IRS BUDGET FOR FISCAL YEAR 1997 AND THE 1996 TAX RETURN FILING SEASON

HEARING

BEFORE THE

SUBCOMMITTEE ON OVERSIGHT

OF THE

COMMITTEE ON WAYS AND MEANS
HOUSE OF REPRESENTATIVES

ONE HUNDRED FOURTH CONGRESS

SECOND SESSION

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CONTENTS

Page

Advisory of March 19, 1996, announcing the hearing 2

WITNESSES

Internal Revenue Service, Hon. Margaret Milner Richardson, Commissioner; accompanied by Mike Dolan, Deputy Commissioner; Judy Van Alfen, Associate Commissioner for Modernization; Jim Donelson, Chief of Taxpayer Service and Acting Chief Compliance Officer; and Tony Musick, Chief Financial Officer 5

U.S. General Accounting Office, Lynda D. Willis, Director, Tax Policy and Administration Issues, General Government Division; accompanied by Rona B. Stillman, Ph.D., Chief Scientist, Computers and Telecommunications, Accounting and Information Management Division 61

National Association of Enrolled Agents, Joseph F. Lane 95

National Research Council, Robert P. Clagett 83

IRS BUDGET FOR FISCAL YEAR 1997 AND THE 1996 TAX RETURN FILING SEASON

THURSDAY, MARCH 28, 1996

HOUSE OF REPRESENTATIVES,
COMMITTEE ON WAYS AND MEANS,
SUBCOMMITTEE ON OVERSIGHT,
Washington, DC.

The Subcommittee met, pursuant to notice, at 10:14 a.m., in room 1100, Longworth House Office Building, Hon. Nancy L. Johnson (Chairman of the Subcommittee) presiding.

[The advisory announcing the hearing follows:]

ADVISORY

FROM THE COMMITTEE ON WAYS AND MEANS

SUBCOMMITTEE ON OVERSIGHT

FOR IMMEDIATE RELEASE
March 19, 1996
No. OV-11

CONTACT: (202) 225-7601

Johnson Announces Hearing on Internal Revenue Service Budget for Fiscal Year 1997 and the 1996 Tax Return Filing Season

Congresswoman Nancy L. Johnson (R-CT), Chairman, Subcommittee on Oversight of the Committee on Ways and Means, today announced that the Subcommittee will hold a hearing on the Internal Revenue Service's budget proposal for fiscal year 1997 and the 1996 tax return filing season. **The hearing will take place on Thursday, March 28, 1996, in the main Committee hearing room, 1100 Longworth House Office Building, beginning at 10:00 a.m.**

In view of the limited time available to hear witnesses, oral testimony at this hearing will be heard from invited witnesses only. However, any individual or organization not scheduled for an oral appearance may submit a written statement for consideration by the Subcommittee and for inclusion in the printed record of the hearing.

BACKGROUND:

The Administration's fiscal year 1997 budget request for the Internal Revenue Service (IRS) totals almost $8 billion and will support the IRS's operations in collecting nearly $1.5 trillion in revenue and in administering the Federal tax laws. By way of comparison, the fiscal year 1996 appropriation for the IRS totaled $7.3 billion, approximately $900 million less than the Administration had requested and $200 million less than the IRS received for fiscal year 1995.

The $8 billion fiscal year 1997 budget request includes $1.8 billion to process the tax returns which taxpayers will file in 1997; $4.5 billion to examine tax returns; and $1.7 billion for information systems. Almost $850 million of the information systems request is earmarked for the Tax System Modernization (TSM) program. TSM is a long-term program which is estimated to cost over $8 billion upon completion, and which is supposed to upgrade the IRS's computer capability and bring it closer to state-of-the-art performance levels. However, numerous experts who have reviewed TSM have criticized the IRS's ability to successfully implement TSM in its current form.

The 1996 tax return filing season is the period of time between January and April 15th when American taxpayers are expected to file 118 million tax returns. Approximately 83 million taxpayers are expected to receive an average refund of over $1,300 in 1996. During the 1995 tax return filing season, the IRS applied rigorous compliance checks in order to identify fraudulent refund claims.

FOCUS OF THE HEARING:

As a result of the reduced level of the fiscal year 1996 appropriation, the IRS must absorb a $200 million funding reduction during the current fiscal year. The Subcommittee is interested in reviewing how the Service is adjusting its operations to comply with the reduced funding, and how the IRS is retargeting its resources to meet the demands of the 1996 filing season and its other responsibilities in administering the nation's tax laws.

In reviewing the fiscal year 1997 budget request, the Subcommittee will review all aspects of IRS operations, and particularly the TSM program. The Subcommittee will explore the status of specific systems upgrades, such as the Integrated Case Processing system, which will allow IRS taxpayer service representatives to access IRS databases on-line in order to respond to telephone inquiries from taxpayers. The Subcommittee will also review the appropriate level of TSM funding in the future in light of the current restricted funding environment, the critical evaluation of TSM by outside experts, and the Administration's recent testimony that the program is off track and needs to be rethought.

Chairman Johnson is also concerned that the IRS hasn't been able to adequately account for the $4 billion already invested in TSM. "While I understand that over-hauling the Service's antiquated computer systems is a major endeavor which will require mid-course adjustments, the IRS's learning curve in implementing TSM appears to be very costly. I want to make sure that the $4 billion spent so far has not been wasted," Johnson explained.

The Subcommittee will also inquire into the progress of the 1996 tax filing season, the availability of taxpayer services, the effectiveness of anti-fraud efforts in the 1995 filing season, and what the IRS is doing in the 1996 filing season to deter improper refund claims.

DETAILS FOR SUBMISSION OF WRITTEN COMMENTS:

Any person or organization wishing to submit a written statement for the printed record of the hearing should submit at least six (6) copies of their statement, with their address and date of hearing noted, by the close of business, Thursday, April 11, 1996, to Phillip D. Moseley, Chief of Staff, Committee on Ways and Means, U.S. House of Representatives, 1102 Longworth House Office Building, Washington, D.C. 20515. If those filing written statements wish to have their statements distributed to the press and interested public at the hearing, they may deliver 200 additional copies for this purpose to the Subcommittee on Oversight office, room 1136 Longworth House Office Building, at least one hour before the hearing begins.

FORMATTING REQUIREMENTS:

Each statement presented for printing to the Committee by a witness, any written statement or exhibit submitted for the printed record or any written comments in response to a request for written comments must conform to the guidelines listed below. Any statement or exhibit not in compliance with these guidelines will not be printed, but will be maintained in the Committee files for review and use by the Committee.

1. All statements and any accompanying exhibits for printing must be typed in single space on legal-size paper and may not exceed a total of 10 pages including attachments.

2. Copies of whole documents submitted as exhibit material will not be accepted for printing. Instead, exhibit material should be referenced and quoted or paraphrased. All exhibit material not meeting these specifications will be maintained in the Committee files for review and use by the Committee.

3. A witness appearing at a public hearing, or submitting a statement for the record of a public hearing, or submitting written comments in response to a published request for comments by the Committee, must include on his statement or submission a list of all clients, persons, or organizations on whose behalf the witness appears.

4. A supplemental sheet must accompany each statement listing the name, full address, a telephone number where the witness or the designated representative may be reached and a topical outline or summary of the comments and recommendations in the full statement. This supplemental sheet will not be included in the printed record.

The above restrictions and limitations apply only to material being submitted for printing. Statements and exhibits or supplementary material submitted solely for distribution to the Members, the press and the public during the course of a public hearing may be submitted in other forms.

Note: All Committee advisories and news releases are now available over the Internet at GOPHER.HOUSE.GOV, under 'HOUSE COMMITTEE INFORMATION'.

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Chairman JOHNSON. The hearing will come to order.

Some of our Members are en route, but in view of the heavy floor schedule, we would like to get started.

Good morning and welcome. The fiscal year 1997 budget proposal for the IRS would give it almost $8 billion and almost 109,000 employees in order to collect $1.5 trillion in revenue. This represents an increase of 10 percent over the 1996 level. I respect the prerogative of the administration to present a budget designed to carry out its priorities; however, I believe that the Congress will have some tough, legitimate questions about this proposal.

This morning we want to learn how the IRS intends to use its resources in fiscal year 1997. Most IRS programs show only small changes, but a few programs deserve special attention. The budget proposes $850 million for the Tax Systems Modernization Program. The TSM is supposed to upgrade the IRS' computer capability and move it closer to modern performance levels. It is essential to improve the IRS' computer capability if it is to cope with the crushing burden of processing over 1 billion documents every year, but there are many unanswered questions about the TSM Program at the present time.

No one questions the goal of TSM, but significant doubts have been raised as to whether the IRS is on the right road to achieve its goal. Two weeks ago, Deputy Secretary of the Treasury Lawrence Summers testified before a House Appropriations Subcommittee that TSM had gone "badly off track," and that it "needed to be rethought from top to bottom."

I certainly understand that a complex computer project might need a midcourse correction, but it sounds as if the IRS is going back to square one on TSM. The question raised by this decision is: What have we gotten for the $4 billion we have invested so far? How much of the past TSM funding will the IRS now have to just chalk up to experience? How much of that money spent so far has been wasted? And how much of it has gone for something useful and productive? And how long will it take to get TSM back on track?

We don't want TSM to become the IRS equivalent of the baggage handling system in the new Denver airport: High tech, high cost, low performance.

Today we will examine how the IRS is absorbing the reduced funding in the current fiscal year. We want to learn what the Commissioner's priorities are in operating with fewer resources. Are all the activities being trimmed a similar amount, or are a few activities bearing the brunt of the reduction?

The 1996 tax filing season appears to be normal and uneventful. This is a welcome contrast to the disruptions which occurred last year because of the IRS' crackdown on fraudulent refund claims. I commend the Commissioner's strong action to identify and deter improper refund claims. But a regrettable side effect was a good deal of confusion and some late refunds.

Commissioner, the IRS is the one Federal agency that touches the lives of every American. How Americans view their government often is determined by how they view the IRS. A large part of the enthusiasm for pursuing a flat tax or a consumption tax is rooted in a negative attitude toward taxes and, derivatively, toward the

IRS. The tax collector may never be loved, but it is a sobering message when the average person supports the elimination of the IRS.

My goal is to work with you to modernize the system and assure that the IRS delivers a uniformly high standard of professional service. Because of its tough assignment to help taxpayers who genuinely need guidance and to assure that every citizen pays his or her fair share, whether they want to or not, the quality of customer service, the attitude of every IRS employee as they deal with the public as both guide and enforcer is crucial to restoring respect, civility, and efficiency to government.

While citizens need to know and understand the many important services government delivers day in and day out that do make our lives individually and collectively better, government needs to be far more customer oriented and user friendly, and I hope to work with you toward those goals. Today's hearing to review your 1997 budget request and the current filing season are the beginning of what I hope will be a fruitful collaboration.

Before we begin, let me thank you, Commissioner, for implementing by administrative action many of the provisions of the Taxpayer Bill of Rights when it looked like we would not get it onto the floor of the House and to the President's desk. I am pleased to report that we expect to have the new bill, which your people have also been involved in shaping, on the floor hopefully this week and very soon to the President's desk.

Commissioner Richardson, it is a pleasure to have you back with us. Please proceed.

STATEMENT OF HON. MARGARET MILNER RICHARDSON, COMMISSIONER, INTERNAL REVENUE SERVICE; ACCOMPANIED BY MIKE DOLAN, DEPUTY COMMISSIONER; JUDY VAN ALFEN, ASSOCIATE COMMISSIONER FOR MODERNIZATION; JIM DONELSON, CHIEF OF TAXPAYER SERVICE AND ACTING CHIEF COMPLIANCE OFFICER; AND TONY MUSICK, CHIEF FINANCIAL OFFICER

Ms. RICHARDSON. Thank you. Madam Chairman and other distinguished Members of the Subcommittee, I have with me today Mike Dolan, who is on my immediate left, the Deputy Commissioner; Judy Van Alfen, who is the Associate Commissioner for Modernization; and on my right I have Jim Donelson, who is the Chief of Taxpayer Service and our Acting Chief Compliance Officer; and Tony Musick, who is our new Chief Financial Officer. We all appreciate the opportunity to be here this morning to discuss the filing season, our efforts to modernize the tax administration system, as well as our fiscal year 1997 budget request.

The IRS is in the financial services business—like a bank, a credit card company, or an insurance company—and we understand the importance of providing good customer service. Of course, we understand there are some significant differences between our business and other financial services firms. But despite these differences, like many other financial services firms, what we are seeking may be easier to describe than to achieve. We want to provide our customers with better service at lower cost, we want to use less paper, and we want to be able to take advantage of new technologies.

We are in the midst of a major transition, as I know you are aware, Madam Chairman, but it is one that began several years ago, and it will continue for several more years. Today I would like to focus on what we are trying to do to make things easier for taxpayers, how we are doing our job more efficiently and effectively.

This filing season—and every filing season—begins with taxpayers filling out their tax returns and sending them in either through the mail or electronically. Since coming to the IRS almost 3 years ago, I have made it a top priority to try to improve service to taxpayers. For most taxpayers, this means making communicating with us easier and filing tax returns as simple as possible. While we are certainly not yet at a stage we could call perfection, I do believe in the past 3 years we have made progress in improving our service to taxpayers.

We understand that taxpayers get frustrated when they call us and repeatedly get a busy signal, and in the past 3 years we have answered more calls than ever before. But we still have taxpayers whose calls are not answered. We also have a growing number of taxpayers who visit or write us. In 1993, we heard from taxpayers by phone, visits, or letters 73 million times. Last year that grew to 118 million. But we were able to serve more taxpayers by increasing our productivity, expanding our hours of service, and installing call-routing equipment that does allow us to better manage our telephone workload. It allows us, among other things, to route calls to available assistors who may be in the next county, the next State, or even across the country. We are doing our best to try to answer more taxpayer questions more quickly and efficiently.

When I became Commissioner in 1993, not only were we unable to move calls around the country, but our assistors only had access to taxpayer account information that was stored at the particular service center their office had to rely on. Technology has allowed us to remove this artificial barrier and to enhance our ability to route calls automatically to personnel who have both the data and the expertise needed to handle taxpayers' specific questions. And we can now resolve issues with a single call 75 percent of the time, and we are bringing more tax account information online.

But despite these improvements, not every taxpayer call is being answered, and not all taxpayers who need to be served are getting served. So we are looking for other ways to meet taxpayers' information needs.

Technology is certainly helping by creating entirely new ways for taxpayers to get forms and information from us while reducing our postage and printing costs. Taxpayers who have access to a computer and modem can get forms and information anytime anywhere in the world from our FedWorld or our Web site on the Internet. So far this year, millions of taxpayers have visited our Internet home page, and an average of 25,000 forms a day are being downloaded. Forms are also available on CD–ROM and, for the first time this year, through our automated "fax on demand" service.

One of my goals has been to make it easier for taxpayers to file their returns. Today nearly 40 percent of individual filers use our easiest forms, and over 70 percent take a standard deduction.

What could be easier than filing by telephone? This filing season, over 20 million taxpayers are eligible to file their tax returns with a phone call that takes less than 10 minutes. As of March 22, over 2.5 million taxpayers have already used this option. Three years ago, our TeleFile Program was a pilot, and just last year it was available in only 10 States and we had only 680,000 returns filed that way.

Making it easier for taxpayers to both file their returns and communicate with us is only part of our effort to improve our relationships with taxpayers. As you mentioned, Madam Chairman, we worked with you and Members of the Subcommittee on the Taxpayer Bill of Rights 2, and I am pleased to say that we were able to work with you on the bill that we hope will be reported out next week and passed. But when we weren't successful in getting the legislation earlier, we did go ahead and administratively adopt many of the proposals that didn't require congressional action.

We look forward to continuing to work with you and Members of your Subcommittee on our continuing priority, which is responsible tax administration while ensuring taxpayers' rights.

Last year when I appeared before this Subcommittee, I said that our biggest challenge was to put in place better methods to protect the tax revenue from those who improperly attempted to claim refunds. We accomplished this by using both technology and a different approach to compliance to stop improper refund claims. We used numerous systemic verifications, including checks of Social Security numbers. We established new criteria for electronic return originators, including fingerprint and credit checks, and we increased our monitoring of the EROs. We delayed about 8 percent of the refunds, and we did increase compliance resources devoted to checking those refunds for accuracy.

I am pleased to report our efforts were most successful. One-and-a-half million fewer dependents were claimed, and there were approximately 100,000 fewer earned income tax credit claims than in the prior year. In our direct compliance efforts, including prerefund audits, we prevented $503 million in improper refunds from being issued.

This filing season we are continuing to devote substantial resources to detecting and stopping improper and fraudulent claims for refund. We have refined our efforts to address improper refund claims based on what we learned last year.

I would also like to spend a few minutes talking about modernizing our current tax administration system. Modernization requires an ongoing effort to update technology, to improve our business processes, and to develop a flexible organization. Today I would like to touch on our efforts to update the technology.

As you pointed out, we have undertaken a series of technology modernization projects, collectively referred to as the Tax Systems Modernization Program, to modernize our information systems. It was originally designed in 1988 as a program to replace our technology. It has been redesigned since then to assist us in achieving our business vision by the year 2000, although many of the projects are scheduled for completion before then, and some, like our TeleFile Project, have already been completed.

Our TSM investments are putting a new infrastructure in place. A number of initiatives are currently underway with substantial long-term benefits. During the past 4 years, we have awarded contracts that upgrade computer center hardware, modernize operations, and allow us to utilize commercial expertise for software and hardware support, information engineering, telecommunications, and security. As of today, about $1.7 billion in new equipment and software has been installed across the country.

Over the past several years, our technology modernization efforts have benefited from oversight of the General Accounting Office, the National Research Council, and from the Congress. On balance, we agree with the assessments that have been made. We take them seriously but, more importantly, we are doing something about them.

During the past year, management of the Tax Systems Modernization Program has changed significantly. Modernization management has been centralized under the Associate Commissioner for Modernization who has been given all of the responsibility and authority to manage and control consistently all systems development and reengineering efforts within the IRS. We also have a new Chief Information Officer, Arthur Gross, who will be working with the Associate Commissioner for Modernization, and he is joining us on April 15. He was most recently the deputy tax commissioner in New York, responsible for systems and processing in that State. He had led a broad modernization effort in that State for the past several years, and we look forward to having his counsel and expertise.

But a vital aspect of updating our technology is enhancing capabilities for safeguarding taxpayer information. We very much concur with the National Research Council's advice regarding the security of tax processing systems and the privacy of tax information. We are also relying heavily on private sector expertise to assist our technology modernization projects. We have developed a plan with the help of outside experts from other government agencies and the private sector to aggressively expand the work of our current integration support contractor. Under this new approach, the integration support contractor will assume as much of the systems integration role as our current contracts permit. This will include the architecture, systems engineering, integration, and test activities that are essential to successfully integrate the systems.

I would like to briefly touch on our 1996 budget and our fiscal year 1997 budget request. The fiscal year 1996 budget decrease we experienced posed a particular challenge to us since we require about $200 million more each year for cost increases that are beyond our control, such as pay raises and rent increases, just to maintain the current level of operations. Our current budget allows us to run our basic operations and will not affect the processing of returns or the payment of refunds within our customer service standards of 40 days for paper filing and 21 days for electronic filing during this filing season.

But what we will not be able to accomplish again are the impressive results we achieved in the deficit reduction last year through our compliance initiative funding. We collected an additional $803 million, more than double the $331 million we had promised. We

have asked for an increase of $647 million in our fiscal year 1997 budget. If instead our funding remains flat for 1997, we would experience a real reduction of between $200 and $400 million from our fiscal year 1996 funding level because, once again, we would be forced to absorb pay raises and increased costs, and we would be faced with difficult choices.

Like this year, we will continue to make it a priority to sustain our basic operations—processing more than 200 million tax returns and paying more than 90 million refunds. To accomplish this, however, we will, like we did last year, have to find alternative ways to serve taxpayers, and like this year, we will have to decrease the amount of face-to-face contact with taxpayers. While we will continue to process tax returns and pay refunds on time, service to taxpayers may suffer, and the amount of money collected next year could certainly be impacted. What is more difficult to measure, though, is the longer term impact of reductions on overall taxpayer compliance levels.

Madam Chairman, since becoming Commissioner almost 3 years ago, I have worked hard with our staff to try to improve our service. As I said earlier, I am pleased to report we have made significant progress. But despite that progress, we do recognize we still have much to do.

This concludes my prepared remarks, and we would certainly be happy to answer any questions you or your colleagues might have.

[The prepared statement and attachments follow:]

STATEMENT OF
MARGARET MILNER RICHARDSON
COMMISSIONER OF INTERNAL REVENUE

BEFORE THE
SUBCOMMITTEE ON OVERSIGHT
HOUSE COMMITTEE ON WAYS AND MEANS
MARCH 28, 1996

Madame Chairman and Distinguished Members of the Subcommittee:

With me today are Mike Dolan, Deputy Commissioner, Judy Van Alfen, Associate Commissioner for Modernization, Jim Donelson, Chief Taxpayer Service and Acting Chief Compliance Officer, and Tony Musick, Chief Financial Officer. We appreciate the opportunity to be here this morning to discuss the IRS's 1996 filing season, the results of the 1995 filing season, our efforts to modernize the tax administration system, and our FY 1997 budget request.

BACKGROUND

The IRS is in the financial services business -- like a bank, a credit card company or an insurance company. We have the same basic processes -- collecting money, processing data, maintaining customer accounts, and responding to account questions. Customers expect us to do this accurately and efficiently while maintaining the highest level of integrity and safeguarding their privacy.

Of course, there are some significant differences between our business and other financial services firms. We are also in the law enforcement business -- we are charged with administering and enforcing the tax laws of this country and combating financial crimes. Another significant difference is sheer volume. Compared to other financial services businesses, we have many more customers -- more than 200 million -- and we handle much more money -- over a trillion dollars annually. We also operate under different constraints. We cannot modify our product line, and we do not choose our customers. And, of course, we cannot change the laws that govern our operations; they are written by others.

Despite these significant differences, like many financial services firms, what we seek is easier to describe than achieve. We want to provide customers with better service at lower cost. We want to use less paper and take full advantage of new technologies.

Some say that all businesses must learn how to "do more with less." Having thought a lot about how we can do our job better, I believe instead that we must devise innovative solutions to problems. That requires a combination of updated technology, improved business processes and a flexible organization -- the essence of modernization. We are modernizing the IRS on all three fronts.

We are in the midst of a major transition -- one that began several years ago and that will continue for many more years. As I discuss the filing season, our modernization efforts and the FY 1997 Budget Request, I would like to focus on what we are doing to make things easier for taxpayers and how we are doing our job more efficiently and effectively.

THE FILING SEASON - SERVING TAXPAYERS BETTER

The filing season begins with taxpayers filling out their tax returns and sending them, either through the mail or electronically, to the IRS. Since coming to the IRS almost three years ago, I have made it a top priority to improve our service to taxpayers. For most taxpayers, this means making communicating with us and filing returns as simple as possible. While we have yet to reach perfection, I believe in the last three years we have made progress in improving our service to taxpayers.

Making It Easier For Taxpayers

Taxpayers get frustrated when they call us and repeatedly get a busy signal. In the past three years we have answered more calls than ever before, but we still have taxpayers whose calls are not answered. We also have a growing number of taxpayers who visit or write us. For example, in 1993, we heard from taxpayers by phone, visits, or letters 73 million times. Last year, this number grew to 118 million. We expanded

access to our TeleTax recorded information line, which offers taped information on 148 topics all day every day, and refund information 16 hours a day, Monday through Friday. Last year, we answered 61 million TeleTax calls, over twice the 30 million answered in FY 1994. In FY 1995, our assistors also answered 39 million calls, an increase of more than 3 million over the prior year. We were able to serve more taxpayers by increasing productivity, expanding our hours of service, and installing call routing equipment that allows us to better manage our telephone workload. This technology allows us, among other things, to route calls to available assistors, who may be in the next county, next state or across the country. Taxpayers cannot tell the difference, but I hope they are aware of the improved service that results.

We are trying to answer taxpayer questions more quickly and more efficiently. In 1993, when I became Commissioner, not only were we unable to move calls around the country, but our assistors had access only to the taxpayer account information that was stored at the particular Service Center their office relied on. Technology has allowed us to remove this artificial geographic barrier and to enhance our ability to route calls automatically to personnel who have both the data and expertise needed to handle taxpayers' specific questions. Last year, we began providing nationwide access to certain taxpayer account information. As a result, we could resolve issues with a single call 75 percent of the time; and we are bringing more tax account information on-line.

Despite these improvements, not every taxpayer call is being answered and not all taxpayers who want to be served are being served. So we are looking for other ways to meet taxpayers' information needs. At the outset, that means making the information we do provide so clear that taxpayers will not need to contact us.

We are also reducing the number of notices we send. We recently decided to eliminate notices that are now sent out about 46 million times a year. This is good for both the IRS (we save $20 million in printing and postage and eliminate subsequent questions) and taxpayers who are relieved of the stress that can surface when an official looking letter from the IRS arrives in the mail. The notices we will continue to send are being rewritten in clearer language so that fewer recipients will require further explanation.

Technology is creating entirely new ways for taxpayers to get forms and information from us while reducing our postage and printing costs. Three years ago, taxpayers requesting a publication or form either had to call us to have the material mailed or they had to drop by one of our offices, their local post office or library. Not today -- at least for many taxpayers. Taxpayers with access to a computer and modem can get forms and information anytime, anywhere in the world from FedWorld or our Web Site on the Internet. So far this year, millions of taxpayers have visited our Internet home page and an average of 25,000 forms a day are being downloaded. Forms are also available on CD-ROM, and, for the first time this year, through our automated "fax on demand" service.

We also sponsor VITA, the Volunteer Income Tax Assistance program, and TCE, Tax Counseling for the Elderly. With these two programs we also assist taxpayers by giving them the opportunity to have direct contact at more than 20,000 sites with volunteers trained by IRS personnel. Last year, more than 80,000 volunteers served almost 3.5 million taxpayers through both of these programs.

Easier Filing Methods

One of my goals has been to make it easier for taxpayers to file their tax returns. Current data suggests we're making progress on this front. USA Today recently reported on a poll that showed 52 percent of American taxpayers describe preparing their personal income taxes as easy. The Associated Press also recently reported on a poll that found that 50 percent of taxpayers insist the system is not too complicated for them personally. Nearly 40 percent of individual filers now use the easiest tax forms and more than 70 percent take the standard deduction.

What could be easier than filing by telephone? This filing season, 23 million taxpayers can file their tax returns with a phone call that takes less than ten minutes. As of March 22, 1996, 2.5 million taxpayers have already used this option. Three years ago, TeleFile was a pilot, and, just last year, when it was only available in 10 states, 680,000 returns were filed by telephone.

Beginning in FY 1994, taxpayers could file from their home computers through a third party transmitter. As of March 22, 1996, about 102,000 taxpayers had used this filing method, a significant increase from the 1,000 that filed through this service last year. Also this year, taxpayers in 31 states can satisfy both their federal and state tax obligations with a single electronic transmission, an increase from the 15 states where joint electronic filing was available in FY 1993. As of March 22, 1996, 2.7 million joint Fed/State returns have been filed – more than double the 1.1 million filed last year.

Electronic filing is not just limited to individuals. It is also available to businesses. Employers nationwide can now file their "Employer's Quarterly Tax Return" (Form 941) electronically, and almost 200,000 of these returns were processed for 1995. A TeleFile option for the simpler Form 941 returns is in the works.

Electronic filing offers advantages for both taxpayers and the IRS. Taxpayers file more accurate returns and get their refunds faster, and we receive more accurate information more quickly and eliminate the need for expensive paper processing.

Electronic commerce means more than just receiving returns electronically, it includes electronic payments as well. Most of the more than 90 million taxpayers getting refunds this year can have them directly deposited into their bank accounts. Taxpayers enjoy the safety and ease of direct deposit, and we save the expense of printing and mailing checks.

The TaxLink/Electronic Funds Transfer Payment System, used by employers to pay employment and other depository taxes electronically, is faster, easier and more accurate for tax collectors and taxpayers alike. In FY 1995, more than $232 billion was deposited electronically, a major increase over the $6.2 billion deposited in FY 1994.

Despite these new electronic options, the number of paper tax returns filed has increased since 1992. The good news is that the staff needed to process these returns has decreased, and in the past three years we have realized a productivity improvement of 12.4 percent in processing paper returns.

We are also using other ways to process tax payments. By directing many payments to bank lockboxes, whereby banks process payments and credit them to the Treasury Department, the deposit process has been accelerated and accuracy has been increased. In FY 1995, over $125 billion went through the lockbox payment system, an increase of $18 billion over the prior year.

Taxpayer Bill of Rights 2

Making it easier for taxpayers to both file their returns and communicate with us is only part of our effort to improve our relationships with taxpayers. During the last year, we have had the opportunity to work with you, Madame Chairman, and Members of this Subcommittee on the Taxpayer Bill Of Rights 2 (TBOR 2), and I was pleased to learn that the legislation was reported out of the Ways and Means Committee last week. When last year's efforts to enact TBOR 2 were not successful, working together with this Subcommittee, we administratively adopted the proposals that did not require Congressional action.

In January 1996, we published Announcement 96-5, entitled "Administrative Actions to Enhance Taxpayer Rights", to identify the TBOR 2 proposals that the IRS had either already adopted or could adopt administratively with no legislative action. The Announcement also included IRS regulatory and guidance projects that were similar in nature to the TBOR 2 proposals developed by the Committee.

As a result of this approach, the IRS has been able to provide taxpayers with some of the benefits of TBOR 2 until legislation can be enacted. For example, the IRS has already taken steps to strengthen the role of the Taxpayer Ombudsman in the IRS. The IRS has limited the number of IRS officials who can overrule a Taxpayer Assistance Order ("TAO") to only the Commissioner, Deputy Commissioner or Ombudsman. The IRS also clarified that the Ombudsman may issue a TAO to direct the IRS to pay a refund to a taxpayer to relieve a severe financial hardship and to stop a collection action to ensure review of whether the action is appropriate. The Ombudsman now also has greater power over the selection and evaluation of local Problem Resolution Officers. Finally, the Ombudsman is now required to prepare annual reports on the most serious taxpayer problems and suggest administrative and legislative solutions to those problems.

The IRS has underway two studies: one that is of particular interest to you, Madame Chairman, is on the unique problems faced by divorced and separated taxpayers under the current tax system; the other is on interest netting. To help us with these studies, we issued two Notices last week asking for public comment on issues that may arise in each of these situations.

The IRS has also issued guidance to Revenue Agents and Revenue Officers on new procedures to notify one spouse of actions taken against the other spouse to collect their joint taxes. On April 1, 1996, the IRS will put into place procedures to give taxpayers the right to appeal liens, levies and seizures proposed by the IRS. The IRS has already trained its personnel in this new Appeals procedure. And, we formalized our practice of requiring Regional Counsel to review designated summonses and limiting designated summonses to large (Coordinated Examination Program) cases, except in unique circumstances.

We also helped taxpayers by adopting a number of alternative dispute resolution initiatives, such as an Appeals mediation procedure, simultaneous Appeals/competent authority procedures and advance valuation of artworks for tax purposes. And we have reduced the paperwork burden on taxpayers by issuing a proposed Revenue Procedure on digital computer imaging for storing paper tax documents.

Madame Chairman, we look forward to continuing our work with you and the Members of this Subcommittee on one of my continuing priorities for me -- responsible tax administration while ensuring taxpayers' rights.

IMPROVING COMPLIANCE

Along with responsibility for serving taxpayers and providing easier filing methods; we must also enforce the tax laws -- both civil and criminal. In addition to the improvements we have made in serving taxpayers, we are also improving our compliance operations.

Collection

For the three years prior to FY 1994, yield from our Collection operations had declined between 4 and 6 percent, partly because of a decline in productivity. In FY 1994, despite a 9.5 percent decrease in collection staffing, our Collection yield increased 3 percent. In FY 1995, the Collection yield rose by more than 7 percent -- a 10 percent increase since FY 1993.

One way we accomplished this increase was by recognizing that the earlier a debtor receives a request for payment, the greater the likelihood a debt will be paid. We are now requesting payments at the earliest possible time -- by the Taxpayer Service function after account questions are resolved over the telephone, or at the close of an audit. In FY 1995, Examination secured payment of 64.2 percent of agreed tax assessments.

