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INTERNAL REVENUE SERVICE

Assessment of Fiscal Year 2005 Budget Request and 2004 Filing Season Performance

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Highlights

Highlights of GAO-04-560T, a testimony before the Subcommittee on Oversight, Committee on Ways and Means, House of Representatives

INTERNAL REVENUE SERVICE

Assessment of Fiscal Year 2005 Budget Request and 2004 Filing Season Performance

Why GAO Did This Study

Effective tax administration requires a combination of quality customer service to help those who want to comply, and effective enforcement measures against those who do not. For the last few years, we have been reporting on improvements in taxpayer service and declines in enforcement.

With respect to IRS's fiscal year 2005 budget request, the Subcommittee asked GAO to assess whether (1) IRS will be able to allocate more resources to enforcement, and (2) Business Systems Modernization (BSM) and other technology efforts will deliver cost savings and efficiencies in the immediate future. For the 2004 filing season performance, GAO was asked to assess IRS's performance in processing returns and providing assistance to taxpayers.

What GAO Recommends

GAO is not making any recommendations. However, GAO has recommendations that are still outstanding related to (1) BSM management controls, which have contributed, at least in part, to cost overruns and schedule shortfalls, and (2) IRS's budget justification for its information systems operations and maintenance support.

www.gao.gov/cgi-bin/getrpt?GAO-04-560T.

To view the full product, including the scope and methodology, click on the link above. For more information, contact Jim White (202) 512-9110 or whitej@gao.gov.

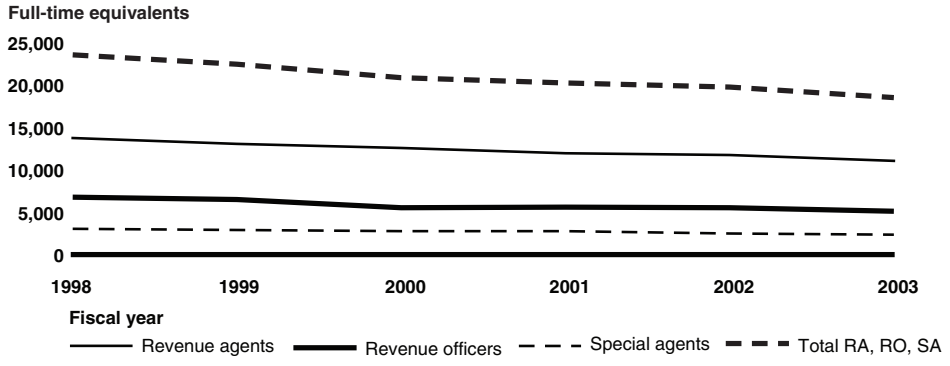
What GAO Found

IRS is requesting $10.7 billion in fiscal year 2005, 4.8 percent over 2004. This includes $377.3 million, primarily for additional enforcement staff, and $373 million for increased costs of maintaining current operations—funded from three sources—the budget increase, program reductions and internal savings. The request for more enforcement staff follows similar requests in IRS's past five budgets. Despite budget requests that were almost fully funded and despite realizing some savings in prior years, the number of most skilled enforcement staff declined by over 21 percent between 1998 and 2003 because of other priorities, including unbudgeted expenses. This history, and the expectation of unbudgeted costs in 2005, raise questions about whether IRS will be able to increase enforcement staff as planned.

IRS's request also includes about $1.93 billion in information technology—$285 million for BSM contractor costs and about $1.64 billion for information systems. Most BSM projects have experienced cost overruns and schedule delays postponing benefits expected under BSM. IRS reduced its BSM budget request to focus on fewer projects and is implementing plans to respond to known deficiencies. IRS has made progress in implementing investment management best practices for developing and supporting its information systems budget request. However, until IRS fully implements the improvements, its ability to develop supportable budget requests for information systems operations and maintenance will be limited.

IRS's reported 2004 filing season performance in key areas improved, with the exception of the accuracy of tax law responses provided over the telephones to taxpayers, which declined. Also, the number of taxpayers seeking assistance at IRS's walk-in assistance sites declined as did the number of tax returns prepared at those sites.

Skilled enforcement staff: revenue agents, revenue officers, and special agents, fiscal years 1998–2003



Source: IRS.

Mr. Chairman and Members of the Subcommittee:

We are pleased to participate in the Subcommittee's hearing on the Internal Revenue Service's (IRS) fiscal year 2005 budget request and its performance to date during the 2004 tax filing season.

Effective tax administration requires a combination of quality taxpayer service to help those who want to comply, and effective enforcement measures against those who do not. Although tax administrators continually debate the proper balance between taxpayer service and enforcement, the ultimate goal is to assure a high level of voluntary compliance. Currently, about 98 percent of the money IRS collects is received voluntarily—without any IRS enforcement action.

For the last few years, we have been reporting on trends in taxpayer service and enforcement. During this period, IRS has noticeably improved the quality of service to taxpayers. At the same time, there have been declines in many of IRS's enforcement programs and in the numbers of the most skilled enforcement staff. Many inside and outside IRS have become concerned that the declines in enforcement efforts have reduced taxpayers' incentive to voluntarily comply with the tax laws. While the actual impact on voluntary compliance is unknown, because IRS does not have a reliable current estimate of the overall compliance rate, the fear is that taxpayers could lose confidence in IRS's ability to ensure that all taxpayers pay what they should. If taxpayers ever lose confidence that their friends, neighbors, and business competitors are paying their fair share of taxes, then they could become less willing to pay themselves.

One key to improving taxpayer service and enforcement is IRS's Business Systems Modernization (BSM) effort, now in its 6th year. If successful, BSM is expected to allow IRS to better serve taxpayers and enforce the tax laws without a major increase in staffing and other resources. However, we continue to report that modernization is a high-risk area, the scope and complexity of BSM is growing, and BSM projects are experiencing additional costs and delays.

As you requested, our statement discusses both IRS's 2005 budget request and its 2004 filing season performance to date. With respect to the budget, we assessed the likelihood that (1) IRS will be able to allocate more resources to enforcement, and (2) BSM and other technology efforts will deliver cost savings and efficiencies in the immediate future. With respect to the filing season, we assessed IRS's performance in processing returns and providing assistance to taxpayers.

Our assessment of the budget request and BSM is based on a comparative analysis of IRS's fiscal year 2002 through 2005 budget requests, funding, and expenditures, supporting documentation, and interviews with IRS officials. Our assessment of the filing season is based on a comparison of IRS's performance this year to the previous two filing seasons, site visits to an IRS processing center and walk-in sites, monitoring processing status meetings, interviews with IRS and Treasury Inspector General for Tax Administration (TIGTA) officials and other external stakeholders, reviews of TIGTA and other external reports, and reviews of IRS's Web site. We used historical budget and performance data including filing season performance data from reports and budget requests used by the IRS, Department of Treasury, and Office of Management and Budget (OMB). Although we have not verified the accuracy of the most recent data, in past reports we have assessed IRS's budget and performance data.[1] As a result, we considered the data to be sufficiently reliable for purposes of this testimony. The budget and performance projections for fiscal years 2004 and 2005 are subject to change. Also, we did not independently validate planned BSM projects' cost estimates or confirm, through system and project management documentation, the validity of IRS-provided information on the projects' content and progress. We performed our work in Washington, D.C. and Atlanta, Ga. from December 2003 through March 2004, in accordance with generally accepted government auditing standards.

In summary, our assessment of IRS's 2005 budget request shows that:

- IRS is requesting $10.7 billion, an increase of $489.8 million over fiscal year 2004. The 2005 budget proposes $377.3 million to fund new initiatives, primarily increases in enforcement staff, and $373 million to cover the increased costs, such as salary increases, of maintaining current programs. IRS plans to fund the additional spending from three sources—the budget increase, program reductions ($149.7 million) and internal savings ($110.8 million). IRS has made increasing enforcement staff a priority in its last five budget requests. However, despite getting its requests almost fully funded and despite realizing some savings—although not all that were projected—IRS did not achieve increases in enforcement staff. Staffing in three key enforcement occupations—revenue agents, revenue officers,

[1] U.S. General Accounting Office, *Tax Administration: IRS Needs to Further Refine Its Tax Filing Season Performance Measures*, GAO-03-143 (Washington, D.C.: Nov. 22, 2002) and U.S. General Accounting Office, *Financial Audit: IRS's Fiscal Years 2003 and 2002 Financial Statements*, GAO-04-126 (Washington, D.C.: Nov. 13, 2003)

and special agents—declined by over 21 percent between 1998 and 2003. IRS funded other priorities such as unbudgeted expenses and improvements to taxpayer service. This raises several questions and concerns. One is whether IRS will be able to increase enforcement staff as planned in 2005. Another is whether the declines in enforcement staff, and the resulting declines in statistics related to IRS's enforcement programs, are eroding taxpayers' incentive to voluntarily comply with the tax laws.

