The Internal Revenue Service's Annual Program Performance Report Could Be Improved

September 2004

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DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

INSPECTOR GENERAL
for TAX
ADMINISTRATION

September 24, 2004

MEMORANDUM FOR CHIEF FINANCIAL OFFICER

Gordon C. Milbourn III

FROM: Gordon C. Milbourn III
Acting Deputy Inspector General for Audit

SUBJECT: Final Audit Report - The Internal Revenue Service's Annual Program Performance Report Could Be Improved (Audit # 200410012)

This report presents the results of our review of the Internal Revenue Service's (IRS) Fiscal Year (FY) 2003 Annual Program Performance Report. The overall objective of this review was to determine whether the IRS prepared its FY 2003 Annual Program Performance Report according to regulations and fully disclosed any known data limitations. Each year, Federal Government agencies are required to compare actual performance with the goals established in their annual plans and make this information available to the President, the Congress, and the American public as part of the process of holding Federal agencies accountable for achieving program results. This audit was conducted as part of our FY 2004 general audit program.

In summary, the IRS needs to ensure all of its FY 2003 performance measures are reported in the Management Discussion and Analysis portion of its annual financial statements. When information in the IRS FY 2005 Congressional Justification is considered along with that in the Management Discussion and Analysis portion of the financial statements, the IRS reported on only 56 of its 69 measures. In addition, the Chief Financial Officer (CFO) and her staff could be more proactive by reviewing the required explanations of measures that did not meet their goals and ensuring the measures developed by the IRS business units are valid. Further, the IRS needs to ensure it has performance measures to gauge its progress in addressing all of its major management challenges.

We recommended the CFO report on all of the IRS performance measures in the IRS Management Discussion and Analysis portion of the annual financial statements; this should include all the measures in each year's Annual Performance Plan. We further recommended the CFO review the quality of the explanations of any shortfalls and future corrective actions to achieve intended goals to ensure there is consistency in the level and type of details provided in the explanations and action plans. The CFO should work with business units' senior executives to review their measures to ensure they are valid. Moreover, the CFO, in coordination with the IRS operating divisions and functions, should ensure performance measures and goals are developed to accurately assess and measure the progress made in all of the major management challenges facing the IRS.

Management's Response: IRS management generally agreed with our recommendations. The CFO will report on all measures, review all explanations of performance shortfalls, and develop guidelines to review the definitions of measures, including verification and validation information. However, the CFO stated that Section 230 of Office of Management and Budget (OMB) Circular A-11 directs agencies to summarize the management challenges and indicate if they significantly impede the use of program performance data. In addition, the IRS is required to report on progress made and planned actions to address these management challenges. Based on the Circular A-11 guidance, the CFO believes that the IRS assessed and reported its progress in addressing these challenges based on a set of planned actions. Management's complete response to the draft report is included as Appendix VI.

Office of Audit Comment: The OMB revised Section 230 in July 2004 and restated the requirements that the FY 2004 Annual Program Performance Report must meet. The revised section states, "…include a summary of the agency's most serious management and performance challenges, as identified by the Inspector General (IG) office, and the agency's progress in addressing those challenges." We believe that it is in the IRS' best interest to develop measures for all of the major management challenges it faces so that it can accurately and readily assess and document its progress in addressing these challenges. While we still believe our recommendation is worthwhile, we do not intend to elevate our disagreement concerning this matter to the Department of the Treasury for resolution.

Copies of this report are also being sent to the IRS managers affected by the report recommendations. Please contact me at (202) 622-6510 if you have questions or Daniel R. Devlin, Assistant Inspector General for Audit (Headquarters Operations and Exempt Organizations Programs), at (202) 622-8500.

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Background

The Government Performance and Results Act of 1993 (GPRA)[1] is intended to improve the quality and delivery of Federal Government services. It was enacted to improve the accountability of Federal Government agencies to achieve program results by emphasizing goal setting, customer satisfaction, and results measurement. The GPRA requires that Federal Government agencies submit to the President and the Congress annual performance plans that set annual goals with measurable target levels of performance. Additionally, each Federal Government agency is required to submit an annual program performance report (APPR) on its success in achieving the goals established in the prior year's performance plan. In addition to providing information to the President and the Congress, these plans and reports are also intended to provide taxpayers with information to allow them to assess the extent to which Federal Government agencies are producing tangible public benefits.

The Reports Consolidation Act of 2000[2] authorizes agencies to produce either stand-alone performance reports or consolidated reports. The expected benefits of issuing consolidated reports are to:

- Provide financial and performance management information in a more meaningful and useful format for the Congress, the President, and the public.
- Improve the quality of agency financial and performance management information.
- Enhance coordination and efficiency on the part of agencies in reporting financial and performance management information.

