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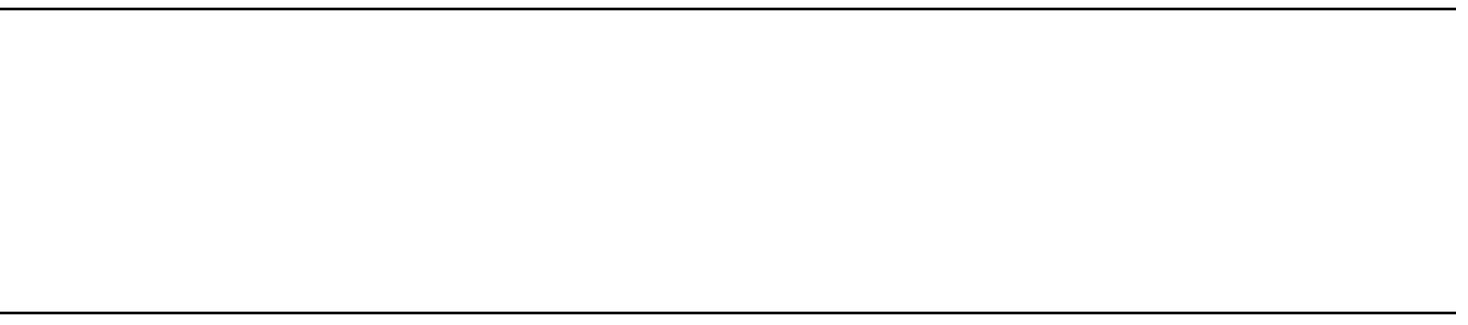Before the Committee on Governmental Affairs, U.S. Senate

TAX SYSTEMS MODERNIZATION

Progress in Achieving IRS' Business Vision

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

Progress in Achieving IRS' Business Vision

In 1986, IRS initiated Tax Systems Modernization (TSM) primarily to replace computers that it was using to process and store the information on tax returns. In 1992, in response to recommendations by GAO and others, IRS began to analyze how it might use new technology to change its business operations. As a result, IRS developed a vision for 2001 that called for organizational, technological, and operational changes affecting the way IRS processes tax returns, provides customer service, and ensures compliance.

Since 1992, IRS has made some progress in modernizing its operations, but the differences between IRS' current operations and those proposed in its vision are great. Congress cut IRS' fiscal year 1996 TSM budget due in part to concerns about IRS' progress in delivering new TSM systems. In response, IRS reassessed its business vision and identified those aspects that it can accomplish by 2000 and those that will be delayed. Although IRS has not released all of the details of its reassessment, it appears that it will affect IRS' ability to resolve by 2001 many longstanding operational problems.

One of the biggest problems facing IRS is its inefficient system for processing most tax returns. IRS has made little progress either in reducing the number of paper returns it processes or in delivering the new systems needed to better process paper. For example, IRS established a goal to receive 80 million tax returns electronically by 2001, but it lacks a comprehensive business strategy for achieving this goal. Recently, IRS began a project to reengineer its tax returns processing system. It is too early to tell whether this effort will have an impact on IRS' ability to reduce the volume of paper returns processed.

The second part of IRS' business vision is to improve service to taxpayers. Taxpayers have long had a problem reaching IRS by telephone. And, when they reach IRS, assistors do not always have easy access to the information needed to resolve their problems. IRS' strategy for improving customer service includes consolidating work units, changing work processes, and increasing the use of or implementing new information systems. It is a promising strategy, but IRS faces many challenges in its implementation.

The third part of IRS' vision is to increase compliance to 90 percent by 2001. Compliance levels have remained at 87 percent for the last several years. IRS established its 90-percent goal on a set of assumptions that have since changed significantly—changes that could jeopardize achievement of IRS' goal. For example, budget and taxpayer burden concerns led IRS to postpone indefinitely the Taxpayer Compliance Measurement Program,

the results of which were to provide more up-to-date information for a new compliance research information system.

GAO questions IRS' ability to make sound investment decisions until reengineering of important processes, such as tax return processing, is sufficiently completed. Until clearly defined business requirements drive TSM projects, there is no assurance that these projects will achieve the desired objectives and result in improved operations.

Progress in Achieving IRS' Business Vision

Mr. Chairman and Members of the Committee:

I am pleased to have this opportunity to assist you in your continuing review of the Internal Revenue Service's (IRS) Tax Systems Modernization (TSM). In March 1996, we appeared before this Committee to discuss the managerial and technical weaknesses of TSM.[1] Today, our testimony focuses on IRS' progress in achieving important programmatic aspects of its business vision for 2001 and how TSM supports that vision.

In 1992, IRS developed a new business vision that was designed to address critical longstanding problems with its programs, such as

- the lack of accurate and readily accessible information on taxpayers, their accounts, and IRS operations, due in part to an antiquated tax return processing system that relies on labor-intensive, error-prone methods to process over 200 million, primarily paper, tax returns annually;
- taxpayer frustration in dealing with IRS as they seek to resolve tax law or account questions. These frustrations revolve around very low levels of telephone accessibility, confusing and hard-to-understand notices, and the need to repeatedly call or correspond with IRS to resolve tax issues; and
- a stagnant level of taxpayer compliance and a sizable inventory of accounts receivable.

