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TAX ADMINISTRATION

IRS' Fiscal Year 2000 Budget Request and 1999 Tax Filing Season

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Statement

Tax Administration: IRS' Fiscal Year 2000 Budget Request and 1999 Tax Filing Season

Mr. Chairman and Members of the Subcommittee:

We are pleased to participate in the Subcommittee's inquiry into the administration's fiscal year 2000 budget request for the Internal Revenue Service (IRS) and the status of the 1999 tax filing season.

Our statement is based on (1) our review of the administration's fiscal year 2000 budget request for IRS and supporting documentation; (2) interim results of our review of the 1999 tax filing season; (3) our ongoing review of IRS' restructuring efforts; and (4) our past and ongoing audits of various IRS activities, including efforts to modernize its computer systems, make its systems Year 2000 compliant, and implement the Government Performance and Results Act.

With respect the fiscal year 2000 budget request, our statement makes the following points:

- For fiscal year 2000, the administration is requesting about $8.2 billion and 97,862 full-time equivalent (FTE) positions for IRS--almost the same as IRS' proposed operating level for fiscal year 1999. Although the request reflects little change in the overall funding available to IRS, there are some changes in how IRS plans to use the fiscal year 2000 funds. For example, the request includes about $197 million for three initiatives—organizational modernization, implementation of the IRS Restructuring and Reform Act of 1998 (RRA98), and customer service training.[1] These are critical initiatives. We cannot comment on the reasonableness of the requested funding, however, because IRS (1) is still developing plans that could affect the costs associated with organizational modernization and (2) did not provide us with sufficient detail to explain how some of the estimates were developed.
- Congressional oversight of IRS' fiscal year 2000 operations could be made more complex because (1) the fiscal year 2000 budget request is formatted in a way that may not reflect IRS' organizational structure in fiscal year 2000 and (2) many of the performance measures included in the fiscal year 2000 budget request are new and two important measures (voluntary compliance and taxpayer burden) have yet to be developed. Both of these situations are understandable, however, because IRS (1) has not finished planning for the organizational modernization and (2) is in the initial stages of a major effort to develop a more balanced set of performance measures.

[1]Public Law 105-206, July 22, 1998.

- IRS' current 5-year cost estimate to make its information systems Year 2000 compliant is $1.3 billion—about $345 million higher than its March 1998 estimate. Changes in business requirements for one of IRS' replacement projects and a decision to upgrade or replace hardware and software for minicomputers/fileservers and personal computers account for some of the increase. For fiscal year 2000, IRS is requesting $250 million for its Year 2000 efforts. Most of that amount has been allocated to the Century Date Change Project Office and one of IRS' Year 2000 replacement projects. About $60 million of the $123.4 million allocated to the Project Office covers funding requests for various activities that have not yet been approved by IRS.

- IRS is requesting $1.46 billion for information systems in fiscal year 2000. IRS' plans for spending those funds are consistent with our prior recommendations and related congressional direction. IRS is also requesting for fiscal year 2001 an advance appropriation of $325 million for its multi-year capital account for systems modernization. IRS has not adequately justified that request in accordance with federal information technology investment requirements. Thus, Congress should consider either not funding the request or restricting obligation of the funds until IRS develops the requisite cost analyses to justify the amount requested.

With respect to the 1999 filing season, preliminary data show that (1) the accessibility and quality of IRS' telephone service has deteriorated considerably since last year, although accessibility has improved in recent weeks; (2) the number of individual income tax returns filed electronically is continuing to increase, although fewer returns are being filed by telephone; (3) many taxpayers have made mistakes with respect to the new child tax credit; and (4) new systems for processing returns and remittances have been performing well.

IRS' Fiscal Year 2000 Budget Request Maintains Staff and Funds at the Fiscal Year 1999 Level

For fiscal year 2000, the administration is requesting $8.249 billion and 97,862 full-time equivalent (FTE) positions, including $144 million and 2,095 FTEs to be funded outside the spending caps for the Earned Income Tax Credit compliance initiative.[2] As shown in appendix I, that request is virtually the same as IRS' proposed operating level for fiscal year 1999 ($8.246 billion and 97,959 FTEs). The overall increase of $3 million between the fiscal year 1999 operating level and the fiscal year 2000 request is the net result of several increases and decreases, the most significant of which are

[2]Fiscal year 2000 will be the 3rd year of funding for this 5-year initiative.

- an increase of $197 million for various initiatives, including organizational modernization;
- an increase of $249 million to maintain current service levels; and
- a decrease of $444 million in funding for IRS' information systems, which includes funding for information technology investments and IRS' efforts to make its systems Year 2000 compliant.

The Reasonableness of Requested Funding for Initiatives Is Uncertain

The fiscal year 2000 budget request includes $197 million for three initiatives--$140 million for organizational modernization, $40 million and 500 FTEs to implement various provisions of RRA98, and $17 million for training to enhance customer service. (See appendix II.) Although we agree that these are critical initiatives for IRS to undertake, we have no basis for determining whether the requested funding is reasonable because IRS (1) is still developing plans that could affect the amount of funding actually needed for organizational modernization and (2) did not provide specific details concerning how some of the estimates were developed.

Beginning in fiscal year 2000, IRS plans to reorganize its operations by establishing four main operating divisions to serve specific groups of taxpayers, including those with only wage and investment income, small business/self-employed individuals, large and midsize businesses, and tax exempt organizations. The administration has requested $140 million for organizational modernization in fiscal year 2000. According to IRS, these funds are needed to cover the costs for employee buyouts, relocations, and retraining in conjunction with the reorganization. We could not assess the reasonableness of the $140 million estimate because planning for the reorganization is ongoing. Until IRS' plans are finalized, it will be difficult to estimate such things as buyouts, relocation expenses, and training needs.

The fiscal year 2000 budget request also includes $40 million and 500 FTEs for the implementation of various customer service provisions in RRA98. Of the $40 million, $27 million is being requested to implement taxpayer protection and rights provisions, such as increased notices and processing for innocent spouse relief and due process in collection actions, Spanish language taxpayer assistance, grants for low income taxpayer clinics, and enhanced toll-free telephone and Internet access to IRS. The other $13 million is earmarked for efforts designed to increase the use of electronic filing.

Another initiative included in the budget request calls for enhancing customer service through improved training. For this initiative, the administration is requesting $17 million. According to IRS, $13 million of this request is needed to permanently increase training funds that had been reduced during the past few years. IRS believes that its limited training funds have contributed to a deterioration in the competency of its employees, particularly front-line employees who have contact with taxpayers.

IRS did not provide detailed support to show how it developed the budget estimates for implementing the RRA98 provisions and for training. This made it difficult for us to assess whether IRS had a reasonable basis for those estimates.

While each of these three initiatives appear to be critical if IRS is to provide first-class customer service, without additional information it is unclear what level of funding would be adequate for these initiatives in fiscal year 2000.

Oversight Could Be More Complex While IRS Modernizes Its Structure

Congressional oversight of IRS' fiscal year 2000 operations could be more complex while IRS is modernizing its structure because (1) the budget format may not reflect IRS' operating structure in 2000; and (2) many performance measures presented in the fiscal year 2000 budget request are new, and two important measures—voluntary compliance and taxpayer burden—have not been developed. The absence of a voluntary compliance measure, for example, makes it is difficult to assess the effects of IRS' diversion of enforcement resources to implement RRA98 and enhance customer service.

Budget Format May Not Reflect IRS Operating Structure in Fiscal Year 2000

The format of IRS' fiscal year 2000 budget request may not reflect IRS' organizational structure in fiscal year 2000. This is understandable given the fact that IRS has not finalized its restructuring plans. Until those plans are finalized, it would be premature for IRS to revise its budget format. At the same time, however, any significant disconnect between the existing budget structure and IRS' operating structure could make congressional oversight more complex.

The format of IRS' fiscal year 2000 budget request is consistent with the format of IRS' fiscal year 1999 budget and generally reflects IRS' current operating structure. However, starting later this year, IRS will be shifting from being geographically based in 33 districts offices to a customer-based structure built around four major groups of taxpayers—wage and investment income, small business and self employed, large and mid-size business, and tax exempt. Technology management is to be centralized, with each of the four major operating components being the business owner for systems that support it. IRS has not completed its planning for this organizational modernization and, thus, it is not yet clear how much change will actually take place in fiscal year 2000 versus years after 2000 and how those changes might affect oversight, if at all.