For Fiscal Year (FY) 2003, the Office of Management and Budget (OMB) required that the Department of the Treasury prepare consolidated performance and accountability reports

[1] Pub. L. No. 103-62, 107 Stat. 285 (codified as amended in scattered sections of 5 U.S.C., 31 U.S.C., and 39 U.S.C.).
[2] Pub. L. No. 106-531.

that include the information for all of its offices and bureaus, including the Internal Revenue Service (IRS).[3]

This review was performed in the Offices of the Chief Financial Officer (CFO) in Washington, D.C.; New Carrollton, Maryland; and Atlanta, Georgia, during the period March through July 2004. The audit was conducted in accordance with *Government Auditing Standards*. Detailed information on our audit objective, scope, and methodology is presented in Appendix I. Major contributors to the report are listed in Appendix II.

The Internal Revenue Service Did Not Report Some of Its Performance Measures

The IRS reported its FY 2003 performance in two separate documents, the IRS FY 2003 Management Discussion and Analysis portion of its annual financial statements and the IRS FY 2005 Congressional Justification. We compared the performance information in these documents to the IRS FY 2003 Annual Program Plan to determine if the IRS fully reported the results of its operations. We determined that the IRS did not report on certain performance measures listed in its FY 2003 Annual Program Plan.

The Reports Consolidation Act of 2000 allows agencies to meet the reporting requirements of several different acts, such as the GPRA and the CFO Act of 1990,[4] through a consolidated report, as long as the information provided adequately addresses the requirements of the acts. In FY 2003, the IRS included its financial and performance information in its financial statements to meet the requirements of both the GPRA and the CFO Act.

The IRS FY 2003 Annual Program Plan contained 69 performance measures that were used to define the level of performance the IRS expected to achieve in FY 2003. The IRS reported on only 37 performance measures (54 percent) in the Management Discussion and Analysis portion of its annual financial statements.

We also reviewed the IRS FY 2005 Congressional Justification. That document principally addresses the IRS

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[3] Circular A-11 Part 6: Preparation and Submission of Strategic Plans, Annual Performance Plans, and Annual Program Performance Reports Section 230.1, dated July 2003.
[4] Pub. L. No. 101-576, 104 Stat. 2838 (codified as amended in scattered sections of 5 U.S.C., 31 U.S.C., and 42 U.S.C.).

budget request for FY 2005, but it also contains both the target and actual performance for FY 2003 performance measures. The FY 2005 Congressional Justification contained an additional 19 (27 percent) performance measures that were not included in the Management Discussion and Analysis portion of the annual financial statements. Between the 2 documents, the IRS reported on 56 of its FY 2003 performance measures, leaving 13 measures unreported.

The measures that were not reported assess various aspects of the IRS Processing, Assistance, and Management program and its Tax Law Enforcement program. Table 1 shows the number of measures the IRS associates with each program and the numbers and percentages not reported.

Table 1: Number of Performance Measures Not Reported (FY 2003)

Program	Number of Measures	Number Not Reported	Percentage Not Reported
Processing, Assistance, and Management	31	7	23%
Tax Law Enforcement	38	6	16%
Total	69	13	19%

Source: Comparison of the IRS FY 2003 Annual Performance Plan to the FY 2003 Management Discussion and Analysis portion of the annual financial statements and the FY 2005 Congressional Justification.

IRS staff in the CFO's office explained that these 13 measures were not reported because the Department of the Treasury CFO instructed all bureaus to limit their reports to outcome measures only.[5] The IRS does not consider these 13 measures to be outcome measures. Further, the CFO staff stated the IRS has discontinued using these 13 measures and did not include them in the IRS FY 2004 Annual Performance Plan. Table 2 shows the 13 measures that were not included in the FY 2003 IRS reports.

[5] An outcome measure provides an assessment of the result of a program activity when it is compared to its intended purpose. An output measure is the tabulation, calculation, or recording of activity or effort expressed in a quantitative or qualitative manner.

Table 2: Performance Measures Not Reported

Performance Measure	Planned	Actual	Difference	Percentage Difference
Advance Pricing Agreements and Prefiling Agreements	140	89	-51	-36.43
Teletax[6] and Toll-Free Automated Calls Answered	50,000	44,775	-5,225	-10.45
Total Returns Prepared	737,000	665,868	-71,132	-9.65
Tax Law Contacts	1,900,000	1,719,230	-180,770	-9.51
Accounts Contacts	3,300,000	3,255,018,	-44,982	-1.36
Offers in Compromise Processed	124,000	136,822	12,822	10.34
Tax Court Cases (Beg. Inventory and Receipts)	30,000	42,146	12,146	40.49
Number of Tax Court Receipts	18,000	21,132	3,132	17.40
Service-wide Full-Time Equivalents (FTE)[7] (including the Earned Income Tax Credit [EITC])*	98,934	*	*	*
Taxpayer Contact FTE Positions (w/EITC)*	675	*	*	*
FTE Positions per Billion Dollars of real Gross Domestic Product*[8]	9.98	*	*	*
Number of Web Site Hits (billions)	4.0	4.36	.36	9.00
Education and Outreach Staff Years	1,600	1,496	-104	-6.50

* These measures were included in the Plan for budget purposes and were not intended to be performance measures.

