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IRS' Budget Request for Fiscal Year 1991 and
Status of the 1990 Tax Return Filing Season

Statement of
Jennie S. Stathis, Director,
Tax Policy and Administration Issues

Before the
Subcommittee on Oversight
Committee on Ways and Means
House of Representatives

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**IRS' FISCAL YEAR 1991 BUDGET
AND
IRS' 1990 TA RETURN FILING SEASON**

**SUMMARY OF STATEMENT
JENNIE S. STATHIS
DIRECTOR, TAX POLICY AND
ADMINISTRATION ISSUES**

Faced with funding shortfalls of about \$825 million in the past 2 years, IRS implemented a hiring freeze, curtailed promotions, cut back support services, and reduced compliance programs. Those actions reduced revenues by about \$700 million, according to the administration, and led to curtailed service. GAO believes that IRS' budget for fiscal year 1991 could stabilize the agency's fiscal environment. Although factors, such as a decision to implement the President's pay proposals, could alter that picture, this year's budget differs enough from those of the recent past to warrant optimism. More encouraging is the fact that IRS has strengthened its controls over spending, which should enable it to better manage its resources.

IRS' budget includes initiatives intended to increase revenues by \$3 billion in fiscal year 1991. The initiatives that call for additional enforcement staff will, in effect, only serve to replace staff that IRS lost in the last year and a half due to a hiring freeze. Although the other initiatives seem reasonable, GAO is not convinced they can be implemented quickly enough to produce the promised revenues in 1991.

Despite funding problems, IRS has generally met its varied returns processing and taxpayer service responsibilities this year and in some important respects has even improved. This year, for example, IRS' telephone assistants have responded accurately to 78 percent of GAO's tax law questions, compared to 66 percent for the same questions last year. Taxpayers should be finding it easier to obtain tax materials this year. IRS is doing a better job of stocking its walk-in sites and filling mail and phone orders.

IRS has also processed more returns and issued more refunds so far this year compared to last. A relatively small number of refunds have been delayed this year for various reasons, including a breakdown in controls that allowed a nondelivery of computer tapes to go undetected for about 2 weeks.

The one aspect of the filing season that has not been as good as last year is telephone access. IRS' funding problems have had an adverse effect on the ability of taxpayers to reach IRS on the phone to ask a question or order materials. This year, for example, IRS is answering 1 of 3 calls to its toll-free telephone sites; last year it answered almost 2 of 3.

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Mr. Chairman and Members of the Subcommittee:

We are pleased to be here today to assist the Subcommittee in its inquiry into the status of the 1990 filing season, IRS' current fiscal condition, and IRS' budget request for fiscal year 1991.

My testimony makes the following points:

- IRS has improved the accuracy of its telephone service. This year, IRS assistors have responded accurately to 78 percent of our tax law questions, compared to 66 percent for the same questions last year. But taxpayers are having more difficulty reaching an IRS assistor. This year IRS is answering 1 out of 3 calls; last year it answered almost 2 of 3.

- Taxpayers should be finding it easier to obtain tax forms and publications this year compared to last. IRS is doing a better job of stocking its walk-in sites and filling phone and mail orders. Taxpayers who want to order materials by phone, however, are probably having more difficulty reaching IRS than in 1989.

- Except for a few problems that have delayed some refunds, returns processing has gone smoothly this year. Service center inventories are within what IRS considers manageable

limits and the percentage of returns with taxpayer errors or IRS processing errors is lower than last year.

- Because of funding shortfalls in fiscal years 1989 and 1990, IRS implemented a hiring freeze; curtailed promotions; cut back training, travel, and other support services; and reduced various compliance programs. The administration estimated that those decisions would reduce revenues by \$700 million over 2 years.

- Prospects for a more stable fiscal environment in 1991 are encouraging. The budget requested is 12 percent higher and IRS has improved its controls over spending. But such factors as having to fund the various pay proposals included in the President's budget, if they should be implemented, and the potential for another sequestration, could alter those prospects.

- IRS' budget includes several initiatives that the administration has estimated will raise about \$3 billion in additional revenues. The initiatives that call for additional enforcement staff will, in effect, only serve to replace staff that IRS lost in the last year and a half due to a hiring freeze. While we generally agree with the objectives of the other initiatives, which call for redirecting existing staff, we are not convinced that they

are achievable quickly enough to produce the promised revenues in fiscal year 1991.