IRS' business vision calls for addressing these problems through a series of organizational, business process, and technology changes, including TSM. Specifically, IRS' vision calls for (1) moving from a paper-laden, labor-intensive tax return processing environment to a modern electronic environment; (2) providing better service to taxpayers through wider use of the telephone, better access to data, and new information systems; and (3) improving compliance through access to accurate, up-to-date data, earlier identification of noncompliant taxpayers, and increased efficiencies in its field enforcement functions.

Our statement today is based on previous and ongoing work on IRS' business vision and TSM. While our statement addresses the importance of technology to IRS' business vision, it also points to the importance of organizational and business process change in making IRS' vision a reality. Our statement makes the following points:

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

- Initially, TSM was technology-driven rather than business-driven. As a result, important business requirements were not fully defined when early TSM projects were designed. IRS subsequently recognized that TSM could be an enabler for organizational and business process change and, in 1992, developed a business vision for 2001. Many of the requirements for this vision remain undefined today, jeopardizing the future success of both TSM and the successful accomplishment of IRS' vision. IRS is far from achieving the operational benefits of its vision.

- Little progress has been made either in reducing the number of paper returns IRS processes or in delivering the new systems needed to better process paper returns. In May 1993, IRS established a goal to receive 80 million tax returns electronically by 2001. As we told this Committee in March, IRS lacks a comprehensive business strategy for achieving its 80-million goal.[2] Recently, after spending about $270 million of a projected $1.3 billion on a Document Processing System (DPS) for scanning and imaging paper returns, and about $94 million on an interim service center scanning and imaging system known as SCRIPS, IRS began a project to reengineer its tax returns processing system. It is too early to tell whether this new reengineering effort will have a significant impact on IRS' ability to reduce the volume of paper returns it processes.

- IRS is beginning to implement aspects of its vision for improving customer service. IRS anticipates improving customer service by consolidating work sites, changing work processes, and putting in place new information systems. However, IRS must address several important managerial, technical, and human resource challenges to fully achieve that vision.

- IRS' goal is to increase compliance from 87 percent to 90 percent by 2001. However, IRS established that goal on a set of assumptions that have changed significantly. For example, IRS no longer plans to reinvest staff savings from TSM into compliance activities. Thus, compliance activities are likely to have fewer staff than IRS envisioned when it established the 90-percent goal. Also, IRS no longer has a specific plan for obtaining more up-to-date information for a new compliance research information system that IRS is developing as a part of TSM.

- We have questions about IRS' ability to make sound investment decisions on TSM until IRS completes the reengineering of important processes, such as its tax return processing system. The outcome of IRS' reengineering efforts could generate new business requirements that are not addressed by TSM projects or that make some of those projects obsolete.

[2]GAO/T-AIMD-96-75.

IRS' Business Vision

In 1986, IRS initiated TSM primarily to replace the computers that it was using to process and store the information on tax returns. IRS planned to introduce the new technology without changing its existing organizational and operating structure, which included 10 service centers that processed tax returns, over 70 telephone call sites that provided various types of service to taxpayers, and 63 district offices that were responsible for many of IRS' compliance activities.

In June 1991, we testified before this Committee on important management challenges facing IRS as it moved to resolve longstanding problems with its programs, their effectiveness, and the quality of service provided to taxpayers.[3] In discussing those challenges, we said that "computers are only tools to help achieve management's vision of a future IRS; they are not a substitute for that vision." We also said that TSM offered IRS the opportunity to rethink the way it does business and the way it is structured to do that business.

In 1992, in response to our and others' recommendations, IRS began to analyze how it might use new technology to change its business operations. Subsequently, IRS decided on a series of business process and organizational changes that it set forth in a business vision for 2001. These proposals envisioned dramatic changes in the way IRS did business, with the changes supported by a new organizational structure, new business processes, and new technology.

The new vision depended on new technology to be the vehicle to resolve many longstanding problems that resulted from IRS managers and employees not having access to the information they needed in a timely fashion. But other equally dramatic changes were envisioned, specifically many fewer processing centers and customer service sites, a shift from correspondence to the telephone in communicating with taxpayers, and a focus on earlier identification and resolution of taxpayer problems and noncompliance. While IRS predicted that it would need many fewer staff to maintain existing work levels, it anticipated investing the staff savings made available from TSM back into its customer service and enforcement programs.

During the past 4 years, IRS has made some progress in modernizing its operations to reflect its business vision, but the differences between IRS' current operations and those proposed in its vision are great. TeleFile, a system that allows filers of very simple returns to do so over the

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[3]Management Challenges Facing IRS (GAO/T-GGD-91-20, June 25, 1991).

telephone, went nationwide this year, and about 2.8 million people participated. Yet the total number of people filing their returns electronically remains below 1994 levels and far below what is needed to accomplish IRS' electronic filing goals. Telephone accessibility was up this filing season—IRS assistors answered over a million more calls than last filing season due in part to better data availability—yet IRS was still able to answer only about 20 percent of the calls. IRS' accounts receivable inventory remains on our high risk list.

Congress cut IRS' fiscal year 1996 TSM budget due in part to concerns about the value of TSM investments and IRS' progress in delivering new systems. In response, IRS recently identified those aspects of its original business vision that it expects to accomplish by 2000 and those that will have to be delayed. We refer to this effort as IRS' reassessment of TSM. Although IRS has not released information on which TSM projects will be continued and on what schedule, it appears the reassessment will affect IRS' ability to resolve by the year 2001 many of the longstanding problems it faces.