- Included in IRS's budget request is about $1.93 billion (including 7,385 staff years) in information technology resources. This includes (1) $285 million for the agency's multiyear capital account that funds contractor costs for the BSM program and (2) about $1.64 billion for information systems, of which $1.55 billion is for operations and maintenance. The BSM request has been developed consistent with federal guidance on budget preparation. While BSM management controls have improved, some weaknesses, such as cost and schedule estimating, still remain. Most BSM projects have experienced cost overruns and schedule delays that have postponed the delivery of benefits to taxpayers and IRS operations. In an effort to better ensure that projects are delivered within budget and on schedule, IRS has reduced its BSM budget request to focus on a smaller modernization project portfolio and is implementing action plans to respond to deficiencies noted in several recent assessments of the BSM program. In addition, with respect to its information systems budget request, IRS has made progress in implementing investment management best practices for developing and supporting it. However, until IRS fully implements planned process improvements, its ability to develop supportable information systems operations and maintenance budget requests will remain limited.

Our assessment of the 2004 filing season to date shows that:

- IRS's performance during the 2004 filing season has improved in most areas compared to this time last year and the year before, based on the data we reviewed on key filing season activities—paper and electronic processing, telephone assistance, IRS's Web site and walk-in assistance. In particular, access to IRS's telephone assistors has improved and Web site usage has increased. However, the accuracy of responses to tax law questions provided by telephone assistors declined the last two years. Additionally, the number of taxpayers seeking assistance at IRS's walk-in sites continued to decline and IRS is shifting work from its walk-in sites to alternative means of providing assistance, such as its volunteer organizations and its Web site. Although it cannot be quantified, the improvements overall in the 2004 filing season performance appear to

represent a payoff from IRS's modernization and increased emphasis on service since 1998.

Enhancing Enforcement Is A Key Priority But Devoting More Resources To Enforcement May Be Difficult

The fiscal year 2005 budget is the fifth consecutive budget request where IRS is proposing increased staffing for enforcement and the third where it has identified internally-generated savings to help fund the increase. The 2005 budget proposes that, of the $377.3 million for new initiatives to be paid for either through new funding and reinvested savings, $315.2 million or 84 percent go to enforcement. In the past, IRS has not been able to realize all the projected savings intended to help fund enforcement staffing increases. In addition, other priorities, including unbudgeted expenses and taxpayer service, have consumed budget increases and internally-generated savings. This raises the question about IRS's ability to increase enforcement staffing as planned in 2005.

IRS is Asking For Significantly More For Enforcement in 2005

IRS's fiscal year 2005 budget request is $10.7 billion, up $489.8 million or 4.8 percent from the amount appropriated for fiscal year 2004. IRS's request identifies a total of $750.3 million of new proposed spending—$377.3 million for new initiatives, primarily enforcement, and $373 million to maintain current operations (such as salary increases included in the budget). IRS plans to fund the additional spending from three sources—budget increases, program reductions, and internal savings. IRS is proposing to receive $489.8 million in budget increases, gain $149.7 million from program reductions, primarily from reducing the amount for BSM, and save $110.8 million from process improvements. For context about IRS's staff resources, we provide information about how IRS allocated those resources in fiscal year 2003 to various functions including returns processing, taxpayers service and enforcement in appendix I.

In its 2005 budget request, IRS makes increasing enforcement staffing its priority. IRS identified its priority enforcement areas as:

- promoters of tax schemes,
- misuses of offshore transactions,
- uses of corporate tax avoidance transactions,
- underreporting of income by higher income taxpayers, and
- failures to file and pay large amounts of employment taxes.

IRS is proposing to spend $377.3 million on new initiatives; $315.2 million, or 84 percent is slated for enforcement initiatives. The rest is for infrastructure projects to, for example, consolidate paper processing operations. The major enforcement initiatives include:

- $90.2 million and 874 Full Time Equivalents (FTEs) to target noncompliance by small business and self-employed taxpayers by hiring field examination and collection, automated collection and service center-based compliance staff;
- $65 million and 260 FTEs for additional criminal investigation resources to combat corporate fraud, increase tax enforcement, and enhance criminal investigation capabilities by hiring additional criminal investigators and special agents to focus on corporate financial fraud, general tax enforcement, improve forensic electronic evidence capabilities and increase special agent support staff;
- $36 million and 207 FTEs to combat corporate abusive tax shelters by devoting more resources to reviewing offshore transactions;
- $15.5 million and 175 FTEs to increase individual taxpayer compliance by focusing on the full spectrum of individual taxpayer noncompliance, including nonfilers, nonpayers of tax owed, and more tax assessments on underreported income; and
- $15.1 million and 144 FTEs to combat diversions of charitable assets and stop abusive transactions in the tax-exempt area by focusing on terrorism funding and civil fraud by charities, and targeting tax avoidance strategies by charities.

IRS is proposing to spend $373 million to maintain current operations, which would cover increased costs of continuing current operations. The increased costs include $133 million for salary increases assumed in IRS's budget. IRS's 2005 budget assumes a federal salary increase of 1.5 percent. If the actual federal salary increase is higher than 1.5 percent, IRS will have to cover the unbudgeted portion of the increase.

For 2005, IRS has identified $110.8 million in savings to be generated from process and system improvements. Key savings initiatives include:

- $34.0 million and 408 FTEs from a reorganization of the information systems function that will consolidate three parallel organizations, and reduce staff, to improve operations and support to IRS customers;
- $15.7 million and 220 FTEs from consolidating insolvency and exam/collection field support from over 80 to 5 or fewer locations;
- $14.9 million and 167 FTEs from the termination of transition employees who could not be placed when offices closed and jobs were shifted when IRS reorganized into business units; and
- $5.1 million and 130 FTEs due to more electronic filing.

In addition to the savings, IRS has identified $149.7 million in program reductions to help fund its 2005 spending priorities. The reductions include $102.7 million due to reductions in the scope of certain BSM

projects (discussed later in more detail) and $18 million in overhead reductions.

Recent History Suggests Increasing Enforcement Staffing May Be Difficult

In its last five budget requests, IRS has asked for more enforcement staff, to be funded partly by budget increases and partly through internal savings. Despite budget requests that were almost fully funded and despite achieving some savings, the number of skilled enforcement staff actually declined. The budget increases and savings were consumed by other priorities including unbudgeted expenses.

IRS's Recent Budget Requests Were Almost Fully Funded, and Some Savings Were Achieved

Table 1 shows that IRS has received almost 98 percent or more of its budget requests since fiscal year 2002.

Table 1: IRS's requested and approved budget for fiscal years 2002 through 2005 (in millions)

	Fiscal Year 2002 (Actual)	Fiscal Year 2003 (Actual)	Fiscal Year 2004 (Actual)	Fiscal Year 2005 (Requested)
Requested budget	$9,422	$9,916	$10,437	$10,674
Budget approved	9,437	9,835	10,185	

Source: IRS data.

Table 2 shows that in 2003 IRS realized about 34 percent of its anticipated budget savings and about 41 percent of its anticipated staff savings. In 2004, IRS officials believe they did a better job in both estimating and tracking the savings and estimate they will be able to reinvest 77 percent of the anticipated budget savings and 53 percent of the anticipated staff savings.[2]

[2] Although IRS officials were able to produce more complete supporting documentation on cost estimates and savings justifications than for fiscal year 2004, we were unable to verify actual IRS claims on savings and reinvestments. IRS's budget office generally accepts the savings and reinvestment data claimed by various IRS operating divisions, and reduces the budget allocation of the unit that identified the savings. If expected savings do not materialize, the operating division must either find a way to make up the savings elsewhere with new efficiencies, reduce expected expenditures, or petition for additional resources from other parts of the organization.