In conjunction with its organizational modernization, IRS is exploring plans to develop new financial and budget structures that could aid Congress in its oversight of IRS. We were told that IRS, as part of that effort, would be considering the needs of this Subcommittee and other congressional overseers. In that regard, there are two aspects of IRS' current budget structure that could hinder effective oversight. Those two aspects, which we discussed in our testimony on IRS' fiscal year 1999 budget[3] and which are still relevant, involve (1) the inability to determine how many FTEs and dollars IRS is devoting to enforcement versus assistance and (2) the lack of a separate budget activity for the Office of the Taxpayer Advocate.

Mix Between Enforcement and Assistance is Not Clear

Achieving IRS' mission requires a mix of enforcement and assistance. Congressional oversight would be enhanced, in our opinion, if Congress knew how IRS was allocating its resources between those two areas. That information cannot be derived from IRS' budget estimates.

For example, IRS is requesting $991.5 million and 20,874 FTEs for the Telephone and Correspondence budget activity within the Processing, Assistance, and Management appropriation. That activity covers all non face-to-face contacts between IRS and taxpayers. Such contacts include typical forms of assistance, such as answering telephone calls and correspondence, as well as several enforcement activities, such as audits handled through correspondence and attempts to collect overdue taxes via the telephone. The budget estimates do not show how much of IRS' request for Telephone and Correspondence is for assistance versus enforcement. Similarly, despite its name, the Tax Law Enforcement appropriation is not exclusively for enforcement. The $3.3 billion and 43,677 FTEs being requested for that appropriation include an unspecified amount of money and FTEs for various forms of assistance, including walk-in service and taxpayer education efforts. Finally, the $144 million and 2,095 FTEs being requested for the EIC compliance initiative also involve a mix of assistance and enforcement, but, again, that mix is not apparent in IRS' budget estimates.

[3] Tax Administration: IRS' Fiscal Year 1999 Budget Request and Fiscal Year 1998 Filing Season (GAO/T-GGD/AIMD-98-114, March 31, 1998).

Absence of a Separate Budget Activity for the Office of the Taxpayer Advocate

The Office of the Taxpayer Advocate is responsible, among other things, for the resolution of taxpayer problems through the Problem Resolution Program. Because of concerns about that Office's independence, Congress included provisions in RRA98 that, among other things, authorized the National Taxpayer Advocate to appoint local advocates, evaluate and take personnel action with respect to any employee of any local advocate's office, and submit annual reports directly to the Senate Committee on Finance and the House Committee on Ways and Means. We believe that congressional oversight of the Advocate's Office and IRS' efforts to solve taxpayer problems would be further enhanced and any concerns about the Advocate Office's independence would be further mitigated if funding for that Office was separately identified in IRS' budget.

According to IRS, the fiscal year 2000 budget request includes about $43.6 million and 628 FTEs for the Office of the Taxpayer Advocate. However, those amounts are not separately identified in IRS' budget estimates but are included within the Telephone and Correspondence budget activity in the Processing, Assistance, and Management appropriation.[4] According to the National Director for Budget, IRS would have had to make substantial coding changes to its financial system to set up a separate line item for the Advocate's Office in IRS' budget request. The National Director explained that it would not have been practical to start developing new financial codes for some organizational functions, such as the Advocate's Office, when many other changes may be needed later as IRS proceeds with its organizational modernization. We agree that it makes sense to make all needed changes to IRS' financial and budget structures at one time. Until a separate budget activity is established for the Advocate's Office, congressional oversight might be enhanced if the narrative part of IRS' budget estimates provided data on the amount of resources being devoted to that activity in the current year and being requested for the coming year.

The Development of Performance Measures Is a Work in Process

IRS is changing most of its performance measures and the way it uses measures to focus attention on priorities, assess organizational performance, and identify areas for improvement. A balanced set of performance measures is critical, not only for IRS management but also for effective oversight of IRS. As explained by IRS:

"It is essential to establish appropriate quantitative performance measures for the IRS and for its major component operations. This is required by the Government Performance and

[4]According to IRS' National Director for Budget, the Taxpayer Advocate's share of the budget will actually be much higher than the amount included in the request because IRS is in the process of transferring to the Advocate's Office funding responsibility for caseworkers who had been funded by other functions, such as Examination and Customer Service.

Results Act and is essential to the proper operation of any large organization. For this reason, an integral part of the overall modernization program for the IRS is the establishment of balanced performance measures which support and reinforce achievement of the IRS' restated mission and overall strategic goals."

IRS is designing Servicewide performance measures in support of its mission and strategic goals as well as performance measures at the individual program level. In September 1998, the Commissioner announced a new mission statement for IRS. It says that the mission of IRS is to "provide America's taxpayers top quality service by helping them understand and meet their tax responsibilities and by applying the tax law with integrity and fairness to all." To achieve this mission, IRS established three strategic goals—service to each taxpayer, service to all taxpayers, and productivity through a quality work environment.

To achieve the first goal--service to each taxpayer—IRS plans to make filing easier; provide first quality service to taxpayers needing help; provide prompt, professional, helpful treatment to taxpayers in cases where additional taxes may be due; and improve taxpayers' access to toll-free telephone assistance. To achieve the second goal—service to all taxpayers—IRS plans to increase fairness of compliance and overall compliance. To achieve the third goal—productivity through a quality work environment—IRS plans to increase employee job satisfaction and productivity while service improves. IRS said that it is realigning processes and activities to ensure that they support the mission of IRS and incorporate the principles of a balanced measurement system that focuses across three areas—business results, customer satisfaction, and employee satisfaction.

Identifying and defining Servicewide and program level performance measures is work in process for IRS. As shown in table III.1, IRS has defined 15 Servicewide performance measures and has one placeholder for a productivity measure that has yet to be defined. Nine of the 15 Servicewide measures are new. IRS has also defined 68 measures to gauge its performance in specific functional areas.[5] (See table IIL.2.) Of the 68 program level measures, more than half (40) are new.

Understandably, the lists of measures included with the fiscal year 2000 budget estimates are neither final nor complete because IRS is in the process of planning its organizational modernization and identifying performance measures. According to IRS' National Director for Budget,

[5] IRS' functional area include such activities as Submission Processing, Telephone and Correspondence, Examination, and Collection.

IRS will continue to revise and add other measures as it proceeds with the organizational modernization and implementation of RRA98. In that regard, IRS' list of Servicewide performance measures does not include two critical measures—voluntary compliance and taxpayer burden. Also, one existing Servicewide measure—toll-free level of access—is not, in our opinion, the most appropriate measure of IRS' performance in providing telephone service.

IRS' Performance Measures Do Not Address Voluntary Compliance and Taxpayer Burden

IRS' performance measures do not yet include any measures of voluntary compliance and taxpayer burden. While performance in both areas is difficult to measure, they are two critical indicators of IRS' performance and thus should be a vital part of any measurement system that IRS develops. According to IRS officials, IRS recognizes the importance of measuring these two areas of performance and plans to continue to explore valid and reliable ways to measure them at the strategic level to gauge IRS-wide performance.

Voluntary Compliance—IRS' Organizational Performance Management Executive told us that IRS would be unable to measure voluntary compliance without something similar to the discontinued Taxpayer Compliance Measurement Program (TCMP). In the past, IRS used TCMP studies to assess voluntary compliance among taxpayers. Those studies involved detailed audits of valid samples of tax returns. IRS projected the results of those audits to determine the extent of voluntary compliance among various groups of taxpayers. IRS conducted its last TCMP studies on returns filed for tax years 1987 and 1988. IRS abandoned the TCMP studies due to concerns about the additional cost and burden placed on taxpayers. Since then, IRS has not considered TCMP studies to be a viable option for assessing voluntary compliance.

Additionally, the Organizational Performance Management Executive explained that the TCMP studies had other limitations. For example, the TCMP studies could not be used to gauge compliance in "real time"—either during the tax year in question or the year after the tax year in question. Also, IRS can not attribute all changes in compliance to its performance because voluntary compliance can be affected by other factors, such as the economy and geographical location.

We believe that a modified version of the TCMP studies, that reduces the burden on taxpayers, could be useful in assessing voluntary compliance. For example, IRS could (1) use smaller samples that project nationwide results, (2) sample groups of taxpayers and project the results to specific groups of taxpayers, or (3) continuously sample a small number of returns over a period of several years.