We have also expanded the use of an important tool -- the installment agreement -- to keep taxpayers in the system who cannot immediately pay all they owe. By increasing the installment agreement authority, we raised collections secured this way from $2.28 billion in FY 1992 to $5.4 billion in FY 1995.

As part of the effort to increase Collection yield, we are improving our knowledge of the composition of our accounts receivable inventory. When taxpayers either do not file returns or file inaccurate returns, we make assessments based on the tax laws irrespective of collection potential. We record these unpaid assessments as accounts receivable and keep them on our books for as long as they are legally collectible. While we attempt to collect these debts, some accounts are obviously uncollectible for various reasons, for example: the taxpayer has died or is insolvent. In other words, we know at the outset that some of these assessments will not be collected. But our gross accounts receivable does not include just unpaid taxes; it also includes the ever-increasing interest and penalties related to those unpaid taxes. In addition, the law prescribes how long we must keep accounts receivable on the books -- 10 years. Thus, unlike private sector businesses, the IRS' accounts receivable cannot be written off even when we know that an account is not collectible.

Having a reliable estimate of delinquent taxes that are truly collectible is essential in enabling us to better manage our collection efforts.[1] At the end of FY 1995, IRS gross accounts receivable inventory equaled $200 billion of which 28.5% or $56.9 billion reflected accrued interest and penalties. This is a $29 billion increase over the FY 1994 balance. A significant portion of this growth was due to additional accruals of interest and penalties, the extension of time we are required to keep the receivables on the books from 6 to 10 years[2], and to our non-filer program. The non-filer initiative was started in 1992 to encourage taxpayers who were not filing returns to get back into the system. While we realized the non-filer program would increase our accounts receivable since many were not filing because of an inability to pay their tax obligations in full, we believed it was more important to get taxpayers filing again and then assist them with ways to meet their obligations by expanding our installment agreement and offer in compromise programs.

The gross accounts receivable inventory for compliance purposes is divided into two components: Currently Not Collectible and Active Accounts Receivable.

- Currently Not Collectible (CNC) are accounts that a collection employee has determined a taxpayer cannot currently pay. Accounts in this category are periodically monitored, and if a taxpayer is able to pay within the statutory 10-year period, the account will be collected. At the end of FY 1995, $87.4 billion[3] -- or nearly half the gross receivable total -- is classified CNC. Of this amount:
  - 37.6% ($32.8 billion) is accrued penalties and interest.
  - Over 85% ($75 billion) is not collectible because it is owed by defunct corporations; taxpayers adjudicated bankrupt; hardships; or the inability to locate the taxpayer.
- Active Accounts Receivable – are accounts that are potentially collectible and that continue to be pursued through activities ranging from notices and telephone contacts, to installment agreements and offers-in-compromise, and, ultimately, liens, levies and seizures. At the end of FY 1995, $88.8 billion[4] is classified in the Active Accounts Receivable category. Of this amount:
  - 41% ($36.6 billion) the largest portion of the active account, has been assigned for enforcement action;
  - 22% ($19.1 billion) of the inventory is either awaiting adjudication by a court or acceptance of an offer-in-compromise;

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[1] The GAO has reported and we agree that financial receivables are those that the taxpayer has agreed to or the courts have set, and that from this amount we should estimate a net realizable value of accounts that are potentially collectible. To accomplish this, we have been working with GAO on a better way to represent these amounts on our financial statements. Starting with the FY 1995 statements, we will classify amounts as financial receivables (the amounts that taxpayers have agreed to pay or courts have set), financial write-offs (financial receivables that have subsequently been determined to have no further collection potential), and compliance assessments (those amounts that taxpayers have not agreed to or on which the courts have not acted). These amounts will be audited by GAO.

[2] FY 1995 was the last year in which the accounts receivable inventory would automatically increase because of the extension of time we must keep accounts on the books from 6 to 10 years.

[3] Not included in this balance are Trust Fund Recovery Penalty assessments of $6.3 billion that are potentially duplicative.

[4] Not included in this balance are Trust Fund Recovery Penalty assessments of $8.7 billion that are potentially duplicative and Resolution Trust Corporation assessments of $9.0 billion that have not yet moved to Currently Not Collectible.

- 13% ($11.7 billion) is currently being collected by sending notices to taxpayers;
- 13% ($11.2 billion) is being collected through installment agreements;
- 2% ($1.6 billion) is lower value cases that will be collected through systemic monitoring, such as refund offsets and yearly notices to taxpayers.

Included in these numbers is $18.5 billion of accrued penalties and interest.

The improvements we have made in the collection process, that I described earlier, not only helped us increase our Collection yield over the last several years but these improvements are also helping us manage the accounts receivable inventory. And we will continue to increase our Collection yield through the use of technology in our field collection operation. In FY 1995, the Integrated Collection System (ICS), which provides on-line access to current account information to our revenue officers, was used in two districts. In these two districts, productivity increased more than 30 percent. This productivity translates directly to additional tax collections "in the bank." In FY 1996, seven additional districts will be using ICS, and it should be fully installed nationwide in FY 1999. Through FY 2004 this initiative alone will result in an additional $2 billion in revenue collected.

Our FY 1996 appropriation required us to conduct a pilot project to contract out a part of our collection activity. On March 5, we issued the Request for Proposals for the pilot. We intend to award up to five contracts and initially deliver approximately 125,000 cases relating to taxpayers who are delinquent in paying their tax obligations. Payments under the contracts will be performance based; however, they will not be contingency fee contracts. Contractors and their employees will be subject to the disclosure laws, the Privacy Act, the Taxpayer Bill of Rights and applicable sections of the Fair Debt Collection Practices Act. Information provided to contractors by the IRS or collected by contractors from taxpayers cannot be used for any purposes other than fulfillment of the requirements for the awarded contract and cannot be sold or otherwise transferred by the contractor.

Examination

Our compliance program is not only about our collection activities or our traditional efforts to audit taxpayers. We continue to refine our compliance programs by developing new compliance approaches. Through programs like Advanced Issue Resolution and Advance Pricing Agreements, we are stressing early resolution of issues -- a practice that saves everyone money. With Advanced Issue Resolution, we can accelerate the collection of the largest corporate assessments by resolving recurring issues and simply carrying the resolution forward to later years. Reducing the number of issues under examination is a cost savings for both taxpayers and for us. Under this procedure, taxpayers have agreed to pay about $1.1 billion during FY 1993 - FY 1995.

The Advance Pricing Agreement program was developed as a new way to resolve intercompany pricing issues. As a cooperative process, both taxpayers and the government derive significant benefits. Taxpayers welcome certainty in a complex area and avoid a lengthy debate with the IRS. At the end of FY 1995, we had entered into 22 Advance Pricing Agreements, more than the number that had been completed in all the previous years of the program combined. Everything this year points to even higher levels of production, and we currently have 109 Advance Pricing Agreements in process.

We are also responding to taxpayer concerns, for example, those raised by the small business community. I participated in numerous town meetings with small business owners and the White House Conference on Small Business, where small business owners described one of their primary concerns as the worker classification issue -- whether workers should be classified as employees or independent contractors. We are doing what we can to respond to these concerns by revising our training

materials, offering an optional settlement program, and providing early referral of employment tax issues to Appeals.

As I stated earlier, we are finding ways to reduce the amount of paper small business owners have to store, by developing rules that permit taxpayers to use computer imaging systems to replace the paper records now required. We also raised the threshold for meals and entertainment expense documentation from $25 to $75, reducing the number of receipts that businesses have to retain for tax purposes.

Working with private industry, we are responding to the increased sophistication of transactions in the financial world and specialization in the business community. We have cooperatively developed Market Segment Specialization Program guidelines, focusing on the practical problems of examining a market segment and identifying particular issues of interest to the IRS. In turn, taxpayers are better informed about the non-compliance in that market and about the IRS's position on that issue. Through January 1996, we had issued 27 Market Segment guidelines covering 23 markets.

Criminal Investigation

In addition to our compliance activities in examination and collection, our Criminal Investigation Division (CI) investigates complex financial transactions of taxpayers, looking for criminal tax violations and money laundering. CI is also actively identifying and investigating new and emerging areas of tax fraud that impact on the economy and prey on honest citizens. These areas include bankruptcy, health care, insurance, motor fuels excise taxes and telemarketing. I would like to share with you the results of our efforts in two of these areas.

Health care fraud is found in a wide range of schemes including home health care, false claims/billings, rolling labs, transportation services, and kickbacks/bribes. While most of this fraud is investigated by the FBI and U.S. Postal Service using the mail fraud statutes, CI investigates them as tax violations if the income is not reported or underreported, the expenses are overstated, or the tax return is otherwise false. CI's ability to bring tax charges coupled with its expertise in money laundering investigations is often essential to the successful prosecution of health care fraud cases. In the last three fiscal years, CI initiated 344 investigations; recommended 168 prosecutions, and obtained 111 convictions in this area.

Health Care Convictions: The CEO of Integrated Systems Incorporated, John P. Milne, was sentenced on October 7, 1995 to 2 years in prison, 5 years' probation and ordered to make restitution of $1.4 million and pay IRS $339,780 in back taxes and penalties. Milne plead guilty to charges of tax fraud, making false claims against the U.S., making false statements to banks and mail fraud. His health care scheme involved negotiating reduced medical rates with hospitals, not disclosing the amount of the discounts to his clients and filing for full payment, then keeping the difference for himself. In this multi-agency investigation, CI's financial investigative expertise not only uncovered income tax evasion but also documented a health care scheme which had defrauded numerous health care providers. This evidence provided the proof which enabled the court to demand the $1.4 million in restitution.

In another Health Care Fraud investigation, Jeanette G. Garrison, owner of Healthmaster Home Health Care in Macon, Georgia, was sentenced on October 30, 1995, to 33 months imprisonment, three years of supervised release and 200 hours of community service on federal charges based on criminal events that transpired while she controlled Healthmaster. She was also ordered to pay $2.5 million in fines and $16.5 million in restitution. Garrison plead guilty to one count of conspiracy to defraud the United States and nine counts of false statements. She conspired to defraud the Medicare Program of millions of dollars by the submission of fraudulent cost reports for reimbursement to the Medicare fiscal intermediary between 1989 and 1993. CI special agents, working with the Georgia Bureau of Investigation and the FBI, combed through hundreds of billing records, financial records and invoices to meticulously document and prove this conspiracy against the government.

Telemarketing Convictions: Another growing area of criminal activity is telemarketing fraud. Fraudsters use telephonic and wire communications to fraudulently promote, solicit, or market products and/or services. Monies obtained through telemarketing solicitations are then used to enrich the promoters of these

frauds. Because telemarketing fraud often crosses state borders, federal and state law enforcement agencies must work together to successfully prosecute the cases. From FY 1993 through FY 1995, 133 telemarketing investigations were initiated; 102 prosecutions recommended; and 86 convictions were obtained.

In September 1994, the Western New York Telemarketing Task Force, including agents from CI, uncovered one of the largest telemarketing cases in the Western New York area. Four corporations and 13 individuals were indicted and charged with operating a telemarketing scam that bilked hundreds of victims, mostly senior citizens throughout the United States and Canada, out of millions of dollars. Three of the individuals indicted were charged with Title 26 Section 7211, having to do with making false statements to purchasers relating to tax, a seldom used statute that can effectively be used in telemarketing fraud investigations. This statute makes it a crime for anyone to solicit payment for the sale or lease of an "article" and falsely state, orally or in writing, that any part of the payment, both sale or lease, is to pay federal tax. The Assistant United States Attorney working with the task force has utilized this statute to facilitate plea agreements for individuals cooperating with the government.

REVENUE PROTECTION

The 1995 Filing Season

Last year, I told you, Madame Chairman, and the Members of this Subcommittee that our biggest challenge was to put in place better methods to protect the tax revenue from those who improperly attempted to claim refunds. We accomplished this by using both technology and a different approach to compliance to stop improper refund claims. We used numerous systemic verifications including increased checks of social security numbers. We established new criteria for Electronic Return Originators (EROs), including fingerprint and credit checks, and increased monitoring of EROs. We delayed 7.4 million refunds -- or about 8 percent -- and increased compliance resources devoted to checking these refunds for accuracy.

I am pleased to report that our efforts were successful. One and a half million fewer dependents were claimed, and there were approximately 100,000 fewer earned income tax credit (EITC) claims than in the previous year. CI identified more than 4,100 refund schemes involving almost 60,000 returns, and prevented the issuance of $78 million in refunds. Last year, we initiated 491 criminal investigations involving refund schemes and return preparers. Prosecution recommendations were forwarded on 404 cases, and we obtained indictments of 329 individuals and convictions in 300 cases.[5] Eighty-two percent of the convictions resulted in prison sentences averaging over 18 months.

Through pre-refund examinations, we prevented the issuance of an additional $425 million in refunds. We visited over 6,600 EROs, issued 707 warnings for violations and suspended 287 EROs. Thus, last year, direct compliance efforts prevented $503 million in improper refunds from being issued. In fact, in its August, 1995 Economic and Budget Outlook update, the Congressional Budget Office decreased anticipated EITC outlays by $2-$3 billion a year over seven years, stating, "EITC spending has been lower than expected this year, possibly as a result of a recent crackdown by the IRS . . . ."

The 1996 Filing Season

This filing season we are continuing to devote substantial resources to detecting and stopping improper and fraudulent claims for refund. We have refined our efforts to address improper refund claims based on what we learned last year. We are still requiring EROs to meet suitability standards, and we are continuing our ERO monitoring efforts. We also continue to look carefully for suspicious returns and check social security numbers. However, we anticipate far fewer delayed refunds this year as taxpayers now understand the importance of filing returns with correct social security numbers. In fact, so far this year, the number of social security number problems on electronically filed returns have decreased by more than 33 percent from last year.

THE 1995 COMPLIANCE INITIATIVE

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[5] These totals include cases initiated in the prior fiscal year.

In FY 1995, we received the first year of funding for a five-year plan to improve compliance with the dollars raised going directly to deficit reduction. Our FY 1995 compliance accomplishments were impressive. We closed an additional 676,000 examinations and audit coverage increased from 1.08 percent to 1.63 percent in FY 1995. We issued an additional 86,000 determination letters for exempt organizations and employee plans. And, we collected an additional $803 million directly attributed to the compliance initiative, far exceeding the $331 million we promised. Overall, with a five year investment of $2 billion, we had conservatively committed to raise $9.2 billion in additional revenue. While the loss of the Compliance Initiative impacts federal revenues, an important point that may be overlooked is the corresponding loss in state revenues, because adjustments made during our compliance efforts are used by the states to make corresponding state adjustments without the need for a state audit.

MODERNIZING TAX ADMINISTRATION

Modernizing our current tax administration system requires an ongoing effort to update technology, to improve business processes, and to develop a flexible organization. These three items are the essence of modernization, and the IRS is modernizing on all these fronts.

Updating Technology

The IRS has undertaken a series of technology modernization projects -- collectively referred to as the Tax Systems Modernization (TSM) Program -- to modernize its information systems. Originally designed in 1988 as a technology replacement program, the TSM Program has been redesigned in order to assist the IRS in realizing its Business Vision in the year 2001, although many of the projects are scheduled for completion before then and some projects have already been completed.

The TSM Program will enable the IRS to move from paper and more labor intensive processes to an electronic environment, enabling it to more effectively accomplish its mission, which is to collect the proper amount of revenue at the least cost and in a way that imposes the least burden on taxpayers. The TSM Program projects are designed to provide more accurate and timely taxpayer account information to enhance the IRS's customer service and compliance efforts while reducing the number of contacts between taxpayers and the IRS.

Tax administration is dependent on the receipt, analysis and utilization of information submitted by taxpayers and other sources, *e.g.*, employers and other payors. The TSM Program projects fall into three broad categories: those that will facilitate capture of data more effectively and efficiently, those that will improve our ability to store and analyze data, and those that will distribute and use the data to improve compliance and customer service.

All of these TSM Program systems will be supported by a common infrastructure and related support services. Infrastructure components include various telecommunication components, systems administration and operational support systems, security, operating and data base management systems, and an integrated environment for systems testing, configuration control and software distribution. All of the TSM Program systems will be built to assure that confidential taxpayer information will be protected from unauthorized access and use.

Although we recognize that a great deal of work remains to be done in updating our technology, progress has already been made. As I discussed earlier, as a result of technology, taxpayers have more options for filing their returns and paying their taxes than ever before through such programs as TeleFile and Tax Link/EFTPS. Taxpayers are also able to get information from the IRS in many different ways through services like our Internet Home Page and the "fax on demand" service. We also are using technology to answer more of taxpayers' questions the first time they call by providing our employees with access to more account information. Also as I discussed earlier, technology is changing the way our compliance operations work, through such programs as the Integrated Collection System that has improved our collection productivity and the Electronic Fraud Detection System (EFDS), an automated fraud detection system that provides on-line research capabilities which are used to validate

claims and identify multi-return schemes. EFDS was used last filing season and continues to be used to stop improper claims for refund.

We are also putting a new infrastructure in place. A number of initiatives are currently underway with substantial long-term benefits. One of the keys to building a world class information management system is to make appropriate investments in the technical infrastructure -- hardware, software applications and telecommunications. During the past four years, we have awarded contracts that upgrade computer center hardware, modernize operations and allow us to utilize commercial expertise for software and hardware support, information engineering, telecommunications, and security. As of today, $1.7 billion in new equipment and software has been installed across the country.

Over the past several years, our technology modernization efforts have benefitted from oversight from the General Accounting Office (GAO), the National Research Council (NRC), and the Congress. On balance, we agree with the assessments in the GAO and NRC reports. We take them very seriously, but more importantly, we are doing something about them. The criticisms of our technology modernization efforts can be categorized as follows:

1.) Accountability and Management - the need to centralize management of technology modernization in one office;

2.) Managing Information Technology Investments - the need to better prioritize technology investments;

3.) Software Development - the need to develop procedures that ensure the development of high quality software;

4.) Technical Infrastructure - the need to develop a comprehensive blue print of the infrastructure;

5.) Electronic Filing - the need to develop a comprehensive strategy for electronic filing.

During the past year, management of the TSM Program has changed significantly. Modernization management has been centralized under the Associate Commissioner for Modernization, who has been given the responsibility and authority to manage and control consistently all systems development and reengineering efforts within the IRS. In September 1995, the Associate Commissioner for Modernization became responsible for the formulation, allocation, and management of all information systems resources. This was an important step in the process of ensuring that all information systems resources are used in accordance with the IRS's strategic objectives.

The Modernization Management Partnership (MMP), a management structure which includes me and the Assistant Secretary for Management/Chief Financial Officer as well as other senior IRS and Treasury Department officials, was established last year to identify and address important technology modernization issues at the Departmental level. The Deputy Secretary has taken action to strengthen the MMP so that it will function more like a board of directors, with day-to-day responsibility for the TSM Program remaining with the IRS.

In response to criticisms about the lack of a clear plan for implementing the TSM program and an adequate analytical process for establishing investment priorities, we put in place an investment review discipline to select, control, and evaluate investment decisions based on GAO best practices. An integral part of this discipline is the Investment Review Board, established in October 1995, chaired by the Associate Commissioner for Modernization, which is responsible for assessing and prioritizing information systems investments, monitoring progress of spending against plans and evaluating the results of those investments. In addition, we recently reexamined our entire modernization program to ensure that information technology investments produce the maximum business value. Based on the results of this review, we are

establishing achievable and manageable priorities for the next five years. We also have a new Chief Information Officer (CIO), Mr. Arthur Gross, who will work with the Associate Commissioner for Modernization. He plans to begin work on April 15th. Mr. Gross was previously the Deputy Tax Commissioner responsible for systems and processing for New York. In that position, he led a broad tax modernization effort for the state during the past several years.

We recognize that our software development capabilities as well as those of our contractors must be improved, and we have taken positive steps in that direction. Our contractors are required to perform at a level that produces high quality software. We are also improving our own systems development capabilities to ensure that the TSM Program is developed consistent with modern processes and standards. Specifically, we are enhancing our system architecture and test plans to provide the critical road maps for developing and implementing fully integrated systems.

A vital aspect of updating our technology is enhancing our capabilities for safeguarding taxpayer information. IRS concurs with NRC's advice regarding the security of tax processing systems and the privacy of tax information. Information systems security and integrity has been and will continue to be one of the highest priorities for the Internal Revenue Service. I have issued two policy statements - the Declaration of Privacy Principles in 1994 and the IRS Information Security Policy in 1995. Based on a similar recommendation from GAO, we recently completed a Security Concepts of Operation which provides an IRS users' view of the security capabilities in the TSM Program systems which will protect taxpayer data from unauthorized access or disclosure. Security will also be an integral part of the information systems architecture.

We are also relying heavily on private sector expertise to assist in our technology modernization projects. To meet the significant challenges of such a large-scale effort, we have the ability to access private sector skills and experience through contracts with the IRS' Federally Funded Research and Development Center (FFRDC), the Integration Support Contract (ISC) and the Treasury Information Processing Support Services (TIPSS) procurement.

We have developed a plan with the help of outside experts from other governmental agencies and the private sector to aggressively expand the work of the current Integration Support Contractor. Under this new approach, the Integration Support Contractor will assume as much of the systems integration role as the existing contract permits. This will include the architecture, systems engineering, integration and test activities that are essential to successfully integrate the systems. IRS will continue to make the decision on final design and development. Production software development work is and will be contracted out.

In addition, the newly-instituted Presidential Technology Team will bring experienced technical professionals from across government to work on technology modernization. The IRS, in fact, worked with OMB to create this concept and will be the first beneficiary of its effort.

We are working to increase electronic filing options -- like TeleFile -- and payment options -- like TaxLink/EFTPS. To accomplish this, we are developing a comprehensive strategy for electronic filing. We are also taking a hard look at how we currently receive returns from taxpayers, and studying ways to reengineer the entire process.

Improving Business Processes

Along with updating our technology, we are also improving our business processes to make them more efficient and effective. For instance, in 1994, the IRS volunteered to serve as a pilot agency for the Government Performance and Results Act (GPRA). GPRA requires agencies to set goals, establish measures, and report on their accomplishments, as well as integrate performance measures into the budget and strategic planning process. Our participation as a GPRA pilot agency has helped us improve our budget, strategic planning and evaluation processes. This year as part of our GPRA responsibilities, we are integrating our planning, budgeting and assessment processes and will complete the first draft of an Integrated Strategic Plan and Budget next month.

We have also reengineered many of our administrative processes to be less labor intensive and to take advantage of available technology. Through an innovation we call "Employee Express," our employees can now manage their own employment accounts, directly changing their tax withholding, savings bond allotments, Thrift Savings Plan contributions and other personnel actions through the use of a touch tone telephone or centrally located kiosks. In the past, these employees filled out forms and sent them to their personnel offices where other employees made the changes to the payroll system.

We have also fully automated our travel accounting system, and this system was showcased as an example of a government agency implementing the best practices of the private sector at a March 8 hearing on Government-Wide Travel Management before the Senate Committee on Governmental Affairs, Subcommittee on Oversight of Government Management and the District of Columbia. In reengineering this process, we were able to eliminate all but two steps: a certification of the claim by the traveler and the approval by the supervisor. Employees are reimbursed in about five to seven days. In FY 1995, we processed 83 percent of our travel vouchers or about 325,000 vouchers electronically.

We have also changed our business processes so that we can serve taxpayers better. For example, as I stated earlier, we have eliminated certain notices we send to taxpayers, and we are in the process of reviewing the remaining notices to make them more understandable. We are providing information to taxpayers in new ways, for instance through our Internet Home Page. Also, as I discussed earlier, in our compliance efforts, we are rethinking the way we accomplish our mission and putting more emphasis on working with taxpayers on difficult issues with such tools as alternate dispute resolution and Market Segment guidance. We will continue reviewing our processes and make changes that will make us more efficient and make it easier for taxpayers to deal with us.

Business Structure

The remaining part of our modernization efforts involves realigning our organizational structure to make it more efficient and effective. We are concentrating on the work currently performed by Service Centers, Computing Centers, Automated Collection and Taxpayer Service telephone sites, and district offices. During FY 1994 and 1995, we consolidated our 70 phone and correspondence operations into 34 and will consolidate ultimately in 23 Customer Service Centers. We will soon be operating with three Computing Centers responsible for centralized mainframe computing instead of the twelve operating today.

On October 1, 1995, the number of regions was reduced from seven to four, the staff in the remaining four regions was reduced, and we began to consolidate from 63 district headquarters to 33 offices. The district consolidations are ahead of schedule and will be completed by October 1. In the summer of 1993, we decreased the number of locations providing administrative support services from more than 80 to 24; three more will be eliminated this year. Despite this 38 percent decrease in support services managers and an overall decrease of 20 percent of support services employees, the job is getting done.

FY 1997 BUDGET REQUEST -- FY 1996 BUDGET

I would like to discuss briefly the IRS's FY 1996 Budget and our FY 1997 Budget request. I have included as an Appendix a summary of the FY 1997 request. As you know, the IRS submitted a budget request for FY 1996 of $8.2 billion, and received an appropriation of $7.348 billion, less than the IRS's $7.483 billion FY 1995 appropriation. This decrease posed a particular challenge to us since we require about $200 million more each year for cost increases beyond our control, such as pay raises and rent increases, just to maintain our current level of operations. Our FY 1996 budget allows us to run our basic operations and will not affect the processing of returns or the payment of refunds within our customer service standards of 40 days for paper filing and 21 days for electronic filing during the 1996 filing season.

What we will not be able to accomplish again are the impressive results we achieved in deficit reduction last year through our Compliance Initiative funding. Based

on our current FY 1996 funding, we will not be able to perform some 290,000 examinations, with a potential loss in revenue collection of $324.8 million. Examinations through our information reporting program will also be affected. For example, reductions in our document matching program and our substitute for return program, an effective means of addressing non-filing, could result in a potential loss of $417 million in collected revenue.

Madame Chairman, in your invitation letter you asked us to try to anticipate the effect on IRS operations if the President and Congress approve an FY 1997 appropriation level which is no greater than the FY 1996 level. Flat funding really means a $200 to $400 million reduction from our FY 1996 funding level because we must absorb pay raises and increased costs. As a result, we would be faced with difficult choices.

Like this year, we will make it a priority to sustain our basic operations -- processing more than 200 million tax returns and paying more than 90 million refunds. To accomplish this, however, we will, like we did this year, have to find alternate ways to serve taxpayers, and, like this year, we will have to decrease the amount of face to face contact with taxpayers. The number of audits will decrease, with a corresponding decrease in the audit coverage rate, and some of our collection operations may have to be curtailed. While we will continue to process tax returns and pay refunds on time, service to taxpayers may suffer and the amount of money collected next year could be impacted. But what is more difficult to measure is the longer term impact of reductions on overall taxpayer compliance levels.

CONCLUSION

Since becoming Commissioner almost three years ago, I have worked hard to improve our service. I am pleased to report progress. Despite that progress, we recognize that we still have much to do.

FY 1997 BUDGET IN BRIEF
Internal Revenue Service

I. Introduction--A Three-Part Investment in Tax Administration

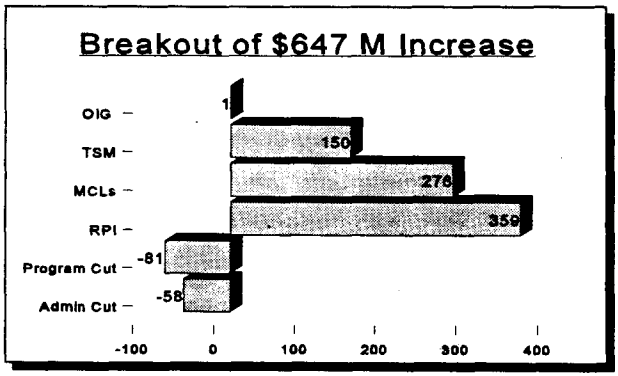
For FY 1997, the Internal Revenue Service has proposed a series of investments that will substantially reduce the burden on the American taxpayer, enhance compliance, and maximize revenue collections. The Service is submitting budget proposals for FY 1997 that total $7.995 Billion and 109,050 FTE. The total budget request represents an increase of $647 Million and 2,699 FTE over the FY 1996 operating level. Our FY 1997 budget consists of three equally significant and critical investment components:

A. **The Tax Systems Modernization (TSM) Program**. IRS is in the financial services business. The Service performs the same basic functions--collecting money, processing data, maintaining customer accounts, and responding to customer questions. Its 200 million customers expect it to do these activities accurately and efficiently, while maintaining the highest level of integrity and safeguarding their privacy. The TSM Program projects are designed to provide customers with better, faster service as well as enhance compliance. IRS has requested $150 Million in additional TSM Program funding in FY 1997 for four tax systems modernization investments. These investments will finance immediate and tangible improvements in our service to taxpayers, with emphasis on electronic receipt of tax returns and payments, extensive data capture, streamlined storage and retrieval of data, and early identification of issues with as many as possible resolved with a single telephone call. In response to guidance received from Congress, the National Research Council and GAO, the Service will extensively use contractor support in developing and integrating modernized operational systems.

B. **Revenue Protection Initiative**. The Service is requesting $359 Million and 3,820 FTE for a Revenue Protection Initiative (RPI) that is estimated to generate $1.5 Billion in FY 1997-- a return on investment of better than 4 to 1. During the outyears--FY 1999 and beyond, the increase to enforcement revenues from this investment will exceed $3 Billion annually. All staffing increases will be placed in call sites and service center based enforcement programs. Not only do these telephone and correspondence activities represent highly cost effective investments that emphasize up-front treatments and early contacts with taxpayers, they are also less intrusive and burdensome than traditional face-to-face enforcement actions that rely on revenue agent and revenue officer involvement. In reviewing the proposed FY 1997 initiative, Congress should consider the proven record of delivering the revenue promised in connection

with the FY 1995 Compliance Initiative. In FY 1995, the IRS received the first year of funding for what had been a five year plan to improve compliance with the dollars collected going directly to deficit reduction. The FY 1995 accomplishments were impressive. Over $800 Million was collected, far exceeding the $331 Million promised. While the loss of the Compliance Initiative impacts federal revenues, an important point that may be overlooked is the loss in state revenues, because adjustments made during IRS compliance efforts are used by the states to make corresponding state adjustments without the need for a state audit.

C. **Maintaining Current Levels of Service.** The Service needs $276 Million just to maintain its FY 1996 program levels in FY 1997. These additional resources, which are offset by administrative and program reductions totaling $139 Million, are needed to cover the expected increase in the number of returns filed. The resources also are used to pay for unavoidable staffing related expenses, such as pay increases. Finally, the additional resources are needed for inflationary increases to non-staffing related expenses, including postage, printing, and essential contracts, such as those for National Archives and Records Administration and Financial Management Services. These costs represent bills the IRS does not control, but must pay. Without these resources, the Service will be forced to reduce programs, or to shortchange funds intended for training, supplies, enforcement travel and essential enforcement expenses.



Total Decreases: $139 Million **Total Increases**: $786 Million

Note: A detailed breakout of increases and decreases is contained in Appendix A--Budget Overview.

II. Mission and Objectives--Collecting Revenue to Finance the Government

The mission of the Internal Revenue Service is to collect the proper amount of tax revenue at the least cost; serve the public by continually improving the quality of our products and services; and perform in a manner warranting the highest degree of public confidence in our integrity, efficiency and fairness. To achieve its mission, the Service has identified three strategic objectives.

A. **Increase Voluntary Compliance**. IRS encourages and assists taxpayers to file timely and accurate returns and pay on time. When taxpayers do not comply, appropriate enforcement action needs to be taken.

B. **Maximize Customer Satisfaction and Reduce Burden**. The Service works to reduce the time and expense to taxpayers, tax professionals, and others in complying with the tax laws, while increasing their satisfaction with the tax system.

C. **Achieve Quality-driven Productivity through Systems Improvements and Employee Development**. IRS is using systems improvement tools and techniques to develop a highly-trained work force.

III. Performance Measures Hierarchy -- Results-Based Budgeting

As one of the country's largest financial services organizations, the IRS needs to be a leader in managing its own finances. The IRS volunteered to serve as a pilot for the Government Performance and Results Act (GPRA), which requires agencies to: formulate strategic plans that articulate their mission, goals, and objectives; develop annual performance plans that spell out annual targets against the strategic goals; measure program performance against their strategic goals and objectives; and hold themselves accountable for achieving results.

As part of its GPRA responsibilities, and to integrate its planning, budgeting and assessment processes, IRS has developed a hierarchy of performance measures. At the top of this hierarchy of measures is a barometer of overall Service performance. This indicator compares the amount of revenue collected during a fiscal year, minus the IRS costs of collecting that revenue and minus the monetized value of the burden hours placed on taxpayers in meeting their tax obligations, with the amount of revenue that would have been collected if all taxpayers had paid their full tax liability.