Table 2: IRS's reported actual and estimated savings and reinvestments for fiscal year 2003 and 2004 (In millions)

	Fiscal Year 2003		Fiscal Year 2004		Fiscal Year 2005 (est)	
	Dollars	Staff Levels	Dollars	Staff Levels	Dollars	Staff Levels
Savings[a]						
Budgeted	157.8	2,287	166.5	2,145	110.8	1,442
Actual	53.4	944	113.0	1,120		
Percentage of actual [b]	34%	41%	68%	53%		
Reinvestments[a]						
Projected	157.8	1,830	166.5	649	110.8	712
Actual	47.4	239	99.5	259		
Percentage of actual [b]	30%	13%	77%	53%		

Source: GAO analysis of IRS data.

[a]IRS considers savings to be gained through process or systems improvements and reinvestments to be those savings that were realized and available for other purposes.

[b]IRS reported actuals for 2003 and end of year projections for 2004.

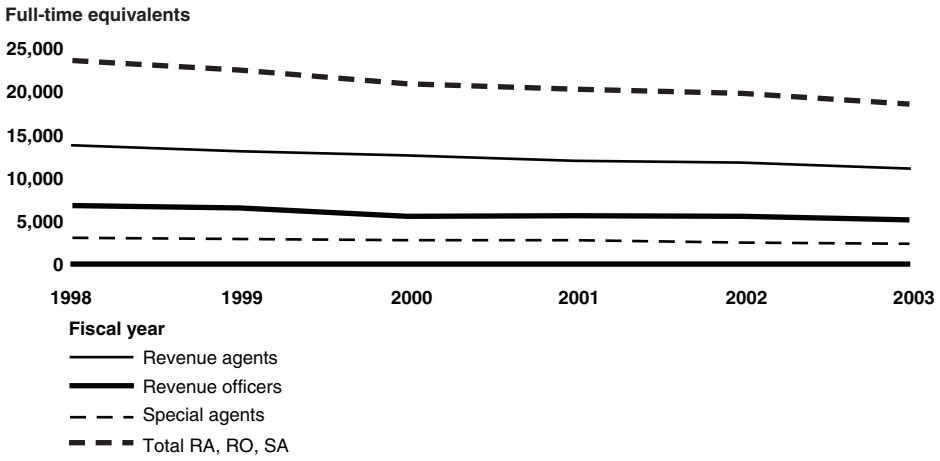
IRS should be commended for identifying saving and reinvestment opportunities in its budget request. While IRS has been unable to achieve its savings targets, we recognize that budget preparation begins about 18 months before the beginning of the fiscal year, making it difficult to accurately predict future savings. IRS officials believe they are doing a better job both estimating and tracking savings. Nevertheless, IRS's history raises questions about its ability to achieve the 2005 savings targets.

IRS Has Been Unable to Achieve Increases In Enforcement Staffing in Recent Years

Despite budget requests that were almost fully funded, and despite realizing some savings, IRS has been unable to achieve the enforcement staffing increases projected in its recent budgets.

As shown in figure 1, the number of revenue agents (those who audit complex returns), revenue officers, (those who do field collection work), and special agents (those who performed criminal investigations) has decreased over 21 percent between 1998 and 2003.

Figure 1: Revenue agents, revenue officers, and special agents, fiscal years 1998 – 2003



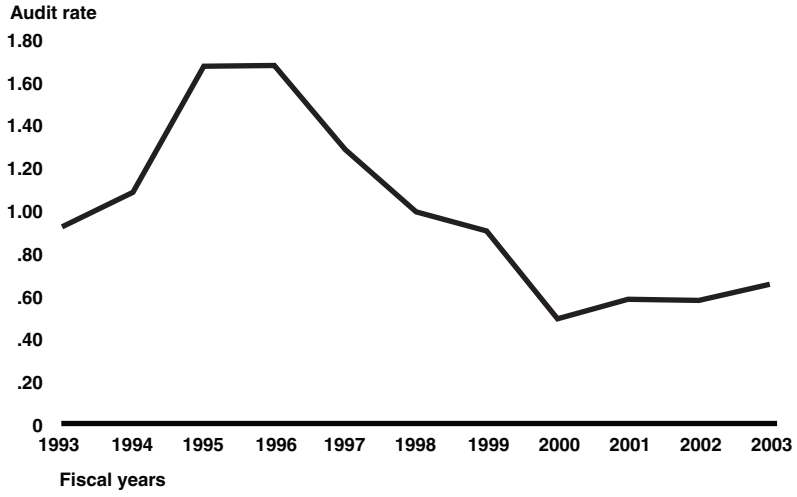
Source: IRS.

The Large- and Mid-size Business (LMSB) operating division, responsible for combating abusive corporate tax shelters and assuring that large businesses are in compliance with the tax laws, is an example of these staffing trends. According to LMSB officials, at the beginning of fiscal year 2002, they had 5,047 revenue agents on board. This was reduced to 4,431 at the beginning of fiscal year 2004—a 12 percent reduction—due to attrition and the inability to hire.

The declines in enforcement staff have been associated with declines in enforcement efforts. For example, audit rates are below the levels of the mid-1990s, even after accounting for recent increases. Figure 2 shows the trend in total audits of individual taxpayers since 1993. Total audits includes both face-to-face audits and less complex correspondence audits. IRS and GAO have reported[3] that IRS has experienced steep declines in audit rates since 1996, although the audit rate has slowly increased since 2000.

[3] U.S. General Accounting Office, *Tax Administration: IRS Should Continue to Expand Reporting on Its Enforcement Efforts*, GAO-03-378, (Washington, D.C.: Jan. 31, 2003).

Figure 2: Audit rate individual income tax returns, fiscal year 1993 – 2003



Source: IRS.

The link between the decline in enforcement staff and the decline in enforcement actions, such as audit rates, is complicated by other factors, such as changes over time in the mix of complex and simple enforcement actions. However, IRS officials have stated that the decline in enforcement staff has restricted their enforcement efforts. For example, LMSB officials stated that they hired about 200 fewer revenue agents than planned in fiscal year 2003 and expect to hire about 95 fewer in fiscal year 2004 because of budget constraints. They estimated that had this hiring occurred as planned, LMSB could have examined an additional 505 returns and 1,877 returns in fiscal years 2003 and 2004 respectively. In addition, the 2005 budget request attributes the decline in enforcement actions to the decline in enforcement staff.

The impact of the recent declines in enforcement staffing and enforcement actions on taxpayers' rate of voluntary compliance is not known. This leaves open the question of whether these declines are eroding taxpayers' incentives to voluntarily comply. As we have reported,[4] the IRS's National Research Program (NRP), which is developing new estimates of taxpayer compliance, is underway. These estimates will be the first based on data more recent than 1988, when IRS last measured voluntary compliance.

[4] U.S. General Accounting Office, *Tax Administration: IRS is Implementing the National Research Program as Planned*, GAO-03-614, (Washington, D.C.: June 16, 2003).

According to IRS officials the new estimates should be available in 2005. Until the NRP estimates are available, IRS lacks current data on compliance including changes in taxpayers' compliance rate.

NRP is important for several reasons beyond measuring compliance. It is intended to help IRS better target its enforcement actions, such as audits, on non-compliant taxpayers, and minimize audits of compliant taxpayers. It could also help IRS better understand the impact of taxpayer service on compliance.

Other IRS Priorities Have Consumed Recent Budget Increases and Savings

Priorities other than enforcement, including unbudgeted expenses and taxpayer service, have consumed IRS's budget increases and savings over the last few years. Unbudgeted expenses include unfunded portions of the annual pay increases, that can be substantial given IRS's large workforce, and other costs, such as postage increases and higher-than- budgeted rent increases. According to IRS officials, these unbudgeted expenses accounted for

- $154 million of IRS's budget in 2002;
- $311 million of IRS's budget in 2003; and
- $169 million of IRS's budget in 2004.

IRS officials also told us that they anticipate having to cover unbudgeted expenses in 2005. As of March 2004, they were projecting unbudgeted salary increases for fiscal year 2005 of at least $100 million. This projection could change since the actual federal salary increase for 2005 has not been finalized.

Another reason for the reduction in enforcement staff has been IRS's emphasis on improving service to taxpayers. According to IRS officials, much of this improvement has been at the expense of additional resources for enforcement and has resulted in less hiring of new staff for enforcement activities.