Taxpayer Burden—IRS discontinued a performance measure it once used to gauge taxpayer burden—a ratio that compared private sector costs to the cost for IRS to collect $100 in "net tax" revenue.[6] IRS discontinued this measure because it was based on an outdated methodology and was considered to be a poor indicator of overall burden. IRS is currently working with a consultant to develop a new means to measure taxpayer burden. Additionally, results of IRS' taxpayer satisfaction surveys may provide some valuable insights on taxpayer burden.

Level of Service Would Be a More Appropriate Servicewide Measure of IRS' Performance in Providing Telephone Service

One important way that IRS helps taxpayers understand and meet their tax responsibilities is through toll-free telephone assistance. By calling IRS, taxpayers can, among other things, get answers to tax law questions, inquire about the status of their account, or order forms and publications. It is important that IRS and Congress know how well IRS provides this critical service. Toward that end, IRS has included "toll-free level of access" as one of its Servicewide performance measures. We believe, however, that toll-free level of access is not the most appropriate Servicewide measure for assessing IRS' performance in providing telephone service. The more appropriate measure, in our opinion, is "toll-free level of service."

The only difference between these two measures, and the reason we favor level of service, is the way in which abandoned calls are handled in computing the measures.[7] IRS computes level of access by adding the number of calls answered and the number of abandoned calls and dividing that sum by the total number of call attempts (which is the sum of calls answered, calls that are abandoned, and calls that receive a busy signal).[8] Level of service is computed by dividing the number of calls answered by total call attempts. Thus, in effect, level of access considers abandoned calls as successful call attempts while level of service considers them unsuccessful. Although level of access is a useful measure because it indicates the extent to which taxpayers are able to access IRS' system (i.e.,

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[6]Net tax revenue is defined to include all revenue collected (i.e. income, employment, estate and gift, and excise taxes) less refunds.

[7]Abandoned calls are ones in which the taxpayer has gained access to IRS' system but subsequently decided, for unknown reasons, to hang up before an IRS assistor came on the line.

[8]Appendix I of IRS' Fiscal Year 2000 Congressional Justification incorrectly describes this measure as being computed by dividing calls answered by calls attempted. That is actually the way level of service is computed.

not get a busy signal), it does not indicate the extent to which taxpayers are successful in actually talking to someone in IRS. For that reason, we believe that level of service is the more appropriate Servicewide measure of IRS' performance in providing telephone assistance.

Impact of Diversion of Resources Is Uncertain

IRS' budget request for fiscal year 2000 discusses the diversion of resources in fiscal year 1999 to implement various provisions of RRA98 and to provide assistance to taxpayers. There is insufficient information, however, for IRS or Congress to assess the overall impact of these diversions.

RRA98 contains various provisions that give additional protection to taxpayers (such as a relief from joint liability for innocent spouses), shift the burden of proof from taxpayers to IRS in certain circumstances, and make IRS liable for some legal fees incurred by taxpayers. IRS says that it plans to divert about 2,500 FTEs and $200 million in fiscal year 1999 to implement these provisions. According to IRS, this diversion marks the "beginning of a continuing curtailment of some compliance activities, primarily the examination of tax returns and the collection of delinquent accounts." In addition, IRS says that another 200 FTEs will be detailed from the Collection function to the Customer Service function in fiscal year 1999 to increase the quality of service to taxpayers through the walk-in program. Other diversions are possible as IRS attempts to improve the quality of its telephone service, which we discuss later.

Although IRS has made statements in the past about the potential impact of these resource diversions on enforcement revenue, its current position is that the monetary effect of such diversions is unknown. We agree with that position. To correctly assess the monetary effect of such diversions, IRS needs to be able to estimate not only the negative effect on enforcement revenues but also the potential positive effect on non-enforcement revenues from any improved taxpayer service resulting from the resource diversions.

It is expected, for example, that implementation of RRA98 will result in better service to taxpayers. Better taxpayer service could lead to an increase in voluntary compliance, which, in turn, could lead to increased revenues. Without a measure of voluntary compliance, as discussed earlier, there is no way for Congress, IRS, or others to assess such an impact.

The 5-Year Cost Estimate for Making IRS' Systems Year 2000 Compliant Has Increased, and Some Needs for Fiscal Year 2000 Are Still Uncertain

IRS' efforts to make its systems Year 2000 compliant represent one of the most expensive civilian agency programs.[9] The current 5-year cost estimate for IRS' Year 2000 efforts is $1.3 billion—about $345 million more than its March 1998 cost estimate. IRS estimates that if its Year 2000 efforts are unsuccessful, the adverse effects could include millions of erroneous tax notices and delayed or erroneous refunds. Accordingly, the Commissioner of Internal Revenue has designated this effort a top priority. IRS is requesting about $250 million and 239 FTEs for its Year 2000 efforts for fiscal year 2000.[10] About $34 million of the $250 million is for a contingency fund for needs that may be identified later in calendar year 1999.

To make its information systems Year 2000 compliant, IRS was to (1) fix existing systems by modifying application software and data and upgrading hardware and system software where needed, (2) replace systems if correcting them is not cost-effective or technically feasible, and (3) retire systems that will not be needed after the year 2000. IRS' Year 2000 efforts include the following two major system replacement projects:

- The Service Center Mainframe Consolidation (SCMC) project involves consolidation of IRS' mainframe computer processing operations from 10 service centers to 2 computing centers. Specifically, SCMC was to (1) replace and/or upgrade mainframe hardware, systems software, and telecommunications networks; (2) replace about 16,000 terminals that support frontline customer service and compliance activities; and (3) replace the system that provides security functions for on-line taxpayer account databases with a new system called the Security and Communications System. Replacement of the terminals and implementation of the Security and Communications System are critical to

[9]IRS' Year 2000 efforts are necessary because IRS' information systems were programmed to read two-digit date fields. Therefore, if unchanged, these systems would interpret 2000 as 1900, seriously jeopardizing tax processing and collection activities.

[10]The $250 million is referred to as an increase in IRS' budget request because IRS' fiscal year 1999 appropriation did not specifically include funds for IRS' Year 2000 efforts. For fiscal year 1999, IRS' Year 2000 efforts were funded from a governmentwide Year 2000 fund that was established in the Omnibus Consolidated and Emergency Supplemental Appropriations Act for Fiscal Year 1999 (P.L. 105-277). This Act provided $2.25 billion in emergency funding for Year 2000 computer conversion activities for nondefense activities. The Director of the Office of Management and Budget (OMB) is responsible for allocating these funds. As of February 12, 1999, OMB had released $1.56 billion; $690 million remains available for emerging requirements. IRS received $483.3 million from the fund, of which $358.3 million is to be used for Year 2000 activities. According to Department of the Treasury budget documents, Congress earmarked the remaining $125 million for other information systems investments that were initially included in IRS' fiscal year 1999 budget request.

IRS' achieving Year 2000 compliance.

- The Integrated Submission and Remittance Processing System (ISRP) is to replace IRS' two primary tax return and remittance input processing systems (the Distributed Input Processing System and the Remittance Processing System) with a single system that is to be Year 2000 compliant. IRS established a goal to complete most of its Year 2000 work by January 31, 1999, to help ensure that it would (1) have a Year 2000 compliant environment implemented for the 1999 filing season and (2) provide time for resolving any problems that surfaced during the 1999 filing season and its Year 2000 end-to-end testing.

For fiscal year 2000, IRS is requesting (1) $123.4 million for the activities of the Century Date Change (CDC) Project Office, which oversees the conversion and testing of changes made to existing systems; (2) $100.6 million for SCMC; and (3) $26.4 million for ISRP.

5-Year Cost Estimate Increased

The 5-year cost estimate for IRS' Year 2000 efforts increased by $345.2 million between March 1998 and March 1999. In March 1998, the 5-year cost estimate for fiscal years 1997 through 2001 was about $1 billion; IRS' current cost estimate is $1.35 billion. Table 1 shows that the activities under the purview of the CDC Project Office and SCMC account for most of the increase.

Table 1: 5-Year Cost Comparison (in Millions)

Spending category	Fiscal years 1997–2001 (March 1998 estimate)	Fiscal years 1997–2001 (March 1999 estimate)	DIfference
CDC Project Office	$572.0	$701.4	$129.4
SCMC	332.2	499.8	167.6
ISRP	101.7[a]	149.9	48.2
Total	**$1,005.9**	**$1,351.1**	**$345.2**

[a]Does not include estimates for fiscal years 2000 and 2001. IRS budget documents indicate that these estimates were identified in April 1998. If these amounts are included, the ISRP cost estimate is $146.3 million—only $3.6 million less than the current estimate.

