a row to propose increased spending for higher priority areas that would be funded, in part, with internal savings redirected from other areas. Specifically, IRS proposes to devote an additional \$454 million and 3,033 more FTEs to enhance programs, primarily in compliance and some customer service areas. As shown in figure 1, \$166 million of the enhancements would be funded from internal savings with the remainder funded from the budget increase.

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**Figure 1: IRS's Proposed Funding for Program Enhancements**



Source: IRS data

As we did in last year's testimony on IRS's 2003 budget request, we commend IRS for identifying savings to be reinvested in operations to improve IRS performance. This approach implements a key principal of IRS's long-term modernization effort. Under this approach, the reengineering of IRS's work processes—much of which is dependent on investments in computer modernization—would automate or eliminate work, improve productivity, and free staff time that could then be redirected to higher priority customer service and compliance activities.

We provide some context for understanding the 2004 budget request in figures 2 and 3 as shown in appendix I. In those figures, we illustrate how IRS allocated expenditures and staff resources in fiscal year 2002, the most recently completed year.

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## Current Projections and Recent History Raise Questions about Whether IRS Will Realize Some Priority Resource Reallocations

Revised projections developed since the 2004 budget request was prepared raise questions about IRS's ability to achieve all the savings projected and shift resources to compliance as planned. In addition, some projected savings are based on reengineering efforts that are not well defined. Further, IRS's recent history also shows that it has been unable to increase resources in the compliance area despite having made it a priority in past budget requests. In fact, for the most recent 3 full fiscal years—2000, 2001, and 2002—compliance resources have declined slightly. Reasons for this decline include unfunded expenses consuming budget increases and workload increases in other essential operations.

## IRS Has Revised Some Savings Shown in Its 2004 Budget Request

IRS has revised the savings associated with several reengineering efforts identified in the 2004 budget request. Revisions this far in advance of the start of the fiscal year are not a surprise. They do indicate that there is some uncertainty associated with the budget request's savings projections.

Four of the seven most significant reengineering efforts—in terms of FTEs and dollars to be saved—will not achieve all of their projected savings because the efforts were based on assumptions that will not be realized, according to IRS data and officials. IRS now projects that the seven most significant efforts will save 1,073 FTEs and \$60.5 million, down from original projections of 1,356 FTEs and \$77.7 million.

IRS provided different reasons for why all savings will not be achieved for the following individual efforts:

- IRS's effort to improve the efficiency of compliance support activities—the single most significant effort—was partially dependent on IRS implementing individual compliance savings projects in 2003. This effort was projected to save 394 FTEs and almost \$26 million. However, due in part to delays until 2004 to allow for additional testing, this effort is now expected to save about 30 percent of the original projections through the end of fiscal year 2004.
- IRS's effort to improve the efficiency of personnel services—the second most significant effort—depended in part on the functions of a new computer system to achieve most of its savings. This effort was originally projected to save 222 FTEs and \$14.6 million. According to IRS officials, these functions will not be delivered on time due to schedule delays. IRS officials have not determined the impact of this

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delay and are currently assessing other potential approaches to achieve savings in this area.

IRS officials said the remaining three of the seven most significant efforts will achieve all or more of their projected savings. For example, the effort to improve the efficiency of handling payments and returns, originally projected to save 121 FTEs and \$4.6 million, is now expected to have more than double the savings, or 235 FTEs and \$11.9 million, due to greater than expected productivity. However, according to IRS officials, even when their savings are combined, these three efforts will not save enough to offset the reduced savings from the other four.

Reengineering efforts may not achieve all of their savings goals, in part, because of the long time lag between when IRS begins developing its budget request and when the fiscal year begins. As with most other federal agencies, IRS usually begins formulating its budget request about 18 months before the start of the fiscal year and about 10 months before the President submits his budget to Congress. With planning beginning so far ahead of the budget's actual execution, there are inevitably intervening events, such as implementation delays with computer systems, that make the assumptions upon which projections are based no longer realistic.

#### Some 2004 Reengineering Efforts Are Not Well Defined

Some of the reengineering efforts listed in the 2004 budget request are not well defined, thus raising questions about whether they will achieve their savings goals. For example:

- IRS still is reviewing its procedures to identify ways to make tax return processing more efficient. Although IRS projected this effort to save 203 FTEs and \$6.9 million, it has not yet identified the operational areas that will be reengineered. IRS officials said that the projected savings are based on a 2 percent efficiency increase, but they are currently determining how to achieve that goal.
- The effort to improve the efficiency of personnel services noted above also included numerous competitive outsourcing assessments affecting several program areas that, according to the budget request, would result in a significant reduction of staffing. However, in response to our request for more information, IRS was unable to provide details on the type or number of specific assessments, program areas that would be affected, how this effort would lead to reduced staffing, or the amount of net savings expected.