The remainder of our testimony provides more information on IRS' business vision and IRS' progress in achieving that vision.

IRS Lacks a Comprehensive Strategy to Significantly Reduce the Volume of Paper Returns

One of the biggest problems facing IRS is its antiquated, inefficient system for processing most tax returns. The system involves thousands of staff moving mountains of paper through several processing stages. It is a time-consuming, inefficient process that requires considerable effort just to correct errors made by IRS employees during the process. Storing and retrieving the paper returns involves further inefficiencies. It can take weeks, for example, for an IRS employee to retrieve a paper return from storage.

IRS' strategy for receiving and capturing data from tax returns was and still is a crucial component of IRS' business vision. Initially, IRS' strategy focused on replacing computers in its 10 service centers with more efficient ones. However, in 1992, IRS began examining other processing options. As a part of that analysis, IRS concluded that it had to make various organizational and business changes. Probably the most important business change was IRS' decision to significantly increase the number of tax returns received electronically by 2001.

Although IRS has implemented some initiatives that have increased the number of electronic returns since 1993 when it established a goal to

receive 80 million returns by 2001, those initiatives are targeted at tax returns that are among the least costly paper returns to process. Furthermore, IRS has not yet successfully addressed one of the major impediments to the expansion of electronic filing—its cost to taxpayers.

IRS' current initiatives to increase electronic filing will not, in their entirety, bring IRS close to its 80-million goal. IRS has acknowledged that it lacks a comprehensive business strategy for achieving that goal and needs to rethink its overall approach for receiving and capturing tax return data. To that end, IRS recently began a reengineering project to identify strategies for significantly reducing its paper tax return filings.

Original Plans for TSM Focused on Imaging a Large Number of Paper Returns

As noted earlier, IRS' original TSM plans for receiving and capturing tax return data centered on replacing existing computers at its 10 service centers. Accordingly, in 1988, IRS began designing a Document Processing System (DPS) that would use imaging and optical character recognition technologies to process paper tax returns and capture 100 percent of the data on those returns (IRS now captures only about 40 percent of the data on paper returns).[4] IRS planned to implement this system at all 10 service centers.

In April 1992, we said that IRS had not adequately assessed the cost/benefit tradeoffs associated with its strategy for receiving and capturing tax return data using DPS.[5] We said that two prerequisites for developing good information systems were an analysis of the business functional requirements and an identification of alternatives for meeting those requirements. We recommended that IRS develop a comprehensive analysis to determine the cost and benefits of alternative strategies for receiving and capturing tax return information. We said that IRS, as part of that analysis, should determine the impact of various electronic filing incentives on the requirements for imaging and optical character recognition. IRS proceeded with the development of DPS without this analysis but decided that DPS would be rolled out in 5 service centers instead of 10. IRS records show that it had spent about $270 million on DPS through fiscal year 1995.

According to IRS officials, it is uncertain whether the benefits of DPS outweigh the costs. Over the next 120 days, according to those officials, IRS

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[4]Data capture involves electronic storage for later retrieval, analyses, etc.

[5]Tax Systems Modernization: Input Processing Strategy is Risky and Lacks a Sound Analytical Basis (GAO/T-IMTEC-92-15, Apr. 29, 1992).

will be evaluating its need for an imaging and data-capture system. One important aspect of this evaluation will be a determination of how much tax return data IRS needs for compliance purposes and whether data needs vary by type of return. This analysis was not done when DPS was initially planned. In light of the ongoing evaluation of DPS, according to an IRS official, the pilot test of DPS that was scheduled for January 1997 has been delayed.

IRS' Business Vision Calls for an Increase in the Number of Electronic Returns and Other Changes

IRS analysis of options for changing its processing system for tax returns and other paper tax documents, such as information returns, resulted in several recommendations. Probably the most important recommendation was one to increase the number of returns that IRS would receive electronically in 2001. The other recommendations focused on consolidating paper processing of tax documents at fewer service centers and providing a return-free filing capability for certain taxpayers.

Electronic Filing

When TSM began in 1986, IRS assumed that it would eventually receive about 40 million electronic returns a year. After analyzing options for business change, IRS adopted a goal of 80 million electronic returns by 2001. Compared with IRS' current procedures for processing paper returns, electronic filing has several benefits for IRS. These benefits include reduced processing, storage, and retrieval costs and faster, more accurate processing of returns and refunds.

Since the inception of electronic filing in 1986, IRS' marketing approach was to encourage tax return preparers to provide electronic filing in the hope that they would market the service to the general public. IRS' rationale for this approach was based primarily on the large number of professional preparers—about 57 million tax returns for tax year 1993 were prepared by professional preparers. Because we saw the need for IRS to expand the appeal of electronic filing, we recommended in January 1993 that IRS identify additional market segments and specify strategies for attracting those segments to electronic filing.[6] To that end, IRS developed a strategy that encompassed 21 initiatives for increasing the number of electronic returns.

IRS has implemented some of the 21 initiatives and has realized some positive results. For example, certain taxpayers who are eligible to file a Form 1040EZ are now allowed to file electronically using a toll-free

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

number on touch-tone phones. This year, about 2.8 million taxpayers used that filing method, known as TeleFile.