IRS's Information Technology Budget Includes Funding For BSM and Information Systems

IRS is requesting about $1.93 billion (including 7,385 staff years) in information technology (IT) resources for fiscal year 2005. This includes (1) $285 million for the agency's multiyear capital account that funds contractor costs for the Business Systems Modernization (BSM) program and (2) about $1.64 billion for information systems, of which $1.55 billion (including 7,137 staff years) are for operations and maintenance. BSM is important for IRS's future because it has the potential for long-term efficiency gains without major increases in staffing or other resources.

Fiscal Year 2005 BSM Request Developed Consistent with Federal Guidance

Consistent with the Clinger-Cohen Act of 1996[5] and the Government Performance and Results Act of 1993,[6] OMB guidance on budget preparation and submission[7] require that, before requesting multiyear funding for capital asset acquisitions, agencies develop sufficient justification for these investments. The guidance requires that agencies implement key IT management practices, including an integrated IT architecture and a process for managing information systems projects as investments. In addition, agencies are to prepare business cases that reasonably demonstrate how proposed investments support agency missions and operations, and provide positive business value in terms of expected costs, benefits, and risks.

Beginning in 1995, when IRS was involved in an earlier attempt to modernize its tax processing systems, and continuing since then, we have made recommendations[8] that IRS implement fundamental modernization management capabilities before acquiring new systems. We recommended, among other things, that IRS (1) put in place an enterprise architecture[9] (modernization blueprint) to guide and constrain its business system investments, and (2) implement disciplined processes for investment decision management and system development management.

[5] This fiscal year 1997 Omnibus Consolidated Appropriations Act, Pub. L. 104-208, renamed both Division D (the Federal Acquisition Reform Act) and E (the Information Technology Management Reform Act) of the 1996 Department of Defense Authorization Act, Pub. L. 104-106, as the Clinger Cohen Act of 1996.

[6] P.L. 103-62.

[7] See, for example, Office of Management and Budget, *Preparing, Submitting, and Executing the Budget*, Circular No. A-11 (Washington, D.C.: July 25, 2003).

[8] See U.S. General Accounting Office, *Tax Systems Modernization: Management and Technical Weaknesses Must Be Corrected If Modernization Is to Succeed*, GAO/AIMD-95-156 (Washington, D.C.: July 26, 1995); *Tax Administration: IRS' Fiscal Year 1997 Spending, 1997 Filing Season, and Fiscal 1998 Budget Request*, GAO/T-GGD/AIMD-97-66 (Washington, D.C.: March 18, 1997); *Tax Systems Modernization: Blueprint is a Good Start But Not Yet Sufficiently Complete to Build or Acquire Systems*, GAO/AIMD/GGD-98-54 (Washington, D.C.: February 24, 1998); and *Tax Administration: IRS' 2000 Tax Filing Season and Fiscal Year 2001 Budget Request*, GAO/T-GGD/AIMD-00-133 (Washington, D.C.: March 28, 2000).

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

In response to our recommendations, IRS developed and is using an enterprise architecture, which describes IRS's current and target business and technology environments, and the associated high-level transition strategy that identifies and conceptually justifies needed investments to guide the agency's transition over many years from its current to its target architectural state. In addition, IRS also implemented a capital planning and investment control process for developing business cases and managing BSM projects as part of an investment portfolio, as well as a systems life cycle management methodology, which IRS refers to as the enterprise life cycle.

IRS's $285 million request for the BSM account for fiscal year 2005 is based on its enterprise architecture as well as its related investment management process and life cycle management methodology. IRS's BSM budget request constitutes a reduction of greater than 25 percent from the planned fiscal year 2004 spending level of $388 million, and reflects the agency's decision, in light of ongoing project delays, to focus on a smaller modernization project portfolio in an effort to better ensure cost targets are maintained, project schedules are met, and the promised projects are delivered.

BSM Management Controls Improved, But Weaknesses Remain

Pursuant to statute,[10] funds from the BSM account are not available for obligation until IRS submits to the congressional appropriations committees for approval an expenditure plan that meets certain conditions.[11] In January 2004, IRS submitted an expenditure plan seeking approval to obligate funds from the BSM account for its planned fiscal year 2004 projects and program-level initiatives. IRS's fiscal year 2004 plan reported the deployment of modernization projects during fiscal year 2003 that have benefited taxpayers and the agency, including an application that provides refund status for the advanced child tax credit and the first release of a new human resources system, HR Connect, which has now been delivered to 73,000 IRS employees.

[10] P.L. 108-199, Div. F, Title II, Jan. 23, 2004.

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

In our briefing to the staff of the relevant appropriations subcommittees on the results of our review of the fiscal year 2004 expenditure plan, we reported that IRS has made progress in implementing our prior recommendations to improve its modernization management controls and capabilities. However, certain of these controls and capabilities related to configuration management, human capital management, cost and schedule estimating, and contract management have not yet been fully implemented or institutionalized. Our analysis has shown that weaknesses in these controls and capabilities have contributed, at least in part, to cost and schedule shortfalls experienced by most BSM projects. In the absence of appropriate management controls, systems modernization projects will likely be hampered by additional costs and schedule shortfalls. The reasons are twofold: the tasks associated with those projects that are moving beyond design and into development are, by their nature, more complex and risky. Also, the fiscal year 2004 expenditure plan supports progress toward the later, more complex phases of key projects as well as continued development of other projects.

BSM Projects Continue to Incur Cost Increases and Schedule Delays

Based on IRS's expenditure plans, BSM projects have consistently cost more and taken longer to complete than originally estimated. In its fiscal year 2004 plan, IRS disclosed that key BSM projects have continued to experience cost and schedule shortfalls against prior commitments. Table 4 shows the life cycle variance in cost and schedule estimates for completed and ongoing BSM projects. These variances are based on a comparison of IRS's initial and revised cost and schedule estimates to complete initial operation[12] or full deployment[13] of the projects. We did not independently validate planned projects' cost estimates or confirm, through system and project management documentation, the validity of IRS-provided information on the projects' content and progress.

[12]Initial operation refers to the point at which a project is authorized to begin enterprisewide deployment.

[13]Full deployment refers to the point at which enterprisewide deployment has been completed and a project is transitioned to operations and support.

Table 4: IRS BSM project life cycle cost/schedule variance and benefits summary for completed and on-going projects

Project	Cost variance (in thousands)	Reported/revised estimated cost (in thousands)	Schedule variance (in months)	Reported/revised estimated completion date	Reported IRS/taxpayer benefits
Completed Projects					
Security and Technology Infrastructure Release 1	+$7,553	$41,287	+5	1/31/02 (initial operation)	Provides infrastructure for secure telephony and electronic interaction among IRS employees, tax practitioners, and taxpayers.
Customer Communications 2001	+5,310	46,420	+9	2/26/02 (full deployment)	Improves telecommunications infrastructure, including telephone call management, call routing, and customer self-service applications.
Customer Relationship Management Exam	-1,938	7,375	+3	9/30/02 (full deployment)	Provides commercial-off-the-shelf software to IRS revenue agents to allow them to accurately compute complex corporate transactions.
Human Resources Connect Release 1	+200	10,200	0	12/31/02 (initial operation)	Allows IRS employees to access and manage their human resources information online.
Internet Refund/ Fact of Filing	+12,923	26,432	+14	9/26/03 (full deployment)	Provides instant refund status information and instructions for resolving refund problems to taxpayers with Internet access.
Ongoing Projects[a]					
Modernized e-File Release 1	+17,057	46,303	+4.5	3/31/04[b] (initial operation)	Provides a single standard for filing electronic tax returns.
e-Services	+86,236	130,281	+18	4/30/05 (full deployment)	Provides a Web portal and other e-Services to promote the goal of conducting most IRS transactions with taxpayers and tax practitioners electronically.
Customer Account Data Engine – Individual Master File Release 1	+36,760	97,905	+30[c]	6/30/05[c] (full deployment)	Provides the modernized database foundation to eventually replace the existing individual master file processing systems. Facilitates faster refund processing and more timely response to taxpayer inquiries for Form 1040EZ filers.

Project	Cost variance (in thousands)	Reported/revised estimated cost (in thousands)	Schedule variance (in months)	Reported/revised estimated completion date	Reported IRS/taxpayer benefits
Integrated Financial System Release 1	+53,916	153,786	TBD[c]	TBD[c] (full deployment)	Provides a single general ledger for custodial and financial data and a platform to integrate core financial data with budget, performance, and cost accounting data.
Custodial Accounting Project Release 1	+72,058	119,219	TBD[c]	TBD[c] (full deployment)	Provides integrated tax operations and internal management information to support evolving decision analytics, performance measurement, and management information needs.