Source: IRS' Year 2000 cost summaries for fiscal years 1997–2001.

CDC Project Office

The CDC Project Office is responsible for (1) overseeing efforts to fix over 60 million lines of application software, (2) ensuring that hardware and systems software are compliant, and (3) overseeing the Year 2000 testing of IRS' information systems. As shown in table 1, IRS' 5-year cost estimate for CDC increased by $129.4 million between March 1998 and March 1999. Most of the increase—$99 million—is for fiscal year 1999.

We had difficulty identifying which aspects of the CDC Project Office budget accounted for all of the $99 million increase because at the time IRS officials developed the March 1998 estimate they were still refining their Year 2000 needs. At that time, IRS had allocated about $50 million to a contingency fund that was to become available for needs as they emerged. According to IRS officials, for those needs that were defined as of March 1998, the largest cost increases are for certain contractor services and for computer hardware and software for IRS' personal computers and minicomputers/file servers.

As we noted in our June 1998 report on IRS' Year 2000 efforts, IRS placed priority on assessing and fixing its mainframe computers, which encompass most of IRS' tax processing systems.[11] Accordingly, the needs for IRS' minicomputers/file servers and personal computers were less defined at that point in time. For example, since developing the March 1998 estimate, IRS has decided to replace about 35,000 personal computers and the associated systems and commercial off-the-shelf software. As part of this replacement effort, IRS plans to reduce the number of commercial software and hardware products for personal computers in its inventory from about 4,000 to 60 core standard products.

Table 2 shows the CDC Project Office's spending categories and associated dollar amounts for fiscal year 1999 as of February 23, 1999.

[11] IRS' Year 2000 Efforts: Business Continuity and Contingency Planning Needed for Potential Year 2000 Failures (GAO/GGD-98-138, June 15, 1998).

Table 2: CDC Project Office Spending Categories and Associated Dollar Amounts for Fiscal Year 1999

Spending category	Amount (in millions)
Personal computers	$51.0
End-to-end testing[a]	48.2
Labor and discretionary	38.3
Program inventory and management	23.2
Applications and development	19.6
Minicomputers/file servers	16.7
Telecommunications	14.0
Noninformation technology	9.2
Contingency fund	8.8
Independent verification and validation[b]	8.8
Mainframe computers	1.1
Total	**$239.0**[c]

[a]The end-to-end test is to verify that a defined set of interrelated systems, which collectively support a business function, interoperate as intended in an operational environment. The test is to have two parts—the first part is scheduled from April to July 1999; the second part is scheduled from October to December 1999.

[b]Provides for an organization that is technically, managerially, and financially independent of the systems developers to assess, among other things, whether a system meets the user's requirements.

[c]Total does not add due to rounding.

Source: CDC budget data.

We cannot comment on the adequacy of the amounts that IRS has allocated to each of these categories. However, as we would have expected, IRS has allocated large portions of its budget to those major Year 2000 activities that are to be completed in fiscal year 1999—the replacement effort for its personal computers and its end-to-end testing activities.

To help ensure that agencies have sufficient funds for Year 2000 activities, OMB has authority to release funds from the government-wide Year 2000 fund. OMB notified agencies to request funding for unforeseen requirements as they emerge. Accordingly, in March 1999, after allocating the $8.8 million in its contingency fund, IRS requested an additional $35 million from the OMB Year 2000 fund to cover the net unfunded needs for fiscal year 1999. As of March 1999, OMB had approved $22.3 million.[12]

IRS' fiscal year 2000 budget request includes $123.4 million for the CDC Project Office. According to CDC Project Office budget documents, as of March 31, 1999, about $29 million of the $123.4 million has been allocated, primarily for CDC Project Office labor and discretionary costs. The CDC

[12]IRS requested funds for several activities such as contingency planning, telecommunications, minicomputers/file servers, and independent verification and validation. OMB approved funding for most of the areas, but reduced the amount for some areas. According to IRS officials, OMB approved funding for those areas in which IRS had demonstrated an actual need and not for anticipated needs. For example, an anticipated need would include any fixes that might be needed as a result of end-to-end testing.

Project Office has received funding requests for about $60 million which are still subject to approval, leaving a contingency amount of about $34 million. IRS officials said that the contingency funds are to be used for needs that may be identified through (1) end-to-end testing, (2) risk management activities,[13] (3) Year 2000 contingency plans for IRS' core business processes,[14] and (4) an independent review of IRS' application software and commercial off-the-shelf software Year 2000 changes.

SCMC

SCMC cost increases account for $167.6 million of the $345.2 million increase in the 5-year Year 2000 cost estimate. As shown in table 3, IRS' March 1998 cost estimate for SCMC was $332.2 million, compared to its current cost estimate of $499.8 million.

Table 3: Comparison of March 1998 and March 1999 SCMC 5-Year Cost Estimates

Year of estimate[a]	FY 1997 actual	FY 1998[b]	FY 1999	FY 2000	FY 2001	Total
March 1998 estimate	43.8	167.3	76.0	38.4	6.7	$332.2[c]
March 1999 estimate	43.8	168.3	111.6	97.3	78.8	$499.8
Difference	**0**	**1.0**	**35.6**	**58.9**	**72.1**	**$167.6**

[a]Estimate includes only contractor costs, except where noted. According to IRS officials, there are $64 million in additional costs excluded from the estimates. As of March1999, these costs include (1) additional IRS staffing costs of $32 million, (2) $20 million for maintenance costs in the seven service centers that have not yet had their tax processing activities moved to the computing centers, and (3) $12 million in relocation and training costs for fiscal years 1999, 2000, and 2001.

[b]According to SCMC officials, the estimates for fiscal year 1998 also include relocation, training, and IRS staffing costs.

[c]In March 1998, IRS' cost estimate for the Year 2000 portions of SCMC was $265 million. IRS no longer reports SCMC Year 2000 costs.

Source: SCMC expenditure and budget documents.

When we testified in March 1998, we said that two of the factors that had the potential to increase SCMC costs were pending expanded business requirements and schedule delays. According to IRS officials, those two factors together with a decision to upgrade one of the tax processing systems, ultimately contributed to cost increases.

[13]IRS' CDC Project Office outlined a risk management process that is to, among other things, (1) identify risks to the successful completion of Year 2000 goals, (2) coordinate the development of risk mitigation strategies, and (3) oversee the execution of these strategies.

[14]In our June 15, 1998, report, we said that IRS' Year 2000 contingency planning efforts fell short of meeting the guidelines included in our Year 2000 Business Continuity and Contingency Planning Guide. Accordingly, we recommended that IRS take steps to broaden its contingency planning efforts to help ensure that it had adequately assessed the vulnerabilities of its core business processes to potential Year 2000 induced failures. In response to our recommendations, IRS determined that it needed to develop 37 contingency plans to address various Year 2000 failure scenarios for its core business processes. IRS officials told us that 26 plans were done as of March 31, 1999; the remaining 11 plans are to be completed by May 31, 1999.

According to IRS officials, IRS' fiscal year 2000 budget request of $100.6 million[15] for SCMC reflects much of the costs associated with implementing expanded requirements and the contractor costs, staff relocation costs, and training costs for moving the tax processing activities of five service centers in fiscal year 2000. According to SCMC officials, cost estimates for fiscal years 2000 and 2001 could decrease because (1) they believe the contractor's cost estimates may be overstated and (2) some SCMC activities may be funded from IRS' Operations and Maintenance budget activity as systems are fully implemented.

According to SCMC officials, expanded business requirements for disaster recovery[16] and a decision to upgrade the hardware and software for one of its tax processing systems[17] account for the vast majority of the $167.6 million increase in the 5-year cost estimate for SCMC. For disaster recovery, IRS plans to obtain contractor services and purchase hardware, software, and related telecommunications for its tax processing mainframe computers and telecommunications networks. SCMC officials said that the tax processing system upgrade is to (1) increase production capacity and disaster recovery capabilities, (2) provide the necessary systems architecture for IRS' planned modernization blueprint, and (3) provide substantial savings by reducing the hardware, software, and maintenance costs associated with the existing system.

According to SCMC officials, the need to have contractor staff on board longer than anticipated to accommodate schedule delays accounts for some of the $167.6 million cost increase. Specifically, in March 1999, IRS decided to delay moving the tax processing activities of five service centers, instead of completing these moves in 1999.[18]

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[15]This $100.6 million includes $3.3 million in relocation and training costs that is not included in the March 1999 estimate for fiscal year 2000 shown in table 3.

