

GAO

Report to the Chairman, Subcommittee
on Oversight, Committee on Ways and
Means, House of Representatives

November 2006

**TAX
ADMINISTRATION**

**Most Filing Season
Services Continue to
Improve, but
Opportunities Exist
for Additional Savings**



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Highlights

Highlights of **GAO-07-27**, a report to the Chairman, Subcommittee on Oversight, Committee on Ways and Means, House of Representatives

Why GAO Did This Study

In 2006, the Internal Revenue Service (IRS) spent about 38 percent of its \$10.8 billion budget on processing returns and providing taxpayer assistance. GAO was asked to (1) assess IRS's 2006 filing season performance processing paper and electronically filed tax returns and providing telephone, Web site, and face-to-face assistance relative to 2006 goals and prior years' performance; (2) identify potential cost savings or other improvements; and (3) report on the status of IRS's Taxpayer Assistance Blueprint (TAB). To address these issues, GAO collected relevant information from IRS and other sources, reviewed performance measures and past filing season assessments, and interviewed officials.

What GAO Recommends

GAO suggests the Congress should mandate electronic filing by paid tax preparers meeting criteria such as filing a certain number of tax returns. In comments, the IRS Commissioner said he appreciated our acknowledging the effect of the statutory limitation.

GAO recommends that IRS timely develop, validate, and implement a plan to consolidate call sites and report to the Congress refund timeliness for its modernized processing system compared to its legacy system. In comments, the Commissioner said he agreed with the recommendations and outlined actions IRS plans to take.

www.gao.gov/cgi-bin/getrpt?GAO-07-27.

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

TAX ADMINISTRATION

Most Filing Season Services Continue to Improve, but Opportunities Exist for Additional Savings

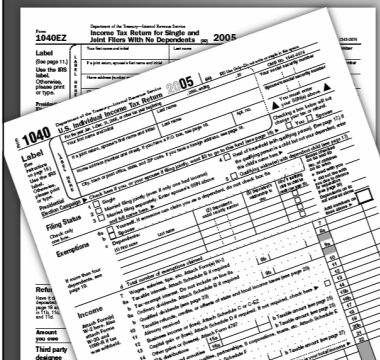
What GAO Found

IRS improved most filing season services in 2006, continuing improvements since 2001. IRS also generated efficiencies from increased electronic filing and benefits for taxpayers through systems modernization. IRS's processing of individual tax returns and refunds improved by most measures, but the growth rate of electronic filing continued to slow in part because of changes to the Free File Program, which reduced the number of taxpayers eligible to use it and the elimination of a program that allowed taxpayers to file via the telephone. Access to IRS's telephone assistors was comparable to last year. The accuracy of responses to telephone inquiries was 90 percent or over in 2006. Use of IRS's Web site increased substantially and IRS reconfigured the site to improve service. Continuing past trends, fewer taxpayers used IRS walk-in sites and more used less-costly volunteer sites. Also, IRS completed Phase I of the TAB, which identified strategic themes for improving taxpayer service; TAB Phase II is expected to be completed by early 2007.

With the slowing growth rate in electronic filing, IRS is missing an opportunity to generate additional savings. Federal and state mandates for electronic filing have demonstrated success in increasing electronic filing; however, IRS currently lacks the authority to mandate electronic filing for certain income tax returns such as individual returns filed by paid tax preparers. Using IRS estimates, savings from such a mandate could be on the order of \$60 million per year. IRS has another opportunity to generate savings because of excess space at its call sites. However, IRS lacks a strategy for eliminating that space by consolidating call sites.

To replace its aging legacy computer system, IRS continues to implement a modernized system for processing tax returns and refunds. However, IRS does not report information on the chief benefit realized to date, faster refund issuance. Such information could be useful for the Congress when making decisions about funding the completion of the individual tax return processing part of the system, estimated by IRS to require at least another \$500 million.

IRS's 2006 Filing Season Activities

	Returns processing	Paper returns 59 million @ 6 paper processing centers
		Electronic returns 72 million @ 5 electronic processing centers
	Taxpayer assistance	Toll-free calls 71 million @ 25 call sites and automation
		Walk-in contacts 5 million @ 400 walk-in and more than 12,000 volunteer sites
		Internet downloads 170 million @ IRS Web site

Source: GAO analysis of IRS data, IRS (images).