The second level of the measures hierarchy contains measures for the Service's three strategic objectives. Also at this level are measures that require the interrelated efforts of multiple functions. The mission and objective level measures and performance targets for FY 1997 are shown in the following table. The multi-functional measures can be found in Appendix B--Performance Measures Hierarchy.

Finally, the third level of the measures hierarchy contains the measures for the Service's 18 budget activities. These 18 activities represent the Service's various functional components; each activity contributes toward the achievement of the Service's mission and objectives. Details on these measures are also shown in Appendix B--Performance Measures Hierarchy.

IRS PERFORMANCE MEASURES--MISSION AND OBJECTIVES			
Performance Measures:	FY 95	FY 96	FY 97
Mission: Collect the proper amount of tax revenue at the least cost			
Revenue Collected - (Budget+Burden) / Total True Tax Liability	.7766	.7825	.7887
Objective: Increase Compliance			
Total Collection Percentage (TCP)	86.0%	86.3%	86.7%
Total Net Revenue Collected	$1.271T	$1.358T	$1.450T
Objective: Maximize Customer Satisfaction and Reduce Burden			
Revenue Collected per Dollar of Burden	$10.97	$11.38	$11.80
The time expended by taxpayers in fulfilling their tax responsibilities (Hours)	5.3 B	5.3 B	5.3 B
Favorability of IRS (Roper Survey)	36.0%	47.0%	49.0%
Objective: Achieve Quality-Driven Productivity			
Revenue Collected per Dollar of IRS Budget	$172	$185	$181

IV. The Tax Systems Modernization Program

The Service is requesting $150 Million for a series of Tax Systems Modernization Program investments. These investments will finance immediate and tangible improvements in IRS' service to taxpayers. The additional resources will be used for the following projects:

A. **Integrated Case Processing System/Integrated Collection System.** With the resources provided by this initiative, IRS employees will be provided with greater access to information and the ability to resolve issues over the telephone by installing 3,500 Integrated Case Processing workstations, 22% of the total workstations required. The Service will also

automate many of the activities of field revenue officers, by implementing the Integrated Collection System in 20 of 33 districts, providing access to 60% of revenue officers. Finally, IRS will modernize telecommunications infrastructure and data and voice connectivity by funding 14 additional sites for universal wiring, approximately 15% of the total universal wiring requirements.

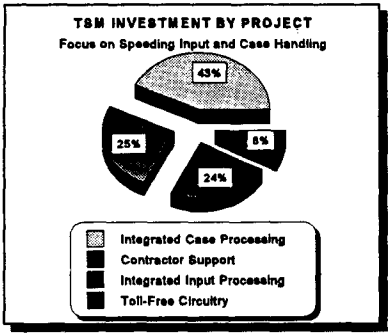


Chart breaks out $150 M TSM Proposed Increase.

B. **Contractor Support**. With the resources provided by this initiative, we will provide funding for contractor support in developing and integrating modernized operational systems, in response to guidance received from Congress, the National Research Council and GAO. The Service will use its major integrator to perform the necessary architecture, systems engineering and design tasks so that specification of hardware, software, and telecommunications products will lead to a fully functioning system. The integrator also will play a major role in the design and development of the Workload Management System, which will provide the IRS with a corporate system to track and prioritize workload.

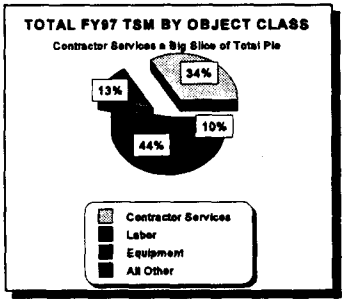


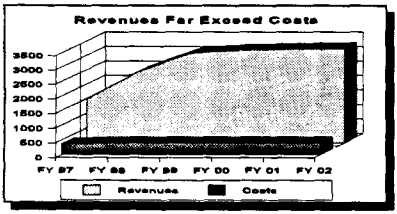
Chart breaks out total $850 M TSM Request.

C. **Integrated Input Processing System**. With the resources provided by this initiative, the universe of taxpayers that can file electronically by telephone will be expanded through funding toll free circuitry costs associated with expanding Telefile.

D. **Toll Free Circuitry.** With the resources provided by this initiative, the Service will resolve many more taxpayer inquiries through a combination of increased on-line assistance and self service applications, using Voice Response Units, which permit callers to route themselves to interactive systems or to specially trained IRS assistors.

V. Revenue Protection Initiative--A Modest Investment with a Big Return

The Revenue Protection Initiative (RPI) is a continuation of the Service's long term strategy to improve voluntary compliance. Consistent with the Service's business vision, the emphasis is on resolving issues by telephone and avoiding more costly face to face contacts with taxpayers. The return on investment is significant--4 to 1 in FY 1997 and 7 to 1 from FY 1997 to FY 2002.



Total Revenues: $16B Total Costs: $2.4B

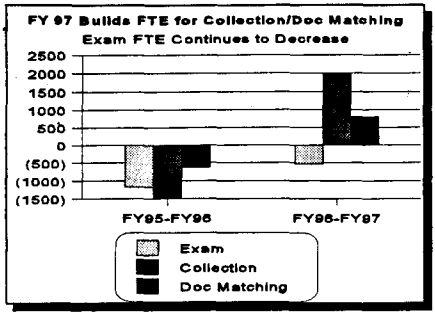
RPI involves four major programs. Collection represents about two thirds of the total program increase. Staffing for Automated Collection System call site and Service Center Collection Branch programs will generate more than $1.25 Billion in revenue in FY 1997. Beyond these increases, the Collection component includes 240 FTE for the Individual Tax Identification Numbering System (ITIN). Scheduled for implementation in the Philadelphia Service Center in July, 1996, ITIN will--during its first year in operation--generate valid TINs for over one million taxpayers (mostly non-resident aliens) who do not have social security numbers.

The remaining one-third of the total program is for three programs. First, Document Matching increases will finance enhancements to the Underreporter Program, which compares data from information returns with filed returns, and also to the Substitute For Return Program, which creates returns for taxpayers who fail to file returns. Second, Examination increases will fund more correspondence audits by service center employees, which will increase the audit coverage rate from 1.4% to 1.5% while expanding revenues.

FY 97 REVENUE INITIATIVE

Program	FTE	$(000)	Revenue
Collection	2,490	$263	$1,265
Exam-SC	300	$35	$88
CI(QRDT)	230	$21	---
Doc Match	800	$40	$136
TOTAL	**3,820**	**$359**	**$1,489**

FY 97 Benefit Cost Ratio is 4 to 1.



Includes Base and Increases, Exam excludes Appeals

Third, the Criminal Investigation increase will be used for Questionable Refund Detection Teams (QRDT), aimed at protecting revenues by prosecuting individuals involved in large scale fraud schemes.

As shown in the chart on the left, the Service's revenue producing activities were reduced in FY 1996. This initiative would restore the reductions to Collection and Document Matching and in the process bring in additional resources and reduce the Federal deficit. The total resources for Examination, which absorbed a big share of the program reduction discussed below, would continue to decrease. The impact of total FY 1997 staffing on some key performance measures is shown at the right:

KEY PERFORMANCE MEASURES		
Measure:	**FY 96**	**FY 97**
CollectionYield	$24.9B	$25.9B
UR Assessments	$1,368M	$1,619M
SFR Assessments	$1,292M	$1,140M
Audit Recommended $	$23.8B	$23.4B
Audit Coverage	1.54%	1.51%

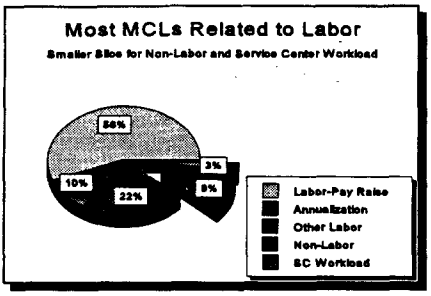
UR=Underreporter SFR=Substitute For Return

VI. Maintaining Current Levels of Service

To maintain current operations and protect the integrity of the filing season, the Service must have the resources to pay for both the inflationary costs associated with statutory pay and other mandatory increases in support costs, and the expected increases in the number of returns filed.

A. **Mandatory and inflationary Costs Related to IRS Staff**:

1. Pay Raise and Benefit Increases. The statutory pay increase for FY 1997 is expected to be 3.1%. Total cost is $155 Million. Without this increase the Service would be forced to reduce FTE and disrupt program delivery.



2. Annualization. This increase is needed to annualize the FY 96 pay increase. Total cost is $28 Million. Without this increase the Service would be forced to reduce FTE and disrupt program delivery.

3. Non-Pay Raise Labor Increases. IRS has experienced $61 Million in labor cost growth in excess of that budgeted for in the usual pay raise and personnel benefit inflation. This is because promotion costs result from career ladder advancements, above journey level promotions, and within grade increases. Without senior graded employees, the Service would be hampered in working higher graded cases in Examination, Collection and other budget activities. Absent this increase the Service would be forced to reduce FTE and programs.

B. **Service Center Workload Growth**. Resources will cover the projected increase in Service Center workload (processing tax returns and issuing refunds) which is due to growth in the taxpayer population and tax law changes. Primary tax returns are expected to reach 199.5 million in FY 1997, an increase of 2.4 million from the current year estimate of 197.1 million. Supplemental documents (amended returns, extensions to file, etc.) are projected to increase .5 million from the FY 1996 level of 12.1 million.

VII. Program Decreases

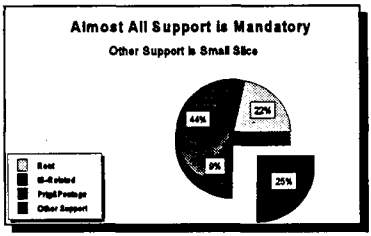
There are two categories of decreases. First, there is a program reduction that represents the Service's portion of a base program cut applied to most Departmental bureaus to help balance the Federal budget over the next seven years. Second, there is the fourth year's installment of administrative cost reductions mandated by Executive Order.

A. **Program Reduction**. Because a base reduction cannot be achieved through further administrative savings, the cut is being taken as a program reduction that could have some impact on the Service's ability to collect revenue in FY 1997. This reduction is being taken in the more traditional enforcement job categories--those that engage in face-to-face examination and collection activities. While these positions continue to be vital to the overall enforcement efforts, and will always play a major role in collecting revenue, the IRS business vision calls for shifting the balance of the enforcement programs toward those that are featured in the Revenue

Protection Initiative (RPI), discussed above. RPI consists of programs based in the service centers and call sites that deal with taxpayers by telephone and through correspondence. *Without RPI, the FY 1997 program reduction to traditional "back-end" enforcement functions performed by Revenue Agents and Revenue Officers is not offset with increases to new "front-end" enforcement functions.*

JOB CATEGORY FTE REDUCTIONS	
Revenue Agents	462
Revenue Officers	230
Special Agents	88
Tax Auditors	91
Tech/Prof/Clerical	470
TOTAL	1,341

B. **Administrative Reduction Pursuant to Executive Order**. This reduction reflects the FY 1997 adjustment relating to Executive Order 12837, which requires agencies to reduce administrative costs by not less than 14 percent from FY 1994 and FY 1997. This is to be achieved by annual reductions of three percent (five percent in 1997) to the baseline FY 1994 amount, adjusted for inflation. These reductions have exhausted the Service's ability to make support reductions. Although IRS has a support budget of $2 Billion, over three fourths of it is either information systems related, and used to purchase ADP equipment or telecommunications, or is mandatory, and pays for categories such as rent, postage, and printing. The remaining one fourth, has been reduced severely; what is left is used for case related travel; enforcement expenses, including lien fees; training; and services and supplies, such as computer discs.



Other Support pays for training, case travel, enforcement expenses, etc.

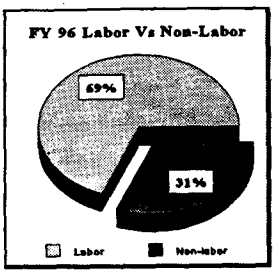
VIII. Conclusion

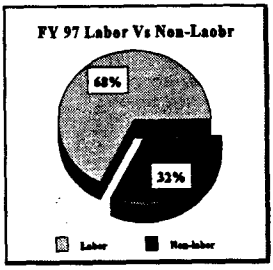
The FY 1997 dollars invested in IRS will be well spent. The Service has proven that it can deliver on its promises. Our investment request is not large when compared with the potential benefits--both in additional revenue collections and in improved service to taxpayers.

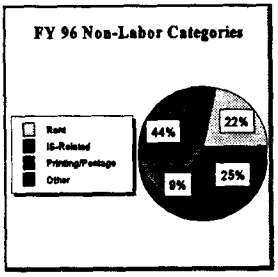
Appendices:
A. Budget Overview
B. Performance Measures Hierarchy

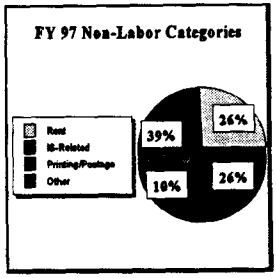
Appendix A

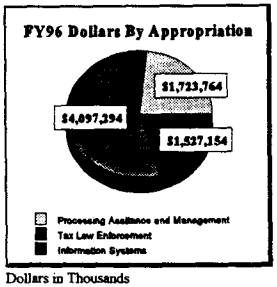
BUDGET OVERVIEW



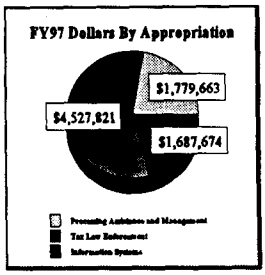








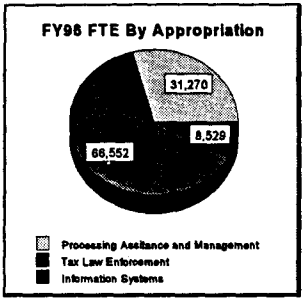
Dollars in Thousands

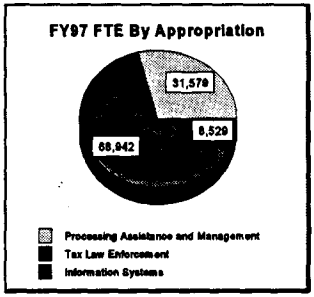


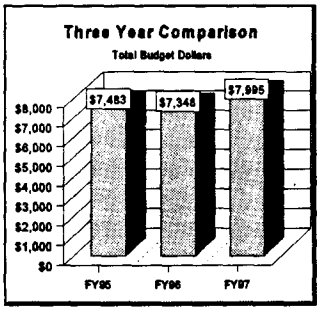
Dollars in Thousands

Appendix A

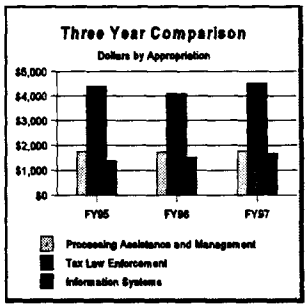
BUDGET OVERVIEW







Dollars in Millions



Dollars in Millions

Budget Overview

	FTE	$(000)
FY 1996 OPERATING LEVEL	100,215	$7,348,212

FY 1997 CHANGES:		
1. Maintaining Current Operations	**FTE**	**$(000)**
(a) Maintaining Current Operations		
1. Labor	--	154,901
2. Non-Labor	--	24,575
(b) Annualization of FY 1996 Pay Raise	--	28,109
(c) Service Center Workload Growth	220	7,227
(d) Non-Pay Raise Labor Shortfall	--	61,000
Subtotal	220	275,812

2. Reductions	**FTE**	**$(000)**
(a) Admin. Cost Reduction (E.O. #1283	--	(58,200)
(b) Compliance/IS Program Reduction	(1,341)	(80,500)
Subtotal	(1,341)	(138,700)

3. Tax Systems Modernization	**FTE**	**$(000)**
(a) Integrated Case Processing System	--	64,176
(b) Contractor Support	--	38,024
(c) Integrated Input Processing System	--	36,000
(d) Tull-Free Circuitry	--	11,800
Subtotal	0	150,000

4. Revenue Protection Initiative	**FTE**	**$(000)**
CI (QRDT)	230	20,812
Examination - Service Center	300	35,423
Collection - ACS & SCCB	2,250	250,746
Document Matching	800	39,631
ITIN	240	12,385
Subtotal	3,820	358,997

5. Other	**FTE**	**$(000)**
OIG Reimbursement	--	834

FY 1997 PRESIDENT'S BUDGET	103,214	$7,795,154

1. Maintaining Current Operations
(a) In order to maintain current operations, the Service must fund: increased salary costs associated with the pay raise, and inflationary price increases. Also included is a 3% rent reduction that reflects a GSA estimate based on the most recent site inventory.
(b) Amounts needed in FY 1997 to pay for FY 1996 pay raise.
(c) Resources needed to cover the projected increase to the growth in taxpayer population.
(d) Labor cost growth due in part to lower attrition rates resulting in increased seniority and higher salaries.

2. Reductions
(a) The FY 1997 adjustment responding to Executive Order 12837, requires agencies to reduce administrative costs by not less than 14% between 1994 and 1997; the FY 1997 reduction is 5%.
(b) The Service's portion of a base program cut applied to all Departmental bureaus - includes a $67.5 million cut to TLE and a $13 million cut to IS.

3. Tax Systems Modernization
Integrated Case Processing System will improve information availability to front-line employees. A subset of that, the Integrated Collection System will be implemented in 20 of 33 districts with 60% of revenue officers having access. As guided by Congress, GAO, and the National Research Council, information systems development and integration work will shift to its major contractors. Cyberfile provides most individual taxpayers the ability to file tax returns electronically. Telefile eligibility will expand to married and head of household taxpayers increasing the number of taxpayers who can use Telefile from 23 million to 40 million.

4 Revenue Protection Initiative
The Revenue Protection Initiative (RPI) is a continuation of the Service's long-term strategy to improve voluntary compliance. During the six year time frame this initiative can be expected to generate more than $16 billion in additional revenue; the FY 1997 revenues are expected to total $1.5 billion. RPI staffing increases are mainly targeted at call site and service center-based enforcement programs. These activities represent highly cost effective investments and are less intrusive and burdensome than traditional face-to-face enforcement actions.

5. Other
Resource requirements for IRS in FY 1997 include a program increase for the cost of the IRS portion of an audited financial statement in order to meet requirements of the Governmental Management Reform Act of 1994 (P.L. 103-356).

Performance Measures Hierarchy

		FY 1995 Actual	FY 1996 Estimate	FY 1997 Estimate
Mission Measure				
Collect the proper amount of tax revenue at the least cost.	Revenue Collected - (Budget + Burden) / Total True Tax Liability	0.7706	0.7826	0.7887
Objective Measures				
Increase Voluntary Compliance	(1) Total Collection Percentage (TCP)	86.0%	86.3%	86.7%
	(2) Total Net Revenue Collected	$1.271 T	$1.356 T	$1.456 T
Maximize Customer Satisfaction	(1) Revenue Collected per Dollar of Burden	$10.97	$11.38	$11.86
	(2) The time expended by taxpayers in fulfilling their tax responsibilities	5.3 Billion Hrs	5.3 Billion Hrs	5.3 Billion Hrs
	(3) Favorability of IRS (Roper Survey)	38%	47%	49%
Achieve Quality-Driven Productivity	(1) Revenue Collected per Dollar of IRS Budget	$172	$185	$191
Multi-functional Measures				
	Total Revenue Protected	$7.6B	$4.14B	$4.15B
	% Tax Payments Paid Timely	97%	97%	97.5%
	Increase in Net Revenue Collected	$588	$878	$926
	PRP average processing time (closed cases in days)			
	District Offices	42.6	40.5	40.5
	Service Centers	26.6	25.5	25.5
	% of PRP Cases Identified	85.6%	86%	86%
	PRP Quality Customer Service Rate (CSR)			
	District Offices	74%	78%	78%
	Service Centers	60%	70%	70%
Budget Activity Measures				
- *Submission Processing*	Number of primary returns filed (in thousands)	193,150	197,063	199,516
	Number of supplemental documents filed (in thousands)	11,937	12,127	12,580
	Total number of individual refunds issued (in thousands)	88,736	90,510	91,536
	Processing accuracy rate -- paper	94%	94%	94%
	Processing accuracy rate -- ELF	99%	99%	99%
	Refund timeliness -- paper (days)	36	40	40
	Refund timeliness -- ELF (days)	21	21	21
	% Dollar amount of Federal Tax Deposits received electronically	12%	18.4%	36.2%
	% Returns filed on media other paper	8%	10%	11%
	% required individual returns filed	86%	86%	86.2%
- Taxpayer Services	Number of calls answered -- toll-free (including Tele-tax calls)	110.0M	102.7M	102.7M
	TPS tax law accuracy (formerly called technical accuracy)	91%	90%	90%
	TPS account accuracy	91%	91%	91%
	TPS Level of Access(Servicewide measure)	38.8%	41.4%	42%
	Calls answered as % of schedule	111%	100%	100%
	Initial Contact Resolution (ICR) rate (formerly called One-Stop Contact Rate)	75%	77%	79%
	Taxpayer Contacts/FTE	7,059	6,843	6,843
- Inspection	Number of Internal Audit reports issued	116	110	110
	Number of Internal Audit recommendations to IRS management	882	860	860
	Number of security investigations conducted	9,350	9,450	9,470
	Amount of fines, restitutions, and funds recovered or imposed by judicial order (in thousands)	$6,882	$6,348	$6,358
	Number of prosecutions/Administrative actions	1,010	1,001	1,003
- Management Services	% of Employees Trained in Systems Management	8.79%	9.0%	9.1%
	Training FTEs % of Total FTEs - RA	9.0%	6.0%	6.0%
	Training FTEs % of Total FTEs - TA	19.0%	9.0%	9.0%
	% Bargaining Unit Employees Filing Step 2 Grievances	1.7%	1.6%	1.5%
	Absentee Rate	68 Hrs.	67 Hrs.	66 Hrs.
	TQO Certification	74%	100%	100%

- Tax Fraud & Financial Investigation	Fraud Convictions	1,954	1,954	1,832
	Narcotics Convictions	994	921	860
	Indictment Rate	91%	90%	90%
	Publicized Investigations per FTE	0.6	0.7	0.7
	Fraudulent return deletion rate - paper and electronic	76%	80%	86%
	Refund fraud deletion rate - paper and electronic	76%	80%	86%
- Examination	**Examination Measures**			
	Recommended additional tax and penalties	$28.62B	$23.6B	$23.4B
	Audit coverage	1.83%	1.54%	1.61%
	Cycle Time (Days) RA 1040 Business	307	298	289
	Cycle Time (Days) RA 1040 Nonbusiness	327	317	307
	Cycle Time (Days) RA 1120	375	364	353
	Cycle Time (Days) TA 1040 Business	265	257	249
	Cycle Time (Days) TA 1040 Nonbusiness	215	209	203
	CEP Currency (Open Year Average)	3.2	3.2	3.1
	$/Hour Mean RA 1040	$967	$1,006	$1,036
	$/Hour Mean RA 1120	$1,073	$1,116	$1,149
	$/Hour Mean TA 1040	$817	$850	$876
	$/Hour using Total Adjusted Revenue (TAR)	$6,897	$5,727	$5,900
	% of Agreed and Partially Agreed CEP Examinations	77.5%	78.5%	79.5%
	% Assessed $ Collected Before 2nd Notice	64.2%	65.5%	66.6%
	Appeals Measures			
	Work Units Closed, Non-Docketed	42,513	41,622	43,183
	Work Units Closed, Docketed	22,813	22,436	23,277
	Revenue in Billions of Dollars, Non-Docketed	2,878	2,817	2,924
	Revenue in Billions of Dollars, Docketed	0.616	0.603	0.626
	Agreed Cases, Non-Docketed	35,371	34,630	35,928
	Agreed Cases, Docketed	20,586	20,169	20,928
	Lapse Days, Non-Docketed Under $10 million	243	238	228
	Lapse Days, Non-Docketed $10 million and Over	824	799	775
	Increase % of Appeals Officer direct time	66.5%	68.3%	69.6%
- Chief Counsel	Technical Advice and Service Assistance (Completions)	4,858	4,566	4,580
	Private Letter Rulings and Advance Pricing Agreements (Completions)	3,256	3,068	3,080
	Regulations, Revenue Rulings, and Revenue Procedures (Completions)	611	574	574
	Docketed Tax Litigation Case Closures	26,787	26,180	26,180
	Docketed Tax Litigation Dollars Protected for Closures ($000s)	$2,067,331	$1,943,290	$1,943,290
	Docketed Tax Litigation Cycle Time	564	530	530
	Counsel Bankruptcy -- Closures	$30,515	28,684	28,684
	Counsel Bankruptcy -- Dollars Protected ($000s)	$6,831,456	$6,233,600	$6,233,600
	Counsel Litigation Support -- Criminal Tax Closures	5,617	5,280	5,280
	Counsel Litigation Support -- General Legal Services Closures	3,247	3,062	3,062
	Counsel Litigation Support -- Other General Litigation Closures	46,019	43,258	43,258
	Counsel Litigation Support -- Refund Closures	841	790	790
	Counsel Litigation Support -- Refund Dollars Protected ($000s)	$72,526	$68,176	$68,176
- Employee Plans & Exempt Organizations	EP Determination Cycle Time (Days)	119	180	126
	EO Determination Cycle Time (Days)	84	83.4	83.4
	EP Determination Letter Inventory	54,900	20,000	20,000
- International	Foreign Controlled Corporation Direct Exam FTE	120	81	81
	US Initiated Competent Authority Case Cycle Time (Days)	658	730	730
	Foreign Initiated Competent Authority Case Cycle Time (Days)	587	730	730
	International Enforcement No Change Rate (Days)	22.46%	21.4%	20.4%

- Collection	Collection Yield	$25.18	$24.9	**25.96**
	ACS Average Cycles to Dispose TDA/TDI	23.9	23.9	**23.4**
	CFf Average Cycles to Dispose TDA/TDI	36.7	42.1	**41.8**
	ACS Level of Service	58%	80%	**85%**
	ACS Average Hours per Entity Disposition	3.5	3.7	**3.8**
	CFf Average Hours per Entity Disposition	44.4	49.8	**48.8**
	ACS $ Collected/FTE	$1,124,000	$1,236,000	**$1,060,000**
	CFf $ Collected/FTE	$413,000	$438,000	**$460,000**
- Document Matching	Assessments, Underreporter (Millions)	$1,658	$1,368.3	**$1,619.0**
	Assessments, Substitute for Return (Millions)	$1,948	$1,291.7	**$1,140.0**
	Refunds, Underreporter	$120	$95	**$125**
	Information Returns Received (Millions)	1,052.0	1,154.4	**1,139.8**
	% of Information Documents Processed	96.68%	96.68%	**96.00%**
- Resources Management Compliance	Support Services Timeliness Index	100.0	100.0	**100.0**
	Support Services Cycle Time Index	100.0	105.4	**105.4**
	Support Services Cost Index	100.0	103.6	**103.8**
	Support Services Customer Satisfaction Index	100.0	100.0	**100.0**
	Support Services Quality Index	100.0	100.0	**100.0**
- TSM Modernized Operational Systems	**FY 1997 Modernization Scheduled Program Accomplishments**			
	FY 1997 MODERNIZATION SCHEDULE			
	The performance measures for the requested investment in tax systems modernization will be provided as part of the report requested in the 1996 appropriations act. The Treasury Secretary will provide this report to the Committees on Appropriations of the House and Senate containing, among four specific requests, a milestone schedule for development and implementation of all projects included in the tax systems modernization program.			

Chairman JOHNSON. Thank you, Commissioner. I appreciate your testimony. And for the Members' knowledge, included in your testimony is quite a long section on debt collection, and you may get a chance to address that in the course of the questions.

Before we get into that, however, let me turn to some other matters, just to return to the part of your testimony where you discussed the impact of your screens last year and your efforts to reduce fraud, particularly in the EITC Program. The outcome was very impressive. Are those screens working this year? Do you have reason to believe that you are going to be able to maintain the progress you made last year? Do you think there will be any increased benefit from the work that you have done to reduce fraud in that area?

Ms. RICHARDSON. Very much so, Madam Chairman. We installed our electronic fraud detection system and a number of filters this year based on things we learned last year. We feel that we certainly weren't going to lessen our efforts, but we were able to refine what we were doing, which I think accounts for the fact that, as you pointed out earlier, we are having a much smoother filing season. But we have certainly not lessened our commitment to preventing refund fraud.

Chairman JOHNSON. There are some other areas where you have a lot of concern about fraud, one of which is health care fraud.

Ms. RICHARDSON. Right.

Chairman JOHNSON. Could you discuss your efforts in that area? And are there any new things in this filing season that you are doing to try to identify fraud? As a Member of the Health Subcommittee of this Committee, we are keenly aware of the problems in some of the provider service areas.

Ms. RICHARDSON. Well, as you and I have discussed, health care fraud is an area that is of grave concern to us and to other Federal law enforcement agencies, as well as State law enforcement agencies. And it is an area of growing concern. It is not particularly geared to a filing season, so we don't have anything that we do that is unique to the filing season. However, our Criminal Investigation Division is working closely with other law enforcement agencies in a number of major health care fraud investigations. We reported on a couple of convictions in our written testimony. I would be happy to provide you and the Committee more information about it.

[The following was subsequently received:]

Many fraud experts estimate that at least 10 percent of all funds expended on health care is lost to fraud. This would mean that over $100 billion is lost annually to fraud.

IRS' current criminal investigations reflect that the scope of health care fraud is extraordinary, not only in the financial losses incurred, but also in the malicious intent of the perpetrators who prey on the most vulnerable members of our society.

IRS currently has 183 health care fraud cases under criminal investigation. The number of cases under investigation has increased from 76 in FY 1993 to 183 currently. The current inventory of cases consists of the "classic" types of health care fraud schemes involving fraudulent claims made by physicians, clinics, and others involved with the health care industry. In addition, they also encompass a broader range of related industries, such as ambulance and patient transportation services, which are not commonly thought to be a part of the health care industry. Since health care fraud is a multi-faceted problem that is pervasive throughout the industry, we anticipate an even greater commitment of IRS' criminal resources in the future.

The cornerstone to combating health care fraud is cooperation between federal law enforcement agencies and industry. Cooperative efforts magnify the results which could be achieved through individual agency efforts and represent the most effective use of IRS' scarce resources. The cooperative efforts currently underway are best exemplified by the Health Care Fraud Task Forces mandated by the Attorney General. These task forces have been established in every judicial district under the leadership of the respective United States Attorney. IRS agents are members of these task forces where their unique skills are in demand in the investigation and prosecution of these complex financial crimes.

The diversity of health care cases under investigation by the IRS are illustrated by the following examples:

- On February 28, 1996, a former dentist was sentenced to two years in prison for defrauding the Medicaid Program and income tax evasion. To generate fraudulent Medicaid billings, the dentist extracted, filled, and installed crowns on healthy teeth of poor children. This scheme began in 1985 and continued until 1992. IRS' investigation established that in tax years 1987-1989, the defendant failed to report over $219,000 in income annually.

- Taxicab Scheme - On October 20, 1995, forty-two individuals were indicted with cheating the Medicaid system out of at least $4 million by falsifying transportation costs. The investigation substantiated several types of fraud including submitting claims for services not performed and over billing Medicaid for services when actually provided. Defendants face prison terms ranging from one to thirty years and fines from $100,000 to $250,000.

- Pharmacist - On October 12, 1995, George A. DiLeo, a former pharmacist, entered into a plea agreement with federal prosecutors by admitting he defrauded $350,000 from state and federal government insurance programs and failed to report $274,000 in income to the IRS. DiLeo was sentenced to 8 months in a halfway house, 3 years probation, and 200 hours community service.

Chairman JOHNSON. Are you making any changes in your screens or enforcement or forms or routine business in order to reduce the possibility of fraud in this area?

Ms. RICHARDSON. I might have Jim Donelson comment.

Mr. DONELSON. Madam Chair, if I may, on the compliance side, the criminal investigation organization has open cases in the health care industry. We know that there is approximately $100 billion annually that experts estimate is lost through fraud in the health care industry, and we are concerned about that money flowing through that industry and the potential of money laundering and other aspects of, as you describe it, fraud in that industry. So we do have cases throughout the country that have been initiated by our criminal investigators.