TELEPHONE ASSISTANCE

IRS' telephone assistors are answering tax law questions more accurately than last year, but service availability has declined.

Between February 5 and March 16, 1990, we made test calls to 29 IRS call sites and scored 1,261 responses to 20 test questions. Assistors answered the questions correctly 78 percent of the time. Last year, assistors answered the same 20 questions correctly 66 percent of the time.

In addition, we monitored 245 test calls made by IRS between March 5 and 16. Our scores of those calls agreed with IRS' scores about 94 percent of the time. Given the consistency of these results, we believe that the accuracy rates reported by IRS for each of the 2 weeks (76 percent and 79 percent, respectively) are reliable. Those rates show that accuracy has improved over last year, when the overall score from IRS' test was about 63 percent.

As the Subcommittee requested, we will continue to monitor IRS' test calls throughout the filing season and will provide the results for the hearing record.

Several factors have contributed to IRS' improved accuracy this year: (1) increased managerial emphasis and involvement; (2) a more stable and experienced workforce; and (3) increased emphasis on probing to obtain all the facts needed about a taxpayer's situation--a problem we identified in prior years' tests--as evidenced by the development and use of various assistor guides that identify probes and responses needed for various tax law questions.

IRS' national office developed a probe and response guide when it became evident during the design of last year's test that IRS lacked agreed upon standards that assistors should use when answering tax law inquiries. That guide is a good first step in providing assistors with acceptable response standards. IRS regions expanded and revised the guide in different ways so that various guides are now in use. Although similar in content, the guides differ in the way probes are stated and in the tax law subjects addressed. These differences could affect the accuracy of assistor responses from call site to call site. IRS should review the various guides, cull the most useful information from each, and incorporate it into the national guide. Once that is

accomplished, IRS should include information on how to use the guide in next year's training programs. IRS agrees and plans to take steps along these lines.

Another IRS effort to improve telephone assistors' performance is the Taxpayer Service Expert Assistant System. This automated system, being tested at IRS' Boston call site, contains information on about 100 tax law "knowledge bases". The system is designed so that an assistor can lead the taxpayer through a series of questions, each dependent on the taxpayer's response to a prior question, and reach a system-provided answer.

We believe the Expert System holds promise in improving IRS' telephone service. Our test suggests a lower accuracy rate--72 percent at Boston compared to a 78 percent average at the other sites. In contrast, IRS' test results show that, after a bumpy start, Boston's accuracy rate is a little better than the national average. Similarly, Boston's rate of improvement thus far is in the mid-range compared to other sites. At this early stage in the system's development, these results can be used to improve the design and use of the system. IRS is evaluating the Expert System to decide on any changes or expansion to other locations; and we will continue to share with IRS any suggestions we have.

While taxpayers may be having less trouble getting correct answers to their questions, they are having more trouble reaching IRS.

-- As of March 17, 1990, taxpayers had called IRS about 31.5 million times and IRS had answered about 10.7 million of those calls, a 34 percent answer rate. Those who did not reach an assistor received busy signals or were put on hold and hung up before IRS took their calls. Taxpayers were much more successful reaching IRS during the comparable period last year, when IRS answered 11.8 million of 19.3 million calls, a 61 percent answer rate.

-- IRS also tracks the number of calls answered on a caller's first or second attempt--a measure that has also declined. As of March 10, 1990, IRS had answered 73 percent of incoming calls on the caller's first or second attempt, compared to 90 percent in 1989.

-- Our test of IRS' telephone assistance also showed a decrease in accessibility. This year we reached an IRS assistor on the first attempt 55 percent of the time, compared to 69 percent last year and 76 percent in 1988.

IRS attributes its reduced accessibility to funding cutbacks and a higher than expected demand for toll-free service. Because of

funding cutbacks, for example, IRS reduced the number of toll-free telephone lines from 4,622 in fiscal year 1989 to 4,411 in fiscal year 1990. IRS also estimates that staffing during peak workloads will total 4,732 employees, down from 5,095 employees in 1989. These reductions come in the face of taxpayer demand for toll-free service that, according to IRS estimates, is running about 7 percent higher than last year and 7 percent higher than IRS had projected for this year.