Source: Review of the IRS FY 2003 Management Discussion and Analysis portion of the annual financial statements and the FY 2005 Congressional Justification.

The IRS has developed 26 new measures to be included in the FY 2004 Annual Program Plan and assessed in the FY 2004 APPR.[9] While we agree it is important for the IRS

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[6] Telephone Tax Assistance (Teletax) allows taxpayers to use an automated application through a telephone to access refund and fact of filing information to determine the status of their tax refund or tax return, or to obtain limited tax law information.
[7] A measure of labor hours in which 1 FTE is equal to 8 hours multiplied by the number of compensable days in a fiscal year.
[8] Total market value of the final goods and services produced by a nation's economy during a specific period (usually a year).
[9] See Appendix IV for the list of new measures.

to continually work to improve its measures, OMB Circular A-11 does require that the APPR include actual performance for any goal that was discontinued after the fiscal year covered by the report. Moreover, to comply with the GPRA and the Reports Consolidation Act of 2000, the IRS should include all of the measures in the Management Discussion and Analysis portion of its annual financial statements. In this document, the IRS could separate and annotate the measures that were included in its yearly annual performance plan which it plans to discontinue or does not classify as outcome measures.

Recommendation

1. The CFO should report the IRS' performance on all of the measures included in each year's annual performance plan. These measures should all be in the Management Discussion and Analysis portion of the IRS' annual financial statements. In this document, the IRS could separate and annotate the measures that it does not classify as outcome measures.

Management's Response: The CFO will designate which measures will be discontinued in future year submissions as well as any measures that will not be reported in the Management Discussion and Analysis section of its annual financial statement and the Treasury Performance and Accountability Report.

More Information Needs to Be Reported to Explain Why Some Performance Goals Were Not Met

We analyzed the FY 2003 Management Discussion and Analysis portion of the IRS' annual financial statements to assess its adherence to GPRA requirements and OMB instructions. OMB Circular A-11 specifies that the APPR describe why any projected level of performance was not met and what steps will be taken to meet the goal in the future.

In its FY 2003 Management Discussion and Analysis portion of the annual financial statements, the IRS reported that 13 of 37 performance measures did not meet established targets. For 5 of the 13 measures, the IRS provided sufficient details about why the goals were not met and what actions the IRS will take to meet the goals in the future. For example, the IRS established a goal of 74 percent for the telephone level of service in the Automated Collection System (ACS)[10] but was able to achieve only a 70 percent rate in FY 2003, which is only a 1 percent improvement over FY 2002. The IRS explained the shortfall as follows:

> *The target was missed due to an increasing number of calls not related to a collection matter and therefore, not belonging to this specialized area. In addition, during the filing season, service was further impacted by the re-assignment of collection specialized representatives to assist in customer service areas of tax law and accounts.*

The IRS outlines its plan to address the problem as follows:

> *In FY 2004, a small increase in resources and enhancements to the scheduling process should contribute to an improved service level. In addition, a team has been established to look at what drives telephone traffic and is expected to develop recommendations related to call forecasting and suggest upgrades to the management tools designed to match resources to call demand.*

In contrast, the explanations given for shortfalls in the remaining eight measures were not well described. For example, the National Taxpayer Advocate, who leads the Taxpayer Advocate Service (TAS), established a Casework Quality Index of 90 percent[11] but achieved a rate of only 84 percent. The explanation for the shortfall was, "Despite an improvement of 10 percentage points over the FY 2001-2002 levels, … the goal was not met due to inconsistency in addressing taxpayer issues and customer education."

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[10] The ACS is a telephone contact system through which telephone assistors collect unpaid taxes and secure tax returns from delinquent taxpayers who have not complied with previous notices.

[11] A valid random local (i.e., TAS office-level) sample of "criteria closed" cases are reviewed and scored monthly against customer service standards of timeliness, accuracy, and communication. The quality index score is the number of points achieved divided by the total applicable points (on a 100-point scale).