[16]Disaster recovery refers to the procedures or plans for responding to the loss of an information system due to flood, fire, or computer virus. Under the original SCMC disaster recovery plan, in the event of a disaster, 70 percent of the computing center's processing capability was to be restored in 36 hours. Under the expanded requirements, 100 percent of the processing capability is to be restored in 6 hours.

[17]This tax processing system encompasses IRS' automated collection function and the print capabilities for notices to taxpayers.

[18]This decision represents the second significant schedule change for SCMC. Originally, IRS had planned to have the tax processing activities of the 10 service centers moved to the computing centers by the end of calendar year 1998. In May 1998, IRS revised the schedule and established two new schedules—one for the Year 2000 portion of SCMC and another for the tax processing activities. The Year 2000 portion was to be completed by December 31, 1998. The schedule for tax processing activities called for moving the activities of five service centers by 1998 and the remaining five service centers in calendar year 1999. As of January 31, 1999, IRS had completed the Year 2000 portion of

IRS officials cited several reasons for changing the SCMC schedule. Specifically, IRS' business organizations had limited involvement in SCMC during its early stages. As their involvement increased, they expressed concern about the ambitious schedule and helped identify certain critical success factors that needed to be addressed for SCMC to be successful. Some of these critical success factors include (1) fully implementing the automated processes associated with the consolidations before the service centers' tax processing activities were moved to the computing centers, (2) providing adequate numbers and types of staff in the service centers and computing centers, and (3) developing new business procedures for operating under consolidation. Also, SCMC officials said that the original schedule did not acknowledge that new issues might surface during each move because of operational differences among the service centers. According to IRS officials, the revised schedule provides additional time for addressing these issues.

Information Technology Budget: Observations and Suggestions

Beginning in 1995, we reported on serious and pervasive information technology (IT) management and technical weaknesses. Since then, we have monitored IRS' progress in implementing our recommendations to correct these weaknesses and have reviewed IRS' annual budget requests to ensure that they are consistent with IRS' modernization capability and are otherwise adequately justified.

IRS' IT budget request for fiscal year 2000 includes $1.46 billion and 7,399 FTEs to fund such things as operation and maintenance of existing systems, activities to make IRS' systems Year 2000 compliant, correction of IT management weaknesses, and development of systems to sustain IRS operations until IRS is ready to modernize. These funding categories for fiscal year 2000 are consistent with our prior recommendations and related congressional direction concerning IT spending.

In addition to the $1.46 billion, IRS is requesting for fiscal year 2001 an advance appropriation of $325 million for IRS' multiyear capital account for systems modernization, referred to as the "Information Technology Investments Account" (ITIA). However, IRS has not adequately justified this ITIA request because IRS has not yet developed its modernization strategic plan and supporting cost-benefit analyses for proposed system investments. Accordingly, we suggest that Congress consider either denying (i.e., not funding) the $325 million advance request or restricting

SCMC and moved the tax processing activities of three service centers. In March 1999, IRS revised the schedule for moving the tax processing activities. Under the revised schedule, two additional moves are to occur in calendar year 1999, four in calendar year 2000, and one in early January 2001.

its obligation until IRS develops the requisite cost analyses to justify the amount requested, which IRS plans to do by September 30, 1999.

IRS Acting to Correct IT Management and Technical Weaknesses

In July 1995, we reported on serious management and technical weaknesses with IRS' modernization and made over a dozen recommendations to help IRS build the capability necessary to successfully modernize it systems.[19] In June 1996, we reported that IRS had made progress in implementing our recommendations.[20] However, to minimize the risk of IRS investing in systems before the recommendations were fully implemented, we suggested that Congress limit IRS' IT spending to certain cost-effective categories. These spending categories were those that (1) support ongoing operations and maintenance; (2) correct pervasive management and technical weaknesses, such as a lack of requisite systems life cycle discipline; (3) are small, represent low technical risk, and can be delivered in a relatively short time frame; or (4) involve deploying already developed systems that have been fully tested, are not premature given the lack of a complete systems architecture, and produce a proven, verifiable business value. The act providing IRS' fiscal year 1997 appropriations[21] and the related conference report limited IRS' IT spending to efforts consistent with these categories.

In 1997, IRS continued to address our recommendations. For example, in May 1997, IRS issued its modernization blueprint. We briefed IRS appropriations and authorizing committees on the results of our assessment of IRS' modernization blueprint in September 1997. In those briefings and in a subsequent report, we concluded that the modernization blueprint was a good first step that provided a solid foundation from which to define the level of detail and precision needed to effectively and efficiently build a modernized system of interrelated systems.[22] However, we also noted that the blueprint was not yet complete and did not provide enough detail for building and acquiring new systems. As a result, the conference report accompanying IRS' fiscal year 1998 appropriations act again limited IRS' fiscal year spending to efforts that were consistent with the aforementioned spending categories. IRS' fiscal year 1999

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

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

[21] Public Law 104-208, September 30, 1996.

[22] Tax Systems Modernization: Blueprint Is a Good Start But Not Yet Sufficiently Complete to Build or Acquire Systems (GAO/AIMD/GGD-98-54, Feb. 24, 1998).

appropriation act and conference report continued these spending limitations.[23]

In its budget requests for fiscal years 1998 and 1999, IRS requested over $1 billion for ITIA. In our testimonies before this Subcommittee on these requests, we questioned the justification for these funds because (1) all or major parts of the amounts being requested were not based on analytical data or derived using formal cost estimating techniques, as required by OMB, and (2) IRS had not yet developed the capability to modernize.[24] Subsequently, Congress provided $506 million for the account. Specifically, it appropriated $325 million in fiscal year 1998, of which $30 million it rescinded in May 1998 for urgent Year 2000 century date change requirements. Congress also provided $211 million in fiscal year 1999. In providing these sums, Congress prohibited their obligation until IRS and the Department of the Treasury submitted to Congress for approval an expenditure plan that (1) implements IRS' modernization blueprint; (2) meets OMB investment guidelines; (3) is reviewed and approved by OMB and Treasury's IRS Management Board and is reviewed by us; (4) meets requirements of IRS' life cycle program; and (5) is in compliance with acquisition rules, requirements, guidelines, and systems acquisition management practices of the federal government.

In December 1998, IRS awarded its Prime Systems Integration Services Contract (PRIME) for systems modernization. IRS is working with the PRIME and other support contractors to develop a strategic business systems plan and complete the modernization blueprint, as we recommended, and to account for (1) changes in system requirements and priorities caused by IRS' organizational modernization and (2) changes to accommodate new technology and to implement RRA98 requirements. IRS is also working with the PRIME to establish disciplined life cycle management processes and structures, including mature software development and acquisition capabilities, before IRS begins building modernized systems. By June 30, 1999, IRS plans to have these processes and structures in place and have the necessary approvals to begin using ITIA funds to modernize systems. By September 30, 1999, IRS also plans to have its strategic business systems plan for the entire modernization, which is to identify the systems to be modernized over the next 5 years, their estimated costs, business case justification, the sequence in which

[23]Public Law 105-277, October 21, 1998.

[24]GAO/T-GGD/AIMD-98-114 and Tax Administration: IRS' Fiscal Year 1997 Spending, 1997 Filing Season, and Fiscal Year 1998 Budget Request (GAO/T-GGD/AIMD-97-66, Mar. 18, 1997).

they will be developed and deployed, and the architecture standards governing their development.

Fiscal Year 2000 Information Systems Budget Request Is in Line With GAO and Congressional Spending Categories

IRS' fiscal year 2000 request of $1.46 billion for information systems appears consistent with the aforementioned spending categories. Specifically, 78 percent of the request, or $1.14 billion, is to (1) operate and maintain information systems that support tax administration, (2) consolidate mainframe computing from 10 centers to 2, and (3) restructure the information systems organization. Seventeen percent of the request, or $250 million, is for Year 2000 conversion activities. The remaining 5 percent, or $66 million, is for initiatives to correct IT management weaknesses or to develop systems to sustain IRS operations until it implements modernized systems. For example, funding from this activity is to be used to complete and implement the modernization blueprint, including establishing system life cycle management processes.

IRS Has Not Adequately Justified Its Fiscal Year 2001 ITIA Request

Key provisions of the Clinger-Cohen Act, the Government Performance and Results Act, and OMB Circular No. A-11 and supporting memoranda, require that, before requesting multiyear funding for capital asset acquisitions, agencies develop accurate, complete cost data and perform thorough analyses to justify the business need for the investment. For example, agencies must show that investments (1) support a critical agency mission; (2) are justified by life cycle cost-benefit analyses; and (3) have cost, schedule, and performance goals.