In past years, IRS has acted to meet increased demand by hiring additional temporary employees or by reassigning employees who have related duties. IRS officials told us they have opted not to adopt these measures this year so as not to compromise the accuracy of assistance by using lesser-trained staff. Ideally, we would expect IRS to maintain adequate levels of both accessibility and accuracy. Given IRS' recent fiscal problems, however, we believe its decisions were reasonable.

AVAILABILITY OF FORMS AND PUBLICATIONS

IRS made several changes this year in trying to improve the availability of tax materials. Those changes appear successful.

Last year we reported that IRS needed to improve distribution of tax materials to the public. Tax materials were not always

available at the IRS walk-in sites we visited, especially early in the filing season, and some sites were not stocking certain forms and publications that they were required to stock. Also, we did not receive about 20 percent of the items we ordered by phone and mail from IRS' three distribution centers, and we often did not receive an explanation when an item we had ordered was not included in the shipment IRS sent us.

Our spot checks of IRS walk-in sites this year indicate that forms and publications are more available. Between January 22 and February 26, 1990, we visited 13 walk-in sites in 5 states to check on the availability of 82 forms and publications that all walk-in sites are required to stock. One site was missing 8 items, 2 sites were missing 6 items, and the other 10 sites were missing 5 items or less. That compares favorably with last year when, during the same general time frame, we found 15 of 35 sites missing 10 or more of the 79 items that they were required to stock.

Of this year's 82 required items, 2 (Publication 553 on 1989 tax law changes and Publication 575 on pension and annuity income) were not available to any walk-in site until mid to late February. The delay in Publication 553 was due, in part, to legislation that was enacted late in 1989. According to IRS officials, both publications were also delayed because

responsible staff were also working on the Taxpayer Service Expert Assistant System.

Taxpayers can also order tax materials by mail or phone from one of three IRS distribution centers. Between January 22 and February 23, 1990, we placed 77 random mail and phone orders. Each of our orders was for 4 items (as opposed to 10 items last year). The orders were randomly split into four groups: phone orders of items randomly selected from IRS' list of 82 commonly ordered items, phone orders of items randomly selected from a list of 325 less commonly ordered items, and two groups of mail orders randomly selected from the same lists. As of March 9, we had received 266, or 87 percent, of the 307 ordered items.

IRS has done a better job this year explaining to taxpayers why items ordered by phone or mail are not included in the shipments received by the taxpayers; but there is still room for improvement. If an item is out of stock, for example, IRS is supposed to backorder the item and let the taxpayer know. Last year, IRS failed to provide an explanation for 61 percent of the items missing from our orders. In this year's test, 81 of the 307 items we ordered as of February 23 were not included in the initial shipments we received from IRS. In about 29 percent of those instances, we received no explanation.

We received 58 percent of our mail-ordered items and 86 percent of our phone-ordered items within the 14 days IRS tells taxpayers to expect delivery. This compares with the on-time rates of 58 percent for mail items and 84 percent for phone items that we found last year.

As was the case with taxpayers seeking answers to tax law questions, taxpayers attempting to order tax materials by phone are probably having more trouble reaching IRS this year. As of March 10, 1990, according to IRS' statistics, the distribution centers had answered about 46 percent of the calls on the caller's first attempt, compared to 66 percent for the same period last year.

RETURNS PROCESSING

Although there have been some delays in issuing taxpayer refunds, IRS appears to be doing a good job processing returns so far this year.

As of March 9, 1990, IRS had received 3.5 percent more returns than at the same time last year, but had processed 12.5 percent more. Consequently, IRS had issued about 21.5 million refunds, or 16.7 percent more than last year. A relatively small number of refunds have been delayed this year due to various problems.

Recently, for example, about 250,000 refunds, including about 53,000 to be issued through IRS' electronic filing program, were delayed about 2 weeks. The delay occurred because a courier failed to deliver tapes that were being transported between the Cincinnati Service Center and IRS' Martinsburg, West Virginia computer facility. A breakdown in controls allowed the nondelivery to go undetected for about 2 weeks.