Additionally, the explanation of how this shortfall would be addressed was not clear:

> *FY 2004 activities include validation of TAS' ability to take consistent and appropriate efforts to address taxpayer related issues and effectively educate its customers, and a re-evaluation of quality standards to ensure they match customer service standards developed using customer satisfaction survey data.*

The IRS reported a total of 19 measures in the FY 2005 Congressional Justification. All of the 19 measures reported in the Congressional Justification met their established targets.

Without a detailed explanation of why a goal was not met, and clear explanations of plans to ensure future achievement, the APPR cannot be used to assess the IRS' past performance and evaluate whether planned corrective actions are adequate. See Appendix V for a complete list of measures with explanations which we did not consider to be adequate.

While the CFO and her staff are not responsible for developing the performance measures for each individual business unit, they are responsible for compiling all the measures and producing the IRS APPR. Consequently, they are in the best position to review the quality of any explanations of shortfalls and future actions provided by the business units. They should notify the business units of any explanations which do not meet the GPRA requirements and request that the business units provide specific, detailed explanations.

Recommendation

2. The CFO should review the consistency and level of details provided in any explanations of shortfalls and future corrective actions associated with reported performance measures. Any explanation(s) determined to not meet the GPRA requirements should be returned to the respective business unit for correction.

Management's Response: The CFO will implement a more comprehensive process for reviewing explanations of performance shortfalls to ensure the IRS provides clear and specific explanations.

Measures Reported in the Congressional Justification Do Not Contain the Elements Needed to Meet GPRA Requirements

In addition to explaining why any goals were not met and providing plans to improve performance relative to these goals, agencies are also required to:

- Compare actual performance with planned performance set out in the annual program plan and report the success of achieving any performance measure.
- Include actual performance data for 3 preceding fiscal years.
- Evaluate the current fiscal year annual program plan relative to the performance achieved on the goals in the fiscal year covered by the APPR.

For the 19 performance measures not in its FY 2003 annual financial statements but reported in the FY 2005 Congressional Justification, the IRS met only 2 of the elements required by the GPRA. The IRS did compare actual performance to planned performance goals and did provide actual performance data for 3 preceding fiscal years. However, the Congressional Justification is not the vehicle intended to report agency results and, as recommended previously, the IRS should address all of its performance measures in the Management Discussion and Analysis portion of its annual financial statements.

Limitations Pertaining to the Accuracy of Certain Performance Measures Should Be Disclosed

We identified three performance measures that included information which distorts the measures:

- Total Paper Business Returns Filed.
- Toll-Free Tax Law Quality.
- Toll-Free Account Quality.

The Total Paper Business Returns Filed measure is intended to report the total number of paper business returns filed. The IRS includes in this measure Estimated Tax for Individuals (Form 1040-ES). However, Form 1040-ES is a payment slip for individuals to include with their estimated tax payments; it is not a business tax return form.

The Toll-Free Tax Law Quality measure reports the percentage of taxpayers who receive accurate responses to their tax law inquiries. The Toll-Free Account Quality measure reports the percentage of taxpayers who receive accurate responses to their account inquiries. For each of these measures, if the IRS employee accurately answers the taxpayer's technical tax or account question(s), but does not provide his or her identification number to the taxpayer, the employee's response is considered inaccurate. This issue was previously raised by the Government Accountability Office (GAO) in a report issued in November 2002.[12]

OMB Circular A-11 requires that agencies determine and describe how they will verify and validate the measured value of actual performance. When creating its annual performance plan, the IRS requires that its business units define their critical performance measures in the document referred to as the IRS performance measures data dictionary. The data dictionary also identifies any limitations the IRS has identified with its measures or the data used to compile the measures. In the FY 2003 data dictionary, IRS management used conformance to certain administrative procedures, such as providing the IRS representative's identification number to the taxpayer, as part of the definitions for Toll-Free Tax Law Quality and Toll-Free Account Quality, despite the fact that nonadherence to this procedure does not indicate whether the correct tax law answer or taxpayer account information was provided.

Members of the CFO staff stated that two of the three measures we discussed have been revised for FY 2004. The IRS will no longer count as an error those instances in which an employee does not provide his or her identification number to the taxpayer.

Recommendation

3. The CFO should review the definitions of the measures developed by the business units and ensure they are

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[12] Formerly the General Accounting Office. *Tax Administration: IRS Needs to Further Refine Its Tax Filing Season Performance Measures* (GAO-03-143, dated November 2002).

appropriate for the results that the measures were created to assess.

Management's Response: The CFO requires the business unit subject matter experts to develop the definition and identify the limitations to accuracy for each program measure. In addition, the CFO will also develop and implement guidance to include data dictionary reviews of measures definitions, verification, and validation information as part of its annual performance review process.