Contents

Letter		1
	Results in Brief	2
	Scope and Methodology	5
	Background	6
	Opportunities Exist to Generate Savings by Encouraging Electronic Filing; Processing Performance Continued to Improve	10
	Access to IRS's Telephone Assistors Was Comparable to Last Year and Accuracy Improved, but IRS Has Excess Space at Its Call Sites	20
	IRS's Web Site Use Grew Substantially and Is Now a Major Component of Taxpayer Service	26
	Continuing Past Trends, Fewer Taxpayers Used IRS Walk-in Sites and More Used Volunteer Sites, but Data on Services Provided Remains Incomplete for Both	28
	IRS Has Completed the First Phase of the TAB and Has Begun Assessing Taxpayers' Service Needs	33
	Conclusions	34
	Matter for Congressional Consideration	35
	Recommendations for Executive Action	35
	Agency Comments and Our Evaluation	35
Appendix I	Differences between the 2002 and 2005 Free File Agreements	37
Appendix II	Status of CADE Implementation and Future Releases	40
Appendix III	State Mandates for Electronic Processing	44
Appendix IV	IRS's Processing Performance Relative to 2001–2005 Performance and 2006 Goals	48
Appendix V	Telephone Access Varies Depending on the Time of Year and Type of Call	51
Appendix VI	Comments from the Internal Revenue Service	52

Tables

Table 1: IRS Processing Performance Measures	17
Table 2: IRS Telephone CSRs Accessibility Performance, 2001–2006 Filing Seasons	21
Table 3: IRS Telephone CSRs Accuracy Performance, 2001–2006 Filing Seasons	22
Table 4: Schedule of CADE Releases and Related Functionality	40
Table 5: Electronic Filing Rates of Growth in Federal Returns for States with Mandates Compared to National Averages	45
Table 6: IRS's Processing Performance, Fiscal Years 2001–2006	49

Figures

Figure 1: IRS's 2006 Filing Season Activities	9
Figure 2: Number of Individual Returns and IRS Staff Years for Individual Paper and Electronic Processing, Fiscal Years 1999–2007	11
Figure 3: How IRS Handled Calls during 2006	24
Figure 4: Assistance Provided by IRS Walk-in Sites, 2001–2006 Filing Seasons	29
Figure 5: Direct FTEs Used for Assistance Provided at IRS Walk-in Sites, 2001–2006 Filing Seasons	30
Figure 6: States with Electronic Filing Mandates for Paid Tax Preparers	44

Abbreviations

BSM	Business Systems Modernization
CADE	Customer Account Data Engine
CSR	Customer Service Representative
EIN	Employer Identification Number
ETAAC	Electronic Tax Administration Advisory Council
ETLA	Electronic Tax Law Assistance
FTE	Full-time Equivalent
IRS	Internal Revenue Service
NTA	National Taxpayer Advocate
RAL	Refund Anticipation Loan
RRA 98	IRS Restructuring and Reform Act of 1998
TAB	Taxpayer Assistance Blueprint
TIGTA	Treasury Inspector General for Tax Administration

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United States Government Accountability Office
Washington, DC 20548

November 15, 2006

The Honorable Jim Ramstad
Chairman
Subcommittee on Oversight
Committee on Ways and Means
House of Representatives

Dear Mr. Chairman,

In fiscal year 2006, the Internal Revenue Service (IRS) spent approximately \$4.1 billion or 38 percent of its \$10.8 billion budget on processing income tax returns and providing taxpayer assistance, with most of this occurring during the annual tax filing season.¹ During the 2006 filing season, taxpayers filed an estimated 131 million individual income tax returns and received almost \$218 billion in refunds. IRS's filing season performance is a key indicator of how well IRS is serving taxpayers and helping them fulfill their tax responsibilities.

In past reports and testimonies² we said that IRS has made significant progress improving taxpayer service since passage of the IRS Restructuring and Reform Act of 1998 (RRA 98).³ However, we also described challenges to continued progress. For example, the President's proposed fiscal year 2007 budget for IRS would cut staffing by over 2 percent. At the same time, IRS has ambitious goals of maintaining or improving filing season services, while also maintaining or increasing enforcement activities in order to improve voluntary compliance by 2009. Another challenge is continuing progress on the Business Systems

¹Most taxpayers file their tax returns between January 1 and April 15, which is the deadline for filing individual income tax returns. However, millions of taxpayers receive extensions from IRS, which allows them to delay filing until as late as October 15.