As many as 170,000 additional refunds, including those on 31,000 electronically filed returns, were delayed about 1 week because tapes containing data from returns filed at the service center in Ogden, Utah could not be read by computers at the Martinsburg facility. IRS officials said that although Martinsburg received corrected backup tapes within 24 hours, refunds were delayed a week because Martinsburg processes refunds weekly and the refunds for that week had already been processed.

Another delay affecting much fewer taxpayers occurred because new IRS procedures to correct a 1989 processing problem were not properly implemented. Last year, refunds due spouses of previously-divorced taxpayers were delayed if the previously-divorced taxpayer was subject to the refund offset program. The entire refund on jointly-filed returns was erroneously frozen while refund offset action was taken. To prevent a recurrence of the problem this year, IRS planned to isolate these returns--which it calls injured spouse returns--during processing and

determine the proper portion of the refund to offset.

Unfortunately, refunds other than those relating to injured spouse returns were set aside and frozen this year. Until IRS reviews the returns in more detail, it will not know how many of the 13,000 refunds frozen under the injured spouse program through the first week of March were frozen erroneously. IRS issued new procedures that it believes will prevent further errors. According to IRS officials, refunds for taxpayers affected by this problem will be delayed about 4 weeks.

IRS received considerable press coverage earlier this year when it announced that about 566,000 taxpayers received tax packages that contained envelopes addressed to the wrong IRS service center. The problem occurred because the vendor who printed the envelopes erred when matching taxpayer addresses with service center locations. IRS said that returns would be properly processed regardless of the center receiving the return and that this error should not delay any refunds. However, if a return is processed by a center other than the one that would normally handle the return, the taxpayer may not be able to determine the status of his or her refund through IRS' refund inquiry program.

Service center

inventory levels

Although service center inventories fluctuate weekly, making it difficult to assess their overall manageability, inventory levels as of March 9, 1990, appeared to be within IRS' manageability limits and were generally lower than at the same time last year. For example, the entity inventory, which involves cases that require IRS to update or correct taxpayer files for such things as name and address changes, was about 39 percent below last year's level. Likewise, the unpostables inventory, which involves transactions that must be corrected before they can be posted to taxpayers' accounts, was running about 16 percent below last year. As of March 9, two inventories were running slightly ahead of last year's pace, although they were both within IRS' manageability limits. The adjustments/correspondence inventory, which includes adjustments needing to be made to taxpayer accounts in response to taxpayer correspondence, had increased by about 7 percent, and the unidentified remittance inventory, which includes taxpayer payments that IRS must research in order to determine to which taxpayer or tax period the payment applies, had increased by about 13 percent.

One inventory that for several months had been well above the level IRS considers manageable was the adjustments/correspondence inventory at the Kansas City Service Center. One of IRS'

criteria for manageability is that not more than 20 percent of the cases should be unresolved 45 days after receipt. Between June 1989 and February 1990, Kansas City's 45-day and older inventory was generally above 20 percent and rose as high as 34 percent--a condition service center officials attributed to staffing shortages due to IRS' financial condition. After staffing was increased and overtime authorized, Kansas City's 45-day and older inventory dropped below 20 percent for the week ended March 2, 1990, and stood at about 17 percent as of March 9.

Errors on filed returns

Continuing a recent trend, the percentage of returns with taxpayer errors or IRS processing errors is decreasing. IRS' cumulative statistics for the filing season through March 7, 1990, show that the number of returns with errors stood at about 14 percent, down from about 16 percent in 1989 and 18 percent in 1988.

IRS statistics show that taxpayers account for about 61 percent of the errors and that taxpayers are continuing to make the same types of errors as they have in the past. Predominant errors are mistakes in calculating or claiming the earned income credit and determining the correct standard deduction. As in past years, IRS made changes in tax forms and instructions in an

attempt to reduce errors in these areas. Although the overall error rate has declined, these areas continue to pose problems.

IRS' FISCAL YEAR

1991 BUDGET

For the past 2 fiscal years, IRS made several adjustments to its financial plan to deal with significant budgetary shortfalls--adjustments that led to curtailed service and reduced revenues. The most important question to be answered in assessing IRS' budget for fiscal year 1991 is whether it provides a base for stabilizing what has been an unstable fiscal environment. We believe that it does. Although various decisions could alter IRS' financial picture, we see enough differences between this year's budget and those of the past couple of years to warrant optimism. Even more encouraging is the fact that IRS has taken steps to strengthen its controls over budget execution--steps that should enable it to better manage its resources.