Chairman JOHNSON. The $100 billion is the industry activity. That is not——

Mr. DONELSON. Exactly. It is not the tax implication.

Chairman JOHNSON. In terms of the reduction in your budget last year, and particularly looking to the future, some of the things you are doing like encouraging filing by telephone, making your forms available, some of the projects you have done to make it easier to pay your taxes and easier to get the information you need to do so have also reduced some of the burden on your staff.

Ms. RICHARDSON. That is correct.

Chairman JOHNSON. In looking at absorbing reductions, has there been any reduction in taxpayer services?

Ms. RICHARDSON. Well, we have certainly had to reduce the face-to-face contact, as I mentioned in my oral statement. But we have tried to provide alternatives for taxpayers to get information through our automated telephone system, our TeleTax system. We have had, I think, about 28 million calls this year that we have already answered through our TeleTax system. It is a system where you can get refund information, the status of your refund, and there are automated answers to 148 of the most frequently asked questions.

As I mentioned, we have our forms and publications on the Internet. We have a fax-on-demand system for forms as well. And we have almost 20,000 volunteer tax counseling for the elderly sites this year. So we have done what we could to try to serve more customers, but not necessarily do it in a face-to-face way.

Chairman JOHNSON. From the comments that I get from my constituents, my conclusion is that you have successfully improved your ability to service taxpayers in a number of automated ways and that you actually do have the personnel to satisfy the walk-in business and the face-to-face contact that is necessary. Would that be your conclusion?

Ms. RICHARDSON. Well, obviously we would always like to be able to serve more people and answer more phone calls.

Chairman JOHNSON. I understand.

Ms. RICHARDSON. I think anybody in business, and particularly in the customer service business, would like to answer every call on the first ring. But we understand that resources are somewhat limited.

Chairman JOHNSON. What is the primary focus of your professional education and training efforts? And to what extent are they going to be affected by tight budgets?

Ms. RICHARDSON. I might ask Jim Donelson to address that. He is both Chief, Taxpayer Service and Acting Chief Compliance Officer and knows a lot about the professional education issues.

Chairman JOHNSON. And as you are talking about that, would you talk about if there are impacts on your training programs, which ones. And are you doing it equally across the board, or are there programs that you are committed to retaining at the same level or stronger? I want to get a better idea of the training component, how it affects staff capability, and how reductions in funding are being handled.

Ms. RICHARDSON. Excuse me. I might just say in a general way, though, what we have tried to do in the last several years and will continue to do is analyze our training money so that we can provide the highest quality training with the least amount of cost. We are doing much more with distance learning, using videos, videoconferencing, and teleconferencing. A good bit of our training money in the past had gone to pay for travel and lodging as people came for offsite training. We are trying to shift that balance so that we can provide high-quality training to a greater number of people.

Mr. DONELSON. Madam Chairman, if I may, we have had to take some reduction and cuts in our continuing professional education and training, as well as our outservice training where we send our employees out to receive training outside the Agency. We are continuing to give the basic training to our employees and making the cuts as judiciously as possible where we think we can afford to take them. I am sure that there are employees that wish they could have certain training courses that we just can't afford to send them to as we may have in the past, and we have done a lot, as the Commissioner has said, by using technology to train people across the country.

Our Office of Chief Counsel has a very excellent process that they use for satellite training around the country, and we are engaging in that to help train our examination people, for example. And we continue to run our CID, our criminal investigation people, through the Glynnco Program, as well as all of the other Treasury enforcement agencies. So we have taken cuts. We have tried to absorb them as judiciously as possible.

Chairman JOHNSON. Thank you very much. I am going to recognize my colleague, Congressman Laughlin, for some questions, and then we will come back to the TSM issue. Thank you.

Mr. LAUGHLIN. Thank you, Madam Chairman.

Commissioner Richardson, one of the most serious criticisms that has been leveled at the Tax Systems Modernization Program is that there is a lack of focus and an inability to establish priorities. Both the General Accounting Office and the National Research Council have raised this repeatedly in their reports.

Have you prioritized your systems development efforts? And can you provide us with a list of programs where you will focus your resources?

Ms. RICHARDSON. Yes, Mr. Laughlin, and as I mentioned in my oral statement, we have taken those criticisms very seriously, and

I think they are valid criticisms. I would like to get Mr. Dolan to tell you what efforts we have had underway this past year to refocus the program and reprioritize the various projects.

Mr. DOLAN. One of the things we did, Mr. Laughlin, is we looked at—as this endeavor started, as the Commissioner said in her testimony, back in the late eighties, it was, I think, designed originally more as a replacement of technology, and what we have done very aggressively in the last several months is put the cart maybe a little bit back behind the horse in the sense of looking at some of our very basic business choices and looking at the parts of our business for which we most wanted to leverage the technology.

We went through last summer something we called a rescoping effort which essentially had us take all of our projects and priorities and apply them against a metric that the General Accounting Office had advanced to us as a best practices set of metrics. We evaluated our investments both in terms of their business value to us and their risk on a cost and schedule basis. And we essentially have redone our entire suite of investments in what we now think is a much tighter focused set of increments that both are high value on the side of achievability and high value with respect to the benefit they bring to the customer and customer service, to compliance, and then to us in terms of productivity.

Mr. LAUGHLIN. Well, could you give us the list of the programs where you are now going to focus as a result of these efforts?

Ms. RICHARDSON. I would be happy to submit these to you for the record. We have four reports that we are in the process of finalizing for the Appropriations Subcommittee, and one of those reports will have that list in it. We would be happy to provide that to you as well.

Mr. LAUGHLIN. Provide it to the Chairwoman, if you would.

[The following was subsequently received:]

Electronic Filing

Provide Alternative Means of Filing and Paying

- Electronic Federal Tax Payment System (EFTPS)
- Electronic Management System (EMS)
- CyberFile
- TeleFile
- Simplified Tax and Wage Reporting System (STAWRS)

Paper Filing

Process Remaining Paper More Efficiently

- Document Processing System (DPS)
- Service Center Recognition/Image Processing System (SCRIPS)
- Lockbox

Modernization Foundation

Build and Maintain a Robust Infrastructure

- Workload Management System (WMS)
- Corporate Accounts Processing System (CAPS)
- Sevice Center Replacement System (SCRS) Consolidation
- Corporate Systems Modernization/Mirror Image Acquisition (CSM/MIA)
- Servicewide Technical Infrastructure (STI)
- Software Development Environment (SDE)
- Enterprise Security System (ESS)
- Customer Support and Automated Operations (CSAO)
- Revenue General Ledger System (RGLS)
- Telecommunications

Customer Service

Give Employees Access to Complete Information and Modern Tools

- Customer Service/Integrated Case Processing
- Automated Self-Service Applications
- Toll-Free Operations

Compliance

Give Employees Access to Complete Information and Modern Tools
Improve and Accelerate Compliance Issue Identification

- Integrated Collection System (ICS)
- Compliance Research Information System (CRIS)
- Compliance Data Warehouse (CDW)
- Examination Support
- Electronic Fraud Detection System (EFDS)

Table 3-1. TSM Projects by Program Components

Mr. LAUGHLIN. In the past there have been serious questions with respect to your ability to leverage the resources provided by outside contractors. Can you tell us how you plan to improve the use of the outside resources?

Ms. RICHARDSON. Particularly in respect to the Tax Systems Modernization Project?

Mr. LAUGHLIN. Yes.

Ms. RICHARDSON. As I mentioned in my opening statement, we have a systems integrator, and we are moving to utilize them to the fullest extent possible under the contract. Most of the software development on the big projects that we have underway or will undertake will be done by outside contractors. We are working with our systems integrator to make sure that all of the projects integrate as they come together in the final analysis.

Mr. LAUGHLIN. In that area, our staff has given us some information, and I have got to tell you, I share their concern that there appears to be high tech, high cost, but low performance. This brings to mind the debacle at the Denver airport in their baggage-handling system. And in my earlier life in Congress, I was on the Aviation Subcommittee, and we heard too much about what was going wrong there.

Can you tell us what is happening from your management viewpoint that will alleviate the concern that we have that we are going to have a Denver airport baggage problem here?

Ms. RICHARDSON. Well, as I mentioned in my opening statement—and I think we went into more detail in the written statement—we have taken to heart the criticisms. We have put in place a different management structure than we had in the past. All of the authority for modernization—the budget, the resources, and reengineering efforts, not just the technology piece but the reengineering of our business processes—is currently the responsibility of the Associate Commissioner for Modernization. We have a new Chief Information Officer who will be joining us in 2 weeks who has had extensive experience in technology modernization in a major tax administration system.

Mr. Dolan mentioned we moved to reprioritize. We had a project last fall where we reprioritized our investments. We have set up an investment review board so that each and every project has to be rigorously scrubbed for its business investment potential to aid us in our business. A very strict business case, using some of the GAO best practices that we worked with them on, has to be made in order for a project to be funded.

We also recognize that many of the projects that people would like to have had or would like to have done are no longer affordable. The unlimited budgets that looked like people were going to have in the late eighties and maybe early nineties are not going to be there, so we are trying to focus our attention on the projects that we think are most important for us to provide good customer service and also to enhance compliance. Other projects will not be funded unless they meet these rigorous criteria.

Mr. LAUGHLIN. In your review, have you identified programs that are no longer needed because of changes in technology, because of new programs? And are you in the process of identifying any that

are required by law that are no longer needed? And I think on that last point, you and I had this discussion yesterday.

Ms. RICHARDSON. Right.

Mr. LAUGHLIN. If so, what can we do to eliminate those that are no longer needed because of changes that you have either implemented through technological advances or new programs?

Ms. RICHARDSON. As I mentioned to you yesterday, we will give some thought to those on the question that they may not be needed because of changes in the law and I will get back to you.

Mr. LAUGHLIN. And that will include elimination of some programs that we may not need anymore because of either new programs or new innovations that the Service has implemented.

Ms. RICHARDSON. Right.

Mr. LAUGHLIN. You have also spent a great deal of time on developing a business plan for tax system modernization. I understand you are working on a plan to make sure that you develop integrated systems to implement the business plan. When do we get to the implementation itself? Do you have the contractors you need to do the development work?

Ms. RICHARDSON. Again, the reports that will be coming out within the next 30 days should hopefully address the overall plan, the blueprints, and I believe we have most of the contracts in place that we feel we need in order to accomplish our objectives under that business plan. I would ask the Associate Commissioner, Judy Van Alfen, if she would like to elaborate on that.

Ms. VAN ALFEN. Yes, we do have contracts in place that will help us deliver our goals. As both the Commissioner and the Deputy have mentioned, we have been very much involved in looking at all of our investments and laying them out on a 5-year plan, and also breaking them down in a 2-year rollout. We have also strengthened our processes so that we can do a better evaluation of those investments as we move forward.

The contract that we have in place will assist us greatly in moving out of the integrator role which we have chosen to take in the past and moving our integration contractor into that rule.

Ms. RICHARDSON. One project I might mention, Mr. Laughlin, is our integrated collection system which is being used by collection officers. It was used last year in two districts and is being rolled out to more districts this year. But in the two districts where it was fully operational last year, productivity actually increased by over 30 percent, which translates into money in the bank.

Mr. LAUGHLIN. The Federal Government has been pursuing for some time a long-term exercise to reduce the size of the Federal work force, yet the 1997 fiscal year IRS budget proposal proposes to increase the work force at the Internal Revenue Service by 2,699 employees. Why should the IRS be exempt from the downsizing that is occurring throughout the Federal Government? And, second, what effect has the reduced 1996 appropriation had on IRS personnel? Does the Service expect any furlough days or any reduction in force?

Ms. RICHARDSON. Mr. Laughlin, I think in fiscal year 1991 we had about 119,000 FTEs in our budget. This year in fiscal year 1996 we have 106,000 FTEs. So we have certainly not been exempt from any reductions in the Federal work force.

We are 8,000 FTE below where we were 1 year ago. Most of that money and most of those people are directly involved in either frontline collection activities, frontline compliance activities, or in processing tax returns and making sure that money is timely deposited in the Federal Treasury and making sure that people are paying their proper share of taxes, as Chairman Johnson mentioned in her opening statement. Many taxpayers are concerned that while they are paying their proper share, others are not. They want to be assured that others are paying their share of taxes.

At the same time, we don't feel we should be exempt from scrutiny about how we spend our money and whether we use it wisely. And I have said on every occasion meeting with employees, that we, too, need to enhance our productivity and find new solutions to old problems. But I think that the increases that are being proposed for next year are largely in the compliance area and will largely go to raise money that will go for deficit reduction.

Mr. LAUGHLIN. Madam Chairman, I will yield back. Thank you.

Chairman JOHNSON. Thank you. To that last general point, I think some of the projects the IRS has taken on are impressive and have been very successful. The telefiling seems to be going very well. It is clearly improving the quality of taxpayer service and will relieve your staff, and the broader that initiative becomes—now it is very limited to a small group of taxpayers—the more important a resource it will be for taxpayers and the IRS and the more it will enable us to reduce the number of employees in an intelligent and responsive fashion.

There are others of the Tax Systems Modernization Projects that have been very fruitful for us, so for that reason, because I know some of the projects have been very successful, I do want to put on the record and ask you to talk a little bit about the truly shocking depth of criticism of the Tax Modernization Project.

The GAO said there is little tangible evidence that actions being taken will correct the pervasive management and technical weaknesses that continue to plague TSM. GAO described the IRS' software development capability as unlikely to build TSM in a timely and economic manner, and the systems are unlikely to perform as intended. The IRS has placed its software development capability at the lowest level, described as ad hoc and sometimes chaotic, and indicating significant weaknesses.

Now, even for GAO, that is pretty strong criticism, and GAO has worked with you over all the years that you have implemented this system. So words of that nature are very concerning to this Oversight Committee.

In addition, the National Research Council just last month reported that the IRS has had serious technical capability problems that cast doubt on the overall success of TSM if they are not solved. If the IRS does not begin to improve its development processes—and you have spoken here to some of those efforts that you have made to improve your development processes. But they say if you don't take strong corrective action, TSM will degenerate into a collection of individual projects that are poorly integrated, with inadequate privacy and security safeguards that may or may not be able to cope with the increased workload.

Now, these are very strong statements, very recent statements, followed by Deputy Secretary of the Treasury Larry Summers' testimony before the Treasury and Postal Appropriations Committee that TSM has gone badly off track and it needs to be rethought from bottom to top.

Now, you are familiar with all those statements, but the depth of their criticism is very concerning to me, and when they talked specifically about the Integrated Case Processing Project, a $64 million project in 1997, their conclusion was that frontline employees had not had enough input in its development to assure its usefulness to end users.

Now, you are making some changes. They are at the top. The problem doesn't entirely seem to be at the top. There seems to be a systemic issue here that if it is not addressed, it almost doesn't matter how much money you put into technology if it isn't going to be integrated and if the frontline people haven't been part of generating the solutions.

Now, I say this as one who represents a manufacturing district, machine tools, bearings, those kinds of industries that suffered extraordinary challenge at the hands of targeted and grossly unfair foreign competition. But as they tried to survive, they rethought from the bottom. And when they first tried, they rethought from the top and they failed. And not until they rethought from the bottom did they succeed.

The level of criticism that is coming from the National Research Council recently and from the GAO I hear in the light of my experience as the consequence of the old bureaucratic tendency to solve from the top. And that isn't just a public sector problem. That is a private sector problem. Authority tends to believe it can find solutions, and what I want to know is: What is the problem? When you look back at what you have been through—because you got a lot of good people, and you have really worked hard on this. And you have in certain pockets. I mean, I have known this, but I saw it with you in my own office recently. You have made some very significant improvements in your equipment, in your capability, and are able to serve taxpayers at certain levels and in certain instances very much better. On the other hand, you still can't adjust a change in address or if a taxpayer gets married.

The cases that tend to come to the Members' offices are those kinds of cases: For 3 years now we have been dunned because they can't get through their system that we are now married and we have one name and not two.

So the profound level of criticism that you are receiving is of great concern to me, and having been involved in it in good faith and having accomplished some measurable achievements, to what do you attribute this criticism? And what are you going to do to address it, aside from putting new people in the boxes? Because we had new people actually in the boxes a few years ago.

Ms. RICHARDSON. Well, in fairness, the boxes have changed. We did have a Chief Information Officer, but we did not have an Associate Commissioner for Modernization. And one of the early criticisms I think of both the General Accounting Office and certainly the National Research Council was that we needed a single point of accountability for all of modernization and that accountability

had to be not just for the technology piece of it but for the business side of it as well.

As I mentioned, that position was actually created last year. Judy began in October after her predecessor retired. I think that having that single point of accountability has made a significant difference because it has allowed her and her staff to really take charge of all of the resources for technology, not just what would fall under the Tax Systems Modernization Program.

Chairman JOHNSON. Not by way of criticism, but just by way of information, was there not a single point of accountability sooner because you really thought communication would do it? Or what prevented that from happening sooner? Was it lack of real understanding of the sort of vertically integrated process that has to make change?

I do appreciate that you have done that now. I don't understand why that didn't happen sooner, why it wasn't clear to the Agency that more authority had to be invested in the person or in the group that was going to lead this.

Ms. RICHARDSON. I can't speak to this situation prior to my time. I think that one of the issues and one we touched on earlier—and it is not, I think, unique either to the Federal Government or to the private sector—is that the project began as an upgrade of technology without a lot of thought given to changing business processes. And I think it was in part viewed within the province of the Information Systems Division and the Chief Information Officer. People on the business side, compliance, taxpayer service, and other parts of the organization, were interested in modernizing technology, but I don't know that they were integrated into what was happening with the technology modernization that was being led by the Chief Information Officer's efforts.

Chairman JOHNSON. OK. Let's get that a little clearer because that makes a lot of sense to me. What I hear you saying is that it started out as a technology project.

Ms. RICHARDSON. Yes, ma'am.

Chairman JOHNSON. But it became a review of how the whole agency does its business.

Ms. RICHARDSON. That is correct. The technology modernization began—or thinking for it began certainly in the late eighties, but I think in response to both criticisms from the General Accounting Office as well as the National Research Council, the organization realized that it needed to really rethink its business processes and then be able to leverage technology. You didn't just automate old ways of doing business. That caused a real change in approach, change in thinking, and change in the way we began to look at the whole process of modernization.

Chairman JOHNSON. And in addition to appointing a single point of accountability, what changes are you going to make to ensure that there is much deeper involvement from the Agency itself? Because it is a fairly recent comment that was made that the ICP is going to have problems and is not ready to go operational because there wasn't enough frontline employee involvement in its development.

Ms. RICHARDSON. I might let Mr. Donelson take a crack at some of this, but he and I were both out at our Fresno Service Center

last week—I think it was last week or the week before—looking at where we are basically prototyping our customer service and the use of ICP. We very much have taken into account what frontline employees think, want, and need in trying to make ICP accessible to the people who will actually have to use the system, not just the people who were designing the system or who were developing the software.

We have two prototypes—one in Nashville, which is a district office, and one in Fresno, which is a service center. We have moved ahead with the prototype in order for our frontline employees who are using the systems to obtain experience and help in the development process so that we can make a system that works for the ultimate customer, that is, the frontline employee, as opposed to someone sitting back in Washington or sitting back in a design studio.

Chairman JOHNSON. What specific role did those employees have in the process of change?

Mr. DONELSON. The employees have input into the various changes that are made as we try to improve the product. We have had a version we call 1.5 that has been operating in Fresno, and suggestions from employees as to how that should be enhanced——

Chairman JOHNSON. And is the suggestion process informal or formal?

Mr. DONELSON. It is formal. And they——

Chairman JOHNSON. What form does it take?

Mr. DONELSON. Well, we have working groups that have been at this for some time who are a mixture of higher level managers as well as employees, union representatives as well as managers.

Chairman JOHNSON. When you hear that kind of criticism of your ICP, your Integrated Case Processing Project, does it concern you?

Mr. DONELSON. I will answer that. Absolutely. But one of the reasons the Commissioner and I——

Chairman JOHNSON. Because the feedback from outside experts indicates that the IRS may be trying to go operational with ICP too quickly, which could be a mistake. For example, there is concern that frontline employees have not had enough input in its development in order to assure its usefulness to end users. This is a big issue because if this project doesn't reflect the level of horizontal involvement in planning and doesn't come out with a technology that really is powerful to the people in the frontline in their daily lives, then other projects will be seen as in jeopardy.

Mr. DONELSON. Madam Chairman, the Commissioner and I were out in Fresno just 2 weeks ago because of that kind of criticism that we have heard, and we both went out to see it live, and the demonstration that we saw was presented by a union official, as a matter of fact, an employee who represents his fellow employees. And I can only describe his enthusiasm as overwhelming. He walked us through the system, showed us all the terrific aspects of it from his vantage point, how it makes his job not only easier but more fulfilling because he gets to solve taxpayers' problems with one call. He was extremely enthusiastic about it, and he said it was very easy to learn. He said he learned it in just 4 hours of kind of working with the system and teaching himself, as well as the instruction that he was given. So I think that that was an indi-

cation to me that the needs of our employees will be met by this system.

Ms. RICHARDSON. I think that they also had a very formal role in designing the workstations, designing the functionality, as the word seems to be, and to make it suitable for our frontline assistors.

Mr. DOLAN. Madam Chairman, if you would permit, you ticked off a string of criticisms that both thread themselves through the GAO and the NRC and the last part of it we have been talking about is the ICP. One of the difficult things in a hearing like this is to sort of say two things. One is that the essence of the criticism is an essence that we agree with, and at the same time get a chance to talk about how, when all those words and all those criticisms and all those things aggregate in reports that build on each other, sometimes reporting essentially the same thing and other reports that look like there are now five reports that say the same thing, and also dealing with language like "little evidence that actions will"—well, part of our frustration is we are in the midst of reacting about as aggressively as we know how to a body of work that we actually asked get done and that culminated in a briefing last April, a formal report last July, as a template for how, if we were to do all that we could do, how we could really ratchet ourselves from this series of places where we didn't have our act as well together as it might be, into this admittedly world class undertaking. And I think what I would like to hope is that as we deliver against this middle of April date to the appropriators, what will be resident in the four sets of reports that basically our appropriators asked us to come back with is not anything that would allow anybody to say "little evidence," but hopefully something that would say a heck of a lot of evidence.

Now, some of that evidence will be evidence of work in progress, because one of the other things you talked about was our software maturity level. If you read that report on its face, someone might infer that we should take an organization that is today, by metrics that the Carnegie-Mellon folks use, a level 1 organization, and because we are resolved to improve it, should in 3 or 4 or 6 months make that a level 2 organization. It doesn't happen that way. Experts inside and outside will tell us that it doesn't happen that way. They will tell us that as an organization trying to do what we are doing, we had better have level 2 or better skills available to us, and so we have made a very conscious decision that some part of our inside cadre must get to level 2, but we have also made a conscious decision an awful lot of that software is going to be written on the outside, and it is going to be written by people who are already level 2 or above. Our integration support contractor is a level 3 organization.

So what on the face of it is criticism that we say is right on, you can't do this world class endeavor if you are operating at level 1, but when we get a chance to work behind some of those recommendations and talk about, first, what we are doing, and, second, what we will do more of, I would like to believe we could satisfy you that we are not standing still but, quite the contrary, aggressively moving to deal with the essence of those. And your ICP example is another one. That report upon which that data is drawn

is based on observations that at this point have to be, conservatively stated, 18 months old. We are in a pilot which is the way we chose to make sure that the front-end involvements around this get done correctly before we roll it to the entire organization.

A series of iterations have done exactly what you have suggested is the right thing to do, which is to get the iterations of the people using the systems to come back and make a version 1.0 grow to a version 1.5, grow to a version 2.0, all before that gets then visited on the organization as an operational system to roll out across the board.

So the criticism on the front end of if you don't do it this way it will be a failure, is accurate criticism, but the dipstick was taken 18 months ago and I think today we could lay out a series of things we have done which are, indeed are, the positive kind of reactions from that observation.

Chairman JOHNSON. Well, I do believe that you as an agency have achieved some real improvements in recent years, and out there on the frontline you are doing a better job in many regards, and I think the EITC fraud effort that you made last year was a very successful one. And while it involved some delay—and this is sort of off the subject of tax systems modernization, but there are many areas in which you actually have pressed hard and have some significant success to show for it. I thought your collection figures were very impressive.

As I listen to what you are saying and put together the information that you have given me and that we have talked about over the last year, I am pleased to see the aggressive actions that you are taking to deal with the top-level issues and the architectural issues in a sense, the biggest and most difficult issues that everything else has to fit into. And I think probably the best thing for us to think in terms of is an oversight hearing in about 6 months on how far have you gotten, what did this mean. Because we don't have the same timeframe anymore that we had when this project started 5 or 6 years ago. So there does have to be some real payoff to hiring some of these people. You are more knowledgeable below that person and to work with that person, and so at that time we certainly want to get a better view of how the architectural issues are moving and also of frontline involvement amongst employees.

Thank you for your comments on those issues.

Mr. Laughlin.

Mr. LAUGHLIN. Thank you, Madam Chairman.

Commissioner Richardson, I have a couple more questions on your testimony today and I want to ask the question of you in conjunction with some statements that Chairman Jim Lightfoot of Iowa said about the Modernization Program being a $4 billion fiasco. In your testimony you talk about, "As of today, $1.7 billion in new equipment and software has been installed across the country." Somewhere in here, my information is it is about $3.5 billion, and Chairman Lightfoot has a $4 billion price tag.

Ms. RICHARDSON. He rounded it up, he told me.

Mr. LAUGHLIN. OK. Let's just use the $3.5 billion. But when we use your figure of $1.7 billion for equipment, it seems a staggering amount of money left over for overhead and salaries and consultant

studies, and I just want to ask you: Is all of the almost $2 billion going for salaries and overhead?

Ms. RICHARDSON. We would be happy to supply you with even more detailed figures for the record. I believe that $3.5 billion has been appropriated to date, and of that amount, $2.7 billion has been spent. And when I say appropriated to date, I mean through this fiscal year.

[The following was subsequently received:]

The amount obligated on TSM through the end of FY 1995 was $2.77 billion, with $84 million of the funds appropriated between FY 1988 -1995 available for expenditure during FY 1996. Below are the amounts expended (and obligated) through FY 1995.

Amounts Expended through FY 95
(Dollars In Millions)

Category	Dollars
Salaries/Benefits (FTE)	$647
Computer Hardware/Operations	$623
Software, Commercial Off the Shelf (COTS)	$76
Service Contracts	$560*
Telecommunications	$331
Site Preparation Costs	$279
Support, Training and Travel	$262

*Includes contracts for Engineering/Integration, Strategic Planning/IV&V, and Software Development.

In addition, TSM was appropriated $695 million in FY 1996, of which $265 million has been committed/obligated to date. An additional $317 million has been distributed to the Financial Plan and is being committed; $100 million is fenced pending submission of the report to Congress on the Status of IRS' Management and Implementation of Tax Systems Modernization by the Secretary of Treasury. The balance of $13 million will be distributed within the next few weeks based on Investment Review Board (IRB) priorities. Below is a delineation of the total amounts obligated through March 22, 1996.

FY 1996 Obligations To Date (as of 3/22/96)
(Dollars In Millions)

Category	Dollars
Salaries/Benefits	$48 (payroll data thru 2/96)
Equipment	$53
Services	$157
Supplies	$3
Support	$4

Mr. LAUGHLIN. Let me tell you why I am asking this question. I saw in the newspaper today where the Postal Service is using not tax money but revenue money from postage and the Postal Service talking about funding both political conventions. And I am not suggesting that the IRS is doing——

Ms. RICHARDSON. We are not going to do that, I promise you.

Mr. LAUGHLIN. I think that is an absolute misuse of postal revenues to fund political conventions or the World Series or the Rose Bowl or the Cotton Bowl, if it is ever played again in Texas. But the concern I have is: Where is this money going?

Then I read a report today that some of the labor unions have outfitted a brandnew jet, or the head of some union, I am hopeful that we will get a report that all of this is going to modernization of equipment and not recarpeting of the Victoria, Texas, IRS office, which happens to be down the hall from my office.

Ms. RICHARDSON. Right.

Mr. LAUGHLIN. I don't suspect that is happening, or my staff would have told me.

Ms. RICHARDSON. No, I can assure you——

Mr. LAUGHLIN. Do you see where I am headed? I think this Committee is entitled to know where is this $2 billion going.

Ms. RICHARDSON. Absolutely. And I would be happy to provide you great detail for the record. But I might ask Judy Van Alfen to give you some sense of it.

Ms. VAN ALFEN. Yes, we have been appropriated $3.54 billion. We have spent $2.77 billion, and we have in our budget for this year $695 million. We have spent money on telecommunications, including expansion of telecommunications so that we could deliver our integrated case projects and our ADP acquisitions and operations costs, off-the-shelf software. It pays for contractor costs for development of software, engineering and integration, strategic planning and support by our contractors. It also pays for site preparation to be able to install our initiatives. It does cover IRS salaries, travel, and training in connection with the various projects, and we have some other supports costs. We will be happy to give you further breakdowns on that.

Mr. LAUGHLIN. Fine. And, Commissioner, again your written testimony says, "We have developed a plan with the help of outside experts from other governmental agencies and the private sector to aggressively expand the work of the current Integration Support Contractor. Under this new approach, the Integration Support Contractor will assume as much of the systems integration role as the existing contract permits."

I want to key in on "existing contract permits," because my question to you is: Why not modify the contract to make the contractor a real integrator by making him the prime contractor? It is my understanding that the outside contractors can't implement anything without IRS permission. And it seems to me you don't get good input or innovation if the den mother has to approve everything. It occurs to me that we ought to have more flexibility and consider modifying the contract.

Ms. RICHARDSON. As I understand it—and I am certainly not a contract lawyer, and I would be happy to provide you with some people who can give you much more detail, we cannot unilaterally

modify the contract that we have with either our systems integrator, or any other, and turn them into a prime contractor. In order to do something like that, there are a number of legal requirements that would have to be met, and we are not in a position to do that without some significant changes, I think either approval of Congress or rebidding of the contracts. But it is not something that can be done unilaterally or even bilaterally with the one contractor.

Mr. LAUGHLIN. Sure. I would just ask you to review that area, and it doesn't have to be made a part of the record, but I certainly would ask you to make some type of response or report to Chairwoman Johnson——

Ms. RICHARDSON. One of our four reports to Congress that will be coming out in the next 30 days will discuss the role of the integrator and what we are doing to try to get ourselves out of being the integrator.

Mr. LAUGHLIN. And I would like in that report for you to address to the Chairwoman the role of the contractor and being able to implement innovations free of the constraints imposed by the IRS, or the shackles or whatever word we want to use, because I think when you look at private industry, they have gone through a tremendous amount of change in the last few years that we in government have been either unable or unwilling to do. And if you will just address that to Chairwoman Johnson.

Ms. RICHARDSON. Absolutely.

Mr. LAUGHLIN. It is not necessary to respond at this time.

Chairman JOHNSON. I would also like when you do that to be as specific as possible because that phrase caught my eye, too.

What kinds of things are in the existing contracts that are impediments to innovation? And what would be the cost of rebidding? How can we get out from under that? There may be ways that we can help you do that. I can understand how contracts developed a number of years ago might not serve you well now, but I would like a better understanding of what the existing contract impediments are and how you plan to overcome them, and that leads me to another question I wanted to bring up, which is: Why are you serving as your own prime contractor? And what are the pros and cons of that? The FAA did that in trying to develop their new air traffic control computer network.

Mr. LAUGHLIN. I was going to make reference to that.

Chairman JOHNSON. I used to be on the Public Works Committee, too.

Mr. LAUGHLIN. You all were doing it that long ago?

Chairman JOHNSON. That is right, and sat through the first years of that planning and were really appalled how every time we had a report, the report sounded great, but in the end the system didn't work.

Mr. LAUGHLIN. I would just like to add, Commissioner, that what Chairwoman Johnson has asked is so important because I went through those aviation hearings on implementing a new computer system for the FAA and our airliners, and I may be wrong, but it was in the billions of dollars that had been spent, and we still don't have a modern system after years, because they sold the company to get rid of the contract. I think it would be irresponsible on the

part of this Oversight Subcommittee not to have a full and complete report on that and to look at it closely.

Chairman JOHNSON. It is instructive that the Congress came to the conclusion that the only way you could keep a system that large technologically current was to get it out from under the bureaucracy. So what are the barriers within the structure of the bureaucracy and the way the bureaucracy proceeds that are interfering with the accomplishment of this architectural issue and some of the contractual problems? We will look forward to that report, and I would be happy to get those on the Committee who are most interested together for an informal discussion if that would be more appropriate.

