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MANAGING IRS

IRS Needs to Continue Improving Operations and Service

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Managing IRS: IRS Needs to Continue Improving Operations and Service

Chairman Kerrey and Chairman Portman and Members of the Commission:

I am pleased to have this opportunity to assist the Commission in its review on restructuring the Internal Revenue Service (IRS). The Commission's review should provide Congress with fresh insights for resolving IRS' operational, financial, and information management problems. IRS faces formidable challenges to make its organization, operations, and processes more effective and efficient and improve service to taxpayers. My statement today addresses some of those challenges, which we have previously discussed in testimonies before congressional oversight committees. IRS has experienced problems in fulfilling its business vision, which aims to make IRS' tax processing, customer service, compliance, and collection activities more modern and efficient. IRS also has had problems addressing management and technical weaknesses in its Tax Systems Modernization (TSM) efforts and improving the reliability of the financial management information used to account for hundreds of billions of dollars in taxpayer monies. Because of these problems, we included IRS' financial management, accounts receivable, and TSM programs on our list of government programs considered as high-risk areas because they are especially vulnerable to waste and mismanagement.

Our statement, which is based on previous and ongoing work, makes the following points:

- One of IRS' biggest problems has been the inefficient manner in which it processes most tax returns. To improve its operations, IRS needs to develop an effective strategy to reduce the volume of paper returns.
- IRS' strategy for improving customer service offers promise because 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. IRS needs to develop a framework to overcome challenges in implementing the customer service aspects of its business vision.
- Longstanding problems continue to undermine the effectiveness of IRS' collection programs. To address these problems, significant changes are needed in the way IRS does business.
- While IRS has made some progress in resolving the issues that have prevented us from expressing an opinion on the reliability of IRS' financial statements, serious financial management problems remain uncorrected.

- IRS needs to develop the capacity to make sound investment decisions in information technology. 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.

IRS' Business Vision

In 1992, IRS developed a new business vision for 2001 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, which are 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;
- taxpayers' 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 IRS' field enforcement functions. 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. In many ways, IRS' business vision shares similarities with the Commission's mandate of recommending options to make IRS more modern, effective, and efficient.

The new vision depends 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, 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 fewer staff to maintain existing work levels, it anticipated investing the staff savings in 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.

IRS Has Made Little Progress in Achieving Its Tax Return Processing Vision

One of the biggest problems facing IRS is its inefficient system for processing tax returns. IRS' strategy for receiving and capturing data from tax returns was and still is a critical 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. IRS concluded that it had to (1) reduce the volume of paper returns by expanding the use of electronic filing and (2) develop systems that would allow it to more efficiently process the remaining paper returns. IRS has made little progress either in reducing the number of paper returns it processes or in delivering the new systems it said it needed to better process the remaining paper returns.

IRS Lacks a Comprehensive Strategy to Significantly Increase the Number of Electronic Returns

One of the most important aspects of IRS' vision was its decision to significantly increase the number of tax returns received electronically 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.

Although IRS has taken some steps to increase the number of electronic returns filed, it does not have a comprehensive business strategy to reach its electronic filing goal of 80 million filings by 2001. IRS' projections suggested that as few as 39 million individual and business tax returns may be submitted electronically by 2001, less than half of IRS' goal and only about 17 percent of all returns expected to be filed.

IRS' strategy has focused primarily on taxpayers who use a third party to prepare and/or transmit simple returns, are willing to pay a fee to file their returns electronically, and are expecting refunds. Most of the returns filed electronically could be filed on forms (e.g., the 1040EZ) that are among the least costly paper returns to process. By focusing on this limited taxpaying population, IRS overlooked most taxpayers, including those who prepare their own tax returns using personal computers, have more complicated returns, owe tax balances, and/or are unwilling to pay a fee to a third party to file a return electronically.

In October 1995, we recommended 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.[1] Since then, IRS has performed an electronic filing marketing analysis at local levels; developed a marketing plan to promote electronic filing, and initiated a reengineering project with a goal to reduce paper tax return filing to 20 percent or less of the total tax return volume by 2000. IRS also plans to complete an electronic filing strategy in August 1996. These initiatives are not far enough along to determine whether they will result in a comprehensive strategy that identifies how IRS plans to target taxpayers that can file electronically most cost-beneficially.