Source: GAO analysis of data contained in IRS's BSM expenditure plans.

[a] Projects ongoing as of 9/30/03.

[b] IRS subsequently reported that Modernized e-File began initial operation on 2/23/04.

[c] Project schedules for the Customer Account Data Engine, the Integrated Financial System, and the Custodial Accounting Project are currently under review.

As the table indicates, the cost and schedule estimates for full deployment of the e-Services project have increased by just over $86 million and 18 months, respectively, which included a significant expansion from the initial project scope. In addition, the estimated cost for the full deployment of Customer Account Data Engine (CADE) Release 1 has increased by almost $37 million, and project completion has been delayed by 30 months. In addition to the modernization management control shortcomings discussed above, our work has shown that the increases and delays were caused, in part, by

- inadequate definitions of systems requirements. As a result, additional requirements have been incorporated into ongoing projects.
- increases in project scope. For example, the e-Services project has changed significantly since the original design. The scope was broadened by IRS to provide additional benefits to internal and external customers.
- underestimating project complexity. This factor has contributed directly to the significant delays in the CADE release 1 schedule.
- competing demands of projects for test facilities. Testing infrastructure capacity is insufficient to accommodate multiple projects when testing

schedules overlap.

- project interdependencies. Delays with one project have had a cascading effect and have caused delays in related projects.

These cost overruns and schedule delays impair IRS's ability to make appropriate decisions about investing in new projects, delay delivery of benefits to taxpayers, and postpone resolution of material weaknesses affecting other program areas.

Producing reliable estimates of expected costs and schedules is essential to determining a project's cost-effectiveness. In addition, it is critical for budgeting, management, and oversight. Without this information, the likelihood of poor investment decisions is increased.

Schedule slippages delay the provision of modernized systems' direct benefits to the public. For example, as table 4 shows, slippages in CADE will delay IRS's ability to provide faster refunds and respond to taxpayer inquiries on a timely basis.

Delays in the delivery of modernized systems also affect the remediation of material internal management weaknesses. For example, the Custodial Accounting Project is intended to address a material weakness in IRS's financial reporting process and provide a mechanism for tracking and summarizing individual taxpayer transactions. This release has yet to be implemented, and a revised schedule has not yet been determined. In addition, the Integrated Financial System is intended to address financial management reporting weaknesses. When IRS submitted its fiscal year 2003 BSM expenditure plan, Release 1 of the Integrated Financial System was scheduled for delivery on October 1, 2003. However, it has yet to be implemented, and additional cost increases are expected.

IRS Is Acting to Resolve Issues Identified in Recent BSM Assessments

Given the continued cost overruns and schedule delays experienced by these BSM projects, IRS and the prime systems integration support (PRIME) contractor, Computer Sciences Corporation (CSC), initiated and recently completed several in-depth and more comprehensive assessments of BSM. These assessments revealed several significant weaknesses that have driven project cost overruns and schedule delays and also provided a number of recommendations for IRS and CSC to address the identified weaknesses and reduce the risk to BSM. The deficiencies identified are consistent with our prior findings. IRS developed a BSM action plan to address the findings and recommendations resulting from these

assessments. IRS expects to complete implementation of its actions by the end of the calendar year. Because of the significant risks associated with the findings of these various assessments, continued monitoring by IRS and validation of the effectiveness of corrective actions is critical to reducing the likelihood of additional cost overruns and schedule delays.

It will be important for IRS to continue its efforts to balance the scope and pace of the program with the agency's capacity to handle the workload, and to institutionalize the management processes and controls necessary to resolve the deficiencies identified by our reviews and the recent program assessments. Meeting these challenges and improving performance are essential if IRS and the PRIME contractor are to successfully deliver the BSM program.

Continued Efforts Needed to Strengthen Information Systems Budget Request Development Process

The Paperwork Reduction Act (PRA)[14] requires federal agencies to be accountable for their IT investments and responsible for maximizing the value and managing the risks of their major information systems initiatives. The Clinger-Cohen Act of 1996[15] establishes a more definitive framework for implementing the PRA's requirements for IT investment management. It requires federal agencies to focus more on the results they have achieved and introduces more rigor and structure into how agencies are to select and manage IT projects.

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

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

[14] 44 U.S.C. § 3506(h).

[15] P.L. 104-106.

This focus on projects, their outcomes, and risks as the basic elements of analysis and decision-making is incorporated in the IT investment management approach that is recommended by OMB and GAO.[16] By using these proven investment management approaches for budget formulation, agencies have a systematic method, on the basis of risk and return on investment, to justify what are typically very substantial information systems operations and maintenance budget requests.

In our assessment of IRS's fiscal year 2003 budget request, we reported that the agency did not develop its information systems operations and maintenance request in accordance with the investment management approach used by leading organizations. We recommended that IRS prepare its future budget requests in accordance with these best practices.[17] To address our recommendation, IRS agreed to take the following actions:

- develop an activity-based cost model to plan, project, and report costs for business tasks/activities funded by the information systems budget;
- develop a capital planning guide to implement processes for capital planning and investment control, budget formulation and execution, business case development, and project prioritization; and
- implement a process for managing all information systems investments as a portfolio, patterned after the BSM program.

IRS has made progress in implementing investment management best practices in developing and supporting its information systems budget request. IRS officials reported that the agency is managing all information systems funding requirements as a portfolio within Treasury's IT investment portfolio system, and preparing business cases for many of its operational program activities, as required by OMB. According to IRS, these business cases are updated on a periodic basis and are evaluated within the context of the agency's overall IT funding portfolio. IRS plans to

[16] See, for example, U.S. General Accounting Office, *Information Technology Investment Management: A Framework for Assessing and Improving Process Maturity*, GAO-04-394G (Washington, D.C.: March 2004, Version 1.1).

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

align this portfolio management process with the capital planning and investment control system now being implemented to provide a uniform process to select, manage, and control all IT investments, including modernization, enhancements, and sustaining operations.

Although progress has been made, IRS has not yet completed all of its planned actions to implement our prior recommendation. Completion of IRS's capital planning and investment control guide has been delayed due to changing roles and responsibilities within the Modernization and Information Technology Services organization, and thus was not used in preparing the fiscal year 2005 information systems budget request. According to IRS, the capital planning guidance will not be completed until September 2004. In addition, as of March 2004, IRS has not yet developed an activity-based cost accounting system to enable it to account for the full cost of operations and maintenance projects and determine how effectively IRS projects are achieving program goals and mission needs. This cost model, which is being developed in conjunction with the Integrated Financial System modernization project, has been delayed, and due to Integrated Financial System schedule delays, will not be available until the fiscal year 2008 budget formulation cycle. Until IRS implements the capital planning and investment control guidance and the activity-based cost model and incorporates them into the preparation of its information systems budget request, the agency will not be able to ensure that the information systems operations and maintenance request is adequately supported.

Interim Results Of IRS's 2004 Filing Season Show Improvement Except In Telephone Accuracy

IRS's filing season performance through mid-March has improved in most areas compared to recent years, based on data we reviewed on five key filing season activities—paper and electronic processing, telephone assistance, IRS's Web site, and walk-in assistance. However, the accuracy of tax law answers provided by IRS telephone staff declined. Although we cannot quantify the connection between these improvements and IRS's actions, they appear to represent a payoff from IRS's modernization and an increased emphasis on service since the IRS Restructuring and Reform Act of 1998.[18]

[18] P.L. 105-206.

Table 5 summarizes IRS's filing season performance so far this year compared to recent years. The following sections will address IRS's specific performance in key areas.

Table 5: IRS performance in the first weeks of the 2002 through 2004 filing seasons

Volume in thousands	2002	2003	2004
Actual returns processed [a]			
Paper	24,491	22,117	20,232
Electronic	35,067	38,627	42,988
Telephone assistance			
Total calls [b]	34,489	27,905	29,058
Answered by assistors	9,208	9,434	10,116
Answered by automation	25,281	18,471	18,942
Customer service representative level of service	62%	82%	84%
Accounts customer accuracy rate estimates [c]	88% +/- 1%	88% +/- 1%	89% +/- 1%
Tax law customer accuracy rate estimates [c]	84% +/- 1%	81% +/- 1%	76% +/- 1%
Internet assistance			
Forms and publications downloaded [d]	158,000	195,000	205,000
Refund status inquiries [e]	N/A	9,300	14,300
Child Tax Credit inquiries [f]	N/A	N/A	8,500
Walk-in assistance			
Total Walk-in Contacts [g]	N/A	2,740	2,433
Returns prepared at IRS walk-in sites [h]	436	291	186
Returns prepared at volunteer sites [j]	466	594	737

Source: IRS Data.