However, the one initiative that IRS assumed would have the single most significant impact on electronic filing, generating 46 million electronic returns, has since been dropped. That initiative called for legislative mandates requiring that (1) preparers of 100 or more individual returns offer electronic filing and (2) businesses with 10 or more employees file their returns electronically. IRS dropped that initiative because IRS and Treasury officials believed there was little chance that Congress would pass such legislation.

IRS estimates that it will receive 16 million returns electronically for 1996. To date, most of the returns being filed electronically are ones that, if filed on paper, could be filed on forms (like the 1040EZ) that are among the least costly paper returns to process. With that in mind, we recommended, in October 1995, that IRS identify those groups of taxpayers that offer the greatest opportunity to reduce IRS' paper processing workload and operating costs if they filed electronically and develop strategies that focus on eliminating or alleviating impediments that inhibit those groups from participating in the program.[7] The primary impediment we cited was the cost of electronic filing. To file electronically, taxpayers generally have to go through a tax return preparer or some other third party at a cost that typically ranges from $15 to $40.

As we told this Committee in March, IRS has taken several actions that could result in future progress toward increasing the number of electronic returns. However, these initiatives have yet to culminate in a comprehensive strategy that will help IRS achieve its 80-million goal.[8]

Consolidating Paper Processing

Another aspect of IRS' business vision for 2001 was to consolidate the processing of all paper documents (tax returns, correspondence, and information returns) into 5 of its 10 service centers. IRS has identified which five centers will specialize in paper processing and has consolidated the processing of paper information returns and Federal Tax Deposit coupons in those centers with the roll out of an interim scanning and imaging technology known as the Service Center Recognition Image Processing System (SCRIPS). SCRIPS was also expected to process about 50 percent of the Form 1040EZ returns for the 1996 filing season. However, SCRIPS is performing well below IRS' original expectations. Besides

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

[8]GAO/T-AIMD-96-75.

information returns and tax deposit coupons, SCRIPS was expected to be processing all forms 1040EZ, 1040PC, and 941 (employment tax returns). Instead, SCRIPS is processing about 50 percent of the 1040EZs and none of the 1040PCs and 941s.

Return-Free Filing

As part of its vision for 2001, IRS planned to provide a return-free filing capability for a limited number of taxpayers by 2001. Under this system, the taxpayer would not have to file a tax return. IRS would calculate the tax liability and send the taxpayer either a bill or a refund. However, this capability depends on accelerated processing of information returns, such as wage and interest and dividend information submitted by third parties, so that IRS can determine the taxpayer's liability and prepare a return for the taxpayer during the January through early March time frame. Currently, there is a 1-year lag between the time a taxpayer files a tax return and when IRS notifies the taxpayer that it has identified unreported income for that tax year. For example, in March 1996, IRS was sending out underreporter notices for returns filed in 1995.

However, as a result of IRS' reassessment of TSM, IRS does not plan to accelerate the processing of information returns to the extent needed to support return-free filing. Until it does so, return-free filing will not be an option.

IRS Lacks a Cost-Effective Strategy for Obtaining the Taxpayer Data That May Be Needed for Customer Service and Compliance

Our message regarding IRS' progress in achieving its business vision for processing tax returns is really no different than it was in 1992—IRS' strategy for returns processing needs to be based on a clear definition of its downstream business requirements for customer service and compliance and an analysis of the cost and benefits of providing those requirements under some of the different scenarios that IRS is currently considering as a part of its reengineering effort. Until such an analysis is completed, IRS has no assurance that its technology investments for submission processing are sound.

As part of the reassessment of TSM referred to earlier, IRS reviewed its business assumptions for the receipt and capture of tax return data and the costs associated with those assumptions. In doing so, IRS concluded that it needed to "aggressively reengineer" its returns-processing function to significantly reduce paper filings. According to the Deputy Secretary of the Treasury, this reengineering effort will consider various alternatives beyond simply converting from paper to electronic filing. Those

alternatives include eliminating certain classes of tax returns, expanding eligibility for filing simple forms, and outsourcing the data capture function. Because this reengineering project is in its infancy, it is too early to determine whether the results will provide IRS with a clear definition of the functional requirements for its future returns-processing system. The foundation for this analysis needs to be a determination of the type of tax return data that IRS needs for compliance and customer service—something IRS says it is doing as part of its reevaluation of DPS.

IRS Faces Several Challenges in Implementing Its Customer Service Vision

The second part of IRS' business vision is to improve service to taxpayers. A key IRS goal is to resolve 95 percent of taxpayer inquiries after one contact. For service to improve, taxpayers must be able to reach IRS by telephone when they have questions or problems and IRS employees must have easy access to the information needed to help taxpayers.

Taxpayers have long had problems reaching IRS by telephone. The percentage of taxpayers' calls that IRS assistors answered decreased from 58 percent for the 1989 filing season to 8 percent for the 1995 filing season. Although the accessibility rate improved during the 1996 filing season, assistors were still only able to answer 20 percent of taxpayers' telephone calls. And, even when a taxpayer gets through to IRS, the assistor does not always have easy access to the information needed to resolve the taxpayer's problem. As a result, the assistor may have to either (1) refer the taxpayer to another office, (2) research the problem and call the taxpayer back, or (3) tell the taxpayer to call back later.