There are a couple of other issues that I did want to pursue if my colleague is finished.

Mr. LAUGHLIN. Absolutely. I yield back the balance of my time.

Chairman JOHNSON. The National Research Council did criticize the security features of TSM. That is extremely important. If we can't guarantee people information security, we are going to have very big problems on our hands. And as we move into TeleFile and CyberFile, if there are doubts about the security of the TSM system, it will simply fail.

So how can the IRS expand the filing options to the Internet and assure information security? What are you doing to assure that?

Ms. RICHARDSON. Well, we don't want to develop and are not planning to develop any of our systems without proper regard to security. There is a security concept of operations and security architecture that is under development, and I think we elaborated more on that in the written testimony. I would be happy to give a fuller briefing to the Committee about what we are doing. Specifically, as to any kind of direct filing or Internet-related filing, we would never go forward with any program until it could be assured that such a program could be made absolutely secure.

Chairman JOHNSON. How do you respond to the criticisms that the National Research Council made about your security features? Are you familiar with them?

Ms. RICHARDSON. I will let Mike Dolan answer the question.

Mr. DOLAN. A couple, Madam Chairman. We actually had a fairly robust closeout conversation with them around this point, and I think the thing that we took most from their observation and the follow-on conversation was that the architecture that we are currently operating under, which is a very distributed—it is a process by which an awful lot of our data gets distributed widely in the organization. The NRC said to us two things:

One is that we have got to be very conscious that to overlay on that kind of an architecture the security we want and need is a costly undertaking. And so they encouraged us to be sure that we made the right kind of choices surrounding business needs of distributed data versus cost of securing it the way you need to. They encouraged us to make the right kinds of tradeoffs and that we do that up front, recognizing the kinds of cost consequences of our decision.

The other thing they asked us to be sure we weren't doing was looking only at internal security. They acknowledged that we had placed an inordinate amount—not inordinate, an extraordinary

amount of inside security in all of our plans and architectures, and they said they wanted evidence that the way we were building the security levels was also mindful of all the sort of outside penetration attempts that we have seen elsewhere in government.

I think we will be able to satisfy hopefully both you and them from our security architecture that we have done exactly that.

Chairman JOHNSON. Thank you. We will be interested in discussing that information with you when you have completed it.

I want to just conclude by raising the issue of the Service Center Recognition Image Processing System, SCRIPS. SCRIPS was developed to electronically scan instead of manually keypunch into the IRS computer system certain tax forms. In February of this year, last month, an internal audit report prepared by the IRS Inspection Service was critical of the SCRIPS performance and questioned whether it was ready for wide-scale use.

Has SCRIPS met all the performance goals originally set for it? Has SCRIPS captured all information on the forms it scans or only part of the data? What have been the results from the SCRIPS Pilot Program?

Ms. VAN ALFEN. Madam Chairman, SCRIPS has not met all of the performance goals that we had in place and that we had originally set and desired that the system would deliver on. However, this year it is functioning much better. We have made some upgrades and some workflow improvements and it is showing much improved performance this year.

We encountered some major integration issues with it early on, but we feel comfortable that we are working through those, and it is performing much better.

Chairman JOHNSON. So what percentage of the workload that you originally scheduled for SCRIPS has the IRS had to shift to the traditional processing pipelines perhaps last year and this year?

Ms. VAN ALFEN. Last year we did have to shift some of our workload back to the pipeline processing because we were not able to process it all the way through.

Chairman JOHNSON. Fifty percent?

Ms. VAN ALFEN. On one particular form type, yes, that is correct.

Chairman JOHNSON. And how about this year?

Ms. VAN ALFEN. This year we are still processing 50 percent of one form type. However, in the other forms that we have identified, we are processing those through the system.

Chairman JOHNSON. OK. Thank you very much. That concludes my questions, and I thank the panel for being with us this morning.

Mr. Herger has been detained and has been unable to join us before we have completed our discussion, and we will have some follow-on questions for you which he will submit and we will enter in the record.

[The following was subsequently received:]

WALLY HERGER
2D DISTRICT, CALIFORNIA

PLEASE REPLY TO

☐ WASHINGTON OFFICE
2433 RAYBURN HOUSE OFFICE BUILDING
(202) 225-3076

DISTRICT OFFICES

☐ 55 INDEPENDENCE CIRCLE, SUITE 104
CHICO, CA 95926
(916) 893-8363

☐ 470 HUMBOLDT DRIVE, SUITE 115
REDDING, CA 96002
(916) 223-5899

COMMITTEE ON
WAYS AND MEANS

COMMITTEE ON
THE BUDGET

Congress of the United States
House of Representatives
Washington, DC 20515-0502

March 21, 1996

Margaret Richardson
Commissioner Of The Internal Revenue Service
Room 3000
1111 Constitution Avenue, NW
Washington, District of Columbia 20224

Dear Madam Commissioner:

Sierra Pacific Industries, a significant employer in my district, filed a request for a private letter ruling on January 30, 1996 concerning the application of Internal Revenue Code section 1374 to the harvesting of timber. Upon receipt of a favorable ruling, Sierra Pacific intends to make an election to be taxed as an S corporation. The ruling requested was entirely consistent with a series of recent private letter rulings issued by the Service. Nonetheless, Sierra Pacific was recently informed that the request is being closed without the issuance of a ruling. I understand that the Service has taken similar steps with respect to several other taxpayers and has decided to suspend consideration of private rulings in the area while it analyzes the treatment of timber harvesting under section 1374.

I have two major concerns to bring to your attention with regard to this matter. First, as you are well aware, the President has proposed legislation that would make it prohibitively expensive for companies such as Sierra Pacific to elect S corporation status. The administration recently announced that the effective date of the proposed legislation is being delayed to January 1, 1997. Therefore, it is imperative that the Service conclude its review of this issue in a timely fashion so that Sierra Pacific, as well as any other affected taxpayer, will have the opportunity to apply for a favorable ruling. Resolving the issue in a manner favorable to taxpayers will do little good if they are then prevented from making an S election because of the proposed section 1374 legislation.

The second major concern I have is that by closing down the private ruling process in this area, the Service has shut down the flow of factual information concerning timber operations. My constituent informs me that timber operations vary widely from region to region and state to state. It is possible that these factual differences could be important in your consideration of the overall treatment of the timber industry. Therefore, I urge the service not to resolve these complex issues in a limited factual setting, but to seek input from and be open to meeting with affected taxpayers prior to reaching a final decision.

I am confident that you will take these concerns seriously, and look forward to your response. In particular, I would like your commitment to see that this issue is resolved in a timely fashion.

Sincerely,

Wally Herger

Wally Herger
Member of Congress

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

OFFICE OF
CHIEF COUNSEL

The Honorable Wally Herger
House of Representatives
Washington, D.C. 20515-0502

APR 23 1996

Dear Congressman Herger:

Thank you for your March 21, 1996 letter in which you expressed concern that the § 1374 timber issues involved in a ruling request submitted by one of your constituents, Sierra Pacific Industries, be resolved in a timely and orderly fashion. We appreciate your concerns in this matter and assure you that we are dedicated to resolving the complex issues involved in this matter as soon as possible.

In your letter, you expressed two particular concerns regarding your constituent's ruling request. First, you expressed concern that our temporary ruling suspension on § 1374 timber issues may have inadvertedly cut off the flow of information from other taxpayers that could prove helpful in resolving those very issues. We do not intend to close off the flow of factual information or decide these issues in a limited factual setting. We are willing to meet in a presubmission conference with any taxpayer contemplating a ruling request to learn of that taxpayer's factual setting and hear any arguments they wish to make. In fact, we held such a presubmission conference with your constituent on January 30, 1996, in which we learned a great deal about the timber industry in northern California. At that conference, Sierra Pacific Industries' tax representative submitted a well thought out memorandum discussing a number of the complex issues involved. This memorandum is being thoroughly considered in resolving the § 1374 timber issues.

Second, you pointed out that the President has proposed legislation that would make it prohibitively expensive for companies such as Sierra Pacific Industries to elect S status on or after January 1, 1997. You stated that it is therefore imperative that we conclude our review of this matter in a timely and orderly fashion. We assure you that the § 1374 timber issues are receiving our foremost attention, and we are confident that a resolution of these issues will occur well before the January 1, 1997 effective date of the President's proposed legislation. Furthermore, you can rest assured that once a resolution has been reached, your constituent will be promptly notified. If your constituent resubmits the ruling request, we also intend to grant expeditious treatment to ensure that they receive our response well before January 1, 1997.

If you have any further concerns or questions regarding this matter, please feel free to contact me at (202) 622-7720 or Attorneys Mark Jennings and Gene Raineri of my staff at (202) 622-7530.

Sincerely,

Bernita L. Thigpen

Bernita L. Thigpen
(Acting) Deputy Assistant
Chief Counsel (Corporate)

Sierra Pacific Industries

P.O. Box 496028 • Redding, California 96049-6028 • (916) 378-8000

March 27, 1996

Internal Revenue Service
1111 Constitution N. W.
Washington, DC 20224

Attention: Dwayne Vincent

Ladies and Gentlemen:

CONSENT TO DISCLOSE TAX INFORMATION

I hereby authorize the Internal Revenue Service to disclose return information regarding a ruling request filed by Sierra Pacific Industries on January 30, 1996 and closed without a ruling on February 29, 1996, as that term is defined in section 6103(b) of the Internal Revenue Code, to Members and staff of the Subcommittee on Oversight of the House Committee on Ways and Means.

I am aware that without this authorization, this information is confidential and protected by law under the Internal Revenue Code.

Taxpayer's Name: Sierra Pacific Industries

Taxpayer ID Number:

Address: 19794 Riverside Avenue
Anderson, CA 96007

Yours very truly,

SIERRA PACIFIC INDUSTRIES

Jon D. Gartman
Secretary and Director of Taxes

JDG/br

Chairman JOHNSON. Thank you, Commissioner Richardson.

Ms. RICHARDSON. Thank you very much.

Chairman JOHNSON. And my thanks to your staff.

The next panel is Lynda Willis, the Director of Tax Policy and Administration Issues at the U.S. GAO.

I would ask my colleague to take over for a few minutes, and I will return very shortly. But I would like you, Ms. Willis, to proceed.

STATEMENT OF LYNDA D. WILLIS, DIRECTOR, TAX POLICY AND ADMINISTRATION ISSUES, GENERAL GOVERNMENT DIVISION, U.S. GENERAL ACCOUNTING OFFICE; ACCOMPANIED BY RONA B. STILLMAN, PH.D., CHIEF SCIENTIST, COMPUTERS AND TELECOMMUNICATIONS, ACCOUNTING AND INFORMATION MANAGEMENT DIVISION

Ms. WILLIS. Thank you, Madam Chairman. We are pleased to be here today to participate in the Subcommittee's inquiry into the Internal Revenue Service's financial condition for 1996, the status of the 1996 filing season, and the administration's fiscal year 1997 budget request.

With me today is Dr. Rona Stillman, who is the GAO executive responsible for our work evaluating tax systems modernization.

My statement today makes the following four points:

First, programs directed at identifying noncompliance and, to a lesser extent, assisting taxpayers absorbed a substantial portion of the 1996 budget cuts.

Second, the 1996 filing season seems to be going more smoothly than last year's in some key respects.

Third, TSM continues to be plagued by numerous management and technical weaknesses that put additional investments at risk.

And, fourth——

Mr. LAUGHLIN [presiding]. Could I interrupt you. Did the Commissioner leave somebody from her staff here?

[A show of hands.]

OK. Very good. Please proceed.

Ms. WILLIS. And, fourth, although IRS has taken some actions to address our previous concerns with compliance initiatives, some issues remain.

Turning first to IRS' 1996 financial condition, in fiscal year 1996 IRS had an appropriation of $7.3 billion, $160 million less than its 1995 appropriation and $860 million less than the President requested. To accommodate its reduced budget, IRS took a number of actions. These included a hiring freeze, offering early outs without incentives, reducing awards, travel, and overtime costs, reducing the work hours of seasonal employees, and cutting back on the use of nonpermanent staff.

In making its staffing reductions, IRS wanted to ensure that it had enough staff to process tax returns and issue refunds in a timely manner. As a result, programs directed at identifying noncompliance, such as document matching, automated collection, or ACS, and questionable refund detection, absorbs most of the cuts. Affected to a lesser extent were taxpayer assistance programs.

Turning to the filing season, preliminary information indicates that in certain key aspects the 1996 filing season is progressing

much more smoothly than the 1995 season. However, there are still several outstanding concerns. Available data indicate that IRS has been successful in not adversely affecting its ability to do what it sees as its most critical functions: Processing returns and issuing refunds. As of March 15, IRS Service Centers had processed 71 percent of the paper individual income tax returns they had received and had done so within about the same 8- to 13-day cycle time as last year. IRS officials told us that refunds may be going out a couple of days slower than last year, but still within the 40 days that IRS promises taxpayers.

The performance of IRS' new document imaging system, or SCRIPS, that we just talked about has improved in 1996, but remains far from the level of performance IRS had originally expected. Although IRS made changes to SCRIPS after the 1995 filing season to enhance its performance, we are concerned that more specific performance expectations for SCRIPS this filing season were not established. Without those expectations, it is difficult to determine which enhancements were cost beneficial.

As of March 15, the number of individual income tax returns filed electronically had increased substantially compared to the same time last year. This is true even though the overall number of returns filed as of this date was down slightly. Most of the growth was in TeleFile, which went nationwide this year. Although the number of electronic returns is higher than last year, as of March 15 it was still about 16 percent fewer than the number filed at the same point in time 2 years ago.

Last year IRS also took several steps to better ensure that taxpayers were entitled to their refunds, dependents, and earned income credits they claimed. The most visible of these involve the delay of millions of refunds to allow IRS time to verify Social Security numbers and to do compliance checks. Although those efforts appear to have significant deterrent effect, they were not without problems. Specifically, IRS identified many more missing, invalid, and duplicate Social Security numbers than it was able to pursue and ended up releasing the refunds without resolving the problems and delayed millions of refunds for taxpayers that had valid Social Security numbers to check for duplicates, but also ended up releasing those refunds without doing the checks.

IRS took steps this year to address some of the problems it encountered in 1995. It has said it is being more selective in deciding which cases to investigate and which refunds to delay. Statistics indicate that IRS is, indeed, delaying fewer refunds this year. The impact of delaying fewer refunds is also reflected in higher telephone accessibility rates for the 1996 filing season, according to IRS, although the rate is still very low. Accessibility is at 20 percent as of March 9, up from 8 percent for the 1995 filing season. IRS attributes the improved accessibility primarily to the lower number of calls received this year. The number of calls received is down approximately 40 percent.

Although IRS has apparently been able to process returns and issue refunds this year without significant problems, staffing cuts in other areas could be affecting its ability to serve taxpayers and identify questionable refunds.

In 1996 IRS closed 93 walk-in assistance sites and reduced the operating hours for some of the remaining 442. IRS data show that walk-in sites have served about 16 percent fewer taxpayers through March 9 than in the same time last year. However, I should note that taxpayers are able to obtain assistance and service from other sources, although maybe not as easily.

IRS' primary program for detecting questionable refund claims also absorbed staffing cuts in 1996, a decrease of 31 percent. IRS told us that because of the Staff Reduction Program, procedures were changed to better target staff efforts. In an attempt to recoup most of these staff reductions, IRS' budget request for 1997 includes $21 million and 230 FTEs for the Questionable Refund Program. This is part of the revenue initiative I will discuss later.

Moving now to TSM, which began in 1986, is key to IRS' future business vision. IRS' 1997 budget request for TSM is $850 million, $155 million more than 1996. We have raised significant concerns about TSM and continue to believe that additional investments are at risk and we are concerned about how effectively IRS can use the requested funds until it corrects fundamental technical and managerial weaknesses.

While IRS has initiated a number of activities and made some progress in addressing our recommendations to improve the management of TSM, none of our recommendations have been fully satisfied. As a result, we do not believe that IRS can make effective use of TSM systems development funds at this time. Our concern is heightened by the fact that IRS would not give us specific information on its plans for spending the $850 million requested for TSM in 1997. Information that is available on the $155 million increase raises additional concerns in that it contains an additional $29 million for CyberFile. We believe CyberFile is poorly developed and does not adequately address the security requirements needed to protect taxpayer data.

Finally, IRS' 1997 budget request contains $359 million for revenue protection or compliance initiatives. To help Congress deliberate on that portion of their request, you asked that we summarize our past work on compliance initiatives. That work has raised the following issues:

First, prior to fiscal year 1995, IRS consistently used at least some compliance initiative funds to cover budget shortfalls in base operations. To ensure IRS spent 1995 fiscal year compliance initiative funds as intended, its ability to use those funds for other purposes was restricted by Congress.

Second, until recently, IRS was unable to track actual revenues generated by the compliance initiatives. For the last several years, IRS has been implementing an enforcement revenue information system that is intended to report the actual revenue from compliance programs. However, in the past, concerns have been expressed about the reliability of that data, and IRS has been working to resolve those concerns. We will test the reliability of the data as a part of our audit of IRS' 1996 financial statements.

Third, for several years, we have encouraged IRS to shift its collection focus from revenue officers, who generally collect delinquent taxes through face-to-face contact with taxpayers, to more productive processes like ACS that emphasize early telephone contact. Al-

though IRS reduced the number of revenue officer positions in its 1995 compliance initiative, it planned to hire about 750. IRS is now diverting some revenue officers to ACS to mitigate the impact of ACS' 1996 staffing reductions.

The $359 million is expected to fund 3,830 additional compliance staff. According to IRS, most of those staff are for areas such as ACS and document matching that were significantly affected by the 1996 staffing cuts. However, IRS' budget shows that total compliance staffing is expected to increase by only 2,390 positions in 1997. Almost all of the difference is because the budget also includes a decrease of over 1,300 FTEs for law enforcement. According to IRS, the decrease will come from more traditional enforcement job categories such as revenue officers.

One effect of the increases and decreases in the 1997 budget, if implemented as described, would be to alter the mix of collection staffing toward the kind of mix we have advocated in the past.

In conclusion, although IRS has made some changes, certain questions remain regarding the revenue initiatives. Specifically, one, will IRS spend the additional funds for additional compliance staff? Two, does IRS have reliable data on the revenue generated by its enforcement activities? And, three, will IRS be able to achieve the new staffing mix?

That concludes my statement. I would be happy to answer any questions you may have.

[The prepared statement follows:]

STATEMENT OF LYNDA D. WILLIS
DIRECTOR, TAX POLICY AND ADMINISTRATION ISSUES
GENERAL GOVERNMENT DIVISION
U.S. GENERAL ACCOUNTING OFFICE

Madam Chairman and Members of the Subcommittee:

We are pleased to be here today to participate in the Subcommittee's inquiry into the Internal Revenue Service's (IRS) financial condition for 1996, the status of the 1996 filing season, and the administration's fiscal year 1997 budget request for IRS.

Our statement is based on work we have been doing for the Subcommittee and our past reviews of filing season activities, Tax Systems Modernization (TSM), and compliance initiatives.

In our statement, we address the following four issues:

-- According to IRS officials, IRS' actions to reduce staffing through a hiring freeze and an early-out program were not sufficient to cover the labor-cost shortfall that resulted from an approximately $860-million reduction in IRS' budget request for fiscal year 1996. To further cover the shortfall, IRS reduced support costs, cut the number of hours for seasonal employees, and reduced the number of nonpermanent staff. In making these reductions, IRS wanted to ensure that it had enough staff to process tax returns and issue refunds in a timely manner. As a result, programs directed at identifying noncompliance and, to a lesser extent, assisting taxpayers, absorbed most of the cuts.

-- Notwithstanding the budget cuts that affected some of IRS' taxpayer assistance programs, this year's filing season seems to be progressing more smoothly than did last year's in some key respects. Most importantly, IRS is delaying fewer refunds this year while it validates Social Security Numbers (SSN) and Earned Income Credit claims. IRS revised its procedures for 1996 in an attempt to better target its efforts and impose less of a burden on honest taxpayers. Also, telephone accessibility has improved, and more taxpayers are using alternative return-filing methods. Although this filing season appears to be going more smoothly in these respects, there are still several concerns. For example, (1) although telephone accessibility has improved, it is still very low; (2) IRS closed many walk-in sites this year that had provided assistance to taxpayers in the past; and (3) the document imaging system being used to process some individual income tax forms is still not meeting its original expectations.

-- The administration is requesting almost $8 billion for IRS for fiscal year 1997, an increase of $647 million from fiscal year 1996. Of that request, $850 million is for TSM, $155 million more than in 1996. TSM is plagued by numerous managerial and technical weaknesses that we identified in a July 1995 report.[1] Although IRS has initiated actions in response to these weaknesses, those efforts provide little assurance that the weaknesses will be corrected in the near term. As a result, we believe that additional investments in TSM are at risk.

-- The largest program increase in IRS' fiscal year 1997 budget request is $359 million for certain compliance programs. Our past work on compliance initiatives identified several problem areas, including (1) IRS' inability to fully implement past initiatives, (2) the inaccuracy of IRS' tracking of the revenue from such initiatives, and (3) the focus of past collection initiatives on hiring revenue officers instead of more productive collection staff.

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

Although IRS has taken some actions to address our concerns, some issues remain, particularly in terms of the reliability of IRS' data.

OVERVIEW OF IRS' FINANCIAL CONDITION IN FISCAL YEAR 1996

IRS' fiscal year 1996 appropriation was $7.3 billion. That amount was about $860 million less than the President requested for fiscal year 1996 and about $160 million less than IRS' fiscal year 1995 appropriation.

In June 1995, anticipating possible reductions from the amount the President had requested for fiscal year 1996, IRS began taking steps to reduce its staffing levels. On June 30, 1995, IRS announced a hiring freeze. Earlier in 1995, IRS had announced an early-out program without incentives for employees affected by its district office and regional office consolidations. After enactment of its final appropriation, IRS reopened the early-out program through February 3, 1996, and made it available to all employees. About 1,690 staff retired as a result of this program.

To further cut costs, IRS officials said that IRS (1) reduced employee cash awards by 20 percent, for a savings of $11 million;[2] (2) reduced travel and overtime costs by $49 million; (3) reduced the workhours of seasonal employees[3] by as much as 40 percent; and (4) cut back on the use of nonpermanent staff, such as term employees.[4] IRS officials also said that the above actions enabled them to avert a reduction-in-force (RIF). According to IRS officials, by the time IRS would have been able to implement a RIF for fiscal year 1996, the cost would have exceed the savings.

As of March 1, 1996, according to IRS officials, IRS had about $140 million in unfunded mandatory nonlabor costs for fiscal year 1996. Some of those unfunded costs were for telecommunications, postage, and rent. IRS officials said that they are hoping to resolve these unfunded costs without having to resort to furloughs.

Part of the $140 million shortfall stems from lower user-fee receipts than expected. IRS' fiscal year 1996 appropriation assumed a receipt of $119 million from user fees. IRS now expects to receive from $60 to $70 million in such fees for fiscal year 1996.

Staffing Cuts in the Document Matching Program and at Automated Collection System Call Sites

As noted earlier, IRS' actions to reduce labor costs involved steps directed at seasonal and nonpermanent staff. Most of IRS' seasonal and non-permanent staff (1) help process tax returns during the filing season, (2) assist taxpayers either at walk-in offices or over the telephone, and (3) work in compliance programs that do not require face-to-face interaction with taxpayers. IRS officials told us that in deciding which areas to cut, IRS wanted to ensure that it could process tax

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[2]According to IRS officials, IRS considered eliminating all cash awards but decided against that option.

[3]Although IRS' seasonal staff work less than a traditional 40-hour week, 52-week schedule, they are permanent employees.

[4]Term employees are hired for a finite period of time. During that time, they have employment rights similar to those of permanent employees. However, they can be released once their term expires.

returns and issue refunds in a timely manner. As a result, most of IRS' staffing cuts affected its compliance programs, with some cuts in the taxpayer service area.

According to IRS officials, the two compliance programs that employ the largest number of seasonal and term staff are (1) the Document Matching program, through which IRS identifies taxpayers that either underreport their income or do not file required tax returns, and (2) the Automated Collection System (ACS), through which IRS staff try to contact delinquent taxpayers or nonfilers by telephone and resolve the delinquency. Because IRS' cost-cutting measures for fiscal year 1996 focused on seasonal and nonpermanent staff, these two programs were significantly affected.

Document matching

Through the Document Matching program, IRS matches income reported on tax returns with information provided by third parties, such as wage information from employers and interest and dividend information from financial institutions. Those matches are to identify taxpayers that underreported their income (underreporters) and those that did not file required tax returns (nonfilers).

According to IRS, it spent about 1,950 staff years on underreporter activities in fiscal year 1995 and closed 4.1 million cases with recommended tax assessments of $1.7 billion. Because of staff reductions, IRS estimates that it will spend about 1,300 staff years on underreporter activities in 1996--about a 33-percent reduction--and close about 1.5 million fewer cases. IRS estimates that its assessments from closed cases will be $1.4 billion, $300 million less than in 1995. IRS' matching program also identifies taxpayers who have not claimed refunds to which they are entitled. In fiscal year 1995, IRS issued $120 million in refunds through that program. IRS expects that amount to drop to $95 million in 1996 because of staff reductions.

Also under the Document Matching program, IRS creates returns for nonfilers using information documents provided by third parties. According to IRS, it spent about 600 staff years on that effort in fiscal year 1995, closed about 810,000 cases, and assessed $1.9 billion. Because of staff reductions, IRS estimates that it will spend about 370 staff years on this effort in fiscal year 1996--about a 38-percent reduction--and close about 180,000 fewer cases. IRS estimates that assessments from closed cases will be $1.3 billion, $650 million less than in 1995.

Automated Collection System

Once a tax delinquency or delinquent return is identified, IRS uses a three-stage process to collect the tax or secure the return. In the first stage, taxpayers are mailed a series of notices. If the case is not resolved at this point and meets certain criteria, it is transferred to ACS. At this stage, IRS staff in call sites contact the taxpayer or nonfiler by telephone. If the case remains unresolved at this point and meets certain criteria, it is transferred to a revenue officer, who is to visit the taxpayer or nonfiler or take other steps to secure the delinquent return and/or collect the delinquent tax.

Because of various factors discussed in the appendix, ACS had a significant number of seasonal, term, and other than full-time permanent staff at the end of fiscal year 1995--66 percent more than it had at the end of fiscal year 1994. As a result, ACS was targeted for a significant staff reduction when IRS decided to reduce the number of hours for seasonal staff and not extend appointments for term employees.

IRS officials subsequently decided that the budget impact on ACS was too severe. To mitigate the impact, IRS negotiated with the National Treasury Employees Union to allow the detail of about 300 revenue officers and other compliance staff to ACS. These details are to remain in effect for at least 1 year. IRS officials said that they plan to revisit this agreement with the union once IRS knows its budget situation for fiscal year 1997.

THE 1996 FILING SEASON SEEMS TO BE GOING MORE SMOOTHLY THAN LAST YEAR'S IN CERTAIN KEY RESPECTS

On the basis of our past filing season reviews, we had several questions going into the 1996 filing season:

-- How will IRS' staffing reductions for fiscal year 1996 affect its ability to process returns and assist taxpayers?

-- Will last year's drop in the number of electronic filings be reversed?

-- What can taxpayers expect in the way of refund delays in 1996?

-- Will the steady decline in the accessibility of IRS' telephone assistance over the past several years continue?

-- Has the performance of IRS' Service Center Recognition/Image Processing System (SCRIPS) improved?

As discussed below, preliminary information addressing these questions indicates that, in certain key respects, the 1996 filing season is progressing more smoothly than did the 1995 season. As also discussed below, however, there are still several concerns that we will be monitoring during our continuing assessment of filing season activities. Specifically, (1) although telephone accessibility is up, it is still very low; (2) IRS closed many walk-in sites this year that had provided assistance to taxpayers in the past; and (3) SCRIPS is still not meeting its original expectations.

Effect of Staffing Cuts on Filing Season

In deciding where to make the staffing cuts for fiscal year 1996, IRS wanted to make sure it had enough staff to do its most critical functions--process returns and issue refunds--in a timely manner. Available data indicate that IRS has been successful in that regard. As of March 15, 1996, IRS' 10 service centers had processed 71 percent of the paper individual income tax returns they had received (the same percent as last year), and the centers were processing that workload in about the same cycle time as last year (within an average of 8 to 13 days, depending on the type of individual income tax return filed).

IRS service center officials told us that refunds may be going out a couple of days slower than last year but still within the 40 days that IRS promises taxpayers in its customer service standards. Service center officials told us that IRS had decided to focus on meeting the 40-day standard in 1996 rather than incur the extra costs associated with trying to beat it. However, we were unable to verify whether the refund cycle time has changed because the data we use to track refund timeliness were not available at the time we prepared this statement.

Although IRS has apparently been able to process returns and issue refunds this year without any significant problems, staffing cuts in other areas could be affecting its ability to serve taxpayers and identify questionable refund claims.

Taxpayer service

In the taxpayer service area, IRS closed 93 walk-in assistance sites, reduced the operating hours of some of the 442 sites that remained open, and eliminated free electronic filing at 195 of the sites. According to IRS, the closed sites were selected on the basis of their historical volume of work and their proximity to other walk-in sites. As an indication of the effect of these closures and cutbacks, IRS data show that walk-in sites served about 1.7 million taxpayers from January 1 through March 9, 1996--about 16 percent fewer taxpayers than were served at the same time last year.

Walk-in sites provide various free services, including copies of the more commonly used forms and publications, help in preparing returns, and answers to tax law questions. There are other ways taxpayers can obtain those services free, although maybe not as easily.

Taxpayers needing forms and publications, for example, might find them at their local library or can get them by calling IRS' toll-free forms-ordering number. Our reviews of past filing seasons showed that taxpayers were generally able to get through to IRS when they called the forms-ordering number, and the forms distribution centers did a good job accurately filling orders. However, according to IRS, it will generally take from 7 to 15 workdays to receive what you order, if it is in stock. Taxpayers with access to a computer can download forms from Internet or the FedWorld computer bulletin board. Forms are also available on CD-ROM and through IRS' "fax on demand" service.

Taxpayers who need help preparing their returns and do not want to pay for that help might be able to take advantage of the tax preparation services offered at sites around the country that are part of the Volunteer Income Tax Assistance and Tax Counseling for the Elderly programs.

Taxpayers who need answers to tax law questions could call IRS' toll-free tax assistance number (which we discuss later) or IRS' TeleTax system, which has prerecorded information on about 150 topics. As of March 16, 1996, the number of tax law calls to TeleTax had increased by about 10 percent over last year (4.5 million this year compared with 4.1 million last year).

Still another option for free assistance is IRS' World Wide Web site on the Internet. Among other things, IRS' site includes copies of forms, information similar to that on TeleTax, and some interactive scenarios that taxpayers can use to help them answer some commonly asked questions. IRS reported on March 18, 1996, that its World Wide Web site had been accessed more than 25 million times since January 8, 1996.

Questionable refund program

IRS' primary program for detecting questionable refund claims also absorbed staffing cuts in 1996. According to IRS data, the 10 service centers have been allocated a total of about 379 full-time equivalents for that program in fiscal year 1996 compared with 551 full-time equivalents in 1995--a decrease of 31 percent. IRS officials told us that, because of the staff reduction, program procedures were changed in an attempt to better target the staffs' efforts. We do not know the initial impact of these changes because we have not yet seen any statistics on the number of questionable refund claims detected in 1996. In an attempt to recoup most of those staff reductions, IRS' budget request for fiscal year 1997 includes $21 million and 230 full-time equivalent positions for the questionable refund detection program. That request is part of the revenue protection initiative discussed later.