²See, for example, GAO, *Tax Administration: IRS Improved Some Filing Season Services, but Long-term Goals Would Help Manage Strategic Trade-offs*, [GAO-06-51](#) (Washington, D.C.: Nov. 14, 2005), *Internal Revenue Service: Assessment of Fiscal Year 2006 Budget Request and Interim Results of the 2005 Filing Season*, [GAO-05-416T](#) (Washington, D.C.: Apr. 14, 2005), and *Internal Revenue Service: Assessment of the Interim Results of the 2006 Filing Season and Fiscal Year 2007 Budget Request*, [GAO-06-615T](#) (Washington, D.C.: Apr. 6, 2006).

³Pub. L. No. 105-206 (1998).

Modernization (BSM) program, IRS's ongoing effort to replace its aged computer systems. Earlier this year we testified that proposed reduced funding levels could affect the pace of modernization and ultimately of improving service and enforcement.⁴

In light of these challenges and the tax filing season's cost and importance to taxpayers, you asked us to assess IRS's 2006 filing season performance. Our objectives were to (1) assess IRS's 2006 filing season performance in processing paper and electronically filed tax returns and providing telephone, Web site, and face-to-face assistance relative to 2006 goals and prior years' performance; (2) identify potential cost savings or other improvements; and (3) report on the status of IRS's Taxpayer Assistance Blueprint (TAB), which is intended to be the long-term strategy for cost effectively delivering services that meet taxpayer needs. We testified on IRS's interim 2006 performance in a hearing held by your Subcommittee on Oversight, House Committee on Ways and Means, on April 6, 2006.⁵

Our assessment is based on the reported results and analysis of key IRS performance measures, observations of IRS's operations, interviews with IRS officials, information from representatives of the paid tax preparer community, and analyses by the Treasury Inspector General for Tax Administration (TIGTA).⁶ For the purpose of this report, we found IRS's data to be sufficiently reliable for assessing IRS's 2006 filing season performance and comparing to prior filing seasons. Further details on our scope and methodology are provided later in this report. We performed our work from January through October 2006 in accordance with generally accepted government auditing standards.

Results in Brief

IRS improved most of its primary filing season services, including returns processing, telephone, Web site, and face-to-face operations. This continues a trend of recent improvements. Opportunities exist to generate

⁴[GAO-06-615T](#).

⁵[GAO-06-615T](#).

⁶We refer to paid tax preparers for both tax practitioners and commercial preparers. According to IRS, tax practitioners complete tax returns for money, are governed by the requirements outlined in U.S. Department of the Treasury Circular 230, are authorized to represent taxpayers legally before IRS, and include attorneys, certified public accountants and enrolled agents. Commercial Preparers include corporations, self-employed individuals, and electronic return originators; they are not regulated by IRS or governed by Circular 230.

additional savings by increasing electronic filing of tax returns and consolidating some operations.

Processing: Electronic filing continued to grow, which has resulted in significant cost savings. Since 1999 IRS has eliminated approximately 1,600 staff years that were devoted to processing returns and closed two paper processing centers, with a third center scheduled to close in 2007. However, the growth rate of electronic filing in 2006 slowed to about 6 percent, lower than any of the previous 3 years. Two factors contributed to the slower growth rate: fewer taxpayers being eligible for and using the Free File Program, which allows some taxpayers to file for free through IRS's Web site, and the elimination of a program that allowed some taxpayers to file electronically via telephone. Slower growth limits opportunities to generate additional savings from electronic processing. Federal mandates requiring large corporations to electronically file and state mandates requiring certain paid tax preparers to electronically file individual returns have demonstrated success in increasing electronic filing. State mandates imposed on paid tax preparers have also increased electronic filing, including of federal returns. In eight of the nine states with mandates in place by 2005, the growth rate of electronically filed federal returns increased in the year the mandate was implemented. In four of the states, the growth rate more than doubled. This experience demonstrates that mandated electronic filing can generate savings. Using IRS's estimates, if 90 percent of returns submitted by paid preparers that are filed on paper were filed electronically, IRS would save about \$68 million per year. However, IRS lacks the statutory authority to mandate electronic filing of individual income tax returns by paid tax preparers. With respect to processing performance, most measures show improvement. However, IRS does not report the information to the Congress that would clearly highlight the benefits of its new processing system, such as gains in refund timeliness. As we previously reported, having estimates of the benefits of large investment programs could be useful for the Congress when making decisions about funding. IRS estimates the completion of the individual tax return processing part of the new system will require at least another \$500 million.

Telephone service: The percentage of taxpayers who got through to IRS customer service representatives (CSR) was slightly lower than last year, but there were improvements both in wait times and in the rate at which taxpayers abandoned their calls while waiting for an assistor. The accuracy of responses to telephone tax law and accounts questions is 90 percent or over, an improvement since last year and more so since 2001. However, IRS could reduce costs. IRS officials told us that during peak

staffing the agency had about 850 unused CSR workstations spread across IRS's 25 call sites. Because IRS directs incoming calls through a centralized routing system, the location of call sites does not affect the level of service provided. As a result, IRS has the potential to generate savings by closing some sites without negatively affecting customer service even at peak times.