IRS has not performed the requisite analyses to justify its fiscal year 2001 investment account request of $325 million because the information it needs to prepare such analyses will not be available until IRS completes its strategic business planning in September 1999. Consequently, IRS was unable to base its budget request on a clear and complete definition of fiscal year 2001 IT investments and did not justify these investments with cost-benefit analyses. Instead, IRS officials told us that they needed to develop an estimate for the fiscal year 2000 budget process in order to ensure that funds would be available for modernization in fiscal year 2001. These officials stated that if they did not have a budgetary "placeholder" for modernization, IRS faced the possibility of a funding shortfall in fiscal year 2001 when IRS plans to be building modernized systems. Consequently, IRS developed its budget request using (1) cost estimates from its March 1998 PRIME request for proposal (RFP) and (2) a cost estimate that was documented following our inquiries and using what IRS termed "rough order of magnitude" cost estimating processes. However, these estimates have shortcomings. First, IRS officials acknowledged that the RFP cost estimates are out-of-date and are for IT projects underway now and not planned for fiscal year 2001. Second, the "rough order of magnitude" estimate lacked verifiable analysis and supporting data. Finally, neither estimate was based on a specified set of fiscal year 2001 IT investments because these investments have yet to be defined.

Matter for Consideration by the Congress

We support IRS' efforts to first strengthen its modernization capability and then acquire modernized systems. However, IRS' fiscal year 2001 request for ITIA funds is not justified in accordance with federal IT investment requirements. Accordingly, we suggest that Congress consider either denying (i.e., not funding) the $325 million advance request or restricting its obligation until IRS develops the requisite cost analyses to justify the amount requested, which IRS plans to do by September 1999. Neither of these congressional actions should impact fiscal year 1999 and 2000 modernization efforts because the ITIA has enough funds to cover IRS' proposed spending in both years. Specifically, of the $506 million in the ITIA, IRS plans to spend about $361 million during fiscal years 1999 and 2000—$79 million and $282 million, respectively—which will leave $145 million for fiscal year 2001.

Preliminary Data on the 1999 Filing Season Show Mixed Results

At the request of this Subcommittee, we are reviewing IRS' performance during the 1999 tax filing season. Our preliminary work has shown some mixed results. Specifically, (1) taxpayers have experienced a significant decline in IRS' telephone service, although service has improved in recent weeks; (2) the number of individual income tax returns filed electronically has continued to increase, although the number filed over the telephone has decreased; (3) there appears to be a significant amount of confusion among taxpayers with respect to the new child tax credit; and (4) new computer systems for processing returns and remittances appear to be performing well.

Significant Decline in Telephone Service

According to IRS' data, taxpayers who called IRS with tax questions during the first few weeks of the 1999 filing season had considerable difficulty reaching IRS on the telephone and, once they did reach IRS, getting an accurate answer to their questions. Although that situation has improved in recent weeks, IRS' performance overall has declined significantly compared to its level at the same point in time last year.

Ability of Taxpayers to Reach IRS on the Telephone Has Worsened Since Last Year

Over the last few years, there has been a steady increase in the ability of taxpayers to reach IRS by telephone. This year, however, there have been serious problems. As shown in table 4, IRS data for the first 3 months of this filing season compared to the same period last year show a significant decline in IRS' performance.[25]

Table 4: Toll-Free-Telephone Level of Access and Level of Service for the First 3 months of the 1999 and 1998 Filing Seasons (in Millions)

	1999	1998
(a) Calls answered	27.9	29.6
(b) Calls abandoned	7.3	6.5
(c) Subtotal—Calls that got into IRS' system	**35.2**	**36.1**
(d) Busy signals	16.9	3.5
(e) Total call attempts	**52.1**	**39.6**
Level of access[a]	68%	91%
Level of service[b]	54%	75%
Percent of calls that received busy signals[c]	32%	9%
Percent of calls that got into IRS' system but were abandoned[d]	21%	18%

Note: Data are for January 1 through March 27, 1999, and January 1 through March 28, 1998.

[a]Level of access is the sum of the number of calls answered plus the number of calls abandoned divided by the total call attempts--computed in this table by dividing row (c) by row (e).

[b]Level of service is the number of calls answered divided by the total call attempts--computed in this table by dividing row (a) by row (e).

[c]Computed in this table by dividing row (d) by row (e).

[d]Computed in this table by dividing row (b) by row (c).

Source: GAO analysis of data in IRS' Weekly Customer Service Report.

The significant declines in level of access (from 91 percent to 68 percent) and level of service (from 75 percent to 54 percent) come at a time when IRS, in an attempt to improve service, extended its operating hours to 24 hours a day, 7 days a week.

Cognizant IRS officials have mentioned several factors that they believe contributed to the declines in telephone access and service. One factor was IRS' decision to discontinue the use of a procedure that it had used in 1997 and 1998 to handle calls involving complex tax topics. Under that procedure, callers with questions in certain complex areas of the tax law, such as self-employment income and sale of a residence, were automatically connected to a voice messaging system. They were instructed to leave their name, address, telephone number, and the best time for IRS to call them back. Within 2 to 3 business days, an IRS employee knowledgeable in that area of the tax law was to return the taxpayer's call. During our review of the 1997 filing season, IRS told us

[25]In reporting telephone data, IRS combines data on six of its toll-free telephone lines—tax law assistance, Earned Income Credit/refund inquiry, account inquiry, forms ordering, Automated Collection System, and the fraud hotline.

that it decided to use this procedure after a study showed that calls dealing with complex topics involved 20- to 30-minute telephone conversations and that an assistor could answer about 5 simpler calls in that same amount of time.

According to cognizant officials, IRS decided to discontinue the use of voice messaging for complex topics because they expected to have sufficient staff available in 1999 to allow all calls to be directed to "live" assistors. There was also some concern that IRS was not providing the best possible service when it asked taxpayers to leave a message and wait a few days for a return call. Thus, IRS started this filing season by attempting to answer all taxpayer calls with live assistors.

Other contributing factors mentioned by IRS officials included

- unanticipated staffing problems associated with the expansion to 24 hours-a-day, 7 days-a-week service;
- start-up issues associated with IRS' new call routing system; and
- the lack of reliable data on accessibility during the first weeks of the filing season.

IRS has taken steps to address these contributing factors. For example, during the week of February 15, 1999, IRS reestablished the use of the messaging system for questions involving certain tax law topics. IRS' actions appear to have had a positive effect. In that regard, IRS' data show that telephone accessibility and service have improved in recent weeks. For example, IRS data on calls received during the week of March 21 through 27, 1999, showed an 83 percent level of access and a 66 percent level of service during that week—significantly better than the cumulative percentages shown in table 4.[26]

The Accuracy of IRS' Answers to Tax Law Questions Has Also Declined

IRS data show that taxpayers are more likely to receive inaccurate responses to their tax law questions this year compared to last. IRS checks the quality of its telephone service by monitoring a sample of telephone calls. IRS' monitoring during the period October 1, 1998, through February 28, 1999, showed that the accuracy rate had dropped 11 percentage points (from 80 percent to 69 percent) compared to the same time period a year ago. Although still well behind last year, the 69 percent accuracy rate as of the end of February 1999 is better than the 66 percent rate that IRS reported as of the end of January 1999.

[26]For the same week in 1998, IRS reported a 91 percent level of access and a 72 percent level of service.

According to a cognizant IRS official, the decline in quality compared to 1998 can be attributed to many of the same factors that contributed to the decline in telephone accessibililty. For example, the decision to stop using voice messaging required customer service representatives to handle complex topics that they were not responsible for last year.

Use of Electronic Filing Continues an Upward Trend

As noted in our report on the 1998 filing season, the number of returns filed electronically increased about 28 percent between 1996 and 1997 and about 28 percent again in 1998.[27] According to IRS data, as shown in table 5, that growth is continuing, although at a reduced rate.