IRS Has Had Problems Delivering the Systems Intended to Process Paper Returns

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 and to use imaging and optical character recognition technologies to process those documents.

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 rollout of the Service Center Recognition Image Processing System (SCRIPS). However, SCRIPS is performing well below IRS' original expectations. Besides information returns and tax deposit coupons, SCRIPS was expected to process all forms 1040EZ, 1040PC, and 941 (employment tax returns). Instead, SCRIPS is processing about 50 percent of the form 1040EZ and none of the forms 1040PC and 941.

IRS had intended to eventually replace SCRIPS with the Document Processing System (DPS)—a more sophisticated system that could be used to process all paper tax returns. IRS began designing DPS in 1988 and, according to IRS records, had spent about $270 million on DPS through fiscal year 1995. However, the future of DPS is now in doubt because, according to IRS officials, it is uncertain whether the benefits of DPS outweigh the costs. According to those officials, IRS is reevaluating its need

[1] Tax Administration: Electronic Filing Falling Short of Expectations (GAO/GGD-96-12, Oct. 9, 1995).

for an imaging and data-capture system. This evaluation is to include a determination of how much tax return data IRS needs and whether data needs vary by type of return. This analysis was not done when DPS initially was planned.

IRS Faces Several Challenges in Implementing Its Customer Service Vision

The second part of IRS' business vision is to improve service to taxpayers and improve its efficiency in using resources. IRS expects these improvements to contribute to a higher level of compliance with tax laws. 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 because it is designed to improve taxpayers' ability to get assistance from IRS and to provide IRS employees easy access to information. However, our work shows that IRS faces many challenges in implementing that strategy.[2]

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 IRS offices rather than those they initially contacted. As a result,

[2]Tax Administration: IRS Faces Challenges in Reorganizing for Customer Service (GAO/GGD-96-3, Oct. 10, 1995).

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 prototype customer service centers (Nashville, TN, and Fresno, CA) 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 were scheduled to close, 6 are closed. The remaining offices are to 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 making it easier for taxpayers to reach IRS and resolve their problems by telephone.

The Fresno prototype customer service center has experience in converting from 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, IRS' 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 other offices, 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. 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 has 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 that would 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.[3] 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 is to 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. The inaccessibility of data has been a longstanding problem in IRS. IRS' primary taxpayer account database that is

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

used for 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, mailed it to the location that had access to the information, and the staff of that location 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 systems that are not linked to IDRS. For example, an IRS employee using IDRS might 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. Only by going into that system could an assistor find such information as the amount of unreported income and the source (e.g., an interest payment to the taxpayer that was reported to IRS by a financial institution 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.

In the interim, IRS plans to use Integrated Case Processing (ICP) to gain access to and integrate information from each of the IRS functional databases that contain taxpayer information. 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. 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.

IRS plans to deliver ICP in several software increments. The first increment consists of computer hardware and software that eliminates the need for IRS' employees to use multiple workstations to access data on individual taxpayers from different information systems. As of June 1996, the first increment of ICP was partially deployed in 14 of the 23 customer service centers.[4] We are currently reviewing ICP and believe the success of ICP will depend to some extent on IRS' ability to address many of the management and technical weaknesses we have reported on in the past.

Managerial, Technical, and Human Resource Challenges Remain

IRS' strategy for improving customer service offers promise because 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 (1) 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; (2) develop the information systems necessary to support the accomplishment of its vision, including interactive telephone systems that are easy for taxpayers to use; and (3) determine the scope of responsibilities for those staff employed at customer service centers and provide the requisite training for that staff.

Until recently, IRS had assumed that staff savings resulting from modernization (such as savings anticipated in the returns processing function) would be reinvested to provide more front-line staff, with a corresponding increase in revenues. That appears no longer to be the case, at least to the extent originally anticipated. According to IRS officials, on the basis of a reassessment of TSM, IRS would be smaller and could not rely on reinvesting TSM savings. Thus, changes in staffing assumptions can make achievement of IRS' compliance goals more difficult. This is because IRS' success in increasing compliance is directly related to the numbers of staff involved in compliance-related activities. IRS could mitigate such effects, at least somewhat, by making sure that it has the right mix of staff. 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. The key to evaluating the success of

[4]IRS' plans call for purchasing 16,000 ICP workstations through 2000. IRS has already purchased about 2,500 of those workstations.

improvements, however, lies in developing reliable performance measurement tools, something IRS currently lacks.