IRS' budget also includes several initiatives that are intended to increase revenues. The initiatives that call for additional enforcement staff will, in effect, only serve to replace staff that IRS lost in the last year and a half due to a hiring freeze. While we generally agree with the objectives of the other initiatives, which call for redirecting existing staff, we are

not convinced that they are achievable quickly enough to produce the promised revenues in fiscal year 1991.

Funding shortfall in
fiscal year 1990

As we reported last year, IRS took several steps to deal with a \$360 million shortfall in fiscal year 1989. This year, IRS is dealing with a bigger shortfall of about \$465 million. IRS attributed this year's shortfall to an unfunded pay increase, growth in salary and benefit costs, sequestration, a transfer of funds to support the Government's War on Drugs, and a decision to spend additional funds on various activities such as the distribution of forms and publications and the processing of currency transaction reports.

To cover the fiscal year 1990 shortfall, IRS continued the hiring freeze begun in fiscal year 1989; cut expenditures for training, travel, equipment, supplies, and other support services; limited promotions and position upgrades; and reduced funds for information systems other than Tax System Modernization. Because of the hiring freeze, IRS has not implemented seven of the nine revenue initiatives that Congress authorized as part of IRS' fiscal year 1990 budget. IRS also made some program adjustments in an attempt to cut costs, such as reducing its level of taxpayer service. Treasury's Office of Tax Analysis estimated

that the decision to delay the fiscal year 1990 revenue initiatives and to freeze hiring will result in lost revenues totaling almost \$700 million in fiscal years 1990 and 1991.

As additional funds have become available through reprogramming, IRS has selectively lifted the hiring freeze. When the results of IRS' mid-year financial review become available in early April, we will know more about the agency's ability to further ease hiring and spending restrictions and the effect on enforcement revenues.

We discussed the impact of IRS' fiscal problems with officials at IRS' National Office; Central, Midwest, and Western Regional Offices; Cincinnati, San Francisco, and St. Louis District Offices; Cincinnati, Fresno, and Kansas City Service Centers; and Indianapolis, Oakland, and St. Louis Automated Collection Sites.

Our inquiries showed that field offices have had to eliminate all but the most essential training. Some officials told us, for example, that employees are not getting industry-specific, computer, and other technical training necessary to do their jobs effectively. We were also told of positions that are going unfilled because of insufficient funds to relocate employees and of reductions that affected the use of space and equipment.

Field operations have also been affected by staffing cutbacks. As noted earlier, funding shortages have made it more difficult for taxpayers to get through to IRS with their tax law questions and contributed to the growth in Kansas City's older adjustments/correspondence cases. IRS' enforcement activities appear to have suffered most from the cutbacks.

For example, service center officials told us of cutbacks in various service center compliance programs including those that involve (1) the use of information returns to identify persons who have underreported their income and (2) the audit of simple issues through correspondence with the taxpayer. Also, enforcement officials at two district offices said they expect to do fewer complex cases because of a shortage of higher graded staff to do the work. And officials at one automated collection site reported that 22 vacant tax examiner positions and 3 vacant group manager positions caused a significant increase in the number of older cases in the site's inventory. Other offices complained that some professional staff are doing their own clerical work, allowing them less time to do their normal enforcement activities.

Attachment I contains a list of the various effects cited by field offices in discussing IRS' funding cutbacks.

Prospects for a more stable
fiscal environment in
fiscal year 1991

IRS' proposed budget for fiscal year 1991 totals \$6.1 billion and provides for 118,759 average positions, an increase of about \$635 million (11.6 percent) and 3,667 average positions (3.2 percent) over the authorized levels for fiscal year 1990. The \$635 million increase is a net of various increases and decreases. The increases are (1) \$377.7 million to maintain current operating levels and handle an anticipated workload growth in the processing of returns and the printing of forms; (2) \$191.0 million to fund several initiatives directed at collecting additional tax revenues; (3) \$146.2 million for information systems, including Tax System Modernization; and (4) \$23.7 million for the War on Drugs and an expansion of Internal Audit coverage. The decreases involve (1) \$58.2 million in program reductions needed to offset unfunded pay costs, (2) \$22.2 million in anticipated savings, (3) \$12.4 million transferred to the Department of Justice for the War on Drugs and to Treasury's Inspector General, and (4) \$10.5 million in nonrecurring costs.