IRS' strategy for improving customer service includes consolidating work units, changing work processes, and increasing the use of or implementing new information systems. IRS' strategy offers promise as it is designed to improve taxpayers' ability to get assistance from IRS and to provide IRS employees easy access to information. However, IRS faces many challenges in implementing that strategy.

Consolidating Work Units

IRS' customer service vision calls for consolidating the work of different functional areas that do not have face-to-face interaction with taxpayers.

IRS has different functional areas that answer taxpayer inquiries, clarify and correct tax returns, and collect unpaid taxes. Because each of these functional areas maintains separate taxpayer databases, taxpayers who contact IRS either by mail or by telephone are often told to write or call

other offices rather than those they initially contact. As a result, taxpayers may have to make several inquiries before locating an IRS office that can address their concern or question.

Non face-to-face interaction with taxpayers has traditionally been done in at least 70 IRS organizational units in 44 locations. The customer service vision calls for consolidating the work of these 70 organizational units into 23 customer service centers. Customer service centers would absorb the functions of (1) toll-free taxpayer assistance sites, which answer calls about tax law and procedures, taxpayer accounts, and notices that taxpayers receive from IRS; (2) automated collection call sites, which contact taxpayers to secure delinquent tax returns and payments and answer calls from taxpayers who are the subject of collection actions; and (3) forms distribution centers, which handle requests for tax forms and publications.

IRS has made some progress toward implementing the organizational changes. IRS has selected the locations for its customer service centers, developed a schedule for start-up operations, and formulated a plan for progressively expanding the workload of the new centers. Two customer service centers (Nashville and Fresno) are experimenting with new ways of providing customer service over the telephone. As of April 1996, IRS had partial customer service operations at 13 of its 23 sites. Of the 28 organizational units that are scheduled to close, 6 are closed. The remaining offices will be closed on a staggered schedule through 2002.

Changing Work Processes

IRS' customer service vision emphasizes use of the telephone to interact with taxpayers. As such, IRS' plans include actions directed at converting to telephone much of the work now being done by correspondence and at making it easier for taxpayers to reach IRS and resolve their problems by telephone.

The Fresno prototype customer service center has experience in converting paper correspondence to the telephone. According to IRS, after it began including Fresno's telephone number on some outgoing notices, the center's correspondence receipts declined by 15 percent. Other customer service centers are testing a new toll-free telephone number that IRS added to certain account notices this year. In past years, those notices instructed taxpayers to write to IRS if they had any questions.

IRS' strategy for improving the accessibility of its telephone service calls for (1) extending its hours of operation, (2) improving its ability to route calls, (3) increasing the use of interactive systems, and (4) reducing demand for assistance.

First, office hours would be extended to 20 hours a day during the week and 8 hours each day on the weekend. Also, taxpayers would have access to interactive systems 24 hours a day. Starting in January 1995, by routing calls among some call sites and extending the hours of others, IRS enabled taxpayers nationwide to call IRS from 7:30 a.m. to 5:30 p.m. weekdays—an additional 2 hours of service than in the past.

The second part of IRS' strategy for improving telephone accessibility calls for enhancing IRS' ability to route taxpayer calls nationwide to those locations that have employees available to answer taxpayers' questions. Early in 1995, IRS installed automated call distributors that can send calls to other locations where IRS employees are available to answer questions. However, IRS currently routes calls using a "bottom up" approach—i.e., the call site notifies the cognizant regional office when it is overloaded, and the regional office then notifies the National Office. On the basis of daily trend data, the National Office sends the calls to other call sites not thought to be busy. National Office staff manually log the change and log it into a terminal. After this process, the change can be operational within 15 minutes to 1 hour later. However, by the time the National Office responds, the overload situation may have subsided or callers may have simply abandoned their calls. As part of its customer service vision, IRS hopes to have a "top down" approach to call routing using real-time data in 1997. This capability depends on certain technology and establishment of a National Command Center that will have access to real-time call volumes for all customer service centers.

Increasing the use of interactive systems is the third part of IRS' strategy to expand telephone service. Specifically, IRS expects that 45 percent of all taxpayers' calls will be resolved through interactive systems. These systems are to allow taxpayers to get answers to their questions and complete certain transactions, such as making tax payments or entering into installment agreements, without talking to an IRS employee. Overall, IRS expects to have 30 or more of these systems available to taxpayers by 2000. As of January 1996, IRS had developed and tested three such systems and had rolled-out one of them to seven locations. Four more interactive telephone systems are scheduled to be tested in September 1996.

We recently reported that the three interactive telephone systems that IRS has tested were difficult for taxpayers to use because IRS' telephone routing system (1) required taxpayers to remember up to eight menu options when the design guidelines called for no more than four options and (2) did not allow taxpayers to return to the main menu when they made a mistake or wanted to resolve other issues.[9] We recommended that IRS assess the various menu options and take actions to overcome the problems caused by too many options, including using multiple toll-free numbers and providing taxpayers with a written step-by-step description of how to use the interactive systems' menus. In response to our recommendation, IRS plans to further test telephone menu options and interactive telephone systems to determine taxpayers' needs and their ability to use the system easily. The clarity of menu options will be even more critical as IRS plans to expand its use of interactive systems.