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According to IRS budget officials, IRS uses its budget formulation process to establish productivity goals, although the responsible business units may not know specifically how savings will be achieved. Officials said that this approach encourages innovation in meeting performance goals while identifying ways to save FTEs and budget dollars.

### In Recent Years, Compliance Staffing Declined

Since 2001, IRS's budget requests have made increasing compliance staff one of several key priorities. For example, in its 2001 budget request IRS asked for funding for the Staffing Tax Administration for Balance and Equity (STABLE) initiative, which was designed to provide additional staffing for examination, collections, and the new Tax Exempt and Government Entities Division. However, TIGTA recently reported data that showed an over 7 percent decline in compliance staff between 2000 and 2002.<sup>2</sup>

There are several reasons for the decline, including increased workload and unfunded costs. In September 2002, the Commissioner attributed the decline in compliance staffing to increases in workload in other essential operations such as processing returns, issuing refunds, and answering taxpayer mail. In the most recently completed fiscal year, 2002, IRS faced unbudgeted cost increases, such as rent and pay increases, in the amount of about \$106 million. As a result, IRS had to delay hiring revenue agents and officers, tax compliance officers, and tax specialists. As shown in appendix I, in 2002 figure 2 shows about 69 percent of IRS's spending was for labor costs. IRS noted in its budget request that any major negative changes in the agency's financial posture, such as unfunded salary increases, will have a negative effect on staffing levels.

### IRS's Experience in 2003 Illustrates the Difficulty of Projecting Savings and Investments

IRS's experience with last year's budget request illustrates the difficulty of projecting and realizing savings and investing resources in higher priority areas. As part of its 2003 budget request, IRS identified internal savings of almost \$197 million and 2,287 FTEs to be accomplished through various reengineering efforts and workload decreases. IRS planned to reinvest those savings in higher priority areas—compliance and customer service program enhancements, including efforts to stabilize audit rates, improve telephone assistance level of service, and target highest priority collection cases. However, IRS now estimates that about \$75 million, or 38 percent, of

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<sup>2</sup>Treasury Inspector General for Tax Administration, *Trends in Compliance Activities through Fiscal Year 2002*, Reference No. 2003-30-078, Washington D.C.: March 2002. The compliance staff figures include revenue officers, revenue agents, and tax auditors.



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the dollar savings and about 1,280, or 56 percent, of the FTE savings will be achieved by the specific reengineering efforts and workload decreases as identified in the 2003 budget request. IRS officials provided several reasons why some savings for these particular reengineering efforts will not be realized, including delays in modernization projects and less-than-anticipated workload decreases. For example, IRS received more innocent spouse cases than anticipated, and the cases received were more complex, causing the hours spent per case to increase.

While savings associated with a particular effort listed in the 2003 budget request may not materialize, IRS officials said that business unit managers have identified other ways to increase productivity and did more work with fewer staff—therefore achieving productivity increases through efforts not identified in the 2003 budget request. As an example, officials provided an analysis showing increased telephone collections cases closed with significantly fewer staff than in the previous year. While GAO did not verify these savings, IRS officials were confident that this and other similar productivity increases were being achieved. Furthermore, IRS budget officials said the results of productivity increases not listed in the 2003 budget request should be included in any tally of IRS's savings.

We agreed that productivity increases generate savings. IRS was unable to quantify the gains from productivity increases in time for this hearing. IRS officials also said that most of the savings generated by the productivity increases would be used to handle workload increases in the same area where savings were generated. They said the savings would not be available for reallocation to other areas.

As was the case in 2002, cost increases not included in the 2003 budget request are also limiting IRS's ability to fund new investments. According to IRS officials, IRS will need to fund a total of about \$388 million out of existing resources, including about \$128 million for pay increases.