Longstanding Problems in Accounts Receivable

While most taxpayers voluntarily pay their taxes on time, some taxpayers are unable or unwilling to do so. It is this latter group that IRS must deal with in its efforts to collect delinquent taxes. In doing so, we have found that IRS faces several significant challenges that have limited its ability to collect tax debts and manage its accounts receivable.[5] These challenges include (1) the need for better information on the debt and the effectiveness of IRS collection tools, (2) the age and nature of tax debts, (3) out-of-date collection processes, and (4) antiquated computer systems.

Better Information Needed

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 alternate collection strategies, and develop programs to help keep taxpayers from becoming delinquent in the first place.

Without reliable information on the accounts they are trying to collect and the taxpayers who owe the debts, IRS agents generally do not know whether they are resolving cases in the most efficient and effective manner and may spend time pursuing invalid or unproductive cases. IRS data show that of the approximately $200 billion currently in IRS' accounts receivable inventory, approximately $63 billion represent taxes that, although they have been assessed, may not be valid receivables but rather "place markers" for compliance actions.

For example, under IRS procedures, when IRS identifies a taxpayer who received a Form W-2 but did not file a tax return, it creates a return for the taxpayer. Generally, this is done using the standard deduction and single filing status and often results in the taxpayer owing taxes. IRS then sends balance due notices to the taxpayer reflecting the amount of taxes owed as calculated by IRS—to encourage the taxpayer to file a return with the correct tax amount owed. If the taxpayer does not subsequently file the return, IRS records the amount it calculated as taxes due and generates a receivable. However, when contacted by IRS collection staff, the taxpayer may demonstrate that either no tax or a lesser amount of tax is actually owed. To more efficiently account for and collect money actually owed to the government, IRS would have to be able to differentiate these

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

IRS-calculated accounts from those where there is an acknowledged balance due.

In addition, IRS does not have reliable data on the effectiveness of its collection activities and programs. Consequently, it is unable to target its efforts specifically to the taxpayer and tax debt in question. IRS is currently trying to capture these data on its Enforcement Revenue Information System and other computerized systems. However, IRS has noted in the past that there are questions regarding the accuracy of the data produced by these systems.

Age of Tax Debts

The age of the debts in IRS' accounts receivable inventory is also problematic. IRS' inventory of tax debt includes delinquent debts that may be up to 10 years old. This is because there is a 10-year statutory collection period, and IRS generally does not write off uncollectible delinquencies until this time period has expired. As a result, the receivables inventory includes old accounts that may be impossible to collect because the taxpayers cannot be located or are deceased or the corporations are defunct.

Of the over $200 billion total receivables inventory as of September 30, 1995, IRS data show that about $38 billion were owed by either deceased taxpayers or defunct corporations. Out of a total of 460 accounts receivable cases that we reviewed in our audit of IRS' 1995 financial statements, IRS identified 258 as currently not collectible; 198 of these cases represented defunct corporations, while the remaining 60 cases represented entities that either could not pay or could not be located. These cases represented $12 billion of the $26 billion included in accounts greater than $10 million.

The age of the receivable only reflects the length of time that has elapsed since the debt was assessed. It does not reflect the additional time it took for IRS to assess the taxes in the first place. Enforcement tools, such as IRS' matching programs and tax examinations, may take up to 5 years from the date the tax return is due until IRS finally assesses the additional taxes. This reduces the likelihood that the outstanding amounts will be collected.

The age factor significantly affects the collectibility of the debt because, as both private and public sector collectors have attested, the older the debt, the more problematic collection becomes. Because of these and other factors, IRS considers many of the accounts in the inventory to be uncollectible. Specifically, IRS has estimated that only about $46 billion of the $200 billion inventory of tax debt as of September 30, 1995, was collectible.