The final part of IRS' strategy is to reduce the need for taxpayers to call IRS. IRS plans to do this in several ways. In the near term, demand on IRS' customer service centers will be reduced by eliminating unnecessary notices. In that regard, as part of a recent notice reengineering project, IRS decided to eliminate certain notices. When the recommendations from the reengineering effort are fully effective, in fiscal year 1997, IRS expects to be issuing almost 46 million fewer notices annually to taxpayers. By eliminating those notices, IRS expects to receive 9 to 10 million fewer telephone calls from taxpayers.

In the longer term, IRS plans to reduce demand by successfully responding to more taxpayer issues with only one contact. According to IRS, this will require its assistors to have better quality information and tools at their disposal. As discussed in the next section, some progress has been made, but the systems IRS needs to accomplish this goal remain in development.

Improving Information Systems

In addition to organizational and work process changes, IRS' customer service vision depends on increasing the use of and implementing new information systems.

Making it easier for taxpayers to reach IRS by telephone is of limited value if IRS employees on the other end of the line do not have access to the data needed to help the taxpayers. Inaccessible data has been a longstanding problem in IRS. IRS' primary taxpayer account database that is used for

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[9]Tax Administration: Making IRS' Telephone Systems Easier to Use Should Help Taxpayers (GAO/GGD-96-74, Mar. 11, 1996).

assisting taxpayers, known as the Integrated Data Retrieval System (IDRS), was designed in the 1960s. Until 1995, account information in IDRS was spread among 10 service centers and employees in each center had access to information on only a small percentage of the IDRS accounts. When an employee did not have access to the account information needed to respond to a taxpayer's question, the employee typically wrote down the question and mailed it to the location that had access to the information whose staff would then respond to the taxpayer.

Early in 1995, IRS implemented a networking capability among the 10 service centers so that employees could have access to IDRS data nationwide. This networking capability is referred to as Universal IDRS. Although Universal IDRS gives IRS employees access to taxpayer account information nationwide, IDRS does not always contain complete information on a taxpayer's account. Other information needed to help the taxpayer may reside in different systems that are not linked to IDRS. For example, an IRS employee using IDRS will know that a taxpayer was sent an underreporter notice, but would not have access to the actual notice. That notice is contained in IRS' Automated Underreporter system. The notice would provide additional information, such as the amount of unreported income and information return data that may indicate, for example, the amount of dividend or interest reported by financial institutions but not by the taxpayer.

To resolve these kinds of problems, IRS eventually intends to provide its employees with access to greater amounts of on-line taxpayer data in shorter time frames than those for the current IDRS data. This capability is to be delivered when IRS implements two TSM projects—the Corporate Accounts Processing System (CAPS) and the Workload Management System (WMS). CAPS is to be the main repository of taxpayer account data, and WMS is to track and manage all open account issues for a taxpayer. These projects are scheduled to be implemented in 1999.

In the interim, IRS plans to use Integrated Case Processing (ICP) to gain access to and integrate information from each of the existing IRS functional databases that contain taxpayer information. Using a taxpayer's social security number to obtain case information, the ICP software is expected to automatically assemble the relevant information on screen, provide questions and prompts for the customer service representative, and perform calculations for updating the account. With ICP, it is envisioned that IRS customer service staff will have all relevant information from a

number of important databases available to them when they talk to the taxpayer. This is key to meeting IRS' customer service goals.

IRS plans to deliver ICP in four software increments. The first software increment consists of eliminating the need for IRS employees to use multiple workstations to access data on individual taxpayers from different information systems. As of February 1996, the first increment of ICP was partially deployed at 13 of the 23 customer service centers.[10] The next ICP software increment is being designed to provide enhancements over the first increment. Some of the enhancements include consolidating the information from multiple systems onto a single standard screen and providing IRS with the capability to route calls to the most skilled IRS employee who is available at the time of a taxpayer's call. Later versions are expected to provide this same level of access to information for business taxpayers.

Managerial, Technical, and Human Resource Challenges Remain

IRS' strategy for improving customer service offers promise as it is designed to improve taxpayers' ability to get assistance from IRS and provide IRS employees access to the information they need to help taxpayers. However, IRS faces important managerial, technical, and human resource challenges to fully achieve its customer service vision. Specifically, it has to manage the transition to the customer service vision while continuing to meet the current workload for providing answers to taxpayer inquiries, managing taxpayer accounts, and collecting unpaid taxes. IRS also has to determine the scope of responsibilities for those staff employed at customer service centers and provide the requisite training for that staff. IRS also has to develop the information systems necessary to support the accomplishment of its vision, including interactive telephone systems that are easy for taxpayers to use.

IRS' Compliance Goal May Be Jeopardized by Changing Assumptions

The third major part of IRS' vision is to increase compliance. According to IRS, compliance levels have remained at 87 percent for the last several years. IRS estimates that each percentage point increase in compliance could generate billions of dollars in revenue. In addition, IRS is faced with an inventory of collectible tax debts that, according to IRS estimates, was about $46 billion as of September 30, 1995.

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[10]IRS' plans call for purchasing 16,000 ICP workstations through 2000. IRS has already purchased about 2,300 of those workstations.