Alternative Ways of Filing

As of March 15, 1996, the number of individual income tax returns filed in ways other than the traditional paper format has increased substantially compared to the same time last year. That is true even though the overall number of returns filed as of March 15 was down slightly from last year. As shown in table 1, most of the growth in alternative filings is due to 1040PC and TeleFile.[5]

Table 1: Individual Income Tax Returns Received, 1994-1996

Type of filing	March 15, 1996	March 17, 1995	March 18, 1994
Traditional paper	36,258,000	40,787,000	38,333,000
Electronic	9,811,000	9,259,000	11,647,000
TeleFile	2,379,000	592,000	459,000
1040PC	2,767,000	673,000	1,723,000
TOTAL	**51,215,000**	**51,311,000**	**52,162,000**

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

Growth in the use of 1040PC is due, in part, to the largest user rejoining the program after dropping out in 1995.[6] The growth in TeleFile is due primarily to its expanded availability. It is now available nationwide; it was only available to taxpayers in 10 states in 1995. IRS' budget request for fiscal year 1997 includes $7 million to allow expansion of TeleFile to other forms and taxpayers. Although IRS has made substantial progress in expanding the use of TeleFile and further expansion seems logical, it is important to note that only about 12 percent of the more than 20 million 1040EZ taxpayers who IRS estimated would be eligible to use the system in 1996 had actually used it as of March 15. In past reports, we have discussed the benefits of TeleFile to taxpayers (e.g., reduced filing time, fewer errors, and quicker refunds) and the presumed benefit to IRS in reduced processing costs. In addition to expanding TeleFile, it seems that IRS could increase participation in the program by (1) determining why many currently eligible users are not participating and (2) taking steps to address any identified barriers to their fuller participation.

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[5]Under TeleFile, certain taxpayers who are eligible to file a Form 1040EZ are allowed to file using a toll-free number on touch-tone telephones. Under the 1040PC method, a taxpayer or tax return preparer uses computer software that produces tax returns in an answer-sheet format. The 1040PC shows the tax return line number and the data (dollar amount, name, etc.) on that line. Only lines on which the taxpayer or preparer has made an entry are included on the 1040PC. Under the third alternative filing method, electronic filing, returns are transmitted over communication lines to an IRS service center, where they are automatically edited and processed.

[6]For the 1995 filing season, IRS required that preparers provide taxpayers with some type of descriptive printout or legend that explained each line on the taxpayer's 1040PC return. According to an official of a private tax preparation firm that had been the largest user of 1040PCs, the firm chose to stop participating in 1995 rather than incur the extra cost associated with providing the legend.

Last year was the first year since electronic filing started in 1986 that the number of returns received electronically decreased from the number received the prior year. Although the number of electronic returns is on the rise this year compared with last, the number filed as of March 15 was still about 16 percent fewer than the number filed at the same time 2 years ago. As we recommended in October 1995, if IRS is to reach its goal of 80 million electronic returns in 2001, it needs to (1) identify those groups of taxpayers who offer the greatest opportunity to reduce IRS' paper processing workload and operating costs if they were to file electronically and (2) develop strategies that focus resources on eliminating or alleviating impediments, such as the program's cost, that inhibit those groups from participating.[7]

Refund Delays

Last year, IRS took several steps in an attempt to better ensure that persons were entitled to the refunds, dependents, and Earned Income Credits they were claiming. The most visible of those efforts involved the delay of millions of refunds to allow IRS time to verify SSNs and do compliance checks. Although those efforts appeared to have had a significant deterrent effect (e.g., preliminary information indicates that 1.9 million fewer dependents were claimed in 1995 than were in 1994), they were not without problems.

IRS (1) identified many more missing, invalid, and duplicate SSNs than it was able to pursue and ended up releasing the refunds without resolving the problems and (2) delayed millions of refunds for taxpayers whose returns had valid SSNs to check for duplicate SSNs but ended up releasing those refunds after several weeks without doing the checks. Many taxpayers and practitioners were surprised that IRS delayed some refunds even if all of the SSNs on the return were good. They were also upset that IRS split some refunds--issuing part of the refund and delaying the rest--but only honored a taxpayer's direct deposit request for the first part of the refund.

As we noted in our report to the Subcommittee on the 1995 filing season, IRS identified fewer fraudulent returns during the first 9 months of 1995 than it did during the same period in 1994, and the percentage of fraudulent refunds it stopped before issuance declined.[8] Neither we nor IRS know whether those decreases were due to a decline in the incidence of fraud or a decline in the effectiveness of IRS' detection efforts. The Director of IRS' Office of Refund Fraud expressed the belief that there were fewer fraudulent returns to be identified in 1995. He opined that the additional controls IRS implemented in 1995 and knowledge of those actions had deterred persons from filing fraudulent returns.

IRS took steps this year to address some of the problems it encountered in implementing its new procedures in 1995. For example, IRS has said that it is being more selective in deciding which cases to investigate and which refunds to delay this year--trying to focus its resources on the most egregious cases and minimize the burden on honest taxpayers.

Statistics on the number of notices sent to taxpayers in 1996 concerning SSN problems and refund delays indicate that IRS is indeed delaying fewer refunds. As of March 9, 1996, IRS had mailed about 56-percent fewer refund-delay notices than at the same time last year. Another indicator that fewer refunds are

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

[8]We limited our comparison to the first 9 months because IRS had not compiled data for the last quarter of 1995.

being delayed in 1996 is the decrease in the number of "where is my refund" calls to IRS. Taxpayers wanting to know the status of their refunds can call TeleTax and get information through the use of an interactive telephone menu. This filing season, as of March 16, 1996, IRS reported receiving 26.5 million such calls--a decrease of about 15 percent from the 31.0 million it reported receiving as of the same time last year.

Telephone Accessibility

For the past several years, taxpayers have had difficulty reaching IRS by telephone. As we reported to the Subcommittee in December 1995, IRS data showed that (1) an estimated 46.9 million callers made 236 million call attempts to IRS for tax assistance between January 1 and April 15, 1995 and (2) IRS was able to respond to only 19.2 million of those attempts--an accessibility rate of 8 percent.[9]

Accessibility has improved this year, although it is still low. IRS data for January 1 through March 9, 1996, showed 63.3 million call attempts, of which 12.7 million were answered--an accessibility rate of about 20 percent. As of the same time last year, IRS reported receiving about 107 million call attempts, of which 11.7 million were answered--an accessibility rate of about 11 percent. As the data indicate, a major reason for the improved accessibility is the significant drop in call attempts. IRS attributed that drop to (1) fewer refund delay notices being issued, as discussed earlier; (2) a slippage in the number of returns filed; and (3) IRS efforts to publicize other information sources, such as Internet.

SCRIPS

In our report to the Subcommittee on the 1995 filing season, we noted that IRS' new document imaging system--SCRIPS--did not perform as expected, leading to increased returns processing costs and lower-than-expected productivity.[10] For example, SCRIPS had such significant downtime that two of the five service centers that were using SCRIPS stopped using it to process Forms 1040EZ. As a result, IRS had to redirect more of the Form 1040EZ processing workload to its manual data entry system. After the 1995 filing season, IRS identified hardware and software upgrades that would be needed to correct the SCRIPS performance problems. IRS made some of those changes for the 1996 filing season.

Our discussions with IRS officials and our review of processing rate data indicate that SCRIPS' performance has improved in 1996. Specifically, SCRIPS is processing at faster rates in three of the five centers and operating with less system downtime in all five centers. However, the two centers that stopped using SCRIPS to process Forms 1040EZ last year are experiencing slower processing rates than those of last year. Despite the improved performance, SCRIPS is far from the level of performance IRS had originally expected. For example, IRS originally planned to be processing all Forms 1040EZ on SCRIPS by 1996; it now expects to process about 50 percent of the Forms 1040EZ received in 1996 on SCRIPS. The remaining forms are being processed through IRS' manual data entry system.

Although IRS made changes to SCRIPS and performance has improved, we are concerned that IRS did not establish more specific performance expectations for SCRIPS this filing season. IRS specified volume expectations by form type, but it did not

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[9]The 1995 Tax Filing Season: IRS Performance Indicators Provide Incomplete Information About Some Problems (GAO/GGD-96-48, Dec. 29, 1995).

[10]GAO/GGD-96-48.

establish expectations for improvements in processing rates or reductions in system down time that should result from the enhancements made for the 1996 filing season. Without those expectations, it will be difficult for IRS to determine which enhancements were cost beneficial. We are currently reviewing SCRIPS and plan to report our results later this year.

ADDITIONAL INVESTMENTS IN TSM ARE AT RISK GIVEN CURRENT MANAGERIAL AND TECHNICAL WEAKNESSES

TSM, which began in 1986, is key to IRS' vision of a virtually paper-free work environment in which taxpayer account updates are rapid and taxpayer information is readily available to IRS employees to respond to taxpayer inquiries. IRS' fiscal year 1997 request for TSM is $850 million, a $155 million increase from IRS' proposed operating level for fiscal year 1996. We continue to believe that TSM is a high risk and are concerned about how effectively IRS can use the requested funds until it corrects some fundamental technical and managerial weaknesses.

The Treasury, Postal Service and General Government Appropriations Act for 1996 "fenced" $100 million in TSM funding until the Secretary of the Treasury reports to the Senate and House Appropriations Committees on IRS' progress in responding to the recommendations we made in a July 1995 report on TSM.[11]

Many of our recommendations were intended to correct critical IRS management and technical weaknesses by December 31, 1995. Without these corrections, IRS will not have the sound management and technical practices it needs to successfully meet TSM objectives in a cost effective and expeditious manner. A recent National Research Council report on TSM had a similar message.[12] The Council's recommendations parallel the recommendations we made involving IRS' (1) business strategy to reduce reliance on paper, (2) strategic information management practices, (3) software development capabilities, (4) technical infrastructures, and (5) organizational controls.

In our March 14, 1996, testimony before the Subcommittee on Treasury, Postal Service and General Government, House Committee on Appropriations, we assessed IRS' progress in responding to our recommendations.[13] Because IRS' progress report on implementing our recommendations was not finalized, our assessment was based on several follow-up meetings with IRS officials and a review of various planning documents. According to the Deputy Secretary of the Treasury, the Department is currently reviewing IRS' progress report and plans to submit it to Congress "as soon as possible."

IRS has initiated a number of activities and made some progress in addressing our recommendations to improve management of information systems; enhance its software development capability; and better define, perform, and manage TSM's technical activities. However, none of these steps, either individually or in the aggregate, has fully satisfied any of our recommendations.

As a result, we do not believe that IRS can make effective use of TSM systems development funds at this time. Our concern is heightened by the fact that IRS would not give us specific information on its plans for spending the $850 million being

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[11]GAO/AIMD-95-156.

[12]Continued Review of the Tax Systems Modernization of the Internal Revenue Service--Final Report, Computer Science and Telecommunications Board, National Research Council, 1996.

[13]Tax Systems Modernization: Status of Tax Systems Modernization, Tax Delinquencies, and the Potential for Return Free Filing (GAO/T-GGD/AIMD-96-88, Mar. 14, 1996).

requested for TSM in fiscal year 1997. IRS' budget request contains some general information on its plans for the $155 million increase over the proposed operating level for fiscal year 1996. However, the information provided raises additional concerns. In this regard, IRS is requesting an additional $29 million for Cyberfile, an electronic filing system. Earlier this week, we testified that Cyberfile is a poorly developed system that does not adequately address the security requirements needed to protect taxpayer data.[14]

FISCAL YEAR 1997 BUDGET REQUEST INCLUDES
$359 MILLION FOR REVENUE PROTECTION INITIATIVES

In every year but one from 1990 through 1995, Congress has appropriated IRS funds for various compliance initiatives aimed at increasing IRS' enforcement staff with the expectation that the increase would produce more revenue. For fiscal year 1995, Congress appropriated $405 million for compliance initiatives. In estimating the revenue that would be generated from those initiatives--$9.2 billion--IRS assumed that Congress would continue to provide $405 million for the additional staffing over the next 4 years. However, Congress did not provide the second-year funding installment for fiscal year 1996.

IRS' fiscal year 1997 budget request includes $359 million for "revenue protection initiatives". Although the name has changed, these initiatives are directed toward achieving the same goal as were previous compliance initiatives--to increase revenue. To help Congress deliberate on this portion of IRS' budget request, you asked that we summarize our past work on compliance initiatives. That work focused on the following issues:

-- Before fiscal year 1995, IRS consistently used at least some of the compliance initiative funds for purposes other than those that Congress intended. Specifically, IRS used these funds to cover budget shortfalls in base operations. As a result, many of the past compliance initiatives were never fully implemented. To ensure that IRS spent fiscal year 1995 compliance initiative funds as intended, the Appropriation Committees restricted IRS' ability to use those funds for other purposes.

-- Before fiscal year 1995, IRS only tracked the staffing and revenue associated with an initiative. Using this approach, IRS could claim that compliance initiatives had met their revenue goal even if IRS' base staffing had declined, which was often the case. We recommended that IRS provide Congress with information on the total revenue achieved--from both base staffing and compliance initiative staffing--to ensure that Congress had a more accurate picture of IRS' total compliance program.[15] IRS revised its tracking approach for fiscal year 1995.

-- Although IRS revised its tracking approach, we cannot yet comment on the accuracy of the revenue figures in IRS' tracking reports. Until recently, IRS had to estimate the amount of revenue derived from its compliance efforts because it was unable to track actual revenue--regardless of whether it was generated from compliance initiative staff or base staff. For the last several years, IRS has been implementing an Enforcement Revenue Information System (ERIS) that is intended to report the actual revenue from

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

[15]Tax Administration: Congress Needs More Information on Compliance Initiative Results (GAO/GGD-92-118, July 31, 1992).

various compliance programs. In the past, we have discussed concerns about the reliability of ERIS data, and IRS has been working to resolve those problems. We plan to test the reliability of ERIS data as part of our audit of IRS' fiscal year 1996 financial statements.

-- Although we generally supported the fiscal year 1995 compliance initiatives, we did not support hiring more revenue officers. For several years, we have encouraged IRS to shift its collection focus from revenue officers, who generally collect delinquent taxes through face-to-face contact with taxpayers, to more productive processes like ACS, that emphasize early telephone contact. Although IRS subsequently reduced the number of revenue officers for that initiative, it still planned to hire about 750 in fiscal year 1995. As noted earlier, IRS is now diverting some revenue officers --who are paid at higher rates than ACS staff--to ACS to mitigate the impact of ACS staffing reductions.

The $359 million included in IRS' fiscal year budget request for the revenue protection initiatives is expected to fund 3,820 additional compliance staff. According to IRS, most of those staff are for areas, such as ACS and Document Matching, that were significantly affected by fiscal year 1996 staffing cuts.

Despite the 3,820 additional staff associated with the revenue protection initiatives, IRS budget shows that total compliance staffing is expected to increase by only 2,390 positions in fiscal year 1997. Almost all of that difference is because IRS' budget also includes a decrease of 1,341 full-time equivalents for tax law enforcement. That decrease is part of IRS' contribution to reductions in base programs to reduce the federal deficit. According to IRS, the decrease of 1,341 positions will come from the more traditional enforcement job categories--those, such as revenue officers and revenue agents, that engage in face-to-face audit and collection activities. IRS' budget states that although "these positions still comprise the lion's share of IRS enforcement efforts, they also represent, on the margin, the least efficient use of IRS resources." According to IRS officials, these staff reductions will be achieved through attrition.

Thus, one effect of the increases and decreases in IRS' compliance staffing for fiscal year 1997, if IRS' budget request is approved and is implemented as IRS has described, would be to alter the mix of that staffing. IRS would have fewer revenue officers, for example, and more ACS staff--the kind of mix that we have advocated in the past.

In conclusion, although IRS has made some changes, there are certain questions that remain appropriate in discussing the revenue protection initiatives: (1) will IRS spend the additional funds for additional compliance staff? (2) does IRS have reliable data on the revenue generated by its enforcement activities? and (3) will IRS be able to achieve the new staffing mix?

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

FACTORS AFFECTING ACS STAFFING FOR FISCAL YEAR 1996

Factors surrounding IRS' organizational and business restructuring led to ACS having a large number of seasonal, term and other than full-time permanent staff at the end of fiscal year 1995. As a result, ACS was targeted for a significant staff reduction given IRS' cost-cutting approach for fiscal year 1996.

IRS' customer service vision calls for combining into 23 customer service sites the work of at least 70 organizational units that employ staff who do not have face-to-face interactions with taxpayers. These centers are to employ staff who will work primarily by telephone to assist taxpayers, collect delinquent taxes, and adjust taxpayer accounts. As part of this consolidation, IRS is to close 10 of its 20 ACS sites.

After IRS announced which 10 sites would be closed, two things happened. First, ACS employees who could find other positions left ACS. Some of these employees were hired for revenue officer positions that became available as part of the fiscal year 1995 compliance initiatives. Second, the 10 ACS sites that were scheduled to close could hire only term and seasonal staff, according to an IRS official. Therefore, at the end of fiscal year 1995, ACS had 448 seasonal, term, and other than full-time permanent staff--66 percent higher than the number at the end of fiscal year 1994.

Mr. LAUGHLIN. Thank you very much.

Dr. Stillman, are you testifying?

Ms. STILLMAN. I am available to answer any questions you may have in the TSM area.

Mr. LAUGHLIN. Thank you.

Ms. Willis, how long do you think it will take the IRS to put the TSM back on the right track? And how will we know if the new track is any better than the current track?

Ms. WILLIS. Let me refer that question to Dr. Stillman.

Ms. STILLMAN. We made a series of recommendations in a July 1995 report, over a dozen recommendations, specific recommendations telling IRS what they needed to do to put themselves in a better position to invest their large budget in it well, to build their systems well, and to manage it well. We have dates on those ranging from June 1995 to improve their investment strategy and prioritize their investments through December 1995 to make technical improvements.

At that time IRS agreed with the recommendations, and in their written comments took no exceptions to the dates. At this point they have implemented none of those recommendations.

Mr. LAUGHLIN. That was my question.

Ms. STILLMAN. They have completely implemented none.

Mr. LAUGHLIN. Have you seen any implementation of any of the 12 that you recommended 9 months ago?

Ms. STILLMAN. We have seen activities aimed at making progress on those recommendations. Those activities neither individually nor in the aggregate completely addressed any of the over a dozen recommendations.

Mr. LAUGHLIN. And when you made the recommendations, the IRS agreed with them?

Ms. STILLMAN. They did so in writing at the back of that report.

Mr. LAUGHLIN. And you have seen no implementation?

Ms. STILLMAN. We see no effective implementation at this point.

Mr. LAUGHLIN. It is kind of like me saying I am going to marry you and then not show up.

Ms. STILLMAN. Absolutely.

Mr. LAUGHLIN. How will the intervention of the Treasury Department affect the timetable and acquisition costs for TSM?

Ms. STILLMAN. We did not evaluate that specifically, and I don't have that answer for you now. There are joint activities including Treasury and IRS. I am unable to tell you what the time or quality effect of that is.

Mr. LAUGHLIN. Dr. Stillman, this may be something you should answer. In the prepared statement by Ms. Willis, you talk about having seen no steps that satisfy your recommendations, and then you say, "we do not believe the IRS can make effective use of TSM system development funds at this time."

What do you recommend?

Ms. STILLMAN. It is quite clear that IRS cannot control from an investment perspective or from a technical perspective their very large budget, in the neighborhood of $850 million or $700 million or $1 billion annually.

What would seem to be more prudent would be for IRS to identify what it needs for basic day-to-day operations, what it needs to

continue current operations. Major developments over that, I think, should have to be justified convincingly to the Congress, perhaps in supplement appropriations requests.

Mr. LAUGHLIN. Is this an area where the existing contracts should be reviewed for modification to determine whether any of the outside contracting agencies would be more appropriate to manage the development of TSM?

Ms. STILLMAN. We made one recommendation in our July 1995 report directly addressing the use of contractors, and that was that in all new contracts, IRS should require that their contractors perform software development at a repeatable level, the Software Engineering Institute's level 2. That would give you some confidence that, in fact, IRS could deliver repeatably products of reasonable quality, on time, and within budget.

There is no evidence that IRS requires all its contractors to perform at SEI level 2, and, in fact, CyberFile is an example of a contractual effort that IRS has undertaken since our report that does not require that its contractors build software at SEI capability level 2.

Mr. LAUGHLIN. Ms. Willis, early in your remarks, you said some issues remain dealing with TSM, and I am not smart enough or knowledgeable enough to keep up. Did you address those concerns later in your testimony?

Ms. WILLIS. The issues that remain with TSM, as Dr. Stillman alluded to, are the issues associated around the managerial and technical weaknesses that we identified that we attempted to address through our recommendations.

Mr. LAUGHLIN. Are there any other issues remaining that either you or Dr. Stillman have not testified to at this point in your testimony?

Ms. WILLIS. No.

Mr. LAUGHLIN. What are the advantages and disadvantages of having the IRS act as its own prime contractor? And would you recommend that the IRS continue as its own prime contractor, or would you recommend they seek outside help?

Ms. STILLMAN. We have had some discussions with IRS and its integration support contractor in the past. It is unclear to me what IRS means by a prime contractor, what prime contractor responsibilities connote to IRS. It is unclear to me what obstacles they see in using the integration support contractor as an integration contractor. IRS has explained to me that the integration support contractor acts in an advisory role. I have asked the question, What precludes IRS from taking the integration support contractor's advice in every case or in most cases? And I have never gotten an answer that I understood.

Mr. LAUGHLIN. When will the IRS be capable of making realtime, online adjustments to a taxpayer's account? What benefits would the taxpayer and the IRS enjoy from such a capability? And do you have any idea when the IRS will have its computers connected in such a fashion as it will not have to transport the data tapes around the country by airplane?

Ms. WILLIS. Mr. Laughlin, I don't think there is any question that there are great benefits to the taxpayer and to IRS for IRS being able to immediately access and make corrections to taxpayer

accounts. It would help not only reduce taxpayer frustration in dealing with the IRS, but also would allow IRS to more efficiently address taxpayer concerns.

I will ask Dr. Stillman to elaborate, but my understanding at this point in time is that we do not have any confidence in when IRS will be able to provide that service to taxpayers.

Ms. STILLMAN. As a level 1 organization, which IRS itself knows it is, IRS develops systems without using disciplined processes. It doesn't use tools to estimate how systems will perform, on what schedule they can deliver, and what they will cost, and therefore there is no basis for any confidence in any of their estimates in any of those areas.

Mr. LAUGHLIN. Last year the IRS experienced problems in the testing of SCRIPS. It is my understanding SCRIPS is supposed to image the data on Form 1040EZ, Form 941, and Form 1040PC. How well is SCRIPS performing during this filing season? And does it catch all the data on the forms it scans or only part of the data?

Ms. WILLIS. This filing season SCRIPS is working better than it did last year. In the five centers where SCRIPS is in place, it has less downtime than it did last year. In the two centers that ceased using SCRIPS last year, they are reporting they are able to continue using it, but it is operating at a much slower rate than what they had anticipated.

Right now they are capturing about 50 percent of the 1040EZ forms through the SCRIPS process, and the rest are being done through manual data entry.

Mr. LAUGHLIN. How effective was the IRS Antifraud Compliance Program during the 1995 filing season? And in connection, how many taxpayers who filed accurate returns last year nevertheless had their refunds delayed? Earlier in your testimony, you talked about invalid Social Security numbers and refunds, if you can work that into your response. And I have got to tell you in my area of the country, which is south Texas—you probably thought I was from the North—we hear a lot about Americans retiring to Mexico, and then their Social Security numbers getting jumbled up, and never having paid into the system. Can you respond to that?

I asked too many questions. Let me start over.

How effective was the IRS antifraud program? And talk about the——

Ms. WILLIS. The IRS 1995 fraud detection efforts were effective. As the Commissioner noted in her testimony and we noted in ours, there was a reduction in the number of dependents claimed. There were a number of fraudulent or noncompliant refunds identified and held up. However, there were also a number of taxpayers who filed accurate returns with appropriate Social Security numbers who also had their tax returns held up while IRS intended to look for duplicate uses of SSNs. That match was never done, and as a result, these refunds were held up and were ultimately released without any follow-up checks being done.

In addition, for some of the returns where there were missing or invalid SSNs, IRS went and worked with the taxpayer and discovered there was a fairly high no-change rate. By that I mean that the information on the return, while the missing or invalid SSN

was incorrect, the information regarding the refund was correct, and the taxpayer did, indeed, warrant it.

I am not sure that I understand your question about Mexico.

Mr. LAUGHLIN. Forget that part. I will rephrase the question, though. Is there a satisfactory system for pursuing invalid Social Security numbers? And let me direct your attention to credit card abuse to focus where I am trying to go.

I had a credit card stolen, a gasoline company credit card, and I didn't know it. But the company called me after several days because there were charges being made outside the geographic area where I normally charged. I thought it was wonderful. I had no clue it was missing.

Is there anything in the IRS system that will trigger them, trip them that there is an invalid Social Security—how do they address that?

Ms. WILLIS. If you were attempting to file a return electronically and the Social Security number is either missing or invalid, IRS filters will kick that back and not allow you to file it. So they do have a system within the Electronic Filing Program to identify missing or invalid SSNs which prohibits the filing of the return.

In terms of paper returns, they have a process where the return is actually filed, and then they go back through and look for missing and invalid SSNs. They do not have a system that would allow them to say that your SSN was used on somebody else's return and notify you to that effect.

Mr. LAUGHLIN. Now, let me go to Mexico, but we can go to any other country where Americans will retire and move, and a substantial amount of people do that. People will retire, move to another country, and receive their refunds or their Social Security using numbers that often get transferred around, and then you have fraud. What is in the system to prevent that from happening?

Ms. WILLIS. Sir, we really haven't done any work to look at that question.

Mr. LAUGHLIN. Madam Chairman, that completes my questioning, and I not only yield the time back to you, but your Chairman's chair, also.

Chairman JOHNSON. Thank you, Congressman Laughlin, for taking over in that interim. I will recognize Mr. Portman.

Mr. PORTMAN. Thank you, Madam Chair. And, Mr. Chair, you did a superb job as always.

I was a little disappointed in your brief response with regard to the SCRIPS Program. I come from Cincinnati and have toured the Covington Service Center where SCRIPS is up and going, and about a year ago I had a very upbeat assessment from the local IRS office as to how it was working. I actually witnessed it working. And it is my view that if this can work, in fact, we will see instant modernization in the sense that there will be less need for manual input. And if we can't do SCRIPS right, it seems to me it doesn't bode well for TSM.

So my thought is, we need a little more information as to what is wrong with SCRIPS, why isn't it working, why do we have the downtime—do you have any other information? Have you all spent much time on SCRIPS? I know there has been an internal audit, I guess, but has GAO spent much time looking at that?

Ms. WILLIS. We are currently in the process of doing an evaluation of SCRIPS and identifying what the problems have been, how it is, indeed, performing against expectations over time, and whether the improvements that are being made are bringing it up to the performance levels expected. We expect to be able to report out on that later this year.

Mr. PORTMAN. Is it your thought, with regard to the 1040EZ and perhaps some of the other forms that are easier to scan, that this is a solution to some of the existing problems in the system, making it more efficient, expediting returns and so on?

Ms. WILLIS. The ability to optically scan returns would definitely make certain parts of the system more efficient. It would reduce the amount of manual data entry that is required and allow IRS to process the returns more quickly.

Mr. PORTMAN. Reducing mistakes?

Ms. WILLIS. Reducing mistakes.

Mr. PORTMAN. That would seem to me to be an obvious benefit.

Ms. WILLIS. Right.

Mr. PORTMAN. It is not officially part of TSM; is that correct? Is it a separate undertaking?

Ms. WILLIS. My understanding is it is included under the TSM umbrella.

Mr. PORTMAN. OK. I know in Covington it has already begun.

Ms. WILLIS. Right.

Mr. PORTMAN. Perhaps I should be directing these questions to our friends from Treasury or IRS, but it is something that is up and going, I know, in our area through the Covington Service Center.

Ms. WILLIS. Right, it is up and running in five sites across the United States.

Mr. PORTMAN. OK. And is your report coming out in the short term after the filing season? Or when would you expect to have it ready?

Ms. WILLIS. It will be later this summer.

Mr. PORTMAN. Later this summer?

Ms. WILLIS. Right after we have a chance to get the data and analyze this year's filing season.

Mr. PORTMAN. And obviously you are taking into account the internal audit that has been done. The report done by the Service with regard to SCRIPS?

Ms. WILLIS. Yes.

Mr. PORTMAN. I for one and I think this Subcommittee would be very interested to hear more about what you all are coming up with and to see whether this is an area where we can make some progress. Again, if we can't do it with SCRIPS that would seem more fundamental than some of the other TSM undertakings we were discussing, it seems to me we have a real problem. So we need to focus on that, and if it doesn't work, then move on to other ways to gain efficiency.

Thank you, Madam Chair.

Chairman JOHNSON. We do have a vote that has been called. Let me very briefly ask a question, because I share the gentleman's interest in SCRIPS, and I appreciate his pursuing that questioning. In your estimation, was there a problem in the development of

SCRIPS with input from the frontline people, from the users? Or was that not a problem?

Ms. WILLIS. That is one of the issues that we are looking at right now. To date, our work has been focused more on how well SCRIPS is performing, whether it is meeting the performance expectations processing the returns that IRS expected it to process.

Chairman JOHNSON. I realize it is not the same issue as ICP, but I wondered if there was a parallel there.

I am sobered by your comments in your testimony. You believe that "None of the steps that have been taken, either individually or in the aggregate, has fully satisfied any of our recommendations. As a result, we do not believe that the IRS can make effective use of TSM systems development funds at this time."

Are there no projects under the Systems Modernization Program that you think can benefit from additional investment this year?

Ms. STILLMAN. When we evaluated IRS' capability and maturity to develop systems in general, we asked them to identify specific pockets of expertise that they had, centers of excellence where we would go and assess how well, at those centers of excellence, IRS developed software. It turned out they had none, and nowhere within IRS are they developing software using disciplined repeatable processes. Nowhere.

Chairman JOHNSON. And you also go on to say that the IRS would not give you specific information on its plans for spending the $850 million?

Ms. STILLMAN. That is correct. The kind of information that would have provided some evidence of progress would be a prioritized list of investments and for each their cost and their benefits and how they would contribute to the overall business goals of tax systems modernization.

We would have liked that list prior to their rescoping and postrescoping efforts so we could evaluate the value added by those rescoping efforts. We have gotten none of that, not before and not after, and no explicit criteria for making those prioritizations. They say they have done that, and we have asked them precisely what criteria they used. We have been unable to get that information.

Chairman JOHNSON. Thank you very much. Are there other questions by the Members of the Subcommittee?

[No response.]

Chairman JOHNSON. We will adjourn this panel, and I thank you for your testimony. It was very helpful to us at a difficult time.

Ms. WILLIS. Thank you.

Ms. STILLMAN. Thank you.

Chairman JOHNSON. I thank the panel.

I would ask Mr. Clagett to make his opening statement before we go to vote, and then we can be thinking about that. That is a 5-minute window for you, Mr. Clagett. But then we will all hear that, and whenever there is a series of votes, it is harder for Members to return. So some of us will be back, but it will be at least 20 minutes. Perhaps the staff meanwhile can find out how many votes there are, and we will be able to give people a better idea of what time we will resume.

Mr. Clagett, chairman of the Committee on Continued Review of the Tax Systems Modernization of the IRS, the National Research

Council. Mr. Clagett, we are happy to have you and appreciate the input of the National Research Council throughout this process.

STATEMENT OF ROBERT P. CLAGETT, CHAIRMAN, COMMITTEE ON CONTINUED REVIEW OF THE TAX SYSTEMS MODERNIZATION OF THE INTERNAL REVENUE SERVICE, NATIONAL RESEARCH COUNCIL

Mr. CLAGETT. I am glad to be here. Indeed, I am the chairman of the committee. I am also a lecturer at the University of Rhode Island now and am a member of the National Academy of Engineering.

As I think you know, the National Research Council is the operating arm of the National Academy of Sciences, the National Academy of Engineering, and the Institute of Medicine, chartered way back in 1863, the original NAS. Its charter is to advise the government, and through them, that is what this committee has been doing.

The project I chaired involved an original Committee followed by an extension, and there were some membership changes during that time. We have produced six reports, and my remarks are going to refer to the latest report, which was distributed in February 1996. That publication is the "Continuing Review of the Tax Systems Modernization of the Internal Revenue Service," and it was released to the IRS in December 1995.

I want to point out that the IRS was the sponsor of this project, but consistent with the NRC policy, it did not preview any of the recommendations. The Committee, the original and the extension, that I chaired was rich in both private sector experience with large systems and large systems developments and with technical expertise.

My Committee and I strongly believe that modernization of the information systems at the IRS is very important. Indeed, that is not the question at all. The Service has a lot of old computer equipment, and it certainly is difficult for them to maintain it. Only a part of the returns processing now is computerized, with taxpayer paper files the main mode of operation still. Modernization would enable better customer service and better agency and government performance.