The Internal Revenue Service Does Not Have Performance Measures for Some of Its Major Management Challenges

In FY 2003, the Treasury Inspector General for Tax Administration (TIGTA) and GAO reported to the IRS the 13 most serious management and performance challenges it faces. In its FY 2003 Management Discussion and Analysis portion of the annual financial statements and its FY 2005 Congressional Justification, the IRS addressed only 8 of these challenges.

Security of both information and employees and facilities[13] was not assessed. As the primary revenue collector for the United States, the IRS is a target for terrorists and hackers. Threats to information have increased as the result of internal factors (such as increased connectivity of systems) and external factors (such as the volatile threat environment resulting from increased terrorist activity).

There were no measures to assess the IRS Business Systems Modernization program. The IRS has several projects and initiatives underway to update its outdated computer systems. The IRS' dependence on such old technology has been repeatedly identified as a major challenge the IRS must meet.

As with many other Federal Government agencies, the IRS continues to face a range of serious personnel management issues, including recruiting, training, and retaining employees, collectively categorized as human capital issues. The GAO considers strategic human capital management as a high-risk area for the Federal Government, and the President added human capital to his list of Priority

[13] Security of IRS – Information, and Security of IRS – Employees and Facilities are considered to be two separate challenges.

Management Objectives in FY 2001. While the IRS identified the recruiting, training, and retaining of a highly skilled workforce as one of its strategic initiatives, its FY 2003 annual program plan and APPR did not contain any measures to assess the IRS' progress in meeting this initiative.

Collecting taxes due the Federal Government continues to be a significant challenge for the IRS. As of May 2004, the IRS had an accounts receivable of unpaid taxes, including interest and penalties, totaling $292 billion. Because of the potential revenue losses and the effect on voluntary compliance, this is a high-risk area that IRS management needs to focus on. However, this is another area for which the IRS did not include a measure in its FY 2003 APPR.

Without effective performance measures and goals for these five major management challenges, the IRS cannot adequately measure and report its progress in addressing them. This makes it difficult for the IRS and its stakeholders to assess the IRS' progress in addressing these challenges.

Recommendation

4. The CFO, in coordination with the IRS operating divisions and functions, should ensure performance measures and goals are developed to accurately assess and measure the progress made in the major management challenges/high-risk areas identified by the TIGTA and GAO.

Management's Response: Per the CFO, Section 230 of Circular A-11 directs agencies to summarize the management challenges and indicate if they significantly impede the use of program performance data. In addition, the IRS is required to report on progress made and actions planned to address these management challenges. The CFO stated that the IRS assessed and reported its progress in addressing these challenges based on a set of planned actions.

Office of Audit Comment: The OMB revised Section 230 in July 2004 and restated the requirements that the FY 2004 APPR must meet. The revised section states, "…include a summary of the agency's most serious management and performance challenges, as identified by the Inspector General (IG) office, and the agency's progress in addressing those challenges." We believe that it is in the IRS' best interest to develop measures for all of the major management challenges rather than just discuss plans to address the challenges it faces so that it can readily and accurately assess and document its progress in addressing these challenges.

Appendix I

Detailed Objective, Scope, and Methodology

The overall objective of this review was to determine whether the Internal Revenue Service (IRS) prepared its Fiscal Year (FY) 2003 Annual Program Performance Report (APPR) according to regulations and fully disclosed any known data limitations. We also determined whether the measures addressed the IRS' major management challenges. To accomplish the overall objective, we:

I. Determined the procedures and processes used to gather data from the organizational and functional business units.

   A. Interviewed the Chief Financial Officer's staff to learn how data are collected for input to the IRS APPR.

   B. Interviewed the Office of Strategic Planning and Budget staff to gain an understanding of their input for the submission of the Annual Program Plan (APP) and the APPR.

   C. Determined if any additional guidance (from the Office of Management and Budget, the Department of the Treasury, or other sources) was used for preparation of the APPR.

II. Evaluated the effectiveness of the validation and verification process applied by the operational and functional business units to the performance measures.

   A. Determined who performs the data verification and validation in each operational and functional business unit.

   B. Determined the process used by each operational and functional business unit to validate and verify its measures.

III. Determined if all the Government Performance and Results Act of 1993[1] requirements of the APPR were addressed by the IRS. If any were not, we described and if possible quantified the impact on the APPR and the IRS measures as a whole.

IV. Analyzed the measures to determine which changed from FY 2002 to FY 2003. For those that changed, we determined if there is an explanation of how the increased or decreased goals were met.

[1] Pub. L. No. 103-62, 107 Stat. 285 (codified as amended in scattered sections of 5 U.S.C., 31 U.S.C., and 39 U.S.C.).

