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United States General Accounting Office
Washington, DC 20548

June 29, 2001

The Honorable William M. Thomas
Chairman, Committee on Ways and Means
House of Representatives

The Honorable Charles E. Grassley
Ranking Minority Member, Committee on Finance
United States Senate

The Honorable Amo Houghton
Chairman, Subcommittee on Oversight
Committee on Ways and Means
House of Representatives

Subject: Follow-up to the May 8, 2001, Hearing Regarding the IRS Restructuring Act's Goals and IRS Funding

The May 8, 2001, annual hearing convened by the Joint Committee on Taxation to review the Internal Revenue Service (IRS) Restructuring and Reform Act of 1998[1] reemphasized the importance of the act's goals. By passing the act, Congress signaled strong concern that IRS had been overemphasizing revenue production and compliance at the expense of fairness and consideration of taxpayer interests. Accordingly, the act mandated that the IRS mission more strongly emphasize serving the public and meeting taxpayers' needs.

In a letter following the hearing, you asked whether, 3 years into the act's implementation, its goals are realistic, and if not, whether the act should be changed. You also asked us about areas of disagreement at the hearing among the IRS Oversight Board, the Treasury Inspector General for Tax Administration (TIGTA), and us. We are basing our response primarily on work we did for the hearing, other recent testimony, and our discussions with officials from the Oversight Board and TIGTA about the disagreements.

In summary, the IRS Restructuring Act's goals of meeting taxpayers' needs while ensuring compliance with the tax laws require a massive modernization of IRS. These changes present major management challenges and will require considerable time to successfully implement. While IRS officials believe they have complied with the act's requirements, they are still learning how to effectively manage in the new environment. Therefore, we believe it is premature to consider significant changes to the act. On the matter of differences among the Oversight Board, TIGTA, and us, there are some differences with respect to specific IRS funding issues.

[1]P.L. 105-206, July 22, 1998.

No Demonstrated Need to Make Fundamental Changes to the Goals of the Act

The IRS Restructuring Act presents very significant management challenges to IRS. The act's overall goal of better balancing revenue production and compliance with fairness and taxpayer service requires modernizing all facets of IRS' operations, from business processes to performance management and information systems. Similarly, the act's requirements for revising programs such as offer-in-compromise and innocent spouse, and changing procedures such as enhancing taxpayer rights, are substantial changes that continue to challenge IRS' capacity to manage change without disrupting its core operations.

IRS has made both strategic and specific program changes in response to the act. For instance, it has revised its mission statement and developed new goals and objectives; implemented a new organization structure focused on different types of taxpayers to better carry out its mission and goals; and implemented new taxpayer rights and protections, such as enhanced due process rules and expansions of the offer-in-compromise and innocent spouse programs. IRS has also made important progress in implementing systems modernization management controls and capabilities.

However, as we indicated in our May 8 testimony, IRS is struggling with the management of many of these changes. The offer-in-compromise program has a growing backlog of cases. IRS' performance in important areas of taxpayer service, such as telephone assistance, is not at the level that IRS or Congress expects. Enforcement trends continue to be troubling. Financial information is not available to IRS managers on a timely basis for use in day-to-day decisionmaking. Some systems modernization projects are passing critical milestones without having certain essential management controls in place and functioning.

Whether IRS can achieve the goals set by Congress in the IRS Restructuring Act with current resources is an open question. The answer will depend, to an important extent, on how well IRS can manage its resources. Currently, IRS managers do not adequately understand the factors that affect performance in many areas, and IRS is still developing its new performance management system. Until IRS better develops these evaluation and performance management capabilities, it will continue to struggle with achieving the strategic goals of improving taxpayer service and compliance and managing specific programs, such as offer-in-compromise and innocent spouse. And until then, it is difficult to know enough about the efficiency of IRS to make well-informed judgments about altering the act's goals or adjusting IRS resource levels.

As we said on May 8, performance evaluation--the collection of data on performance and the analysis of those data to determine the factors that explain performance--is a key part of performance management. IRS managers do not consistently evaluate the performance of their programs to make decisions about how to improve performance. In some cases, relevant, accurate data are not available on a routine basis to support program evaluations. Financial information, such as program and project cost data, is one example. In other cases, analyses of past performance are not complete enough to give managers an understanding of how to improve performance. A case in point is the decline in the productivity of telephone assistors: IRS has studied the time assistors spend handling a call, but not other segments of assistors' time, including the time waiting to receive a call.