Out-Of-Date Collection Processes

Because of convention, IRS follows a collection process introduced several decades ago, and although some changes have been made, the process generally is costly and inefficient. The three-stage collection process—computer-generated notices and bills, telephone calls, and personal visits by collection employees—generally takes longer and is more costly than collection processes in the private sector. IRS had a reengineering effort ongoing to redesign its collection process, but it was suspended in November 1995. According to IRS, the suspension was related to the need to rescope priorities brought on by fiscal year 1996 budget reductions. IRS subsequently initiated another broad reengineering effort that is to focus on processes beginning from the point taxpayers collect information needed to file tax returns until their accounts are satisfied. Thus, the collection process may be included in this effort.

While the private sector emphasizes the use of telephone collection calls, a significant portion of IRS' collection resources is allocated to field offices where personal visits are made by revenue officers. IRS' fiscal year 1997 budget request states that, although "these [revenue officer] positions still comprise the lion's share of IRS' enforcement efforts, they also represent on the margin the least efficient use of IRS resources." IRS has initiated programs and made procedural changes to speed up its collection process, but, historically, it has been reluctant to reallocate resources from the field to the earlier, more productive collection activities. Due to budget cuts, however, IRS temporarily reassigned about 300 field staff to telephone collection sites to replace temporary employees who were terminated.

Antiquated Computer Systems

Modernized systems are also needed to facilitate IRS' collection programs. Modernized systems would also help provide the management information needed to evaluate the effectiveness of collection tools and the ability to adopt flexible and innovative collection approaches. Existing IRS computer systems do not provide ready access to needed information and, consequently, do not adequately support modern work processes.

Although TSM is not expected to be completed any time in the near future, IRS has started to automate some collection activities. For example, IRS is currently developing an automated inventory delivery system that is intended to direct accounts, on the basis of internally developed criteria, to the particular collection stage where they can be processed most efficiently and expeditiously. This system, which IRS plans to test this summer, is intended to move accounts through the collection process faster and cheaper than under the current system.

Another effort under way involves the automation of certain field collection tasks. These tasks, like many in IRS, have for years involved the manual processing of paper, which has resulted in IRS field collection employees spending significant amounts of time on routine administrative duties. The Integrated Collection System (ICS) is a computer-based information system that is intended to automate some of the labor-intensive tasks performed by field revenue officers. While this effort is not a major technological advancement, it should help IRS employees be more productive by allowing them to spend their time on more effective and efficient collection-related activities. Basic automation is a given in today's business environment, and if IRS is to operate like a private sector business as it says, systems that automate basic work processes are a must.

According to IRS, implementing ICS in two pilot districts has resulted in increased collections, faster case closings, and less time spent on each case. IRS employees using the system were also very supportive of it and enthusiastic about its benefits. The system is currently operating in six districts, and IRS plans to roll it out in three additional districts this year. According to IRS, further implementation depends on future funding and final measurements of productivity.

To stay competitive in today's business environment, IRS must continually strive to improve collections by testing new and innovative approaches. Private collectors and states that engage in collection activities similar to IRS' may also provide some best-practice examples for IRS to use in benchmarking its efforts. On the basis of our survey conducted several years ago, many states used private collectors to supplement their own collection programs, thereby taking advantage of private sector capability in managing receivables, gaining access to better technology, or avoiding the expense of hiring permanent staff. Although many states—including 33 of the 43 states that responded to our survey—had used private collectors, their experiences varied widely.[6]

[6]Tax Administration: State Tax Administrators' Views on Delinquent Tax Collection Methods (GAO/GGD-94-59FS, Feb. 2, 1994).

IRS soon plans to test the use of private collection companies in collecting some delinquent accounts that are classified as currently not collectible—primarily old accounts that have been previously worked by IRS staff. Using the experience of states in our survey as an indicator, IRS could expect some additional collections, but not necessarily a significant windfall. Although the test results may not be directly comparable to IRS, IRS may benefit and learn from the private companies' collection techniques and use of technology.

IRS faces significant challenges in collecting tax debts. As we have previously recommended, because the problems are pervasive across all IRS activities and processes, IRS needs to develop a detailed and comprehensive long-term plan to deal with the major challenges it faces and their interrelationships.[7] With such a plan, IRS could better ensure itself and Congress that it is on the right track and thereby better position itself to obtain the support it needs.