V. Determined if the major management challenges (as determined by the Treasury Inspector General for Tax Administration [TIGTA] and the Government Accountability Office [GAO][2]) were identified and effectively addressed in the IRS FY 2003 APP and APPR, in accordance with the Reports Consolidation Act of 2000.[3] As part of determining effectiveness, we determined if the measures were appropriately sized in relation to the known extent of the challenge.

VI. Determined if any prior TIGTA or GAO reports identified concerns with IRS performance measures or the systems that produced the measures and if any recommendations were made. We then determined if the IRS followed through on its response.

[2] Formerly the General Accounting Office.
[3] Pub. L. No. 106-531.

Appendix II

Major Contributors to This Report

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Appendix III

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Appendix IV

New Measures for Fiscal Year 2004

Performance Measure	2004 Goal	New or Prior Measure
Timeliness of Tax Products to the Public(o)[1]	75%	New
Customer Accuracy-Customer Accounts Resolved(o)	89%	Customer Account Correspondence Quality
Field Assistance Accuracy of Tax Law Contacts(o)	80%	New
Automated Collection System[2] Accuracy(o)	88%	New
Compliance Services Collection Operation Accuracy	95%	New
Automated Underreporter (AUR)[3] Case Accuracy(o)	94%	AUR Paper Quality
AUR Customer Satisfaction(o)	49%	New
Correspondence Examination Accuracy(o)	94%	Correspondence Examination Quality
Examination Customer Satisfaction (Large and Mid-Size Business Division)(o)	83.5%	New
Office of Appeals Closure to Receipt Ratio(o)	81%	Office of Appeals Cases Closed
Accuracy Rate of Distributed Tax Products-External(o)	100%	New
Percentage of Business Returns Processed Electronically(o)	19.6%	New
Deposit Timeliness(o) Wage and Investment (W&I) Division Small Business/Self-Employed (SB/SE) Division	 $500.00 $500.00[4]	New
Deposit Error Rate(o) W&I Division SB/SE Division	 4.0% 1.7%	New
Refund Timeliness(o)	98.4%	New
Refund Error Rate (w/systemic errors)(o)	5.3%	New
Business Master File[5] Refund Interest Paid(o)	$1,500	New
Percentage of Payments Received Electronically	33.6%	New
Customer Accounts Resolved-Customer Satisfaction(o)	56%	New

[1] (o) Denotes the measure is considered an outcome measure, not a workload indicator, by the Internal Revenue Service (IRS).
[2] A telephone contact system through which telephone assistors collect unpaid taxes and secure tax returns from delinquent taxpayers who have not complied with previous notices.
[3] The automated analysis and processing of potential underreported/over reported issues identified through information return matching.
[4] The lost opportunity cost of interest money received by the IRS but not deposited by the next day, per $1 million of deposits, using a constant 8% interest rate.
[5] The IRS database that consists of Federal tax-related transactions and accounts for businesses. These include employment taxes, income taxes on businesses, and excise taxes.

Performance Measure	2004 Goal	New or Prior Measure
Taxpayer Assistance Center[6] Contacts	8,367,959	1) Total Returns Prepared 2) Tax Law Contacts 3) Accounts Contacted
Employee Health and Safety-Lost Workday Case Rate(o)	0.49	New
Number of Post filing Legal Advice Cases Closed	12,400	New
Number of Tax Court Cases Closed	19,000	1) Tax Court Cases (Beginning Inventory and Receipts) 2) Number of Tax Court Receipts
Potentially Collectible Inventory (billions)	$85.7	New
Ticket Activity-Open[7]	1,153,250	New
Ticket Activity-Closed[8]	1,153,250	New

Source: IRS' Fiscal Year 2005 Congressional Justification.

[6] An IRS office with employees who answer questions, provide assistance, and resolve account-related issues for taxpayers face-to-face.
[7] Ticket Activity-Open is the number of help desk requests received via a telephone call, email, fax, walk-in, or other means.
[8] Ticket Activity-Closed is the number of help desk tickets resolved during the period of interest.

Appendix V

List of the Reported Measures With Incomplete Explanations[1]

G. **Toll-Free Tax Law Quality**

Description: The percentage of customers receiving accurate responses to their tax law inquiries. This evaluates the customer (external), administrative (internal) and regulatory accuracy of this service.

FY 2003 Performance: The goals for FY 2003 were set based on FY 2002 performance and anticipated score increases due to the implementation of the new Embedded Quality (EQ) process. The expected improvement from EQ was not realized, and IRS is conducting a root-cause analysis to determine the reasons why the outcomes were not achieved.