IRS' goal is to increase compliance to 90 percent by 2001 through improved voluntary compliance and enforcement. However, it is unclear how IRS expects to achieve that goal, especially considering some of the changes since the goal was established. Since then, for example, IRS (1) has begun reassessing its data needs and revised its plans to capture 100 percent of the data on tax returns; (2) has postponed indefinitely the Taxpayer Compliance Measurement Program (TCMP), which has been IRS' primary program for obtaining comprehensive and reliable taxpayer compliance data since the 1960s; (3) no longer anticipates being able to do up-front matching of tax returns and information returns, at least until sometime after 2000; and (4) has abandoned its assumption that staff-year savings from modernization would be reinvested in front-line customer service and compliance positions.

Ready Access to Good Data Is Critical to Achieving IRS' Compliance Goal

Achievement of IRS' compliance goal hinges on the ability of enforcement staff to readily access good data. For example, as we discussed in recent testimony on IRS' debt collection practices, existing IRS computer systems do not provide ready access to needed information and, consequently, do not adequately support modern work processes.[11] Access to current and accurate information on tax debts is essential if IRS is to enhance the effectiveness of its collection tools and programs to optimize productivity, devise alternative collection strategies, and develop programs to prevent taxpayers from becoming delinquent in the first place.

Although technology plays a key role in helping an organization collect good data and make it readily accessible to employees, it is critical that the organization first determine what data it needs. IRS has not yet identified all of the data that enforcement staff need to do their job.

IRS currently captures about 40 percent of the data provided by taxpayers on their individual income tax returns. IRS' intent, as part of modernization, was to capture, either through electronic submission or imaging, 100 percent of the data. However, as part of the TSM reassessment effort discussed earlier, IRS has decided that it will continue capturing about 40 percent of the individual income tax return data for at least the next 5 years, with the intent of moving to 100 percent data capture sometime after that. If IRS is going to continue capturing 40 percent of the tax return data, it is critical that it capture the right 40 percent. IRS does not now know if it is capturing the right data. According to IRS officials, efforts are underway to validate IRS' business needs and to do a line-by-line review of

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[11]Tax Administration: IRS Tax Debt Collection Practices (GAO/T-GGD-96-112, Apr. 25, 1996).

the individual income tax return (Form 1040) to determine what is and is not needed.

It is also important that any data IRS captures, whether 40 percent or 100 percent of the universe, be easily accessed by staff who need it. In that regard, IRS officials told us that enforcement staff are not able to readily access the data that IRS is now capturing. Like Customer Service, IRS' enforcement functions should benefit from the eventual replacement of the current master files with CAPS and WMS.

Data are also critical to IRS' new approach for researching ways to improve compliance. IRS has traditionally responded to noncompliance through audits and other enforcement efforts. Over time, IRS concluded that enforcement was essential to pursue intentional noncompliance but that improved taxpayer assistance and education, rather than enforcement, might be more appropriate for correcting unintentional noncompliance. With this in mind and concerned about noncompliance levels, IRS created a compliance research and analysis approach in 1993, with the intent of identifying noncompliant market segments and appropriate enforcement and nonenforcement efforts to address that noncompliance. IRS' major research tool is to be the Compliance Research Information System (CRIS). Plans call for CRIS to be an integrated network of databases containing a sample of internal, external, and multi-year data, accessible to national and district office personnel to support analyses of voluntary compliance levels. CRIS is expected to enable IRS to develop working hypotheses on the means to increase voluntary compliance, test hypotheses, evaluate the results, and make decisions on how to implement the new strategies.

IRS may not have objective compliance data available when needed for its research efforts. In October 1995, IRS indefinitely postponed TCMP due to budget and taxpayer burden concerns. TCMP has been IRS' primary program for obtaining comprehensive and reliable taxpayer compliance data since the 1960s. IRS has not done a TCMP of individual income tax returns since 1988. With the postponement of TCMP, IRS lacks current measures on compliance and does not have the data it needs to determine which market segments to research on ways to correct noncompliance. As we discussed in an April 1996 report to the Commissioner of Internal Revenue, although IRS plans to mitigate the data losses resulting from the postponement of TCMP, it has no specific proposal on how to accomplish this.[12]

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[12]Tax Administration: Alternative Strategies to Obtain Compliance Data (GAO/GGD-96-89, Apr. 26, 1996).

IRS' original vision assumed that compliance efforts would be enhanced by more timely issue identification and resolution, facilitated in part by accelerating the matching of tax return data with data provided by third parties, such as banks and employers. The ultimate goal was to achieve up-front matching whereby data are received and processed soon enough to allow matching with the tax return while the return is being processed and before any refund is issued.

IRS has been accelerating the matching process, but the first notice to taxpayers advising them of any discrepancy is still not sent out until about a year after the tax return was filed. According to IRS officials, IRS eventually wants to be able to send out notices in the same year the return was filed. Besides increasing the likelihood of contacting the taxpayer and resolving the case, sending the notice the same year the tax return is filed might help taxpayers avoid the same mistake on the following year's return. It is not clear when IRS will be able to do up-front matching.