For several reasons, this budget would appear to provide the foundation for a more stable fiscal environment at IRS than has existed in the recent past.

IRS, like other federal agencies, was not allowed to include funds for the 1989 and 1990 general pay increases in its fiscal years 1989 and 1990 budget submissions. In contrast, IRS' 1991 budget submission includes funding for one-half of the expected 3.5 percent 1991 general pay raise. Also, unlike last year, the 1991 budget reflects the impact of unfunded pay costs--program reductions of \$58.2 million and about 1,600 staff years. The administration estimates that the unfunded part of the pay raise will reduce revenues by \$82 million in 1991 and by an additional \$153 million in fiscal year 1992.

Part of the fiscal year 1989 and 1990 shortfalls were attributed to IRS underestimating its baseline salary and benefit costs. In response to that problem, IRS has reprogrammed its 1990 budget to ensure more adequate funding of baseline salary and benefit costs and has based its 1991 request on that corrected baseline. IRS officials believe that, barring unforeseen cost increases, the 1991 request will cover their anticipated on-board personnel costs. There also appears to be a heightened sensitivity in IRS regarding the need to consider the long-term implications of staffing and promotion decisions in terms of personnel and benefit costs. National office officials told us that a failure to adequately consider those implications had contributed to IRS' problems in 1989 and 1990.

IRS' fiscal stability should also be enhanced by improved controls over spending. IRS now has the budget execution module of its Automated Financial System on line, which enables financial plan managers, including the recently-appointed Chief Financial Officer, to better assess past and current spending trends, compare regional spending patterns, analyze specific expenditures, and project future spending requirements. That improved monitoring capability should contribute to better financial control and accountability Service-wide.

IRS' prospects for an improved fiscal condition in 1991 appear good, but several factors could alter that prognosis. The President's budget includes provisions for several pay-related reforms, including locality pay in three major cities, higher entry level salaries in grades 5 and 7, and hiring and retention bonuses. On the basis of our review last year of IRS' recruitment program, we believe that IRS would benefit from being able to offer higher pay. But IRS' budget does not include funds to cover any costs that might be incurred if these proposals are implemented. IRS' financial plan could also be affected by the anticipated postal rate increase, which is not provided for in the budget, and by a fiscal 1991 sequestration, should that occur.

IRS' fiscal year 1991 budget also includes some questionable savings. As in past years, the budget includes savings expected

from studies done under OMB Circular A-76--savings that IRS has not realized in the past and will probably not realize in 1991. The budget also includes anticipated savings from IRS' conversion to the FTS-2000 telephone system--savings that IRS thinks may be overstated. To the extent these savings go unrealized, IRS will have to absorb the difference.

Revenue initiatives

A major feature of IRS' budget is the inclusion of several initiatives that are expected to raise \$3 billion in tax revenues in fiscal year 1991 and about \$10.0 billion through fiscal year 1995. Those initiatives fall into two main categories.

The first category provides more resources to allow IRS to (1) increase collections of additional taxes owed but not paid, (2) audit more tax returns and refund claims, (3) verify more taxpayer deductions and credits, and (4) hire contract instructors to train new revenue agents. IRS is asking for \$191 million to implement these initiatives and expects them to produce \$500 million in enforcement revenues in fiscal year 1991. The second category contains management initiatives that do not require additional resources but provide, instead, for a retargeting of existing resources. In these initiatives, IRS intends to (1) accelerate the closure of tax shelter cases, large

audits, and large-dollar appeal cases; (2) audit more excise tax returns; and (3) do more actuarial examinations of small retirement plans. IRS expects this retargeting of resources to generate \$2.5 billion in additional tax revenues in fiscal year 1991.

The objectives of all these initiatives seem reasonable. IRS' success in achieving the objectives, however, and generating the expected revenues will depend on its ability to implement the action plans it has prepared for each of the initiatives. In the first category, revenue initiatives, we believe IRS has a reasonable chance of implementing its plans. IRS' action plan for the accounts receivable initiative, for example, includes a step that calls for deploying staff "in a manner that will maximize revenue collections".