In the course of our work, we focused on the ability of the IRS to modernize while monitoring its progress. We made several recommendations relating to the IRS structure and management, and they have been implemented. Among them, for example, they have established focused units to address the needs in architecture and privacy and elevated positions in human resources and, most importantly, as you have heard, for the management of the tax systems modernization, the modernization executive position, which is now an Associate Commissioner level.

Through such actions, the IRS has improved its organization involved with TSM. A central concern of our committee was management, and it runs the spectrum from vision through planning and implementation. Quoting from our 1996 report, "The committee believes that 'success' starts with a concise business vision, a well-organized modernization process, a clear systems architecture, a complete development plan, and a strong set of metrics to determine

progress." The IRS has created a vision statement, and it has begun the process of reengineering its business processes. However, these efforts remain somewhat disjointed from TSM.

Of greatest concern are the enduring deficiencies in technical management. It is in this area that progress must be made if TSM is going to succeed. Those deficiencies show up in the IRS' own software and system development organization, its lack of a concise statement of the system architecture, its approach to and slow rate of improvement in development processes, and its incomplete attention to system and data security. The committee frequently expressed concerns in the six reports that I have mentioned over the 5 years about the lack of experience in large systems development and implementation within the IRS management. This deficiency shows up in the rate of internal progress and in the nature and effectiveness of interactions with contractors involved in TSM development.

I would say here, as I have said repeatedly to the IRS, that the Service should not have had in-house capability to take on such a large project when it started. That condition was no embarrassment. But it should have assessed the size and complexity in developing such a large project and then acquired the trained, experienced management team needed to direct it. In fact, that is the way most private industries approach such a project. Instead, it relied on competent in-house management who were—and are—generalists who have advanced through the IRS through many years. They are good people. They know how to run the IRS as it exists today. At the same time, they have not grasped our recommendations as to what it takes to develop a huge information system such as TSM.

Quoting again from our report, "The IRS must implement the following"——

Chairman JOHNSON. Excuse me, Mr. Clagett. You are at the point in your testimony where you are going to go into detail on your recommendations.

Mr. CLAGETT. Fine.

Chairman JOHNSON. I am going to ask you to suspend because we only have 3 minutes left to vote.

Mr. CLAGETT. Fair enough.

Chairman JOHNSON. We have two votes, and we will reconvene about 12:30.

Mr. CLAGETT. That is fine.

[Recess.]

Chairman JOHNSON. Mr. Clagett, we will resume. We have Mr. Hancock here and myself, and we will resume. Please feel free to take your time.

Mr. CLAGETT. Thank you very much. I will start off where I stopped.

Quoting from our report, "The IRS must implement the following recommendations immediately and forcefully; otherwise, the goals of the TSM effort are in serious jeopardy"—and that is a quote, of course, from our report. And I am going to comment and tick off those basic recommendations.

Recommendation 1, Acquire more technical management expertise, through both hiring and contracting, starting with a highly

qualified Chief Information Officer to fill the vacant position. And, of course, I am pleased to note that they have now done so. It might be interesting to talk some time about the effort they had and the frustration in trying to find somebody within the constraints both of salary and the position, of the caliber they wanted.

Chairman JOHNSON. If I may interrupt you, I am glad you mentioned that, because that is something we should come back to and that we will be very interested in, particularly in your perspective on it, since you do see this in many areas where the government is seeking scientific or other expertise. I know when we worked on the air traffic controllers issues, we simply had to change the pay structure in order to get people into the more difficult areas like O'Hare and Kennedy.

Mr. CLAGETT. Well, perhaps after I finish we can talk, because I have, indeed, thought about the way in which an agency can go about it, and maybe we can talk some more about that.

Chairman JOHNSON. Thank you.

Mr. CLAGETT. So I am pleased they have got such a person. I hope he has the background and experience that will really help TSM become effective.

The second recommendation was to effectively integrate the operational and technical goals by developing a proper set of metrics to measure performance. That is, at the very outset, know what it is you want to accomplish; in other words, know when TSM has succeeded, and then start to develop the systems, instead of developing the systems and then trying to figure out what those goals should be. Those metrics are still not in place.

Recommendation 3, Develop an adequate architectural definition and design led by the Systems Architects Office—they do have one now—and enforced by a strong set of interface specifications for key applications of systems—and that includes security—and a process for maintaining them properly. I would be glad to talk some more about that as well.

Significantly increase the scope, level of effort, management attention, and tools devoted to security development. Next, the SEI level 2 issue that was mentioned by GAO is very important. I would add not only for internal, but if, indeed, their contractors are at level 2 and beyond, I doubt that there is a significant amount of communication between the two if inside the IRS they are at level 1. That would be tough.

Recommendation 5, Implement an overall process improvement plan. I have just gone into that. That is the SEI level 2 challenge.

Recommendation 6, Focus efforts on the Integrated Case Processing System. That is the target system we picked. The main message here is pick one, do it well, develop it, test it, put it in the field, prove it out, and use your best people to do that, and then move on to the next one. We think integrated case processing is central to the whole TSM effort, and that is why we recommend that project.

Absent sufficient followthrough, new approaches to TSM may be necessary. We have thought about what alternatives there are. One would be to assess, justify, and fund each component project individually. Another possibility is to outsource the whole system as a project. The committee believes, however, that correcting the defi-

ciencies that have been identified and strengthening management is the best course of action for both the IRS and the country. That is the tone, as you know, of our report. We have expressed concern with the problems we have raised here and that we have raised previously, I might add. In fact, this last report specifically talks about how many times we have raised over the 5 years most of these same problems.

So we suggest that some ongoing mechanism be established that can both advise the Commissioner and foster constructive interaction between the IRS and its oversight organizations to assure the best possible focus, decisionmaking, and communication.

With that, I thank you and I will be glad to try to answer any questions you have.

[The prepared statement follows:]

Statement of

Robert P. Clagett
Chairman of the Committee on Continued Review of the Tax Systems Modernization of the Internal Revenue Service
National Research Council,
Member of the National Academy of Engineering,
and
Lecturer at the University of Rhode Island

Good Morning, Mr. Chairman and members of the Committee. I am Robert P. Clagett, lecturer at the University of Rhode Island and chairman of the National Research Council's Committee on Continued Review of the Tax Systems Modernization of the Internal Revenue Service. I am also a member of the National Academy of Engineering. The National Research Council is the operating arm of the National Academy of Sciences, National Academy of Engineering, and Institute of Medicine, chartered by Congress in 1863 to advise the government on matters of science and technology.

The project that I chaired involved an original committee followed by an extension with some membership changes. It produced six reports over a period of five years. My remarks today will draw from the February 1996 publication, *Continuing Review of the Tax Systems Modernization of the Internal Revenue Service,* which was released to the Internal Revenue Service in December 1995. The IRS was the sponsor for this project, but consistent with NRC policy did not preview the findings and recommendations. The committee, original and extension, that I chaired was rich in private sector experience with large systems development and management as well as technological expertise.

My committee and I strongly believe that modernization of the information systems of the IRS is very important. The Service still has a lot of old computer equipment, which is difficult to maintain. Only a part of returns processing is computerized, with taxpayer paper files the main mode of operation. Modernization would enable better customer service and better agency and government performance. In the course of our work we focused on the ability of the IRS to modernize, while monitoring its progress. We made several recommendations relating to IRS structure and management that have been implemented. Among them, for example, are establishment of focused units to address needs in architecture and privacy and elevation of positions with responsibility for human resources and for management of Tax Systems Modernization (the Modernization Executive position, now with Associate Commissioner status). Through such actions the IRS has improved its organization.

A central concern of our committee was management, running across a spectrum from vision through planning and implementation. Quoting from our 1996 report, "The committee believes that 'success' starts with a concise business vision, a well-organized modernization process, a clear systems architecture, a complete development plan, and a strong set of metrics to determine progress." The IRS has created a vision statement and it has begun a process of re-engineering its business processes. However, these efforts remain somewhat disjointed from TSM.

Of greatest concern are the enduring deficiencies in technical management. It is in this area that progress must be made if TSM is to succeed. Those deficiencies show up in the IRS' own software and system development organization, its lack of a concise statement of the system architecture, its approach to and slow rate of improvement in development processes, and its incomplete attention to system and data security. The committee frequently expressed concern about the lack of experience in large systems development and implementation within IRS management. This deficiency shows up in the rate of internal progress and in the nature and effectiveness of interactions with contractors involved in TSM development.

I would say here, as I have said repeatedly to the IRS, that the Service should not have had the in-house capability to take on such a large project when it started. That condition was no embarrassment. But it should have assessed the size and complexity of developing such a large project and then acquired the trained, experienced management team needed to direct it. Instead, it relied on competent in-house managers who were—and are—generalists who have advanced within IRS for many years. These are good people who know how to run the IRS as it exists today. At the same time, they have not grasped our recommendations as to what it takes to develop a huge information system such as TSM.

Quoting again from our report, "The IRS must implement the following recommendations immediately and forcefully, otherwise the goals of the TSM effort are in serious jeopardy:

"*Recommendation 1.* Acquire more technical management expertise, through both hiring and contracting, starting with a highly qualified Chief Information Officer to fill the vacant position.

I am pleased to note that the position has recently been filled. I sincerely hope the new CIO has the background and experience to help TSM be effective. Qualified, trained, and experienced managers are needed at other levels as well.

"*Recommendation 2.* Effectively integrate operational and technical goals by developing a proper set of metrics to measure performance.

"*Recommendation 3.* Develop an adequate architectural definition and design, led by the Systems Architects Office and enforced by a strong set of interface specifications for key applications or systems, and a process for maintaining them properly.

"*Recommendation 4.* Significantly increase the scope, level of effort, management attention, and tools devoted to security development.

"*Recommendation 5.* Implement an overall process improvement plan. Specifically, require mature software and systems development processes across the entire development organization within 2 years, reaching maturity level 2 on the Software Engineering Institute Capability Maturity Model for Software (CMM) and maturity level 2 on the most pertinent process areas of the Industrial Collaboration Systems Engineering Capability Maturity Model.

"*Recommendation 6.* Focus efforts on the Integrated Case Processing (ICP) project, applying the best talent within the IRS, to demonstrate a mature development ability, to develop processes and procedures for all IRS projects, and to determine the long-term needs of the re-engineered IRS. Furthermore, TSM funding for projects that do not support the focus project directly should be reduced until definite improvement is shown."

Absent sufficient follow-through, new approaches to TSM may be necessary. One possibility would be to assess, justify, and fund each component project individually. Another possibility is to outsource the whole system as a project. The committee believes, however, that correcting the deficiencies it has identified and strengthening its management is the best course of action for the IRS and the country. It has expressed concern that the problems raised here, like some of the specific recommendations, have been raised previously. We therefore have suggested that some ongoing mechanism be established that can both advise the Commissioner and foster constructive interaction between the IRS and its oversight organizations, to assure the best possible focus, decision-making, and communication.

Chairman JOHNSON. I would like you to discuss more fully Recommendation 4, The scope, level of effort, management attention, and tools devoted to security development, but also perhaps in the context of developing also that management effort and the tools in other areas as well.

Mr. CLAGETT. You heard from the Commissioner and her staff that they have, indeed, after, I must say, substantial urging, developed what they call a security architecture. Early on in our discussion, they had not done what has to come first. In fact, you have to establish what level of privacy and privacy criteria you need before you can develop a security strategy. That took a lot of discussion, and I mentioned early on that one of the areas of organization that they improved was to bring in a high level privacy person, and that person immediately started with his staff to develop those sets of privacy criteria.

After that—and this has now only been 1½ years or so—they began to develop security requirements, and they do now have a security architecture document. What must follow that, however, is taking that security architecture document and now move down some levels to what are the specific security systems and system standards that are going to be used by the developers in each of those modules of TSM. That has not been done.

So as you see in the report, if you go into the field and talk to developers, they do not now have guidelines on what secure system is going to be used, either for their own projects or much less one that would be standardized across all the developments. And so they are doing what you would expect them to do. They don't wait. They go ahead and establish their own approaches to security.

Chairman JOHNSON. So the subcontractors or the contractors that IRS is working with have not been given the security document, the architectural document that the IRS has developed?

Mr. CLAGETT. They have been given an architectural document, but that does not establish specific standards that are going to be used throughout TSM. Those are not yet established.

Chairman JOHNSON. So the contractors really need a far more specific document?

Mr. CLAGETT. That is a need both inside and outside. I must say that many of the systems are still developed and/or guided by internal IRS people. In fact, I think every one of the current service centers has a software development team, a large software development team. Their old mode used to be that they farmed out all of their development, essentially, to their regions. In those days, that was a strength in that it did, as you mentioned earlier, involve the field. But even in the old days, there was a lot of local input to a local design. However, it was designed for one area, and they had a lot of problems then duplicating it across all the other service centers.

They still use those development capabilities, and they are good. But our concern is that, absent a fully set group of standards for TSM, neither good interfaces nor communication among all those systems is going to happen nor will you see an effective security system.

Chairman JOHNSON. How do you explain that?

Mr. CLAGETT. How do I explain that? Well, I would like to back up because I have thought a lot about this after spending all these years looking at it. And knowing what most—I certainly won't say all, but what many private industry people would do, it goes something like this: You decide that you need a new system, a very large one, and so the first thing you do is decide what is it you want to have this new system accomplish when it is completed. Those are the metrics I am talking about. What kinds of performance do I want? And, of course, at the same time, or maybe even prior to that, they are asking themselves, when we get this capability or as we get it, how do we want to do business in a new way. And so those two things are done up front. Then most chief executive officers will look around and say we don't have the capability in-house to take on such a large system, so they will make a concerted effort to hire the best possible people they can get; some individual to lead the project who has large system experience and technical experience, and then expect that person to also bring in a cadre of outside people.

I don't think there is any reason, as I said in my testimony, for the IRS or any other agency to be embarrassed that they don't have the capability in-house when they start. What they don't tend to do is try to find outsiders who can lead with that kind of experience. Therefore, now I get back to why they do it the way they do it. In my view, they start doing the development, and in the case of TSM, as you have heard, TSM was preceded by some individual areas of development. And from that, they decided what we really want to do is a major one, the basis of which was to get all of the forms digitized as they come in so that they could then put them in the central database. Once you have got a central database, then you can pull out a taxpayer's complete file. Today, as you know, the front and back of the first page of the 1040 is all that is digitized. So all those other pages are not, and if you as a taxpayer ask them a question, they have to pull out those paper files, and that takes a lot of time.

The goal of TSM is to be able to pull up online most of that. In fact, one of the most meaningful metrics that was established some years ago in the business vision was to be able to respond to taxpayers' questions something like 80 percent of the time on the first call. It is a great goal, and it would make a wonderful thing. It requires all of this to be put together, starting with the database. It certainly means that all the systems they develop under TSM have got to communicate with each other, and that is why we are so worried about the architecture and the standards.

So when IRS, absent that concept, started, I believe what they did was start with the development and then say, maybe under some of our prodding and GAO's, we need to have an architecture and we need to have standards of interface. And that is backward, because the designers are way along in developing some systems, both inside the IRS and outside, without those standards. And that is why the committee has eventually become rather pessimistic that under the current mode you are really going to end up with a TSM. You are going to end up with a bunch of individual systems, but the chances of them both communicating with each other well and having a secure system are not great.

Chairman JOHNSON. Is hiring one skilled leader enough?

Mr. CLAGETT. No.

Chairman JOHNSON. What are going to be the barriers, from your experience of watching this process, to hiring the complement of people? I mean, is it money?

Mr. CLAGETT. Yes. We were pretty naive, I must say, as a group of people coming in here to look at what IRS was doing, and we really did think that what you needed to do was enhance what they are doing, get some people from the outside. The CIO search is a good example.

I am reasonably sure that the Commissioner is very frustrated that, one, they had a nationwide search and hired a search firm—and they should speak to this, not me. But she, I know, was frustrated because she talked to me about getting input from our committee to help her, to get really top-drawer people. It turns out not many people even applied because the pay levels and so forth are well known. And it would have taken, I am sure, to get the kind of CIO that you would find in a comparable private firm taking on a project of the same size, it would take double or triple, at least, the salary they were able to offer.

So that has been a frustration for them. I don't know how—the only way I can conceive of it is not to make that person part of the civil service system, but to do what most private people do now. When they hire somebody at that level, it is usually on a contract. It is usually a contract for several years in which part of that large remuneration depends on performance of the individual.

Chairman JOHNSON. Why didn't they choose that course of action?

Mr. CLAGETT. I don't know, and I am not even sure that it is available to them. I did hear that if they did such a thing under a contract, that contract has to come under, if they want to do it quickly, one of their existing contracts. So that individual would have to work with one of those contractors for some time. I don't really know much about that. I know that it is a problem for them.

But to your other question, would one person or a few help? One of the reasons we have been talking about it for so long was—well, I will say it bluntly. We were having a hard time really communicating with the IRS about what we meant about a systems architecture, about what we meant about changing the level of capability. And it is not surprising when you look at the background of the IRS folks. Most of them are excellent administrators, came up through IRS, as I said earlier. Their background is certainly limited on large projects.

So then we thought, well, the thing to do is to get some outside experts in. I now have a different opinion. I now—as Mr. Portman mentioned earlier, I really don't think it is effective for a Federal agency to either have onhand or try to get the level of experience in seldom approached, very large, complex computer systems. And so I think a much better method would be to have a prime contractor do the development, have enough internal expertise to develop the contract, and then have that prime contractor have cost, performance, time kinds of requirements, and even have incentives, or disincentives if they don't meet those deadlines. That would give

the prime the ability to hire the level of people they need, if they didn't have them, and get the job done.

There might be one other thing. I know there is some talk now about helping CIOs, that there may be—and I don't have any familiarity with the structure. There may be a way to have a cadre of people with that kind of experience available to loan to an agency when they start into such a project. But as was mentioned earlier, IRS is not the first to have a problem creating such a large system.

Chairman JOHNSON. I would appreciate your thoughts about what problems have to be dealt with to get qualified, trained, and experienced managers underneath the CIO or how to address that level of operation, whether that is more appropriately addressed through contract at this point or not. I think we have no shot of getting any support from the Appropriations Committee, nor should we, unless the Agency can be far more specific and unless there are some plans that really everybody agrees will bring to them the expertise they need in the time they need it to do the work that has to be accomplished.

Mr. CLAGETT. I would have to say that by now our committee, at any rate, is rather pessimistic also.

Chairman JOHNSON. I do see that. On the other hand, the public need is to accomplish this, and we are either going to accomplish it badly or well. I mean, it is going to go forward because the computer capability of this agency is simply intolerable and much too outdated. If we don't do anything, it will simply break down, and there we will be. So we are going to have to go forward. And to avoid continued loss both of time and money, we really do have to help the Agency get the resources it needs and somehow press forward on the proper use of those resources.

Mr. CLAGETT. I quite agree with that. As a matter of fact, even though I think, you know, long term—as I said, maybe it is not appropriate for an agency to do it—there is a substantial investment in TSM now, and our recommendation is, and certainly mine, I will refer to the committee's recommendation or at least comment on it, and that is, as is said in the report, to pick one project and to put their best people on it, and that means not do the other projects but to focus on one, complete it, test it, put it in the field, learn from it, use it as a training vehicle for their own people. That would take longer to do but at a slower pace. While they are doing that, I would add, they could be finishing the standards, both the interface standards and the security standards, to make sure that a system would be able to communicate. And I think at this point that is probably the best way to go to allow you to move forward and use as much as you can of the current expenditures and effort to come up with a system.

Chairman JOHNSON. Thank you. Let me recognize Mr. Portman.

Mr. PORTMAN. I thank the Chair, and I have just a few follow-up questions of a general nature.

I am hearing in your testimony a little different emphasis than I see in the summary of the report.

Mr. CLAGETT. Oh, OK.

Mr. PORTMAN. It seems to me the report, indeed, does believe there are a number of deficiencies, and one, the CIO having been

hired I guess is something that has been addressed, although from your conversation earlier I am not convinced that you think that the background and expertise is there, without getting into the individual person. But I sense from the report that you all believe that there is a need for what you call an ongoing mechanism to interact between the Secretary and this project generally and with the technical community, and you believe that there can be some improvements in management and so on. What I am hearing from you, though, is that perhaps it would have been best at the outset to have contracted this project out in total, much as we do in other areas of the government—environmental cleanup would be one that comes to mind, where there is technical expertise required and the government simply can't afford to keep that kind of expertise in the civil service; therefore, it is outsourced.

Is that a fair summary?

Mr. CLAGETT. That is a correct reading, Mr. Portman, and I should probably emphasize that last bit about contracting out was my opinion. It was not something that the committee addressed. It is my conclusion thinking about this thing after going through all that.

We have been recommending a strong person. In fact, we had recommended from the beginning that either the Deputy Commissioner, current Deputy Commissioner, be the person responsible because that person has enough clout to get the job done, or to have someone at that level do the job, beyond the CIO.

It took several years for that to begin. In the meantime, of course, during all that time, the CIO had the development responsibility. So when the former CIO retired, we had been saying you need to have more expertise.

That was our solution during all of this time, and it certainly is still necessary to make sure that you get the maximum benefit from the funds that have been expended. However, as I said, I have now myself come to the conclusion that starting a new one, that is not the way to go.

Mr. PORTMAN. Taking off your National Research Council hat, though, for a moment and just speaking in your individual capacity, given where we are in the process, would you now recommend that the Service, indeed, look at the possibility of contracting out some of these specific projects? I think in your testimony you mentioned the ICP as an example that could be, in a sense, showcased as one that could be successful if it was focused on. Or would you recommend that the Service continue to focus on internal expertise and capability to do that?

Mr. CLAGETT. I think it is pretty late to start changing, and ICP is largely done in-house. DPS, for example, is done essentially outside. That is the document reading, digitizing system.

So what we were suggesting was one that was independent of which system they pick, but that they pick one and focus on it. And we were also recommending one that is being done in-house in order to enhance, build on their own internal expertise at this time. And I still think that is probably the best way.

If there are units that are not now already well underway either inside or outside, I believe they would be better off done outside with a contractor. But one of the problems you see is that it was

not—I was struck by the earlier testimony between the Chairman and the GAO that IRS has some very good examples of achievements in individual developments, and that is so. What they haven't done well in my opinion and the Committee's is with a very, very large system like this, they started developing all of them at once. And they did so without setting the standards and the architecture first.

But they do have a lot of capable people inside, and our suggestion was that they pick an important project and put their best people on it and use that as an internal learning and training mechanism for the next project rather than trying to do all these on such a broad front at the same time. In other words, they have stretched all their people and I believe some of the outside contractors quite thin by doing it that way.

Mr. PORTMAN. All right. That is very helpful. Again, without trying to paraphrase what you are saying, but your recommendation then would be to focus on specific projects to the extent those projects are already being undertaken internally and have made some progress, to continue along that path, develop the expertise internally; projects that are not already inside projects, to consider aggressive outsourcing or outside contractors for those; and all along to stress the need for systems architecture and standards first and then filling in the design logically which would follow.

Mr. CLAGETT. Yes.

Mr. PORTMAN. And security is your other primary issue you feel has not been handled well.

Mr. CLAGETT. We are very concerned about that, because if they don't set enough detailed standards, then as I said, since security in information systems is not something that can be a stand-alone package, it has got to be something that works at both ends, as I am sure you know. And that means you have got to have standards so that all of the designers of the new systems design their security systems to the same standards so that they work.

Mr. PORTMAN. Well, thank you. As the Chair said, there is an appropriations issue here, and there are some interesting ways in which your testimony I think could give direction to the Agency as it looks at its appropriations challenge. Because if you can focus on some doable projects and see some success, I think then you have more likelihood of having—not those of us on this panel, but those of us who control the purse strings being more likely to be understanding and to want to support it. So I thank you for testifying.

Mr. CLAGETT. I must just in passing say I have personally tried for some time to convince the IRS to do that just because I said in industry a chief executive officer with such a project certainly wouldn't sit still for 4 or 5 years without seeing some end result, something completed and implemented. And wouldn't it be better for you to do the same, both for internal and all of your oversight people? That is not the way in which they approached it.

Mr. PORTMAN. Thank you.

Chairman JOHNSON. Thank you very much, Mr. Clagett. We will get back to you and see if there isn't some very specific assistance we can provide in this period, because it is an important moment.

Mr. CLAGETT. OK. I need to remind you, though, that we had a contract, as you know, with IRS, NRC did. That has expired. That

report that you have is our last one. The committee is all volunteers, and so I would say—I will speak personally. The only reward you get after spending all those years learning about it and giving advice is if somebody listens to the advice.

Chairman JOHNSON. Right.

Mr. CLAGETT. That is really the satisfaction. So I am certainly willing to do so.

Chairman JOHNSON. Well, thank you. I appreciate that. Why is the contract expired?

Mr. CLAGETT. Why? Well, remember, this was the IRS' contract. They had a specified period of time. It was originally 2 years to look over TSM and make recommendations as to whether or not they were doing it right. They extended that for 2 years because the process and the project was continuing to go.

I will have to tell you that after 5 years, the committee, and that includes the chairman, was pretty well tapped out in coming down here making recommendations and not seeing a lot happen. And so most of us were not willing to go ahead.

But I think the contractual arrangement with the National Research Council was one that had to be a specified time and a specified number of reports.

Chairman JOHNSON. Thank you.

Mr. CLAGETT. Yes.

Chairman JOHNSON. Thank you very much.

Let me call forward Joseph Lane on behalf of the National Association of Enrolled Agents. Sorry you had to wait so long, Mr. Lane.

You may proceed, Mr. Lane. Thank you for joining us this afternoon. We appreciate your perspective on these issues.

STATEMENT OF JOSEPH F. LANE, ENROLLED AGENT, NATIONAL ASSOCIATION OF ENROLLED AGENTS

Mr. LANE. Thank you. We appreciate the opportunity to come back before the Committee and share some of the insights that our members have about the budget situation with IRS and also the current filing season.

We have prepared some written testimony, and I would request that the Committee accept that. I would be happy to just highlight some of the written testimony and then be willing to take questions from Members, if that meets with your approval.

We attempted to get a lot of input for this session today by going out with an e-mail poll of our members. We received scores of comments from members all around the country, so we are pretty confident in the positions we are taking as an organization with respect to the overall impressions that our members have of the IRS current filing season.

We also tried to take into consideration the average taxpayer that is going to be dealing with IRS, particularly in addressing this budget situation. As we heard this morning from the Commissioner, and we reviewed her written testimony, the budget cutbacks that were necessitated by the financial situation the Service finds itself in resulted in a lot of taxpayer service reductions. We have had an unprecedented report of the increase in the number of taxpayers who are coming to our members asking them for forms because they can't get them elsewhere.

Now, we applaud the Service's efforts this year to make forms available through CD–ROM and through the Internet. I understand that some 25,000 forms a day are being downloaded. But not everybody has a computer, and one of the concerns we have is the reductions in the taxpayer service forms distribution at the local level, the closure of some of these offices, the movement of some of the personnel from what were smaller rural offices into major centers has really necessitated a search and destroy mission on the part of some taxpayers just to be able to comply with their tax filing requirements. We have some problems with that.

I think one of the things we enjoy in this country is a very high compliance rate. Part of the reason we do that is because the American taxpayers are willing to go ahead and go through this self-assessment process. Part of the cost of that system ought to be providing them access to information to allow them to meet those responsibilities without going to too much trouble on their own and also making it easy for them to file.

Now, the Service has made some major steps in the last couple of years in making it easier to get online to get information. Their new Web site is a vast improvement over their prior FedWorld site. The information they have now made available to people who have their own tax software programs and computers to file by modem, we applaud that. But the average person does not have a computer. The average person does not have access to an Internet account. The average person probably does not have a CD–ROM hooked into their computer, if they have a computer. And that person can't get service.

When we are looking at a telephone system in taxpayer service that answers 35 percent of the calls that come in, that is a problem. I dare say if I only answered 35 percent of the phone calls I had, I wouldn't be in business very long. I would submit to the Members if you only answered 35 percent of the calls that came to your office, you wouldn't be elected next time.

So there is a concern that that level of service needs to be addressed because you cannot have taxpayers trying to get in repeatedly, because I think eventually it affects voluntary compliance.

This light is——

Chairman JOHNSON. It is just a warning. When it gets red, you will have had 5 minutes. You don't have to stop immediately, but it is to give us all some indication.

Mr. LANE. OK. So we are concerned. We believe that part of a well-designed taxpayer service component within the Service is a necessary component for the voluntary compliance system. People have to be able to access the system, get information to fulfill their requirements.

I think also in hearing some of the testimony today, the Service obviously is focusing on getting the tax returns they get processed, depositing the checks that they get, and having some degree of control over compliance. So what they have had to do in terms of their allocation of resources is focus on the money that is owed and the processing of the tax returns that come in the door. That makes sense. But somewhere along the line, the short end of the stick has been given to the taxpayer service function, and that has really had a dramatic impact on the average taxpayer out in the street. So I

would urge you on the 1997 budget to take a look at the allocations within that budget, what is happening in the taxpayer service area in terms of making it easier for taxpayers to access the service and increase the quality.

With respect to the current filing season, I have to tell you that there is a vast improvement this year over the prior year. We have many fewer complaints from our Members and from taxpayers in general about the quality of the processing within the Service. I think the revenue initiative adjustments they made this year are clearly working. They are not delaying unnecessarily tax returns and refunds that were due to people that had legitimate filings. And I have to report that the problem resolution officers that we have talked to around the country in preparation for this testimony have all reported a much, much lower level of taxpayer complaints flowing into their offices.

So, in general, given the situation that the Service found itself in this year with the budget restrictions, the bad weather in the East, and the possibility of a tax law change right up to the last minute, I think they deserve a round of applause for the job they are doing in this current filing season. I think the information we got from GAO indicates that it is running fairly smoothly.

In closing, I would like to add one important thing that we have noticed, and that is, some of the cutbacks that the Service has had to do because of the budget situation have affected things like continuing professional education for their employees. Now, this creates a problem for taxpayers because we are in a period of change right now, both in the examination function and the collection function.

As you will recall from the hearings last year, we had exam taking a whole new direction with respect to the financial status or economic reality auditing. We have a new set of collection standards that were implemented last September 1 with respect to national and local standards. And we have a lot of discrepancies being reported by our members in the way that these new standards are being applied across the Nation by revenue officers. One of our concerns is if there is a cutback in continuing professional education training, we are going to have this inconsistency cropping up more and more.

Another part of the problem that we are concerned about with the budget reductions is the district directors have had to curtail their communications with the practitioner community. Many of them eliminated their local newsletter. That newsletter served as a vehicle to communicate procedural changes within the Service that helped tax practitioners advise their clients.

Those types of cuts, while they are understandable given the budget situation, are very shortsighted, because eventually it catches up with the system by having people doing stuff that is out of date, not being aware of new procedures, not being aware of changes that the Service has implemented.

The overall impression we have of the budget problems within the Service is there is a tremendous morale problem at the lower levels of the Service. This is driven by several factors. There are rumors throughout the organization that because they are underbudgeted something in the neighborhood of 8,000 full-time equiva-

lents this year, the average employee will be asked to take anywhere from 8 to 11 days furlough time this year without pay. There are rumors in almost every office that there is going to be a RIF, a reduction in force.

When you talk to people in the offices that are not in major cities, there is discussion about the task force that is looking at the whole question of IRS rents, justifying any area office that is under 10,000 square feet. If implemented, that closes a lot of small offices serving rural communities. Our members are also concerned that we are being asked to go to Sacramento or Chicago to deal with an appeal that might have been closed locally 2 years ago, but that office is gone now.

There are also some real concerns about the reorganization that IRS is going through. The number of districts by October 1 this year will go from 63 to 33. They have eliminated 30 districts. Many of you are serving from congressional districts that now have been combined with other States, and that is of concern to our members and to taxpayers in those areas.

We are also very concerned about employee morale, so much so that we would urge the Committee to have GAO conduct a review of IRS employee morale. In any tax administration system, tax collectors and tax enforcers like revenue officers, revenue agents, and tax auditors, are not exactly the most popular people on the block. Everybody understands that. That is the nature of the business they are in. But you need to keep them happy to a certain degree with their working environment, because the last thing you need is 30,000 or 40,000 disgruntled tax enforcement people roaming around the country. What happens is that their frustrations get taken out on the taxpayers they get assigned to them. That is a major concern of ours and obviously of the Committee as I understand that this Committee is considering the possibility of holding some hearings later this year on the whole IRS collection and enforcement area.