Changes in Staffing Assumptions Make Achievement of IRS' Compliance Goal More Difficult

Data and the technology that provides it are critical, but so are the people who are tasked with using the data. IRS already has tens of thousands of staff who work in areas, such as taxpayer service, examination, and collection, that can affect compliance levels. Until recently, IRS had assumed that staff savings resulting from modernization (such as the savings anticipated in the returns processing function) would be reinvested to provide more of those front-line staff, with a corresponding increase in revenues. That is no longer the case, at least not to the extent originally anticipated. According to IRS officials, one of the assumptions surrounding its recent reassessment of TSM was that IRS would be smaller and could not rely on reinvesting TSM savings.

We have not quantified the implications of this change in staffing assumptions. It is clear, however, that IRS' success in increasing compliance is directly related to the number of staff involved in compliance-related activities and that any significant change in staffing could significantly affect IRS' ability to achieve 90-percent compliance goal. IRS could mitigate that effect, at least somewhat, by making sure that is has the right mix of staff.

Staff mix is an issue, for example, in IRS' collection function. While the private sector emphasizes the use of telephone collection calls, IRS allocates a significant portion of its collection resources to field offices where revenue officers visit taxpayers. IRS has initiated programs and

made procedural changes to speed up its collection process, but historically IRS has been reluctant to reallocate resources from the field to earlier, more productive, collection activities. IRS' fiscal year 1997 budget request states that, although traditional enforcement positions (which include revenue officers) "comprise the lion's share of IRS' enforcement efforts, they also represent on the margin the least efficient use of IRS resources." In that regard, the budget request provides for an increase in staff for IRS' telephone collection activities and a decrease in revenue officers—a shift toward the kind of mix that we have advocated in the past.

Another way to mitigate the effect of fewer-than-expected staff is to improve staff productivity. In that regard, one of IRS' efforts to improve compliance involves the automation of certain tasks done by enforcement staff in IRS' district offices. These tasks, like many in IRS, have for years involved the manual processing of paper, which has resulted in enforcement staff spending significant amounts of time on routine administrative duties. IRS has been implementing systems that are designed to ease this burden and help make enforcement staff more productive.

The Integrated Collection System (ICS) is a computer-based information system that is intended to automate some of the labor-intensive tasks performed by revenue officers. Although this effort is not a major technological advancement, it should enable revenue officers to spend their time more productively. According to IRS, implementing this system in two pilot districts resulted in increased collections, faster case closing, and less time spent on each case. The system is currently operating in six districts, and IRS plans to roll it out in three more districts this year. According to IRS, further implementation depends on future funding and final measurements of productivity.

IRS is also developing an automated inventory delivery system that is intended to direct accounts, based on internally developed criteria, to the particular collection stage where they can be processed most efficiently and expeditiously. This system, which IRS plans to test in July 1996, is intended to move accounts through the collection process faster and cheaper than under the current system.

Another field system, the Totally Integrated Examination System (TIES), provides automated tools to help IRS' Examination staff capture data about their audits and compute tax liability, interest, and penalties—tasks that previously had to be done manually. TIES has been implemented in seven

IRS offices. However, IRS recently decided not to continue funding TIES through TSM. It is our understanding that any future funding will be done outside of TSM.

According to IRS, the features of ICS and TIES will eventually be incorporated into the Integrated Case Processing (ICP) system, which will also provide IRS' compliance function with automated tools for case assignment and tracking. However, as a result of the recent reassessment of TSM, IRS has decided to delay that integration until after the year 2000.

TSM Investments Remain at Risk

In March 1996, we told the Subcommittee on Oversight, House Committee on Ways and Means, that additional investments in TSM are at risk given current managerial and technical weaknesses.[13] Those were weaknesses that we discussed in our July 1995 report on TSM.[14] The Department of the Treasury is expected to report to the Senate and House Appropriations Committees on IRS' progress in dealing with those weaknesses soon.

One of the managerial weaknesses discussed in our July 1995 report that has significant programmatic implications was a lack of integration of IRS' reengineering efforts and TSM projects. Specifically, we said that IRS' reengineering efforts were not tied to its TSM projects and that IRS lacked a comprehensive plan and schedule defining how and when to integrate these business reengineering efforts with ongoing TSM projects.

The reengineering efforts we referred to in July 1995 were put on hold pending the outcome of IRS' reassessment of TSM. As a result of the recent reassessment of TSM, IRS decided to reengineer "the tax settlement process". IRS has defined that process as beginning at the point taxpayers collect information necessary for the filing of tax returns and ending when the current year tax account is satisfied or enforcement action is initiated. IRS has identified 18 high-level processes for this time period. One of those processes focuses on IRS' tax return processing activity that we mentioned earlier.

We question IRS' ability to make sound investment decisions on TSM until reengineering of important processes, such as tax return processing, are sufficiently completed. Reengineering could result in new business

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[13]Tax Administration: IRS' Fiscal Year 1996 and 1997 Budget Issues and the 1996 Filing Season (GAO/T-GGD-96-99, Mar. 28, 1996).

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

requirements that are not addressed by planned TSM projects or that make those projects obsolete. For example, if IRS decides that it is cost-effective to outsource paper tax return processing, it will not need the scanning and imaging technologies that DPS is being designed to provide.

In closing, Mr. Chairman, our main point is that until clearly defined business requirements drive TSM projects, there is no assurance that TSM projects will achieve the desired objectives and result in improved operations. IRS must clearly define its business needs and determine the most cost-effective means for meeting those needs to ensure that it makes effective use of funds provided for information technology projects.

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

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