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## Information Technology Budget Formulation Process Still Needs Improvement

IRS is requesting about \$2.1 billion and 7,986 staff years in information technology (IT) resources for fiscal year 2004. This includes (1) \$429 million for the agency's multiyear capital account that funds contractor costs for the BSM program and (2) about \$1.67 billion and 7,735 staff years for information systems, of which \$1.62 billion is for operations and maintenance. In preparing its fiscal year 2004 budget request for the operations and maintenance of information systems, IRS began to implement an information technology portfolio management process

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patterned after the one used for the BSM program. However, until IRS fully implements planned process improvements, its ability to develop supportable information systems budget requests will remain limited.

Fiscal Year 2004 BSM Request  
Developed in Accordance with  
Federal Guidance

Consistent with the Clinger-Cohen Act of 1996,<sup>3</sup> the Government Performance and Results Act of 1993,<sup>4</sup> OMB guidance on budget preparation and submission<sup>5</sup> require that, before requesting multiyear funding for capital asset acquisitions, agencies develop sufficient justification for these investments. This justification should reasonably demonstrate how proposed investments support agency missions and operations, and provide positive business value in terms of expected costs, benefits, and risks.

Since the BSM appropriation was established in fiscal year 1998, we recommended<sup>6</sup> that IRS put in place an enterprise architecture (modernization blueprint) to guide and constrain its business system investments.<sup>7</sup> Use of such a blueprint is a practice of leading public and private sector organizations. Simply stated, this architecture provides a high-level road map for business and technological change from which agencies can logically and justifiably derive their budget requests and capital investment plans. In response to our recommendations, IRS developed an enterprise architecture. In March 2002, IRS approved a new version of this architecture (version 2.0), which describes IRS's current and target business and technology environments. In December 2002, IRS completed the associated high-level transition strategy that identifies and

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<sup>3</sup>PL. 104-106.

<sup>4</sup>PL. 103-62.

<sup>5</sup>See, for example, OMB Circular No. A-11: *Preparing, Submitting, and Executing the Budget* (Washington, D.C.: June 27, 2002).

<sup>6</sup>See U.S. General Accounting Office, *Tax Administration: IRS' Fiscal Year 1997 Spending, 1997 Filing Season, and Fiscal Year 1998 Budget Request*, [GAO/T-GGD/AIMD-97-66](#) (Washington, D.C.: Mar. 18, 1997); *Tax Systems Modernization: Blueprint is a Good Start But Not Yet Sufficiently Complete to Build or Acquire Systems*, [GAO/AIMD/GGD-98-54](#) (Washington, D.C.: Feb. 24, 1998); and *Tax Administration: IRS' 2000 Tax Filing Season and Fiscal Year 2001 Budget Request*, [GAO/T-GGD/AIMD-00-133](#) (Washington, D.C.: Mar. 28, 2000).

<sup>7</sup>An enterprise architecture provides an institutional "blueprint" for defining how an organization operates today (baseline environment) in both business and technological terms, and how it wants to operate in the future (target environment). It also includes a sequencing plan that provides a road map for transitioning between these environments.

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conceptually justifies needed investments to guide the agency's transition over many years from its current to its target architectural state.

IRS's \$429 million request for the BSM account for fiscal year 2004 is based on its enterprise architecture as well as its related life cycle methodology and investment management process. Thus, this request is based on analyses that meet the statutory and regulatory requirements for requesting multiyear capital investment funding.

**BSM Program Management  
Capability Improved, but Risks  
Remain**

Pursuant to statute,<sup>8</sup> funds from the BSM account are not available for obligation until IRS submits to the congressional appropriations committees for approval an expenditure plan that meets certain conditions.<sup>9</sup> In November 2002, IRS submitted an expenditure plan seeking approval to obligate funds from the BSM account for its planned fiscal year 2003 projects and program-level initiatives. In March 2003, IRS submitted a revised plan that reduced the initial request by shifting funding for two BSM projects to the information systems account and reducing the amount requested for the core infrastructure projects and program-level initiatives.

In briefings to the staff of the relevant appropriations subcommittees and IRS on the results of our review of IRS's November 2002 expenditure plan, we reported that IRS has progressed significantly in improving its modernization management controls and capabilities, and has taken steps to better balance the pace of the BSM program with its management capability. We also reported that, although important progress has been made, certain management controls and capabilities, related to configuration management, human capital management, and cost and schedule estimate validation, have not yet been fully implemented. Our analysis has shown that weaknesses in these controls and capabilities contributed to BSM project cost, schedule, and performance shortfalls during fiscal year 2002. In approving the release of a portion of the fiscal year 2003 BSM funding, the appropriations subcommittees directed IRS to, among other things, fully establish and implement all management processes and controls needed to effectively manage the BSM program.