With regard to the second category, management initiatives, we are not convinced that IRS can implement those action plans in the manner or time necessary to achieve its objectives and produce the expected revenues in fiscal year 1991. Our opinion is based primarily on the fact that these initiatives are predicated on pervasive changes to the way IRS now does business, which, taken together, can pose a significant challenge to IRS.

The Congressional Budget Office (CBO) expressed its views on the initiatives in a report issued on March 5, 1990. With respect to

the first category of initiatives, CBO said that it agreed that the initiatives "could be effective in increasing revenues, but not as rapidly or as substantially as the Administration estimates." Regarding the proposed management initiatives, CBO said that "IRS has been unable to adequately document how [the reallocation of staff] would be successfully implemented in the field and how it would raise additional revenue."

In the past, IRS has been unable to track its progress in implementing such initiatives or to demonstrate success in generating the projected revenues. We understand that IRS is developing a tracking system to monitor implementation of the fiscal year 1991 revenue initiatives. One step that must be taken in developing such a system is to determine the baseline against which to measure accomplishments. In that regard, staffing levels in IRS' enforcement programs have eroded since inception of the hiring freeze in October 1988, to the point that increases called for in the 1991 budget may only serve to backfill some of that erosion--especially if the hiring freeze remains in effect for the rest of the fiscal year. After a major staffing increase authorized by Congress in fiscal years 1987 and 1988, for example, IRS had 17,323 revenue agents on board as of September 30, 1988. As of February 1990, after about 1 1/2 years of a hiring freeze, that number had decreased to 15,924. Even with the increase of revenue agent staff years called for in the

1991 budget, IRS will still be below the September 30, 1988, level.

We also have some specific concerns about individual initiatives. For example, while we agree in concept with the desirability of accelerating the closure of tax shelter cases, large audits, and large-dollar appeal cases, IRS should assure that it has controls in place so that pressures to close cases and collect dollars do not lead to inappropriate settlements. With regard to the proposed shift of resources to do more actuarial examinations of small retirement plans, IRS should ensure that it has adequate staffing to meet its other responsibilities in the exempt organization/employee plans area. And, while using contractors to train revenue agents may be a cost-effective decision, such a change needs to be adequately assessed before IRS implements it across the country. These concerns may be assuaged as we learn more about IRS' plans.

CONCLUSION

IRS has had to make some difficult decisions in the past 2 years to deal with funding shortfalls--decisions that have affected IRS' ability to do its job. We believe that the budget for fiscal year 1991 lays a foundation for improving that fiscal environment. More importantly, it appears that the events of the past 2 years have heightened IRS' sensitivity to the need to

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better manage its resources, and to maintain stricter accountability for the use of those resources. We are especially encouraged by the leadership we see being provided by IRS' Chief Financial Officer in bringing more direction and oversight to the budget execution process.

Despite its funding problems, IRS has generally been able to satisfactorily meet its varied returns processing and taxpayer service responsibilities during the filing season. Although the refund delays are troubling, they have apparently affected a relatively small number of taxpayers. We will continue to monitor that area during the rest of the filing season. We will also continue to monitor IRS' progress in answering taxpayers' tax law questions. We applaud the significant increase in the accuracy of answers being provided by IRS' assistors, but are somewhat troubled by the decreasing ability of taxpayers to get through to the assistors.

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That concludes my prepared statement. We will be happy to respond to any questions.

EFFECTS OF
IRS' FUNDING CUTBACKS

These effects were obtained through discussions with various IRS officials and were not independently verified. In many cases we were unable to get specific information to quantify the impact (in terms of lost revenues, for example).

Cutbacks in training, travel, and other support services.

- . Because of a 50 percent reduction in the region's training budget, most outside training, all advanced technical training, and most cross-functional and management training that was not provided by December 31, 1989, will be eliminated. (Midwest Region)
- . Cutbacks in training have affected specialists (such as people working in resources management and information systems) because those kinds of people need outside training. (St. Louis District)
- . Funds are not available to train programmers in new computer languages. Without training, personnel cannot provide the kind of support needed to write, modify, and update computer programs. (St. Louis District)
- . Other than a 1-day course on the Taxpayer Bill of Rights, Examination personnel have not been trained on 1987 and 1988 tax law changes. We were told that Examination personnel started working 1987 cases in the summer of 1989 and that training for the 1987 and 1988 tax law changes is scheduled for May 1990. (St. Louis District)
- . Very little, if any, continuing professional education has been provided in the last 2 years for Examination and Automated Collection Site personnel. Only 2 or 3 of the 10 Examination employees who needed training in the insurance area received it. (Cincinnati District, Indianapolis Automated Collection Call Site)
- . Positions could not be filled through internal transfers because of limited relocation money. (Midwest and Central Regions)
- . The number of telephone lines in such activities as Examination and Collection was reduced from 1,200 to 900. District officials said that about half of the cut lines were probably not needed. (San Francisco District)