[a] From January 1 to March 22, 2002, January 1 to March 21, 2003, and January 1 to March 19, 2004.

[b] Total calls, calls answered by assistors and automation, and CSR level of service are based on actual counts from January 1 to March 16, 2002, January 1 to March 15, 2003, and January 1 to March 13, 2004. 2002 totals include increased call demand as a result of the Economic Growth and Tax Relief and Reconciliation Act of 2001 (P.L.107-16). Employer Identification Number data has been added to 2002 and 2003 to ensure valid data comparisons can be made to 2004 which includes Employer Identification Numbers.

[c] Based on a representative sample estimated at the 90 percent confidence level from January to February 2002, 2003 and 2004.

[d] From January 1 to February 28, 2002, January 1 to February 28, 2003, and January 1 to February 29, 2004.

[e] From January 1 to March 20, 2003, and January 1 to March 20, 2004.

[f] From January 1 to March 21, 2004.

[g] From January 1 to March 15, 2003, and January 1 to March 13, 2004.

[h] From January 1 to March 16, 2002, January 1 to March 15, 2003, and January 1 to March 13, 2004.

[i] From January 1 to March 9, 2002, January 1 to March 8, 2003, and January 1 to March 6, 2004.

IRS's Processing Operations Have Gone Smoothly, and Electronic Filing Continues to Grow, But Not at Rate to Meet 2007 Goal

According to IRS officials, tax industry representatives and data reviewed, the 2004 filing season is progressing smoothly (meaning without disruptions in IRS computer systems used in processing that would have a negative impact on taxpayers) and IRS is either meeting or exceeding its goals for the number of days to process an individual income tax returns, depending on the type of return. As table 5 shows, through March 19, 2004, IRS has processed about 63 million individual tax returns—of which 43 million were received electronically, which is about 4.4 million more electronically filed returns than this time last year. IRS officials have attributed this year's performance, in part, to having planned appropriately for issues such as correcting errors related to the advanced child tax credit. Through March 12, 2004, IRS had identified about 2.7 million individual tax returns with errors, with approximately 1.6 million related to the advanced child tax credit.[19]

Electronic filing has grown from the same time last year. It has also grown by about 250 percent overall—from about 15 million returns in 1996 to about 53 million in 2003. Although electronic filing continues to grow, IRS is not on track to reach the long-term electronic filing goal of 80 percent by 2007 set by Congress in the IRS Restructuring and Reform Act of 1998.[20] IRS officials recognize that they will not achieve the goal of having 80 percent of all individual income tax returns filed electronically by 2007. However, IRS officials told us they will continue to strive to achieve that goal in the future. Moreover, as we reported last year[21], the growth rate from 1996 through 2003 has been generally decreasing, with the 13 percent growth rate in 2003 representing the smallest percentage increase in the

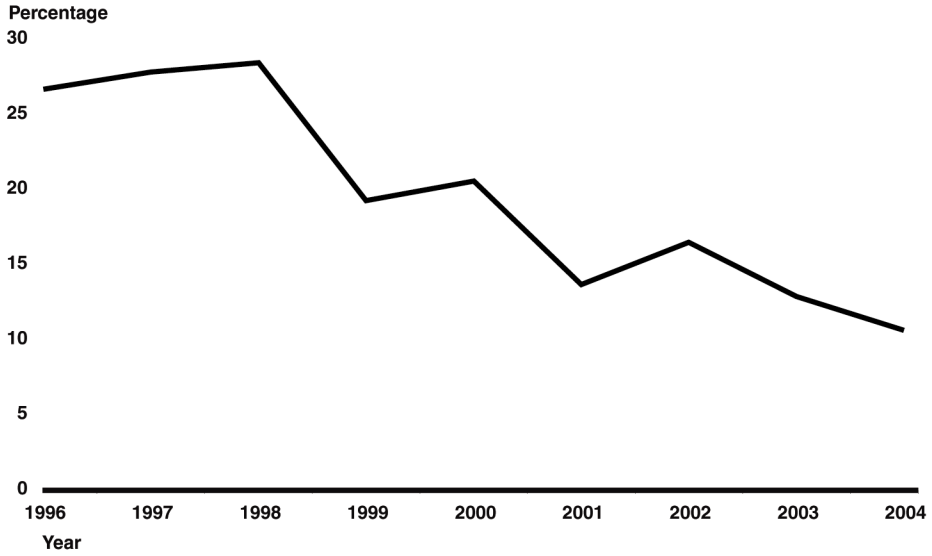
[19] In 2003, the IRS, through Financial Management Service, issued advanced child tax credit payments to more than 25 million taxpayers in a manner similar to the 86 million advance refund checks issued in 2001. See U.S. General Accounting Office, *Tax Administration: IRS Issued Advance Child Tax Credit Payments on Time, but Should Study Lessons Learned*, GAO-04-372 (Washington, D.C.: Feb.17, 2004).

[20] P.L. 105-206.

[21] U.S. General Accounting Office, *Internal Revenue Service: Assessment of Fiscal Year 2004 Budget Request and 2003 Filing Season Performance to Date*, GAO-03-641T (Washington, D.C.: Apr. 8, 2003).

number of individual tax returns filed electronically since 1996.[22] Although the current growth rate is about 11 percent, according to IRS data, the number of electronic filings is ahead of estimates at this time. Consequently, IRS officials believe IRS will meet and might exceed the annual growth rate goal of 12 percent by the year's end.

Figure 3: Growth rate in the number of individual income tax returns filed electronically 1996 – 2004



Source: GAO.

Note: For 2004, the growth rate compares to the number of returns filed electronically as of March 12, 2004 to the same period in 2003.

Growth in electronic filing remains a key part of IRS's modernization strategy. Electronic filing has allowed IRS to reduce resources devoted to processing (discussed in appendix I) and begin consolidating paper processing centers. It also reduces errors because IRS would not have to transcribe tax returns information and some up-front checks are built into electronic filing. Finally, taxpayers get refunds quicker with electronic filing—IRS's goal for refunds for electronically filed returns is about half the 40 days that IRS allows for refunds for returns filed on paper.

[22] Some slowing of the growth rate might be expected because, for example, taxpayers most easily attracted to electronic filing have already been converted.

IRS has implemented numerous initiatives over the years intended to increase electronic filing usage. IRS's new major electronic filing initiatives this year are related to business not individual income tax returns. They are modernized E-File, which allows the electronic filing of corporate income tax form 1120 and E-Services, which is a suite of Internet services offered to tax practitioners such as electronic account resolution and transcript delivery. IRS officials do not expect these initiatives to dramatically increase electronic filing of individual tax returns this year, because taxpayers and practitioners will need to adjust their behavior and take advantage of the new services. However, these initiatives are important, because they should increase the willingness of tax practitioners to file both corporate and individual tax returns electronically in future filing seasons, which can currently be done only on a limited basis for corporate returns.

IRS made some changes to improve the Free File Alliance[23] program, which began last year to promote electronic filing of individual income tax returns. As of March 7, 2004, IRS had received almost 2.5 million free file tax returns compared to 2.0 million for the same time last year—an increase of 24 percent. One issue with the Free File program is that IRS cannot determine how many of the Free File users are new electronic filers. We plan to follow up on this issue as part of our annual filing season report.

Telephone Access Improved Over Last Two Years, While Tax Law Accuracy Declined

Access to IRS's toll-free telephone lines has improved over the last two years, although account accuracy (the accuracy of answers to questions from taxpayers about the status of their accounts) has stabilized and tax law accuracy declined. As table 5 shows, as of March 13, 2004, IRS had received 29 million telephone calls. The percentage of taxpayers that attempted to reach an assistor and actually got through and received service—referred to as the Customer Service Representative (CSR) level of service—increased to 84 percent, which is 2 percentage points over the same period last year and 22 percentage points over the same period in 2002. According to IRS officials, the gains in CSR level of service are largely due to continued improvements resulting from increased

[23] In 2003 IRS entered into a 3-year-agreement with the Free File Alliance, a consortium of tax preparation companies, to provide free electronic filing to taxpayers that access any of the companies via a link from the IRS Web site. IRS is in the second year of its initiative with the Free File Alliance, and there are currently 17 companies that are offering free filing via IRS's Web site.

specialization, improved technology, and continued focus on maintaining telephone staffing.