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<sup>8</sup>Consolidated Appropriations Resolution, 2003 (P.L.108-7).

<sup>9</sup>IRS's BSM expenditure plans are required to (1) meet OMB capital planning and investment control review requirements, (2) comply with IRS's enterprise architecture, (3) conform with IRS's enterprise life cycle methodology, (4) be approved by IRS, Treasury, and OMB, (5) be reviewed by GAO, and (6) comply with the acquisition rules, requirements, guidelines, and systems acquisition management practices of the federal government.

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IRS has acknowledged these weaknesses and has initiatives planned or under way to address them.

Despite the progress made during the past year, IRS's BSM program faces heightened risks because (1) several key projects are entering their later stages of development and deployment, (2) some of these projects provide the foundational infrastructure upon which later projects depend, (3) an increasing number of project milestones are experiencing cost increases and schedule delays, and (4) IRS plans to start more projects. While IRS is better prepared to manage risk and meet the challenges ahead, sustained top management involvement, improved management capabilities, and consistent oversight, are critical to the successful implementation of the BSM program.

Although Progress Made,  
Information Systems Budget  
Request Development Process  
Needs Additional Improvements

Leading private- and public-sector organizations have taken a project- or system-centric approach to managing not only new investments but also the operations and maintenance of existing systems. As such, these organizations

- identify operations and maintenance projects and systems for inclusion in budget requests;
- assess these projects or systems on the basis of expected costs, benefits, and risks to the organization;
- analyze these projects as a portfolio of competing funding options; and
- use this information to develop and support budget requests.

This focus on projects, their outcomes, and risks as the basic elements of analysis and decision-making is incorporated in the IT investment management approach that is recommended by the OMB and GAO.<sup>10</sup> By using these proven investment management approaches for budget formulation, agencies have a systematic method, on the basis of risk and return on investment, to justify what are typically very substantial budget requests for the operations and maintenance of information systems. These approaches also provide a way to hold IT managers accountable for

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<sup>10</sup>See, for example, U.S. General Accounting Office, *Information Technology Investment Management: A Framework for Assessing and Improving Process Maturity*, Exposure Draft, [GAO/AIMD-10.1.23](#) (Washington, D.C.: May 2000, Version 1).

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operations and maintenance spending and the ongoing efficiency and efficacy of existing systems.

In our assessment of IRS's fiscal year 2003 budget request, we reported<sup>11</sup> that IRS did not develop its information systems operations and maintenance request in accordance with the investment management approach used by leading organizations. For example, in developing the request, IRS had not identified and assessed the relative costs, benefits, and risks of specific operations and maintenance systems and projects. Instead, according to IRS officials, they developed the request by beginning with the fiscal year 2002 expenditures and simply adding amounts to fund cost-of-living and salary increases. IRS officials attributed this gap between IRS's practices and those followed by leading organizations to the lack of an adequate cost accounting system, cultural resistance to change, and a previous lack of management priority. We recommended<sup>12</sup> that IRS prepare its fiscal year 2004 information systems budget request in accordance with the investment management approach used by leading organizations. IRS agreed and initiated actions to address our recommendation.

IRS has made progress in incorporating investment management practices into the formulation of its fiscal year 2004 information systems budget request. For example, IRS created information technology portfolios for its operations and maintenance systems in accordance with revised OMB budget guidance.<sup>13</sup> According to IRS officials, these portfolios were used to assist managers and staff involved with information technology planning and investment decision-making to (1) assess initiatives in terms of their cost, risks, and expected returns and (2) determine and maintain the appropriate mix of investments. They also indicated that they are working with Treasury and OMB to improve the information technology investment portfolio development process. IRS's emphasis on portfolio development demonstrates an increased effort to ensure its information systems operations and maintenance requests are supported.

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<sup>11</sup>U.S. General Accounting Office, *Internal Revenue Service: Assessment of Budget Request for Fiscal Year 2003 and Interim Results of 2002 Tax Filing Season*, [GAO-02-580T](#) (Washington, D.C.: Apr. 9, 2002) and *Internal Revenue Service: Improving Adequacy of Information Systems Budget Justification*, [GAO-02-704](#) (Washington, D.C.: June 28, 2002).

<sup>12</sup>See [GAO-02-580T](#) and [GAO-02-704](#).