. The space allocated for a district office move was based on the expectation that it would be furnished with systems furniture. Because there is not enough money to buy all of that furniture, the new space will be inadequate to accommodate some staff. (St. Louis District)

. The district is renting about 15,000 square feet of office space at a cost of about \$350,000 a year. Because of the hiring freeze, the district does not know how many people it will have to accommodate in the space and thus has not laid telephone lines and computer cables. In the meantime, the space remains vacant. (San Francisco District)

. Funds were not available to maintain the district's local area network. When the system failed, the district was able to purchase only 12 of the 36 machines needed to replace the old system. We were told that, as a result, the district's automation effort has gone backwards. Instead of pressing a key to use electronic mail, users now have to print a copy of the document, make copies, and address envelopes or hand carry the document. (St. Louis District)

Cutbacks in staffing

. We heard pervasive complaints about lack of support staff and the need for higher-graded employees to do clerical work.

. Staffing cuts caused the percent of overaged cases in the adjustments/correspondence inventory to rise to as high as 34.4-- well above IRS' level of manageability. (Kansas City Service Center)

. The accessibility of IRS' toll-free telephone assistance has dropped this year compared to last. This year, for example, IRS is answering 1 out of 3 calls; last year, it answered almost 2 of 3. (Nationwide)

. Work in the Underreporters Program (whereby IRS identifies income underreported through matching of information documents with tax returns) was deferred. (Kansas City and Fresno Service Centers) A Fresno official estimated the revenue effect to be about \$16.6 million in unrealized assessments.

. Work in the Substitute for Return Program (whereby IRS uses data on information returns to create income tax returns for nonfilers) was cut back. (Cincinnati, Kansas City, and Fresno Service Centers) Fresno had a backlog of about 200,000 cases which, we were told, would average about \$5,000 in tax liability. A center official estimated the revenue effect of the shortfall in this program to be about \$42 million in unrealized assessments. Kansas City had a backlog of about 65,000 cases which, we were told, would average about \$5,000 in tax liability.

We were told, also, that these cases could eventually be worked because there is no statute of limitations but that their deferral could reduce IRS' potential for collecting anything on these cases by making it more difficult for IRS to locate the taxpayers.

. The Service Center Correspondence Audit Program (whereby IRS audits simple issues through correspondence) was reduced about 20 to 25 percent. As a result, the center will work about 15,000 fewer cases this year. We were told that the average assessment for this type case is \$1,500. (Kansas City Service Center)

. Tax examiners were moved from the Service Center Correspondence Audit Program to do clerical work in the Examination Support Unit. The clerical work in the Examination Support Unit involved processing paperwork related to tax shelters including the paperwork necessary to protect the statute of limitations on shelter cases. (Fresno Service Center)

. Because of limitations on what kinds of cases can be worked by employees at certain grade levels, the cutbacks in hiring and promotions have caused some higher-graded enforcement cases to go unworked. (Cincinnati and St. Louis Districts)

. Agents in the Criminal Investigation function have been taken off the line to act as managers because vacant management positions cannot be filled. (Midwest Region) That same region noted that about 1/3 of its special agents would be retiring in the next 5 years and that it should already be in the process of hiring and training replacements because it takes about 3 years to get a new agent ready. The hiring freeze has affected the region's ability to do that.

. Because Information Systems cannot hire backups, they do not always have properly trained people to fill positions. (Kansas City Service Center)

. The presence of 22 vacant tax examiner positions and 3 vacant group manager positions contributed to a significant increase in the number of overaged cases in the Automated Collection Site's inventory and caused the site to curtail sending letters to taxpayers for whom they had no phone numbers. (Indianapolis Call Site)