Table 5: Individual Income Tax Returns Received by IRS (in Thousands)

Filing type	1/1/97 to 4/04/97	1/1/98 to 4/03/98	Percent change: 1997 to 1998	1/1/99 to 4/02/99	Percent change: 1998 to 1999
Paper					
Traditional	45,306	42,470	-6.3	41,538	-2.2
1040PC[a]	4,488	3,534	-21.3	3.084	-12.7
Subtotal	**49,794**	**46,004**	**-7.6**	**44,622**	**-3.0**
Electronic					
Traditional[b]	13,007	16,306	25.4	20,167	23.7
TeleFile[c]	4,072	5,116	25.6	4,829	-5.6
Subtotal	**17,079**	**21,422**	**25.4**	**24,996**	**16.7**
Total	**66,873**	**67,426**	**0.8**	**69,618**	**3.3**

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

[b]Traditional electronic filing involves the transmission of returns over communication lines through a third party, such as a tax return preparer or electronic return transmitter, to an IRS service center.

[c]Under TeleFile, certain taxpayers that are eligible to file a Form 1040EZ are allowed to file using a toll-free number on touch-tone telephones.

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

As table 5 shows, although there has been an overall increase in electronic filing, there has been a decrease in one form of electronic filing—TeleFile. It is unclear at this point why the use of TeleFile has declined. It is also unclear whether there are any particular factors that primarily account for the overall increase in electronic filing.

One factor that may be contributing to the increase in electronic filing this year, but which has broader implications for future years, is IRS' effort to find workable alternatives to paper signatures. Generally, taxpayers using the traditional form of electronic filing have to send IRS a paper signature form along with copies of their Forms W-2. The fact that electronic filing

[27]Tax Administration: IRS' 1998 Tax Filing Season (GAO/GGD-99-21, Dec. 31, 1998).

has not been completely paperless has been cited as a major barrier to its greater use. In that regard, IRS has been conducting tests this year directed at making electronic filing truly paperless by allowing participants to use electronic signatures and by waiving the need for participants to send their W-2s to IRS.[28] In one test, for example, taxpayers are to choose a personal identification number to use when filing through certain tax preparers. We will be following up on the results of these tests as we continue our review of the filing season.

The New Child Tax Credit Has Been the Source of Many Taxpayer Errors

The individual income tax returns being filed this year include, for the first time, the opportunity for eligible taxpayers to claim a child tax credit. According to IRS data, of about 1.88 million error notices sent to taxpayers as of March 12, 1999, about 202,000 (almost 11 percent) involved errors with the child tax credit. Those errors generally involved taxpayers either (1) miscalculating the credit or (2) not claiming the credit even though they appear to be eligible.

With respect to the latter, taxpayers are to indicate whether a dependent is a qualifying child for purposes of the child tax credit by checking a box on the front of the Individual Income Tax Return (Form 1040 or Form 1040A). They are then to use a worksheet included in the Form 1040/1040A instructions to compute the amount of their credit, if any, and enter that amount on the back of the form.

According to data from IRS' Taxpayer Usage Study, which is a sample of filed individual income tax returns, about 36 percent of the returns filed as of March 12, 1999, included dependents that the taxpayer indicated, by a checkmark on the front page, were qualifying children for the child tax credit. However, the same data show that only about 24 percent of the returns filed as of that date claimed the credit. Thus, about one-third of the taxpayers who indicated eligibility for the credit did not claim it. This apparent discrepancy may be an indicator of the complexity of the new credit or may just reflect taxpayer oversight. Some of the discrepancy could also be explained by the possibility that taxpayers, after completing the worksheet, found that they were ineligible for the credit and, therefore, did not claim it.

Last month, IRS changed its procedure for processing returns when taxpayers do not claim a child tax credit even though they indicate on the front of the return that they have one or more dependents who qualify for

[28] According to a cognizant IRS official, IRS can waive the submission of W-2s because there is no statutory requirement that these forms be attached to tax returns.

the credit. Initially, IRS' procedure called for adjusting the taxpayer's return to include the credit if information on the return indicated that the taxpayer met the adjusted gross income test and certain other eligibility criteria. However, the procedure did not require verification of the qualifying child's age.[29]

IRS modified its procedure in March by instructing service centers to do research to determine if the child meets the age criteria before adjusting the return. If the research determines that the taxpayer qualifies for the credit, the service center is to adjust the taxpayer's return and include the credit. If the research determines that the taxpayer does not qualify for the credit, the service center is to process the return as filed (i.e., without the credit). If the research is inconclusive, the service center is to process the return as filed but notify the taxpayers that they (1) may be eligible for the credit and (2) should file an amended return to claim the credit, if they determine that they are eligible.

Computer Systems Performing Well

Our work to date has not identified any significant disruption of IRS' ability to process returns and issue refunds that might be indicative of computer-related problems.

IRS has made major changes this year to the computer systems it uses to process returns and remittances. One major change involved replacement of the returns processing system at all 10 service centers and replacement of the remittance processing system at 6 centers. According to an IRS spokesperson for that project and processing officials at one service center, the transition to the new systems has gone well, and workloads are being processed as intended. A second major change involves the consolidation of mainframe service center computer equipment at IRS' two computing centers in Martinsburg, WV, and Memphis, TN. So far, three service centers have undergone consolidation. According to a cognizant official at one of those centers, the consolidation has not adversely affected the center's ability to process returns.

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

[29]A qualifying child, for purposes of this credit, is a son, daughter, adopted child, grandchild, stepchild, or foster child who (1) is claimed as a dependent, (2) is a U.S. citizen or resident alien, and (3) was under the age of 17 at the end of the tax year.

IRS' Fiscal Year 2000 Budget Request Compared With Proposed Fiscal Year 1999 Operating Level

Dollars in thousands

	FY 1999		FY 2000		Percent change	
Budget activity	**Dollars**	**FTEs**	**Dollars**	**FTEs**	**In dollars**	**In FTEs**
Submission Processing	$884,000	15,384	$973,599	15,475	10.14	0.59
Telephone and Correspondence	812,651	19,650	991,456	20,874	22.00	6.23
Document Matching	60,683	1,555	60,395	1,555	-0.47	0.00
Inspection[a]	0	0	0	0	NA	NA
Management Services	563,122	6,952	615,941	6,652	9.38	-4.32
Rent and Utilities	664,322	135	671,144	135	1.03	0.00
Subtotal: Processing, Assistance, and Management Appropriation	**$2,984,778**	**43,676**	**$3,312,535**	**44,691**	**10.98**	**2.32**
Criminal Investigation	367,099	3,824	374,306	3,824	1.96	0.00
Examination	1,717,775	23,768	1,835,346	23,588	6.84	-0.76
Collection	679,385	11,195	707,411	11,095	4.13	-0.89
Employee Plans and Exempt Organizations	139,845	2,055	148,999	2,109	6.55	2.63
Statistics of Income	27,513	464	28,731	479	4.43	3.23
Chief Counsel	232,572	2,582	242,045	2,582	4.07	0.00
Subtotal: Tax Law Enforcement Appropriation	**$3,164,189**	**43,888**	**$3,336,838**	**43,677**	**5.46**	**-0.48**
Operations and Maintenance	1,166,583	8,000	1,138,814	6,976	-2.38	-12.80
Year 2000	0	0	250,426	239	NA	NA
Investments	92,947	184	66,161	184	-28.82	0.00
Subtotal: Information Systems Appropriation	**$1,259,530**	**8,184**	**$1,455,401**	**7,399**	**15.55**	**-9.59**
Information Technology Investments[b]	**$211,000**	**0**	**0**	**0**	**NA**	**NA**
Year 2000 Emergency Fund[c] (outside caps)	**$483,300**	**239**	**0**	**0**	**NA**	**NA**
Earned Income Credit (outside caps)	**$143,000**	**1,972**	**$144,000**	**2,095**	**0.70**	**6.24**
Total	**$8,245,797**	**97,959**	**$8,248,774**	**97,862**	**0.04**	**-0.10**

[a]In accordance with Public Law 105-206, the IRS Inspection activity was transferred to the Treasury Inspector General for Tax Administration on January 19, 1999.

[b]New funding for fiscal year 2000 is not needed since IRS will use carryover balances; however, IRS is requesting an advance appropriation of $325 million in fiscal year 2001 for funding of the Prime Systems Integration Services Contract.

[c]For fiscal year 1999, IRS' Year 2000 efforts were funded from a governmentwide Year 2000 fund that was established in the Omnibus Consolidated and Emergency Supplemental Appropriations Act for Fiscal Year 1999 (P.L. 105-277).

Source: IRS' February 1, 1999, budget estimates for fiscal year 2000.