<sup>13</sup>Office of Management and Budget, OMB Circular No. A-11.

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Despite this progress, IRS has not yet completed its planned actions to implement our recommendation. As of April 2003, IRS has not developed an activity-based cost accounting system to enable it to account for the full costs of operations and maintenance projects and determine how effectively IRS projects are achieving program goals and mission needs. IRS officials stated that they are developing an activity-based cost model in conjunction with the Integrated Financial System modernization project, but this model will not be fully implemented until December 2003. Furthermore, IRS officials stated that data from this model will not be available for use until the fiscal year 2006 budget formulation cycle. In addition, IRS has still not completed its capital planning guidance, and thus did not use it in preparing its fiscal year 2004 information systems budget submission. According to IRS officials, the agency has developed a draft Capital Planning and Investment Control guide that is undergoing internal review, but it will not be completed and implemented until late October 2003. Until IRS incorporates the cost model and capital planning and investment control guidance into the preparation of its information systems budget request, IRS will not be able to ensure that the information systems operations and maintenance request is adequately supported.

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## Interim Results of IRS's 2003 Filing Season Show Improvement over Previous Years

IRS's filing season performance through mid-March has improved compared to recent years, based on data we reviewed in five key filing season activities—paper and electronic processing, telephone assistance, IRS's Web site, and walk-in assistance. For example, telephone access has improved, and IRS's Web site has seen increased use. While we cannot quantify the connection between these results and IRS's ongoing systems modernization efforts, the improvement in filing season performance, in part, represents a payoff from systems modernization.

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## IRS's Paper and Electronic Processing Operations Have Gone Smoothly This Year

Through March 28, IRS has smoothly processed about 67 million individual income tax returns. According to IRS data and to officials and tax preparers we spoke with, IRS has not experienced any significant processing or computer problems. IRS officials attribute this year's smooth processing, in part, to the relatively insignificant tax law changes compared to last year.

Electronic filing continues to grow, although at a slower rate than projected. Of the approximate 67 million returns, about 26 million individual income tax returns were filed on paper and 41 million returns

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were filed electronically, as of March 28, as shown in table 1. This represents an increase in electronic filing of 10.4 percent over the same time period last year. Whether IRS will achieve its goal of 54 million tax returns filed electronically in 2003 is uncertain. Last year at this time IRS was also below its goal, but made up the difference late in the filing season.

**Table 1: IRS Performance in the First Weeks of the 2003 and 2002 Filing Seasons**

Volume in thousands		
<b>Actual returns processed<sup>a</sup></b>	<b>2002</b>	<b>2003</b>
Paper	29,014	26,289
Electronic	37,035	40,870
<b>Telephone assistance</b>		
Total calls <sup>b</sup>	60,674	38,213
Answered by assistors	9,540	9,938
Answered by automation	28,130	19,860
Not answered	23,004	8,415
Customer service representative level of service <sup>b</sup>	69%	84%
Average speed of answer <sup>b</sup>	216 seconds	155 seconds
Accounts customer accuracy rate <sup>c</sup>	88% +/- 1%	88% +/- 1%
Tax law customer accuracy rate <sup>c</sup>	84% +/- 1%	81% +/- 1%
<b>Internet assistance</b>		
Forms and publications downloaded <sup>d</sup>	213,000	283,000
Refund status inquiries <sup>e</sup>	N/A	10,200
<b>Walk-in assistance</b>		
Returns prepared at IRS walk-in sites <sup>f</sup>	436	291
Returns prepared at volunteer sites <sup>g</sup>	466	594

Source: IRS data.

<sup>a</sup>From January 1 to March 29, 2002, and January 1 to March 28, 2003.

<sup>b</sup>Based on actual counts from January 1 to March 23, 2002, and January 1 to March 22, 2003.

<sup>c</sup>Based on a representative sample estimated at the 90 percent confidence level from January to February 2002 and 2003.

<sup>d</sup>From January 1 to March, 31 2002 and 2003.

<sup>e</sup>From January 1 to March 28, 2003.

<sup>f</sup>From January 1 to March 16, 2002, and January 1 to March 15, 2003.

<sup>g</sup>From January 1 to March 9, 2002, and January 1 to March 8, 2003.