IRS estimates that accounts accuracy is essentially the same this year as for the last two years at this time. As shown in table 5, taxpayers who called about their accounts received correct information an estimated 89 percent of the time in 2004. IRS officials said that accounts accuracy rates remained stable, because the accounts workload has remained relatively stable.

At the same time, table 5 shows that IRS estimates that tax law accuracy declined from 84 percent in 2002 and 82 percent last year to 76 percent so this year. IRS officials said that tax law accuracy rates declined because formatting changes made in 2003 to the guide CSRs use to help them answer questions have not enhanced the usability as IRS anticipated. According to IRS, although training was provided to the staff for the changes to their assigned subjects, IRS underestimated the impact these changes would have on overall quality. Also, IRS officials said they have begun redesigning the CSRs' guide and are continuing to conduct detailed analysis of quality data to identify immediate opportunities to improve the accuracy of service.

Web Site Usage is Increasing, But Concerns About Usability Still Exist

IRS's Web site use has increased over the last 2 years as shown in table 6. Also, an independent Web site rater reported that, for 7 of out 10 weeks of the filing season, IRS's Web Site has ranked in the top 10 out of 40 in a government Web site index for time it took to download information.

Over the last 2 years, IRS has added two features to assist taxpayers, which likely contributed to the increased usage of the IRS Web site. In fiscal year 2003, IRS added the "Where's My Refund?" and in 2004 added "Remember Your Advanced Child Tax Credit" features. The "Where's My Refund?" feature enables taxpayers to access IRS's Web site to determine if IRS received their tax return, whether their refund was processed, and if processed, when approximately to expect the refund. Table 5 shows that as of March 20, 2004, the use of this feature was up by 53 percent from last year, from about 9.3 million attempts to about 14.3 million. The "Remember Your Advanced Child Tax Credit" enables a person to access IRS's Web site to determine the amount of the advanced child tax credit they received. As of March 21, 2004, about 8.5 million accesses have been made to the "Remember Your Child Tax Credit" feature.

Overall we found that IRS's Web site continues to improve when it comes to providing services to taxpayers. However, we continue to have concerns about the forms and publication search function. We found that the forms and publication search function still does not always make the most pertinent information readily available. For example, when we typed, "earned income tax credit" into the forms and publication search function, Publication 596—the primary publication on the earned income tax credit—was the 79th item on the list and we had to scroll through eight pages to find it.

Use of IRS's Walk-in Assistance Sites Continues to Decline

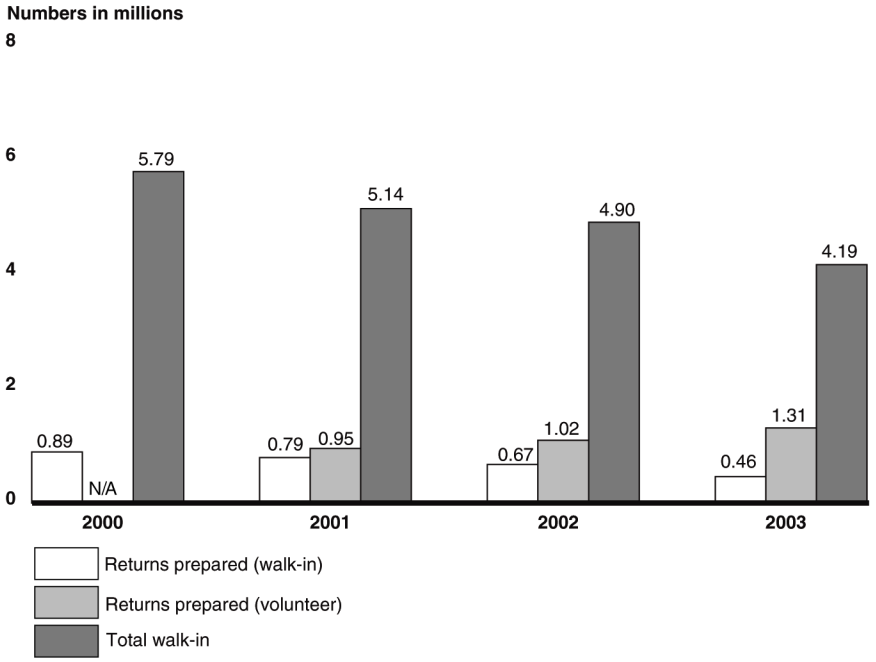
The number of taxpayers receiving assistance at IRS walk-in sites continued to decline. At any one of IRS's over 400 walk-in sites, taxpayers get various types of assistance, including answers to tax law questions, assistance with their accounts, and return preparation assistance (generally for low income taxpayers).

The number of people who received assistance at an IRS walk-in site declined by 11 percent compared to the same period last year. IRS continues to restrict free tax preparation services to, for example, taxpayers with an annual gross income level of $35,000 or less, because of the labor intensive nature of that work and to enable staff to concentrate on other services that only IRS can provide such as account assistance. IRS reduced the number of staff available for return preparation by 20 percent from 2003. As the data in table 5 indicate, the number of returns being prepared has decreased by about 36 percent over this time last year. These trends are consistent with ones we have previously reported for recent filing seasons.[24]

Figure 4 shows a downward trend in the overall assistance provided and in the return preparation at the walk-in sites.

[24] GAO-04-84.

Figure 4: Assistance provided by IRS walk-in and volunteer sites, 2000-2003 filing seasons



Source: IRS.

Notes: Total walk-in figures shows all IRS face-to-face assistance, including return preparation, account services, and tax law assistance. It does not include the number of taxpayers assisted by walk-in employees via telephone or correspondence, which ranged from about 96,000 in 2000 to over 150,000 in 2003. Total figures do not include returns prepared at volunteer sites.

The number of returns prepared at volunteer sites was not available for the 2000 filing season.

The time periods covered by this figure each began on January 1 and ended on April 22, 2000; April 21, 2001; April 20, 2002; and April 19, 2003.

Sites staffed by volunteers certified by IRS do not provide the range of services IRS provides, such as account assistance, and operate primarily during the filing season. IRS is promoting these as alternatives to its walk-in assistance sites for certain types of service. IRS works to ensure that walk-in sites have a listing of services, hours, and locations of the volunteer sites in their area. As of March 2004, there are approximate 11,600 volunteer sites. IRS also promotes its telephone operations and Web site at its walk-in sites as well.

The quality of tax law assistance[25] provided at IRS's walk-in sites in 2004 was comparable to the same period last year. This conclusion is based on TIGTA reviews[26] through February 2004.

Concluding Observations

Congress has been supportive of IRS's efforts to improve service to taxpayers and increase enforcement staff and IRS has succeeded at the former. However, despite budgets that were almost fully funded and realizing savings through efficiency gains, IRS has not been able to increase enforcement staff. In fact, staffing of key enforcement occupations has declined. The declines in IRS's enforcement staff and the related declines in its enforcement efforts raise concerns that taxpayers' incentives to voluntarily comply with their tax obligations could be eroding.

Strengthening enforcement programs by increasing staffing while providing a high level of taxpayer service will continue to be a challenge for IRS. Unbudgeted costs are expected to compete for the funds IRS has allocated in its 2005 budget request for new spending including the enforcement initiatives. If, as has been the case in recent years, IRS fails to realize all expected savings then the funds available for new spending would be further reduced.

One option for increasing enforcement staff in the near-term is to reconsider the level and types of service IRS provides to taxpayers. Taxpayer services are much improved raising a question about the appropriate balance to strike between investing in further service improvements and enforcement. At the same time, the use of IRS's walk-in assistance sites is declining. The improvements in telephone service, increased Web site use, and the availability of volunteer sites raise a question about whether IRS should continue to operate as many walk-in sites. Reconsidering the level and types of service is an option—but not a

[25] IRS determines the quality of account assistance after the filing season. Only tax law assistance is evaluated during the filing season.

[26] TIGTA determines tax law accuracy by measuring the percentage of correct answers to questions asked during anonymous visits to a sample of walk-in sites. Questions were designed by TIGTA to cover a range of tax law topics and assess whether taxpayers were receiving correct answers to questions that a taxpayer might ask when visiting a walk-in site. The TIGTA results are statistically valid only for the times and the locations within which respondents were surveyed.

recommendation—to be considered by IRS management and the Congress.