IRS has continued to make progress in revamping its performance management system, but a results-oriented approach is not yet routine at all levels. IRS' new performance management system is most fully developed at the agencywide level. However, as we discussed on May 8, the new system is less developed at the division level and is weakest at the front line, where interactions with taxpayers occur. In the long run, if managers at all levels consistently apply results-oriented performance management skills in their day-to-day work by routinely gathering and using data to define goals, assess progress, and design improvements, IRS will be better able to achieve the transformation it and Congress desire. Congress will also be in a better position to monitor incremental IRS progress in what necessarily will be a long-term effort.

Making a results-oriented performance management approach routine at all levels of IRS requires a change in management culture. Key steps that remain in this effort include developing a measure of voluntary compliance with the tax laws; developing division-level and smaller unit performance goals that are specific, measurable, and results-oriented; and revamping the evaluation system for frontline employees—areas that we have reported on and will continue to report on.

Given that IRS is still learning to better manage its resources to achieve what will be a long-term transformation, we conclude that it would be premature to make fundamental changes to the goals of the IRS Restructuring Act. Similarly, based on our work to date, we have no recommendations for less fundamental changes to the goals. However, we recognize that others, including IRS, TIGTA, or the Oversight Board, may be able to justify some adjustments to specific provisions of the act if they promote administrative efficiency or further achieving the act's goals. We also believe that IRS must be held accountable for developing the stronger performance evaluation and results-oriented performance management capabilities needed to better manage its resources. To this end, continued congressional oversight of IRS' efforts to modernize is key.

Some Disagreements Over Specific IRS Funding Issues

From discussions we have had with Oversight Board and TIGTA officials since the May 8 hearing, we have concluded that there were some disagreements among us over specific IRS funding issues discussed at the hearing.

One area of disagreement was over fiscal year 2002 funding for IRS business systems modernization. The Oversight Board recommended that $450 million be appropriated to the Business Systems Modernization (BSM) account in fiscal year 2002--$53 million more than IRS sought or justified in its budget submission. Moreover, after the budget submission, IRS decided to slow down its projects so it would not exceed its capacity to effectively manage modernization. Given these facts, in our view, appropriation of the additional $53 million in fiscal year 2002 was not clearly justified. Regardless, even if Congress does appropriate the additional $53 million, IRS' past appropriation acts require such BSM spending to be submitted to Congress via an expenditure plan before BSM funds can be obligated. This provides a follow-on control mechanism to ensure that appropriated funds are effectively managed and spent.

A second area of disagreement was the need for a fiscal year 2002 budget increase to cover inflationary increases in nonpay expenditures and certain other costs. The Oversight Board recommended additional funding ($137 million, or about 1.5 percent of IRS' proposed budget) for these costs. The proposed administration budget for IRS recognized unfunded costs, although the dollar amount was lower ($57 million), but indicated they could be covered through improved resource management.[2] The consequences of not increasing IRS' budget to fund these costs are unclear. We said at the May 8 hearing that it would be difficult for us to support a budget increase for these costs without some facts from IRS showing the consequences of not getting the increase.

[2]See Fiscal Year 2002 Budget Request for the Internal Revenue Service (GAO-01-698R, May 1, 2001).

An area where the Oversight Board recommended a budget increase for IRS, but we took no position at the hearing, was the need for funding such improvement projects as upgrading laptop computers. The Board recommended a $137 million budget amount, $97 million more than the $40 million IRS requested. We have not assessed the need for this funding and thus are unable to describe the consequences if IRS were not to receive it.

During the hearing, the Oversight Board emphasized the importance of 2-year funding for the BSM account. We have no disagreement with the Board on this issue. We believe that, given the BSM control mechanism described earlier, providing multiyear funding that has been justified could be an effective way to provide funding stability and avoid unnecessary interruptions in long-term information technology projects.

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As agreed with your offices, unless you publicly announce its contents earlier, we plan no further distribution of this letter until 30 days from the date on the letter. At that time, we will send copies to the Ranking Minority Member, Committee on Ways and Means; the Chairman, Committee on Finance; the Ranking Minority Member, Subcommittee on Oversight, Committee on Ways and Means; the Secretary of the Treasury; the Commissioner of Internal Revenue; the Chairman of the IRS Oversight Board; and the Treasury Inspector General for Tax Administration. In addition, we will make copies available to others on request. The letter will also be available on our home page at http://www.gao.gov.

Major contributors to this letter were Lawrence Korb and Gary Mountjoy. If you have any questions, you may contact Michael Brostek or me on (202) 512-9110.

Sincerely yours,

James R. White

James R. White
Director, Tax Issues

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