Growth in electronic filing is a key part of IRS's modernization strategy. Electronic filing allows IRS to control costs and improve customer service, by reducing labor intensive processing of paper returns. This year, to help increase electronic filing, IRS entered into an agreement with the Free File Alliance, a consortium of 17 tax preparation companies, to offer free online tax preparation and filing services for at least 60 percent of all taxpayers via the IRS Web site. IRS data shows that as of March 26, about 2.1 million returns were filed through the consortium, close to the goal of 2.5 million.



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While there have been some complaints about pop-up ads, taxpayers reported in IRS surveys that they were generally pleased with the service.

Because of the growth in electronic filing, the number of paper returns has declined in recent years. As a result, IRS is closing processing operations at the Brookhaven Submission Processing Center, one of its eight processing centers for individual income tax returns filed on paper. This closing represents a significant consolidation of IRS's processing operations. Based on processing data to date, the consolidation has not disrupted the filing season.

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### Telephone Access Improved over Last Year, While Accuracy Generally Remained Stable

Access to IRS's toll-free telephone lines improved over last year. As table 1 shows, as of March 22, the percentage of taxpayers that attempted to reach an assistor and actually got through and received service—referred to as the Customer Service Representative level of service—increased 15 percentage points over the same period last year, for the approximately 10 million calls served. In addition, taxpayers have waited 61 seconds less, on average, to speak to an assistor so far this filing season as compared to last year. According to IRS officials, the increase in the level of service is largely due to lower than expected call demand and more effective routing of calls to qualified assistors. Part of the reason for the decrease in demand is that some taxpayers are using the new refund status check feature on IRS's Web site rather than calling.

Accuracy was relatively stable this year as compared to last year. As shown in table 1, taxpayers who called about their accounts received correct information an estimated 88 percent of the time. IRS officials said that accounts accuracy rates remained stable, because many simple refund inquiries were diverted to the new refund feature on IRS's Web site, leaving assistors to handle more complex calls. Table 1 also shows taxpayers who called with tax law questions received correct information an estimated 81 percent of the time, slightly down from last year. According to IRS officials, because many assistors had difficulty in adapting to a change in the guide used to query callers.

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### Web Site Is Seeing Increased Use and Has New Features, although Concerns about Usability Still Exist

IRS's Web site use has increased over last year. About 283 million forms and publications have been downloaded—a 29 percent increase over the same period last year. In addition, an independent study reported that IRS's Web site had ranked in the top 10 out of 40 government web sites and that users

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were able to access IRS's site in less than one second during the January 20 through February 28 test period.

IRS added a new feature to its Web site for use this filing season: the refund status check, ("Where's My Refund?"). This feature enables taxpayers to find out if the IRS received their returns and whether their refunds were processed. IRS intended this feature to divert some simple telephone calls from assistors. Data shows that as of March 28, about 10.3 million taxpayers have used this feature to check the status of their refund.

While some of the problems we identified in previous years appear to have been remedied, we continue to have concerns about the search function on IRS's Web site. Our informal testing of IRS's Web site showed that it is more user friendly than last year. We found it to be more accessible, easier to navigate, and data was more current. However, the search functions still do not always make the most pertinent information readily available. For example, when we typed "earned income tax credit" into the forms and publication search function, Publication 596—the primary publication on the earned income tax credit—was the 70<sup>th</sup> item on the list, and we had to scroll through seven pages to find it. According to IRS officials, an independent contractor is currently looking at ways to improve the search functions, and the contractor expects to issue its report in mid-April of this year.

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### Walk-in Assistance Improved and Community Based Coalitions Expanded over Last Year

The quality of assistance at IRS's walk-in sites has improved this year over last, and service to taxpayers through community based coalitions has increased. At congressional direction, the TIGTA has been responsible for measuring the quality of assistance at IRS's walk-in sites. According to TIGTA officials, the accuracy of tax law assistance provided at IRS's walk-in sites increased as of February this year to about 73 percent—an increase of 27 percentage points over the same period last year. TIGTA also found that the rate at which IRS employees referred taxpayers to a publication instead of answering tax law questions—which had been an issue last year—declined by about 85 percent.

According to TIGTA officials, the increased accuracy rates resulted from various steps taken by IRS, including revising to the guidelines used by walk-in staff, certifying staff proficiency, conducting monthly reviews of tax law accuracy, and taking immediate action to address review information relating to any incorrect answers or improper referrals found during IRS or TIGTA quality reviews.