Toll-Free Tax Law Quality

FY2001	FY2002	FY2003	
		Plan	Actual
75%	81%	86%	80%

Future Plans: The following actions will be taken to improve the accuracy percentage for FY 2004: delivery of application-specific training and subsequent proficiency certification; ongoing research and analysis of quality data to identify improvement opportunities and initiatives; implementation of Contact Recording to enhance the ability of management to gauge and improve individual performance.

H. **Toll-Free Account Quality**

Description: The percentage of customers receiving accurate responses to their account inquiries. This evaluates responses posed by internal and external customers.

FY 2003 Performance: The goals for FY 2003 were set based on FY 2002 performance and anticipated score increases due to the implementation of the new Embedded Quality (EQ) process. The expected improvements from EQ were not realized, and IRS is conducting a root-cause analysis to determine the reasons why the outcomes were not achieved.

[1] Source: The Internal Revenue Service (IRS) Fiscal Year (FY) 2003 Management Discussion and Analysis portion of the annual financial statements. These statements were taken verbatim from the IRS document.

Toll-Free Account Quality

FY2001	FY2002	FY2003	
		Plan	Actual
69%	74%	77%	67%

Future Plans: The following actions will be taken to improve the accuracy percentage for FY 2004: delivery of application-specific training and subsequent proficiency certification; ongoing research and analysis of quality data to identify improvement opportunities and initiatives; implementation of Contact Recording to enhance the ability of management to gauge and improve individual performance.

I. **Customer Satisfaction Walk-In**

Description: Represents the customers' overall level of satisfaction with the services provided by the IRS at its Taxpayer Assistance Centers (TACs). The scores represent the average overall level of customer satisfaction ("Keystone" question) from the Customer Satisfaction transactional surveys. Survey recipients are asked to rate IRS performance on a 5-point scale, where a score of 1 or 2 indicates *Dissatisfied* and 4 or 5 indicates *Satisfied*. A limitation that may affect the validity of the data is the method in which the survey is conducted. The results are based on comment cards that are voluntarily completed by customers who have visited a Field Assistance office. Traditionally, comment cards are completed by customers who are either very satisfied or very dissatisfied with the service received, with the majority of comment cards being completed by customers who tend to be more satisfied. Therefore, the results should be viewed in more of a qualitative, rather than a quantitative, sense.

FY 2003 Performance: Customer satisfaction was below the target because the service at the Field Assistance (FA) offices for this period remains a key improvement factor in the taxpayer's eyes and survey results continue to indicate that customer wait time is highly correlated to their overall satisfaction. Survey results are obtained through comment cards voluntarily completed by customers, generally those who are either very satisfied or very dissatisfied with the service received.

Customer Satisfaction Walk-In Percentage Satisfied

FY2001	FY2002	FY2003	
		Plan	Actual
90%	86%	88%	87%

Future Plans: For 2004, IRS FA offices will continue to implement the network of the Queuing Management System (Q-Matic) to screen and categorize taxpayer needs.

O. **Field Collection Quality**

Description: Score awarded to reviewed Collection cases by a third-party reviewer using the Collection Quality Measurement System standards. Each standard, if met, has a value. Values are totaled to arrive at the score, with deductions in the overall composite score for failure to meet a standard designated as critical.

FY 2003 Performance: Quality scores remained at levels below target despite improved scores in the following areas: clear action dates, no activity lapses over 75 days, and timely follow-ups. In addition, FY 2003 scores improved (over FY 2002 levels) due to increased engagement between managers and revenue officers to facilitate timeliness and quality of case resolution.

Field Collection Quality

FY2001	FY2002	FY2003	
		Plan	Actual
84%	84%	87%	84%

Future Plans: In FY 2004 and beyond, IRS will continue to develop and implement recommendations to improve case quality.

P. **Automated Underreporter Quality**

Description: Quality of all Automated Underreporter (AUR) account actions as a result of taxpayer inquiries or internal requests. Quality of casework in the underreporter area is measured on paper closed cases only.

FY 2003 Performance: Deficiencies include timeliness in meeting interim contact requirements and the format of correspondence sent to taxpayers. The Embedded Quality initiative will capture new data and plans are to replace this measure.

Automated Underreporter Quality

FY2001	FY2002	FY2003	
		Plan	Actual
95%	94%	95%	91%

Future Plans: In FY 2004 IRS will continue to refine the process of identifying and selecting workload using data analyses and additional business rule development with the ultimate goal of removing the screen out cases (cases closed without sending notice to the taxpayer.)

T. **Examination – Case Quality Score**

Description: The score awarded to a reviewed Field Examination case by a Quality Reviewer using the Examination Quality Measurement System quality standards.