The challenge of increasing IRS's enforcement staff highlights the importance of succeeding with NRP and BSM. NRP should, if completed successfully, provide the first new data to estimate the voluntary compliance rate since IRS last estimated the compliance rate using 1988 data. The new estimates could have implications for future IRS budgets. If compliance rates are comparable to those estimated using 1988 data, the pressure to increase IRS' s enforcement staff would likely diminish. If, however, compliance rates are down, the pressure to increase enforcement staff and the pressure on IRS's budget could increase.

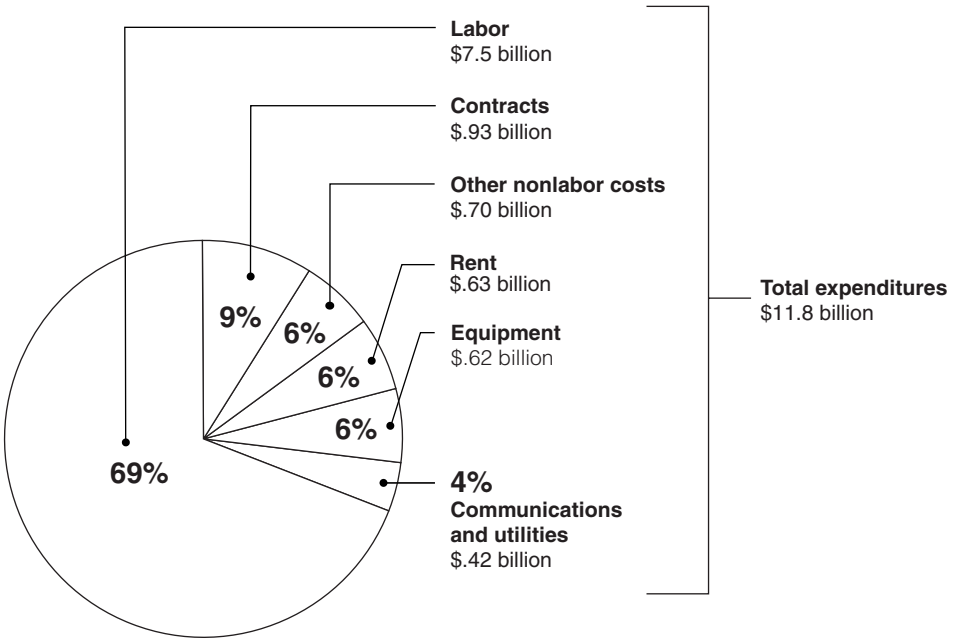
BSM and related initiatives such as electronic filing hold the long-term promise of efficiency gains that could allow IRS to improve both taxpayer service and enforcement without significant budget increases. However, cost overruns and schedule delays associated with on-going BSM projects, along with planned reductions to the BSM project portfolio mean that many of these benefits will not be realized in the short term. As we have recommended, various management controls and capabilities need to be fully implemented and institutionalized. Otherwise the projects will likely encounter additional cost and schedule shortfalls.

Appendix I: How IRS Allocated Expenditures and Staff Resources in Fiscal Year 2003

In our review of IRS's 2004 budget request, we provided figures showing IRS's expenditures and staff allocations in fiscal year 2002.[1] Figures 5 and 6 illustrate how the Internal Revenue Service (IRS) allocated expenditures and staff in fiscal year 2003.

Figure 5 shows that total expenditures increased from $10.4 billion in 2002 to $11.8 billion in 2003. While the division of expenditures across categories has generally remained the same as 2002 allocations, equipment increased from 4 to 6 percent of total expenditures from 2002 to 2003.

Figure 5: IRS's expenditures in fiscal year 2003



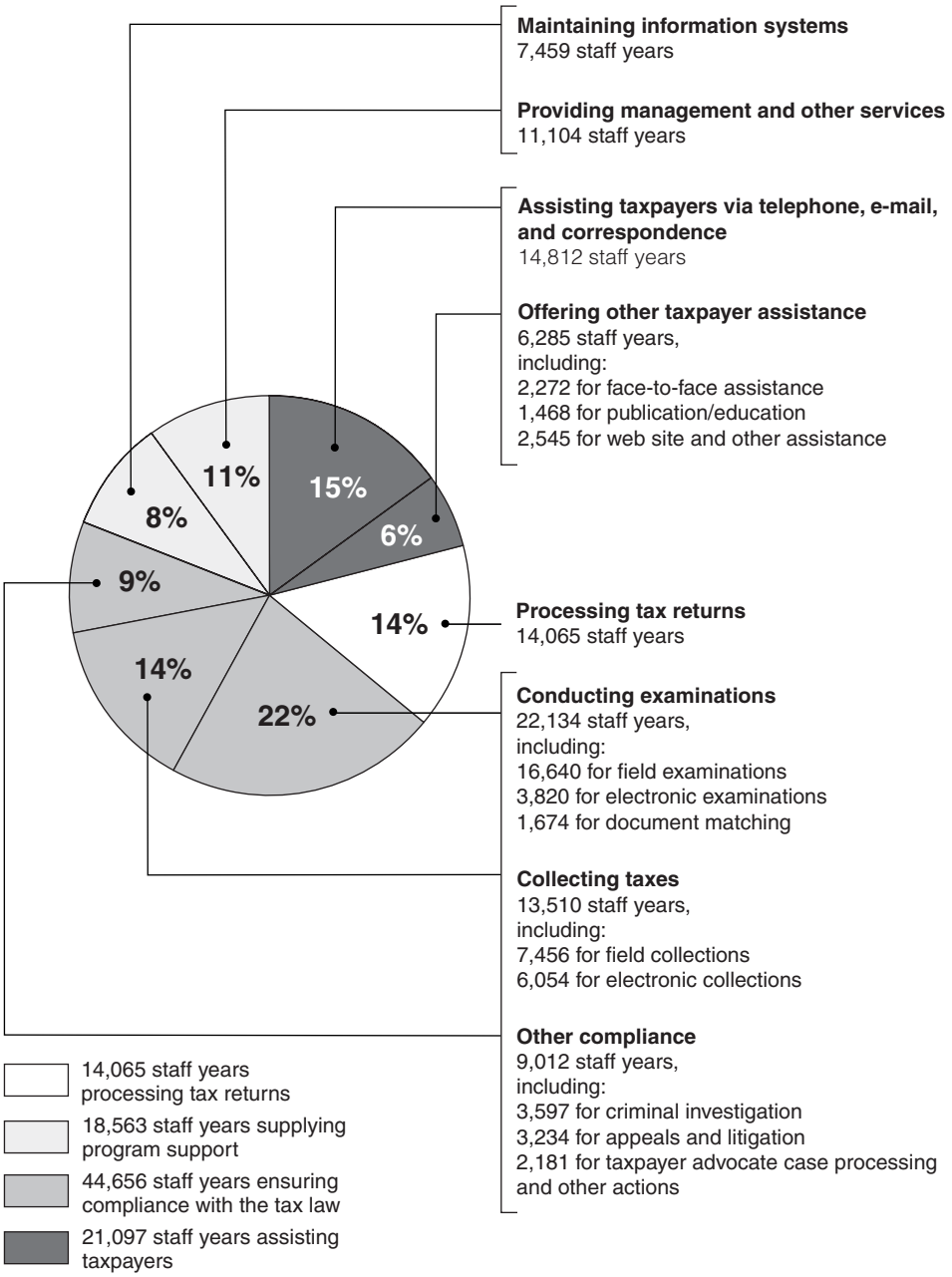
Source: GAO analysis of IRS data.

Figure 6 shows IRS's total staff resources have decreased slightly from 99,180 in 2002 to 98,381 in 2003. IRS's allocation of staffing resources remained largely similar, but with a 1 percentage point decrease in the percent of staff years processing tax returns. The boundaries between the categories presented in these figures may not be well defined. For

[1] GAO-03-641T.

example, staff categorized under providing management and other services could also be considered under taxpayer service, processing, or compliance. Therefore, the figures are meant to provide a summary of how IRS uses its resources and should be interpreted with caution. However, the 1 percentage point decrease in staff years devoted to processing tax returns is important because it represents a cumulative payoff from electronic filing and shows the potential for shifting IRS resources from one area to another.

Figure 6: How IRS spent its 98,381 staff years in fiscal year 2003



Source: GAO analysis of IRS data.

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