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As table 1 shows, more taxpayers had their returns prepared by community-based coalitions and other organizations that provide free tax return-preparation assistance as part of IRS's Volunteer Income Tax Assistance and Tax Counseling for the Elderly programs. These programs use IRS-trained volunteers to help prepare basic tax returns for taxpayers with special needs—including those with a low to fixed income, non-English speaking people, and the elderly.

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## Concluding Observations

As the examples of improved telephone access and the Brookhaven Processing Center closing show, IRS is beginning to realize payoffs from the ongoing systems modernization investments and wider management improvements. Although IRS has not succeeded in reallocating staff to one of its priority needs, compliance, there will likely be increased potential for such reallocation as modernization proceeds. This will present Congress, in its oversight and appropriations roles, with significant opportunities to weigh in on IRS's overall strategy for better accomplishing its mission. Specifically, Congress will have opportunities to help IRS establish strategic priorities and make decisions about the resources needed to meet those priorities.

Mr. Chairman, this concludes my prepared statement, and I would be pleased to respond to any questions.

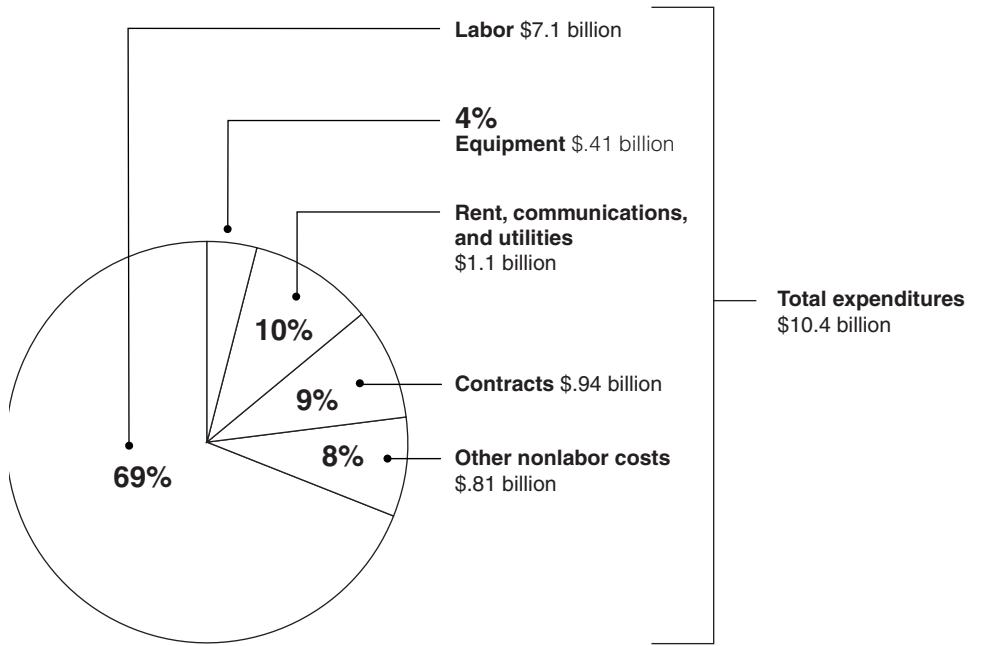
# How IRS Allocated Expenditures and Staff Resources in Fiscal Year 2002

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To provide some context for understanding the 2004 budget request, figures 2 and 3 illustrate how the Internal Revenue Service (IRS) allocated expenditures and staff resources in fiscal year 2002, the most recently completed year. Figure 2 shows IRS's fiscal year 2002 actual expenditures in several categories, including about 69 percent that was spent on labor. Figure 3 shows how IRS allocated its labor across functional areas, including ensuring compliance such as auditing and collecting delinquent taxes (45 percent), providing taxpayer services such as telephone assistance (21 percent), and processing tax returns (15 percent). However, the boundaries between categories may not be as well defined as the figures indicate. For example, in figure 3, staff categorized as maintaining information systems could also be considered under support for processing, taxpayer service or compliance. Therefore, the figures are meant to provide a summary of how IRS uses its resources and should be interpreted with caution.