FY 2003 Performance: Despite continued improvements in examination quality, year-end performance is slightly below the planned target. Areas contributing to shortfall include a lack of embedded quality in Field Examination Operations and the need to further monitor the impact of Examination Reengineering Initiatives on case quality.

Examination Case Quality Score

FY2001	FY2002	FY2003	
		Plan	Actual
70%	71%	77%	76%

Future Plans: In FY 2004 embedded quality will be implemented for field exam, providing the IRS with better tools to manage errors in the field.

U. **Taxpayer Advocate Casework Quality Index**

Description: Measure of effectiveness in meeting customer expectations based on a random sample of cases reviewed and scored against customer service standards of timeliness, accuracy, and communication.

FY 2003 Performance: Despite an improvement of 10 percentage points over the FY 2001-2002 levels, the goal was not met due to inconsistency in addressing taxpayer issues and customer education.

Taxpayer Advocate Casework Quality Index

FY2001	FY2002	FY2003	
		Plan	Estimate
72%	79%	90%	84%

Future Plans: FY 2004 activities include validation of TAS' ability to take consistent and appropriate efforts to address taxpayer related issues and effectively educate its customers, and a re-evaluation of quality standards to ensure they match customer service standards developed using customer satisfaction survey data.

L. **Employee Plans / Exempt Organizations Examinations Closed**

Description: Number of Employee Plans plus Exempt Organizations return examinations closed in all categories.

FY 2003 Performance: The target was missed in the Employee Plan component with the redirection of large numbers of employees to work incoming determination receipts instead of their planned examinations, necessary due to an unanticipated number of receipts.

EP/EO Examinations Closed

FY2001	FY2002	FY2003	
		Plan	Actual
15,988	13,549	15,250	13,260

Future Plans: In FY2004 IRS will continue to address examination challenges with improvements in the Exempt Organization determination process and implementation of electronic filing of Form 990 returns.

Appendix VI

Management's Response to the Draft Report

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

CHIEF FINANCIAL OFFICER

RECEIVED
SEP 2 1 2004

September 21, 2004

MEMORANDUM FOR GORDON C. MILBOURN III
ACTING DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: Eileen T. Powell
Chief Financial Officer

SUBJECT: Draft Audit Report – The Internal Revenue Service's Annual Program Performance Report Could Be Improved (Audit#200410012)

Thank you for the opportunity to review and comment on the draft audit report titled *The Internal Revenue Service's Annual Program Performance Report Could Be Improved.* I agree with most of the recommendations and want to assure you that my staff and I are committed to managing a performance program compliant with the Government Performance and Results Act. The IRS' objective for the performance management program is to have a system which provides timely and accurate performance data to IRS leadership and outside stakeholders, enabling them to successfully assess the IRS' use of resources to accomplish its tax administration mission. Our responses to your recommendations follow:

Recommendation #1: The Chief Financial Officer (CFO) should report the IRS' performance on all of the measures included in each year's annual performance plan. These measures should all be in the Management Discussion and Analysis portion of the IRS' annual financial statements.

Corrective Action
The CFO agrees with this recommendation and beginning with the FY 2006 Budget submission, the IRS will designate which measures will be discontinued in future year submissions as well as any measures that will not be reported in the Management Discussion and Analysis section of its annual financial statement and the Treasury Performance and Accountability Report.

2

Recommendation #2: More Information Needs to Be Reported to Explain Why Some Performance Goals Were Not Met

Corrective Action
The CFO agrees with this recommendation and will implement a more comprehensive process for reviewing explanations of performance shortfalls to ensure the IRS provides clear and specific explanations.

Recommendation #3: The CFO should review the definitions of the measures developed by the business units and ensure they are appropriate for the results that the measures were created to assess.

Corrective Action
The CFO agrees with the recommendation and requires the business unit subject matter experts to develop the definition and identify the limitations to accuracy for each program measure. The CFO, however, recognizes that changing internal and external factors may impact the validity of the measure as well as the meaningfulness of the definition. Accordingly, the CFO will develop and implement guidance to include data dictionary reviews of measure definitions, verification, and validation information as part of its annual performance review process.

Recommendation #4: The Internal Revenue Service Does Not Have Performance Measures for Some of Its Major Management Challenges

Section 230 of Circular A-11 directs agencies to summarize the management challenges, indicate if they significantly impede the use of program performance data, and report progress made and planned to address the management challenge and performance challenges. Based on the A-11 guidance, rather than report on specific measures, the IRS assesses and reports annually its progress in addressing these challenges based on a set of planned actions.

We appreciate your input. If you have any questions or would like any additional information please contact me at 202.622.6400, or have a member of your staff contact Sherri Brown, Acting Associate Chief Financial Officer for Corporate Performance Budgeting, at 202.622.8770.