Serious Financial Management Problems Remain Uncorrected

As part of a pilot program under the Chief Financial Officers (CFO) Act of 1990, IRS began preparing annual financial statements showing the results of its operations starting with those for fiscal year 1992. CFO Act implementation has (1) led to IRS top managers' having a much better understanding than ever before of IRS' serious and pervasive accounting and reporting problems, (2) provided information on the magnitude of IRS' tax receivables collection problems, and (3) identified the need for stronger controls over such areas as payroll operations. The CFO Act's requirements also have provided the impetus for efforts to improve IRS operations and address the substantial problems identified by our financial audits.

We reviewed IRS' financial statements for fiscal years 1992 through 1995 and identified fundamental, persistent problems that remained uncorrected. This situation has prevented us from expressing an opinion on the reliability of IRS' financial statements for those 4 years. The persistent weaknesses and problems include the inability to (1) verify or reconcile total revenue and tax refunds to accounting records; (2) substantiate amounts reported for various types of taxes collected (such as social security, income, and excise taxes); (3) determine the reliability of estimates relating to valid and collectible receivables; (4) verify a significant portion of IRS' nonpayroll operating expenses; and

[7]High-Risk Series: Internal Revenue Service Receivables (GAO/HR-95-6, Feb. 1995).

(5) reconcile appropriation expenditures with records maintained by the Department of the Treasury.[8]

IRS worked to resolve these issues during our most recent financial statement audit and made some progress. We are continuing to work with IRS to develop a plan and strategies for addressing these major weaknesses.

TSM Investments Remain at Risk Until IRS Develops the Capacity to Make Sound Investment Decisions

Part of the solution to the many problems discussed above lies with improved technology. However, in March 1996, we told the Subcommittee on Oversight, House Committee on Ways and Means, that additional investments in TSM are at risk given IRS' current managerial and technical weaknesses.[9] Those were weaknesses that we discussed in our July 1995 report on TSM.[10] On May 6, 1996, Treasury reported to the Senate and House Appropriations Committees on IRS' progress in dealing with those weaknesses. According to Treasury's report, IRS has not made progress on TSM as planned because systems development efforts have taken longer than expected, cost more than originally estimated, and delivered less functionality than originally envisioned. Treasury's report concludes that significant changes are needed in IRS' management approach and that it is beyond the scope of IRS' current ability to develop and integrate TSM without expanded use of external expertise. As we reported on June 1996, although IRS has initiated a number of actions and is making some progress in addressing our July 1995 recommendations, many of those actions are incomplete and do not respond fully to any of our recommendations.[11]

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 2001 and those that will have to be delayed. We refer to this effort as IRS' reassessment of TSM. Although IRS

[8]Financial Audit: Examination of IRS' Fiscal Year 1995 Financial Statements (GAO/AIMD-96-101, July 11, 1996); Financial Audit: Examination of IRS' Fiscal Year 1994 Financial Statements (GAO/AIMD-95-141, Aug. 4, 1995); Financial Audit: Examination of IRS' Fiscal Year 1993 Financial Statements (GAO/AIMD-94-120, June 15, 1994); and Financial Audit: Examination of IRS' Fiscal Year 1992 Financial Statements (GAO/AIMD-93-2, June 30, 1993).

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

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

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

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 fiscal year 1997 TSM funding levels proposed by the House and Senate—which are more severe than the 1996 cuts—will require even further reassessment.

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, 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 subprocesses within that process, one of which 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 lags well behind the TSM effort, whereas it should be ahead of it—defining and directing the technology investments needed to support new, more efficient business processes. Reengineering could result in new business 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 are being designed as a TSM project.

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.

We look forward to working with the Commission as it examines IRS' organization and operations to identify and recommend actions to expedite the implementation of TSM and improve service to taxpayers. With the Commission, Congress has created an excellent opportunity to bring about long-term, fundamental organizational and management changes at IRS. The Commission's work could help provide the added impetus necessary to develop an effective implementation strategy for IRS' business vision, build a strong technical foundation for TSM, and ensure the reliability of financial information and systems.

This concludes my statement. We will be glad to answer any questions.

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