Comparison of IRS' Fiscal Year 1999 Proposed Operating Level and Fiscal Year 2000 Budget Request

Dollars in thousands

	Subtotal	Total
Fiscal year 1999 proposed operating level		$8,245,797
Decreases for fiscal year 2000		
IT investment (non-recur)	$211,000	
Year 2000 emergency fund (non-recur)	483,300	
Absorption of mandatory non-labor costs	50,566	
Subtotal—decreases	**$744,866**	
Increases for fiscal year 2000		
Adjustments necessary to maintain current levels	$299,369	
Year 2000 conversion	250,426	
Organizational modernization	140,000	
RRA98	40,000	
Customer service training	17,048	
Increase in Earned Income Tax Credit compliance initiative	1,000	
Subtotal—increases	**$747,843**	
Fiscal year 2000 budget request		$8,248,774

Source: IRS' Fiscal Year 2000 Congressional Justification.

IRS Performance Measures

Tables III.1 and III.2 show the Servicewide and program performance measures included in IRS' February 1, 1999, budget estimates for fiscal year 2000. IRS' performance measures will continue to evolve as IRS continues to implement its organizational modernization. Fiscal year 1999 represents a transition period for IRS to introduce and baseline (gather and analyze data) the new measurement system. Performance measures with "baseline" noted in the fiscal year 1999 or fiscal year 2000 column indicate that these are new IRS measures. As shown in both tables, IRS plans to establish the baselines for most of its performance measures in fiscal year 1999.

Table III.1: Servicewide Performance Measures With Performance Report Based on Fiscal Year 1998 Data

Servicewide performance goal	Performance measure	FY 1998 Actual	FY 1999 Final plan	FY 2000 Proposed
Service to each taxpayer	Toll-free level of access	89.96%	80-90%	80-90%
	Number of calls answered, includes automated (million)[a]	113.3	120.3	120.3
	Tax law accuracy rate for taxpayer inquiries (toll free)	93.8%	85%	85%
	Customer satisfaction—toll free	[b]	Baseline	[c]
	Number of taxpayers served—walk-in (millions)[a]	10.1	10.0	10.0
	Customer satisfaction—walk-in	[b]	Baseline	[c]
	Customer satisfaction—field and office examination	[b]	Baseline	[c]
	Field collection quality	[b]	Baseline	[c]
	Field and office examination quality	[b]	Baseline	[c]
	Customer satisfaction—field collection	[b]	Baseline	[c]
Service to all taxpayers	Total net revenue collected (billions)[a]	$1,616.0	$1,725.0	$1,785.0
	Total enforcement revenue collected (billions)[a]	$35.2	$33.3	$33.3
	Total enforcement revenue protected (billions)[a]	$7.2	$7.2	$7.2
	Alternative treatment revenue	[b]	Baseline	[c]
Productivity through a quality work environment	Employee satisfaction (Servicewide)	[b]	Baseline	[c]
	IRS productivity measure (placeholder)	[b]	[b]	Baseline

[a]Workload projections only.

[b]Measure not applicable to this period.

[c]To be determined.

Source: IRS' Fiscal Year 2000 Congressional Justification.

	Table 2: Program Performance Measures with Performance Report Based on Fiscal Year 1998 Data	FY 1998 Actual	FY 1999 Final plan	FY 2000 Proposed
1.	Total number of individual refunds issued (millions)[a]	87.9	92.2	94.2
2.	Refund timeliness—paper (%)		Baseline	[c]
3.	Refund timeliness—e-file(%)	98.7%	98%	98%
4.	Processing accuracy rate—paper filing			
	Distributed Input System	94.6%	94.6%	94.6%
	Code and edit	96.1%	96%	96%
5.	Processing accuracy rate—e-file	98.9%	99%	99%
6.	Notice accuracy rate	98.4%	98.5%	98.5%
7.	Number of individual returns filed through electronic returns originators (millions)	17.7	20.9	22.9
8.	Number of eligible quarterly forms (Form 941) filed through TeleFile (thousands)	677.4	1,146.1	1,186.0
9.	Number of TeleFile returns (millions)	5.96	6.6	7 – 7.8
10.	Number of primary returns processed (millions)[a]	209.8	211.9	213.9
11.	Percent of individual returns filed electronically	19.8%	23%	25%
12.	Percent of dollars received electronically	67.7%	78%	78%
13.	Automated Collection System (ACS)—online accuracy	[b]	Baseline	[c]
14.	ACS—Cycle timeliness	[b]	Baseline	[c]
15.	ACS—Customer relations	[b]	Baseline	[c]
16.	ACS—Overage inventory	[b]	Baseline	[c]
17.	Tax law accuracy rate for taxpayer inquires (toll free)	93.8%	85%	85%
18.	Accounts accuracy rate for taxpayer inquires	87.9%	87.9%	88.5%
19.	Toll free timeliness	[b]	Baseline	[c]
20.	Toll free customer relations (tax law and accounts)	[b]	Baseline	[c]
21.	Service Center examination—overage inventory	[b]	Baseline	[c]
22.	Service Center examination accuracy	[b]	Baseline	[c]
23.	ACS level of service	[b]	Baseline	[c]
24.	Toll free—level of service	[b]	Baseline	[c]
25.	Toll free—adherence to scheduled hours	[b]	Baseline	[c]
26.	Service Center examination—volume/mix (placeholder)	[b]	[b]	[b]
27.	Customer satisfaction—toll free	[b]	Baseline	[c]
28.	Customer satisfaction—ACS	[b]	Baseline	[c]
29.	Customer satisfaction—Service Center examination	[b]	Baseline	[c]
30.	Employee satisfaction—toll free	[b]	Baseline	[c]
31.	Employee satisfaction—ACS	[b]	Baseline	[c]
32.	Employee satisfaction—Service Center examination	[b]	Baseline	[c]
33.	Taxpayer Advocate average processing time (days)	37.8	37.8	37.8
34.	Taxpayer Advocate quality customer service rate	80.8	81.3	81.3
35.	Currency of Taxpayer Advocate inventory (days)	91.3	91.8	91.8
36.	Field and office examination—volume/mix (placeholder)	[b]	Baseline	[c]
37.	Field and office examination quality	[b]	Baseline	[c]
38.	Percent of field and office examination cases overage	[b]	Baseline	[c]
39.	Customer satisfaction—field/office examination	[b]	Baseline	[c]

	Performance measure	FY 1998 Actual	FY 1999 Final plan	FY 2000 Proposed
40.	Employee satisfaction—field/office examination	[b]	Baseline	[c]
41.	Appeals customer satisfaction	[b]	Baseline	[c]
42.	Appeals employee satisfaction	[b]	Baseline	[c]
43.	Appeals nondocketed cycle time (days)	210	210	210
44.	Field collection—volume/mix	[b]	Baseline	[c]
45.	Field collection quality	[b]	Baseline	[c]
46.	Percentage of field collection cases overage	[b]	Baseline	[c]
47.	Percentage of offers-in-compromise processed within 6 months	60.5%	59.3%	59.3%
48.	Customer satisfaction—field collection	[b]	Baseline	[c]
49.	Employee satisfaction—field collection	[b]	Baseline	[c]
50.	Employee Plans (EP) determination letter timeliness (days)	118	145	[c]
51.	Exempt Organizations (EO) determination letter timeliness (days)	85	85	81
52.	EP examination timeliness(days)	193	200	230
53.	EO examination timeliness (days)	251	259	294
54.	EO determination customer satisfaction	[b]	Baseline	[c]
55.	EP determination customer satisfaction	[b]	Baseline	[c]
56.	EO examination customers satisfaction	[b]	Baseline	[c]
57.	EP examination customer satisfaction	[b]	Baseline	[c]
58.	Employee satisfaction–EP/EO	[b]	Baseline	[c]
59.	Percent of Statistics of Income projects delivered on time	100%	90%	90%
60.	Quality customer service rate	98%	90%	90%
61.	Guidance and assistance—volume/mix	[b]	Baseline	[c]
62.	Litigation case—volume/mix	[b]	Baseline	[c]
63.	Chief Counsel quality	[b]	[b]	Baseline
64.	Chief Counsel customer satisfaction	[b]	[b]	Baseline
65.	Chief Counsel employee satisfaction	[b]	[b]	Baseline
66.	Master file weekend update completion times	66.0%	85.6%	97.0%
67.	Corporate file on-line availability to front line personnel	99.7%	99.0%	99.0%
68.	Integrated Data Retrieval System real time availability to front line personnel	99.4%	99.0%	99.0%

[a]Workload projections only.

[b]Measure not applicable to this period.

[c]To be determined

Source: IRS' Fiscal Year 2000 Congressional Justification.

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