**Appendix I**  
**How IRS Allocated Expenditures and Staff**  
**Resources in Fiscal Year 2002**

**Figure 2: IRS's Expenditures in Fiscal Year 2002 <sup>1</sup>**

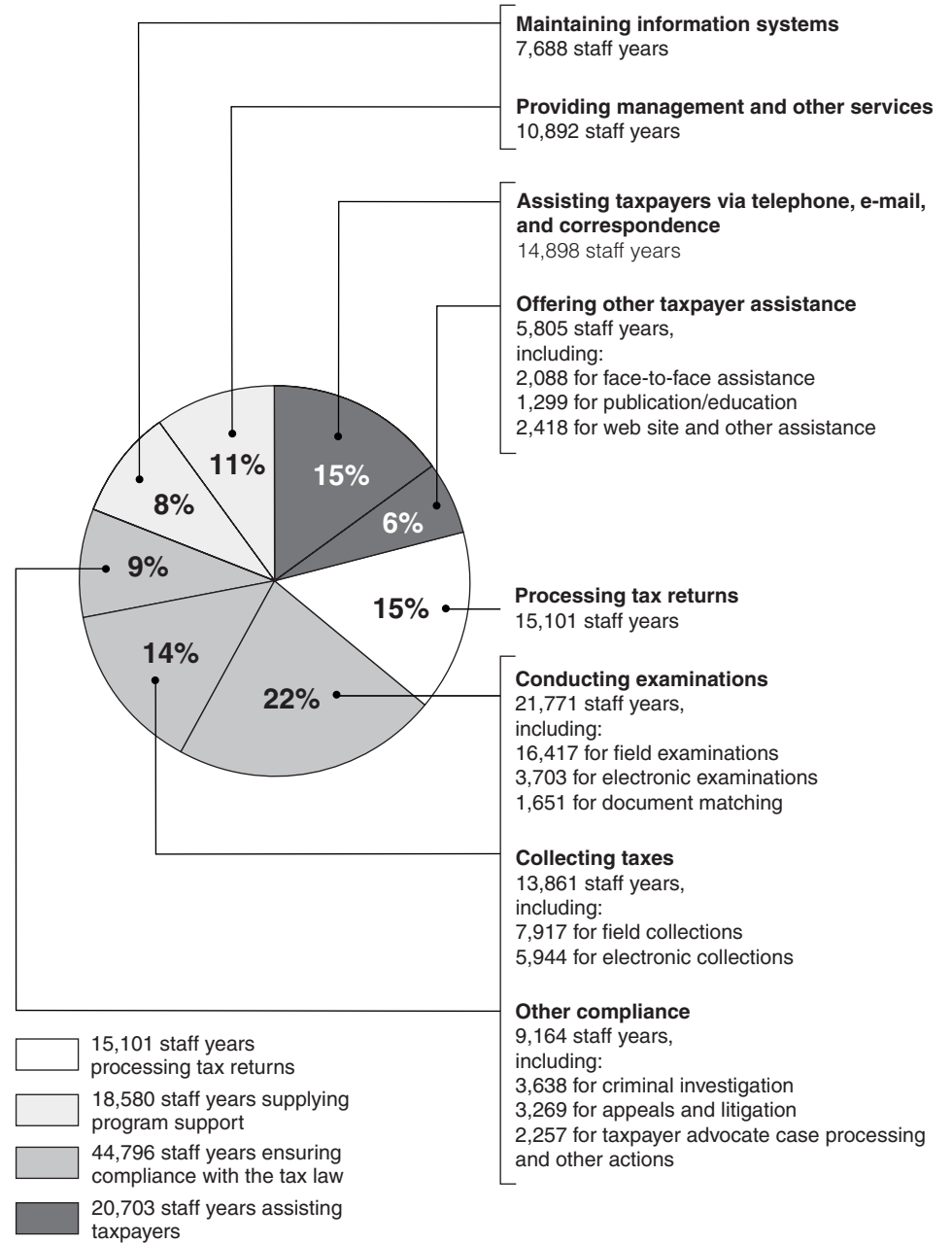


Source: GAO analysis of IRS data.

<sup>1</sup>IRS's annual expenditures may exceed its current year appropriations, because IRS has additional budgetary resources available to it and also incurs certain costs that were funded in prior years. During fiscal year 2002, IRS's total budgetary resources included its fiscal year 2002 appropriation of \$9.437 billion as well as unobligated balances available from prior years, spending authority from offsetting collections, and recoveries of prior year obligations.

**Appendix I**  
**How IRS Allocated Expenditures and Staff**  
**Resources in Fiscal Year 2002**

**Figure 3: How IRS Spent Its 99,180 Staff Years in Fiscal Year 2002**



Source: GAO analysis of IRS data.

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