We are hearing more and more horror stories coming out of the field about specific cases where we have problems with employees not following procedures, and that to me is indicative of a morale problem. IRS had a serious number of resignations and retirements this year, partly as a result of the rumors with respect to the changes in the Service and partly as a result of reorganizations, and that has not contributed to making the IRS a happy place to work within. That is being reflected now in the cases we are seeing come forward to our National Government Relations Committee for action. So we would urge you to take a look at that whole area. Maybe it is appropriate for GAO to conduct a review of that.

One last thing, in the TSM area, I am very concerned both as a tax practitioner and a taxpayer about this question of the IRS technical capability. As you know, I am from Menlo Park, California. That is the heart of Silicon Valley. I have a fair number of Silicon Valley entrepreneurs who are clients of mine. There is a lot of discussion about the impact that we are going to have in terms of our voluntary compliance system when we see more and more electronic commerce happening on the Internet. We have electronic cash. We have virtual banks, and we have encryption technology that is getting better and better. The concern that I have as a tax-

payer is we have a potential disaster brewing out there for our voluntary compliance system if we have an environment where transactions cannot be traced. And we are getting very close to the day when that is going to be a reality.

The Service needs to have as much technological assistance as it can get at this time, perhaps through contracting, as the gentleman that just appeared before me suggested. They need to buy the expertise. Quite frankly, the CIO position that they are offering something at SES level 3 or $108,000 or $112,000 a year, would in private industry, be a $400,000 or $500,000 job with pretty attractive stock options. In addition, if that person guided a successful program they would be in line for a couple of million dollars in compensation. It is way beyond the reach of the government.

We are concerned about asking the government to race in an Indianapolis 500 in a 1936 Plymouth against Formula One cars. We have the potential for a real problem for the voluntary compliance system. I think this fuels a lot of taxpayer discomfort with the current tax system. It fuels the whole discussion about why we need a flat tax or should we throw the whole system out the window. Average taxpayers don't mind paying their taxes if they feel that they are paying their fair share and no more, and everyone else is paying their fair share as well. If there is a widespread perception that there are significant unreported income transactions happening on the Internet, which I think is a good possibility, and that they are virtually untraceable because of this encryption technology, you are going to see a major tax revolt in this country. We are very concerned about that as tax practitioners and as taxpayers.

[The prepared statement follows:]

STATEMENT OF JOSEPH F. LANE, EA
ON BEHALF OF
THE NATIONAL ASSOCIATION OF ENROLLED AGENTS

Madam Chair, Members of the Subcommittee, my name is Joseph F. Lane. I am an Enrolled Agent in private practice in Menlo Park, California. I thank you for your invitation to testify on behalf of the National Association of Enrolled Agents regarding the proposed FY 1997 IRS Budget and the status of the current tax filing season.

I am testifying today on behalf of the more than 9,000 members of the National Association of Enrolled Agents (NAEA). As the members of the Subcommittee well know, Enrolled Agents are the only tax professionals possessing a Federal license to represent taxpayers before the Internal Revenue Service. Our members represent more than four million (4,000,000) individual and small business taxpayers annually. NAEA is especially appreciative of the interest this Subcommittee has taken in the matter of Internal Revenue Service practices and procedures and their impact on taxpayers. We pledge our support to assist the Subcommittee in the future on issues which affect the general taxpaying public.

The Proposed FY 1997 Budget

As small business owners, the members of NAEA fully support the concept that the Federal government should be as careful and diligent in spending the revenues it receives in taxes as taxpayers are in earning those revenues. It is important to all taxpayers to be confident in the ability of the government to adequately account for the expenditures it makes on behalf of taxpayers. It is also important for taxpayers to recognize that certain functions of government need to be adequately funded in order to be effective. We believe that with respect to this last point, the FY 1997 IRS budget needs to be considered in light of the impact of the FY 1996 budget cuts on IRS operations.

During the course of our preparation of today's testimony, we conducted an e-mail poll of our members to solicit their feedback on the issues being examined by the Committee. We received scores of messages from members all over the country and have incorporated many of their comments throughout our prepared statement.

In addressing our comments today, we have tried to take into account the realities of tax compliance for all taxpayers, not only those who are the clients of our members. We point this out because we think the Congress needs to be aware of the effect reductions in Taxpayer Service staffing and availability have had on the general taxpaying public. When the Service has to curtail the availability of telephone and walk-in assistance to taxpayers, the taxpayers that are directly affected are those with the fewest alternative resources to turn to for information. Our members' clients will get their questions answered and their tax returns prepared because they have sought out competent professional advice and have the resources to pay for that advice. About 50% of the taxpayers filing returns in 1996 will seek professional assistance.

Who will service the rest of the taxpayers who need questions resolved in their effort to comply with the law? There are many volunteer organizations, such as senior citizen community centers, college accounting organizations, and other entities which provide free or low-cost taxpayer assistance to certain constituencies. The IRS' own Volunteers In Tax Administration (VITA) program provides a structure and support system for several of these volunteer efforts. Many of our own members volunteer their time as well in these community efforts. However, all of these efforts put together cannot replace the IRS' Taxpayer Service function.

We believe a well-funded and well-staffed Taxpayer Service organization is vital to insure the viability of our voluntary compliance system. We have one of the most complex tax systems in the industrial world. At the same time, we enjoy one of the highest levels of voluntary compliance in the world. The cost of securing this compliance is providing taxpayers with answers to their legitimate questions and assistance in meeting their filing responsibilities. To fail to provide this support is to risk further decline in compliance levels. Everyone involved in tax administration understands that the most expensive way to secure compliance is one-on-one enforcement. The most efficient and cost-effective way to secure high compliance levels is to provide readily accessible information in the most inexpensive way to the widest number of taxpayers, enabling them to comply with their tax filing and paying obligations.

The current budget provides for an inadequate level of service on the Taxpayer Service telephone system. The Service itself estimated that it will be able to answer only 35% of the calls taxpayers make this year. Our members have reported an unprecedented increase in the number of requests they receive in their offices from taxpayers who are not their clients but who are seeking tax forms. These are taxpayers who are trying to comply with the law! They should not have to go on a search and rescue mission to locate forms!

Many of our members report that even the special telephone lines IRS established for practitioners have been going unanswered for up to 30 minutes at a time. One of our members reported that he has not been able to get through to the Atlanta Service Center yet this year! The inability of the practitioner to access the Service through the designated "hotline" merely adds additional volume to the already overloaded public lines.

Other members have told us about attempts to secure new Federal Employer Identification Numbers (EINs) from Service Centers. This used to be taken care of in a phone call but is now requiring weeks because the Service had to reassign the employees to other tasks. If taxpayers are unable to secure EINs in timely fashion, there will be delays in filing of returns or returns will be filed without EINs resulting in even greater backlogs for the IRS.

Due to cut-backs in Taxpayer Service staffing, we have heard complaints about the unavailability of Examination employees to finish audits they began months ago because they are assigned to handle walk-in service. While delaying an audit may seem to some to be a relief, to those taxpayers with audit deficiencies these delays add considerable additional interest charges, not to mention additional professional fees.

The budget reductions have also complicated the processing of other than Taxpayer Service workloads. We have heard complaints from practitioners who now have to travel to cities farther away than before due to IRS office closings or personnel reassignments. The span of control of some Group Managers has been increased substantially, in one case from 11 employees to over 30 located in two posts of duty. This manager spends hours a day shuttling between the posts.

Another area of major concern to us is the announcement made at liaison meetings with practitioner organizations that the Service cannot afford to hold Continuing Professional Education classes this year for employees. This has already caused problems and inconsistencies in how Revenue Officers are applying the new National/Local standards in Collection Division cases.

As another example, we have worked for years to urge the Service to develop a system of Appeals for Collection cases to enable taxpayers to get enforcement actions reviewed prior to implementation. Finally, the Service agreed and the new system is to be implemented next week. We are very concerned with the ability of Appeals to shoulder new work reviewing Collection decisions on liens, levies and seizures when their traditional workload is starting to rise due to attrition caused by senior staff retirements and resignations.

It is reported that the IRS will not be printing Publications 17 and 334 next year as a budget saving measure. Package X may be dropped as well. These are critical publications for many taxpayers who do their own returns, for the many volunteer tax organizations that service their communities, for adult education programs that offer tax and small business courses for individuals who contemplate starting their own enterprises, and for many smaller tax preparation firms which cannot afford extensive tax libraries. To eliminate these publications will prove to be a false economy for certain.

Also due to budget constraints, many district directors have stopped publishing their practitioner newsletters. In California alone, we know of five district directors who have shelved their newsletters. These publications are invaluable, particularly during filing season, to help practitioners keep up with changes in practice and procedure within the IRS. Again, practitioner groups are working with the National Office to fill the gaps, but these efforts do not replace consistent outreach which the district directors have been successfully using in the past.

One of the consequences of the FY 1996 Budget reductions that causes us a great deal of concern is the impact on IRS morale. We understand, perhaps more than most taxpayers because we deal with them everyday in representing our clients, how difficult a job the Service employees have to perform. There has been a decidedly negative impact on employee morale in the past year. The prospect of unpaid leave days being mandated has had a discouraging effect on employees. Rumors of a Reduction in Force or RIF are rampant in every office.

Our members have reported that certain enforcement employees have started to exhibit an attitude of callousness to the plight of taxpayers far in excess of their usual indifference. No one who works for IRS ever expects to be courted at cocktail parties but they do have the right to expect that those they work for appreciate the difficulty of their positions and respect them for the tough job they perform. In the current political climate, it is very effective to launch *ad hominem* attacks against the IRS, government employees, and the tax system. We would hope that constructive criticism would spur an honest debate about the kind of tax system we should have in this country. We are concerned, however, that these gratuitous attacks will only cause further decline in the morale of employees.

As you know, there have been a great many retirements from the Service this past year. In fact, during Calendar Year 1995, 45 senior executives retired. We have been told by some retirees that they left because they no longer felt the organization had the Congressional support it needed to fulfill its mission. This attitude concerns us because our current tax administration system depends on having competent, well-intentioned people on both sides of the table. The ability of the Service to continue to attract capable, dedicated employees is of primary importance for a continued well-balanced tax administration system. The system as currently constituted cannot support a dramatic increase in cases that have to be referred to Problem Resolution or forwarded on to Appeals simply because disgruntled employees start taking their frustrations out on taxpayers. It is difficult enough for some taxpayers to deal with the Service under normal conditions. It is impossible to predict what Kafkaesque nightmare could result if the Service were not able to attract and retain the usually high calibre employees they have had in the past. With the staffing cutbacks, downsizing and reorganizations of late, we are fearful that they may be on the verge of such a situation.

We suggest it may be an appropriate time for the Congress to instruct the GAO to conduct an in-depth employee attitude survey within the Service. Once the attitudes of those expected to do the difficult job of collecting society's bills is assessed, Congress may be in a better position to deliberate changes that affect those employees. We recognize that this topic is not one the committee is addressing in today's hearings but we urge the committee to consider this suggestion and offer our cooperation in any effort undertaken.

The 1995 Tax Return Filing Season

We believe the Service is to be commended for the efforts made this year to expand the vehicles available for taxpayers to secure assistance with their tax filing requirements without a concomitant increase in cost to the Service. The expansion of electronic filing capacity to individuals with their own tax software and computers who elect to file via modem is a welcome development. The new IRS home page on the World Wide Web is orders of magnitude better than the old FedWorld site. The availability of tax forms for downloading has proved very beneficial to taxpayers with computer access. The forms themselves are much more user friendly including the 1040, with color yet! The newly revised Publication 334, Tax Guide for Small Business, and new Publication 583, Starting a Small Business, have won the acclaim of practitioners and small business taxpayers alike. The expansion of the TeleTax program has yielded very positive support from taxpayers in all walks of life. The study group the Service has convened to eliminate unnecessary notices will cut down on needless taxpayer calls to Service telephone sites and free up scarce resources for deployment on more important tasks. Our discussions with the upper management of the Service lead us to conclude that the effort to reassess the traditional ways of interacting with taxpayers will continue to receive significant emphasis and we anticipate more improvements in the future.

Our members report they have encountered far fewer problems this year compared to last year in the area of refund processing and electronic filing. It would appear that the changes the Service

announced in its revenue protection strategy have indeed had the desired effect of involving fewer taxpayer delays in processing. The Problem Resolution officers with whom we have spoken report far fewer problems this year.

We were advised of some problems with the processing of TeleTax returns earlier in the season but now believe those difficulties have been addressed and resolved.

All in all, our members have reported that the current filing season is proceeding rather smoothly from a processing standpoint. When one considers the difficulties the Service confronted this year -- bad weather in the East, possible tax law changes, and significant budget reductions -- it deserves a round of applause for the relative ease of the current filing season.

Summary

We thank the Committee for the opportunity to appear before you today and provide our views on these vital topics. We remain committed to assist in any additional matter where the general taxpaying public has an interest. We will be happy to respond to questions from the Committee.

Chairman JOHNSON. Thank you, Mr. Lane. I appreciate your testimony, and I appreciated your enumeration at the end of it in more detail of your comments about the things they have accomplished and the ways in which the current filing system is going better than past filing systems. And I thought your comment about the difference between what the Service offers to those with computers and modems and what it offers to others was very helpful. Certainly it offers a nice small business opportunity for our local libraries and some of our community-based organizations that have good computer capability. And that may be one area that we want to pursue to assure that all of our libraries are properly equipped in this era in which I think IRS service delivery is going to go increasingly toward use of tools that computers offer rather than individual people, as important as that is.

You do also make some very strong statements about morale—I think that really is a problem—and about the callousness that you find in some of the IRS people, in excess of anything you have ever seen. I do think the IRS people, as most Federal employees have, have taken some really unfair blows through the budget process. It is really unfortunate that much of the discussion about tax reform also involves maligning very good, hard-working, competent public employees who are on the whole doing a pretty good job with limited resources.

I would mention to you that the IRS has just come out with new guidelines governing the use of the economic reality audits or lifestyle audits. I made some very strong statements in the Full Committee hearing when we worked on the Taxpayer Bill of Rights, and the IRS has chosen to include my remarks in the distribution with their manual. So people will see how terribly important it is to not only elected officials but also the general public and folks like you, that these audits be used when there is a cause or a reason or an indication and not randomly or erratically. And that is important, especially in an era when there is dissatisfaction, much of it legitimate, in not letting that spill over onto the taxpayers.

Unfortunately, I have to leave. I appreciate your testimony, and when we come back to that hearing in the future, we may look to you for further input at that time.

Mr. LANE. We would be happy to provide it.

Chairman JOHNSON. I am going to recognize Mr. Hancock, and if he will take over the gavel, he and Mr. Portman may have questions.

Mr. LANE. Thank you again for the invitation.

Mr. HANCOCK. I have just got a couple of questions about your statement that transactions over the Internet can't be traced.

Mr. LANE. That is right.

Mr. HANCOCK. I don't understand how that works. I mean, if you put something on the Internet, almost anybody can pick it up if the information is there.

Mr. LANE. Well, the encryption, as I understand it—I am not a software engineer, but I am fairly familiar with this information. But as I understand it, the encryption technology is so far advanced now that you are going to see, probably within the next 2 or 3 months, a major jump in the number of transactions on the Internet that are encrypted so they are anonymous. Basically there

are electronic cash transactions happening where you could have funds transferred in virtual banks, so the bank does not exist physically anyplace except in one location and the rest of it is online.

Mr. HANCOCK. Well, let me make this comment, Mr. Lane. For everything man can invent, another man can figure out how to circumvent, because you are not going to come up with anything that cannot be counteracted. The fact remains that when people get to the point, as you mentioned earlier, that they feel they are overtaxed, they are going to start trying to figure out some way to keep from paying it.

Mr. LANE. That is right.

Mr. HANCOCK. And nobody really wants to take the chances on going to jail and what have you. And, boy, you are opening the door.

Now, there is only one solution, and that is to get the tax structure back to where people feel like they are paying their fair share.

Mr. LANE. Well, I can't disagree with you on that.

Mr. HANCOCK. OK. I think a good book to read would be Adams' "The Good and Evil of Taxation," which maybe you have already read. This is the history of society as to what has happened when the citizens start feeling that they have been overtaxed.

I would also like to ask you this question. You mentioned being able to figure out your income tax on CD–ROM. Why should it even be necessary for somebody to have a CD–ROM to fill out their income tax return?

Mr. LANE. Well, I think the point was that with a CD–ROM disk, you can put all the tax forms that are available on one disk, and make those available in the library. If somebody needs a form, they can stop by and pick them up. That is a very cost-effective way of distributing forms.

Mr. HANCOCK. Well, it is cost effective, but why have a tax structure set up that way in the first place? And let me ask you this question. I understand, and I think I know what the answer is, but how many of these forms are merely statistical informational forms that actually it costs the taxpayer and the government more money to keep the records for statistical purposes than it does in realizing revenue?

Mr. LANE. Well, I don't know——

Mr. HANCOCK. Now, that is conjecture, you know. I mean, you have got to guess at it. That is one part of the question. The other part of the question is: I understand that about 70 percent of the income tax returns are filed on the short form, so, therefore, you are only concerned about the 30 percent that use the long forms. My question is: How many of the people using those short forms do it for two reasons. One, they don't want to do the paperwork, they don't know how, or they don't understand the law. Therefore, they just go ahead and pay their taxes, and do not keep track of their deductions and fill out the long form. Two, how many people use the short form because they fear the IRS and they know that they don't have anything to fear as long as they just go on ahead and send in their W–2 and forget about it? How many people do that and actually pay more taxes than they really would owe if, in fact, they did go on ahead and fill out the long forms?

Mr. LANE. Well, to answer part of your question, I believe there is something in the neighborhood of about 60 million 1040A, 1040EZ type forms filed. I don't have the exact number. I think it is in the neighborhood of 60 million.

To the extent that we could establish what portion of that tax was overpaid because people didn't take deductions they were entitled to, I don't know of any study anywhere that took a look at that.

Mr. HANCOCK. Well, I am asking you.

Mr. LANE. I see your point, though.

Mr. HANCOCK. Have you ever had anybody come to you about filling out their tax return and say, hey, I don't want to take these deductions and take a chance. I would just as soon go on ahead and pay more than I owe. Have you ever had people tell you that?

Mr. LANE. I have heard that from people, people that had prior audits from IRS, for example, and didn't want to deal with them again on it. Yes, I have had that.

Mr. HANCOCK. Sure.

Mr. LANE. Let me tell you, about half the taxpayers in the country seek professional assistance to get their tax returns done every year. So about half the returns are preparer prepared, and the other half are sent in by taxpayers.

Mr. HANCOCK. But even with a professional tax preparer's help, how many times have you had people come in and say, look, I realize that I can save maybe a couple hundred bucks, but it just isn't worth it. I would rather just go on ahead, send the government the extra $200, rather than take a chance that I might get audited or that they might question it, you know, if I get this refund?

Mr. LANE. Well, I could tell you there are several areas where that absolutely does happen. One of them is anybody that has a business that has a home office. Until there is some material change done in the way this home office stuff is administered, you are going to continue to see taxpayers say, no, I don't want to start a fight with them, just leave that deduction off my return, even though they are entitled to it.

Mr. HANCOCK. Well, they do it with automobile expenses, too.

Mr. LANE. They do it with car expenses, another area. I don't have the information to answer what percentage of revenue is overcollected.

Mr. HANCOCK. I understand that there is no statistical information.

Mr. LANE. But it does happen.

Mr. HANCOCK. But there are a lot of people who do it. You know, in my position as a Member of Congress, I run into a lot of people. And I am not out in the country clubs on weekends. I am out at the truck stops, and I get a lot of this type of information: Look, I don't really feel like I owe the money, but I am just going to go ahead and do it. And I still maintain computers are great up to a point, but without computers there is no way we could have an income tax law like we have got.

Mr. LANE. There is no question about that. There is a certain amount of mythology that surrounds IRS. Some people are doing what you are talking about because they believe they can stay underneath the IRS radar. They may have income that they are not

disclosing, or they just don't want any hassles with IRS. They believe that by filing a short form you don't get audited. There is a lot of mythology about that.

I can't tell you what percentage of clients that come to me every year to get their tax return done because they have never been audited as long as I have been doing their tax return. Well, you know, they don't realize that only 1 percent of the taxpayers get audited. That is like saying as long as this mike has been here, I haven't been audited, so this mike is my good luck piece.

Mr. HANCOCK. Well, let me ask you a hypothetical, probably facetious question. What would happen if a group got together, including some Members of Congress and IRS, and sat back and said how could we design the tax law to where we can get the revenues of government that we need where people wouldn't have to use computers, and analyze it from that standpoint? I wonder how we would change it. I wonder if we could forget about the government's problem of Internal Revenue agents being trained and then having the private sector hire them.

Mr. LANE. I can answer it this way. I have been teaching tax professionals for about 10 years now, and I facetiously have said on many occasions that it ought to be a felony for Members of Congress to get professional assistance with doing their own tax returns, and it ought to be a felony for them to use a computer to do so. OK?

Now, I have said that kiddingly, but I could tell you this: If computers were taken out of the equation, I wouldn't stay in this business any longer. It is too frustrating to try and do these things by hand.

Mr. HANCOCK. The law would have to be changed; correct?

Mr. LANE. You would have to change it.

Mr. HANCOCK. You know, I would even contribute to an organization and send them some money if somebody would sit back and just visualize a tax system without computers. How could we design a tax law that the average Ph.D. without a computer could fill out? You know, we might come up with something even better. You know, that is not a bad idea at all, the more I think about it. We might come up with something that would beat Bill Archer's sales tax and Dick Armey's flat tax. Gosh knows we wouldn't have to worry about industry, hiring all the Internal Revenue agents after they are trained, because this thing would be so simple you wouldn't have to have that much training.

I think we ought to talk about that, Rob.

Mr. LANE. Well, one of the encouraging things about this tax debate we are having now, hopefully—I mean, in a perfect environment—it will lead to a situation where there will be an honest debate about what kind of tax system we ought to have in this country.

Mr. HANCOCK. But the fact remains that with all these forms and everything, you have got all kinds of inaccurate statistical information because by the time you get it in the computer it is 5 years old, anyway. By the time you come up with the figures from the tax return, they don't have any meaning. They won't know for 5 years what the 1995 results are, actually.

Mr. LANE. Well, with respect to TCMP, you are right.

Mr. HANCOCK. Right.

Mr. LANE. Yes.

Mr. HANCOCK. Thank you. I am going to think about that a little bit. We just might put together something on that order.

Mr. PORTMAN. I think I just figured out what Mel is going to be doing next year.

As you may know, Mr. Lane, Mr. Hancock has a long history in the tax area, and he is retiring from Congress. But it sounds like he is going to be busy. You will probably be testifying before us next year at this time, Mel.

Mr. LANE. They could probably arrange a desk for you at the Cato Institute down the street.

Mr. PORTMAN. He is even more radical than they are.

Mr. HANCOCK. Well, I just don't think—pardon me, Rob. I just don't think that filling out your income return ought to drive a person to drink. I mean, they ought to be able to do it without getting so frustrated that they have to go get a shot of bourbon after they have filled it out.

Thank you.

Mr. PORTMAN. I am going to miss him.

Mr. Lane, first of all, thanks for coming back again. It is always a pleasure to have you before the Subcommittee and Committee.

Mr. LANE. My pleasure.

Mr. PORTMAN. You worked for the Service at one point, didn't you?

Mr. LANE. Yes, I did.

Mr. PORTMAN. Yes, as I recall, he is one of those guys that got hired away. Where is Mel?

I just had a couple of quick questions. First of all, you should give yourself more credit for not having your clients audited. You might have had something to do with it. But back home, I have gotten a number of letters from people about date stamping, and this is in connection with the budget cuts you talked about. I just wondered if you had had that experience with some of your members, folks who are calling or writing and saying at our local office—this is in Cincinnati, Ohio—there used to be a clerk behind the counter, and you could take a return in and have it date stamped, which avoided having to send it by certified mail.

Had you heard that complaint raised from any of your members? That the date stamp service has been eliminated?

Mr. LANE. It is happening in California right in an office near us. They used to have a person that would man that desk, and that desk is closed now. It is gone.

Mr. PORTMAN. Is it still closed?

Mr. LANE. Yes.

Mr. PORTMAN. OK. I think, again, so much of the blame for the way our current system works resides up here because we are passing the laws and we are providing the budgets and, therefore, forcing the Agency to look for places to cut. But I think from what I understand about this particular problem, it doesn't make any sense to make that decision not to have date stamping because it actually will end up saving the Service money over the longer haul. It is an interesting way to wake people up as to the budget problem, because a lot of these professionals, many of your members,

I am sure, were shocked when they found out those desks were closed. And I wanted to check and see if that was also a problem elsewhere.

It is my understanding in Cincinnati that has been resolved, although I am not sure and will now look into it more.

You mentioned two things in your testimony. One is that the 1995 calendar year filing is going pretty well. In fact, I think you even say that it is going smoothly, rather smoothly from a processing standpoint. You also, though, then talk about, Mr. Lane, this attitude of callousness that is far in excess of the usual indifference. And I just wanted to touch on that briefly.

You mentioned a morale problem. You talked about the immediate budget cuts and the impact that might be having. You talked about the reorganization, the RIFs. I am in an area, as I suppose most if not all members are, where there has been reorganization, and I didn't oppose that. In fact, I was supportive of it with the idea that we could get some efficiencies out of the system and have more bang for the buck, in a sense. But to what do you attribute this callousness? Do you think it is a combination of all these factors? How would you pinpoint it?

Mr. LANE. I think it clearly is a reflection of employee frustration with the system and uncertainty about their job future, and to a certain degree, it is almost acting out. You can have a situation where there is no other way they can get back at the system, so the way they do it is make sure they follow the book right down the line or be unreasonable in the way that they are making demands on people. This is a very small minority of the employees there, but we see it on a national level because our members fax these situations on to us and say, can you get us some help on this?

It just seems to me the level of e-mail and telephone calls I am getting and the volume we are seeing in our government relations office here in Washington indicates an increase in the sort of unreasonable behavior on the part of some of these enforcement people. And it is a callousness. It is a disregard for the impact their actions have on the taxpayer.

Now, in some cases when we get into these things, the actions are warranted. In other cases, they are not warranted. If they are clearly not warranted, we have to go to upper management to get them to back off.

But my concern is I am trying to look at it in a macrosense. Every one of these individual cases on a case-by-case basis you can see some justification as to why the employee has taken that position. You can also see some justification why the taxpayer is taking the position. But on a macrolevel, when I look at the totality of the complaints that we are starting to see from members, it confirms feedback I am getting from friends of mine that are still within the Service and from employees that I am dealing with on a regular basis, which reflects that there is a real morale problem within the organization.

Now, you know, part of the problem in terms of any enforcement effort you are involved in is the insularity of thinking within the organization. Partly it is a function of reality. My dad was a police officer, a career police officer. You know, all of his friends tended to be other cops, and the reason for that was partly because they

tended to work odd hours, so they had Tuesday afternoons off when everybody else was at work. But also part of it was this kind of us-them thing.

That is very true in the IRS. IRS people tend to socialize with other IRS people. I think you will see in any situation that an attitude, if it is a positive attitude, is reinforced by management coming down and saying, yes, you know, this is good behavior and it has got to be rewarded, and this is bad behavior. Everybody assumes when you go to work for IRS you are not going to be the belle of every cocktail party. That is just a given. It kills more conversations at cocktail parties when you are at someone's house and they say, Where do you work? And you say IRS. It is amazing how many people have to refresh their drink at that time. I think Mr. Hancock might have had a point about needing that bourbon. They just disappear.

So there is a situation in terms of morale within the organization, and right now because of the political season and because of all of this discussion we have had about the tax system, there are ad hominem attacks daily on IRS employees, on the tax system, and on the government in general. I think the problem with that is that if that leads to a constructive discussion about what kind of a tax system we ought to have in this country, that is fine. That is the purpose of democracy. If the only result is that you have a whole bunch of demoralized enforcement people running around with badges now and the only way they can take it out is on the people, that's bad.

Mr. PORTMAN. You have got the same bad system or a system that is comparably bad.

Mr. LANE. Yes.

Mr. PORTMAN. Well, I would agree with you. The irony of it is that the reason we have such a problem—and I think Mel and I would agree on this—is because of the laws that these people are asked to enforce. If it wasn't so darn complicated, if there weren't all these judgment calls to be made, 50 different results from 50 expert tax preparers, as Money Magazine told us last week, you wouldn't have the degree of frustration and the degree of morale problems.

Mr. LANE. That is right.

Mr. PORTMAN. But also, I think given our current system and given where we are, there are probably ways to improve it. And from what you have said, it sounds like part of that can come from leadership, from both elected officials and within the Agency, to try to improve that situation. You talked about the incentives you could put in. You talked about just providing leadership in the sense of saying, hey, it is not the agent's fault; this is a system that is bad; let's work as best we can within it. I think we probably all have some responsibility there.

But I would hope that, in fact, the discussion over the next year will include the fact that we are the people who are going to be responsible for cleaning up the system so that those agents can do their job better. I would also hope we will have fewer agents, frankly, because I think that is part of the consequence of a system that needs fewer judgment calls and less complexity.

Mr. LANE. I think one of the other things that could be driving this is the reorganization of IRS, which has eliminated 30 districts by consolidating districts, has taken the managerial oversight structure out of a lot of areas. What you have now is an agent who is responsible to a group manager who might be 500 miles away, who has a branch chief that, in the case of Hawaii, is 3,000 miles away in Seattle.

Mr. PORTMAN. Do you think the reorganization is a bad idea? How do you come down on it?

Mr. LANE. You know, that is a tough one. I can understand the Service's situation. They had basically an unchanged, 40-year-old organizational structure that was appropriate in a day when it took 12 hours to get to California in a prop jet and you didn't have fax machines and you didn't have teleconferencing. But on the other level——

Mr. PORTMAN. As I understand it, a lot of the RIFs would have occurred—not even RIFs, necessarily, but transfers at the middle management level, that it was part of the IRS catching up with the rest of the private sector to become a leaner operation.

Mr. LANE. What has happened, it has stripped out the management level in a lot of these small districts. So, for example, in Montana and Idaho and those places, you have the agents that are on the street and their supervisors, and that is it. There is nothing else above them. You have to go to another State to get a branch chief or a division chief involved. One of the frustrations to the practitioner community and to taxpayers in those locales is what is the chance of a branch chief getting over to Missoula every week where there used to be a branch chief sitting there?

So you had an appeal process that went up above, and that to a certain degree kept people in check. Now the concern, I know, in Senator Stevens' Committee the other day, there was quite an extensive discussion about what happened to the State of Alaska when they did away with the district director and sent him to Seattle. But we are reflecting that from our membership as well in those States that have been affected. People feel that they are not being supervised anymore, so they can go do what they want to do.

Mr. PORTMAN. Well, maybe that is something after a year or two we will have a better sense of, too, as that system begins to adjust to the new levels of leadership and management.

I thank you very much for coming again today, and I will now, Mr. Chairman, leave it up to you to finish this hearing.

Mr. LANE. Thank you.

Mr. HANCOCK. One final question. Have you ever heard anybody say I would be willing to pay more taxes if I didn't have to keep all these records and fill out these forms?

Mr. LANE. I have heard people say that they wished they had a simpler system. I have heard people say they would be willing to pay more if they knew everybody was paying their share. And I don't argue with you. You know, as a tax professional, I know some people on your Committee might think that we are dealing from self-interest. There is no one more in favor of tax simplification than the people that have to fill out these forms every year. Believe me.

I have a client who is the director of the Stanford linear accelerator unit out in Menlo Park, and we get laughing every year and talking about stuff and tax law changes. And I said to him, "Just imagine if you had to go to work January 1 every year and the laws of physics were repealed and you had to learn a whole new set of physics laws to go do your job." That is what we are dealing with.

You know, we have had 27 tax law changes in the last 29 years.

Mr. HANCOCK. Do you think we need to change the laws a little bit to give you all some legal liability protection for making mistakes? You know, there are a bunch of CPAs getting sued now as a result of improperly completing tax returns due to Internal Revenue laws that nobody really understands.

Mr. LANE. Yes.

Mr. HANCOCK. So, really, you are assuming some liability when you fill out somebody's tax return.

Mr. LANE. That is a cost of doing business. You have got to commit yourself to maintaining a professional library to let you stay out of a lawsuit.

Mr. HANCOCK. Let's work on it. Thank you.

Mr. LANE. Thank you.

Mr. HANCOCK. This hearing is adjourned. Thank you.

Mr. LANE. Thank you very much.

[Whereupon, at 2 p.m., the hearing was adjourned.]