Web site: Taxpayer use increased, as indicated by a 36 percent growth in the number of downloads for tax forms and publications. IRS reconfigured its Web site and the site is performing well, according to independent rating services. One indicator of success is that taxpayers searched less to find the information they needed. The increased usage of IRS's Web site is consistent with IRS's strategy to improve service by providing taxpayers with an option for automated interaction at the convenience of taxpayers.

Walk-in assistance: Continuing a trend since 2001, fewer taxpayers received assistance at IRS's walk-in sites and more received return preparation assistance at sites staffed by volunteers. In response to past concerns raised by us and the TIGTA, IRS has initiatives underway intended to provide detailed management data on the services offered at walk-in sites, and reliable methods for assessing the quality of services offered at walk-in and volunteer sites.

Taxpayer Assistance Blueprint (TAB): IRS has completed the first of two phases of the TAB, its initiative to measure taxpayer services against the needs and preferences of taxpayers and develop a 5-year plan for improving services. Phase I provides information on taxpayer preferences and identifies themes for improving service. IRS anticipates Phase II of its TAB report will be released early 2007, and will include its research plan designed to build on these strategic improvement themes and enhance understanding of the effect of taxpayer service on compliance.

This report includes a matter that the Congress may want to consider to reduce the costs of processing tax returns. Specifically, Congress should mandate electronic filing by paid tax preparers meeting criteria such as a threshold number of returns filed. We are also making recommendations that the Commissioner of Internal Revenue direct the appropriate officials to timely develop, validate, and implement a plan to consolidate call sites and report to the Congress refund timeliness for its new system for processing individual income tax returns compared to the Master File legacy system.

In commenting on a draft of this report (see app. VI), the IRS Commissioner said that, with respect to the matter for congressional consideration, he appreciated our acknowledging the current statutory limitation that is impeding electronic filing growth. The Commissioner said he agreed with our recommendations and he generally outlined the actions IRS plans to take to address those recommendations.

Scope and Methodology

To assess IRS's 2006 filing season performance in the key filing season activities—paper and electronic processing, plus telephone, Web site, and face-to-face assistance—compared to goals and past performance, and report on the status of the TAB, we

- reviewed and analyzed IRS reports, testimonies, budget submissions, and other documents and data, including workload data and data related to IRS's current suite of balanced performance measures and annual goals;
- analyzed staffing data for paper and electronic processing, telephone assistance, and walk-in assistance;
- tested for statistically significant differences between annual performance measures based on sample data;
- observed operations at IRS's Atlanta and Cincinnati paper processing centers, the Atlanta Call Site and Joint Operations Center, and 4 of IRS's 400 walk-in locations;⁷
- reviewed legislation, policies, and procedures;
- reviewed information from organizations that evaluate Internet performance;
- reviewed related TIGTA reports and interviewed TIGTA officials about IRS's performance and initiatives;

⁷Our review focuses on IRS's Wage and Investment Division, which serves taxpayers whose income is from wages and investments, processes individual income tax returns, and provides assistance to taxpayers who call on the telephone or walk into an IRS office. During our audit work, we became aware of problems with IRS's primary information system used to detect and stop fraudulent claims for refunds on income tax returns. However, because this system is largely an enforcement function and TIGTA had initiated an audit on the system, we determined this work to be beyond the scope of our audit.

-
- reviewed prior GAO reports and followed up on our recommendations made in prior filing season and related reports;
 - interviewed IRS officials about current operations, performance relative to 2006 performance goals and prior filing season performance, trends, and significant factors and initiatives that affected or were intended to improve performance; and
 - interviewed representatives of the few larger private and nonprofit organizations that prepare tax returns including H&R Block and trade organizations that represent both individual paid tax preparers and tax preparation companies including the American Institute of Certified Public Accountants.

This report discusses numerous filing season performance measures and data that cover the quality, accessibility, and timeliness of IRS's services. We report on IRS's filing season measures that, based on our prior work, we consider to be objective and reliable. To the extent possible, we corroborated information from interviews with documentation and data and where not possible, we report the information as attributable to IRS officials. We reviewed IRS documentation, interviewed IRS officials about computer systems and data limitations, and compared those results to GAO standards of data reliability.⁸ As a result, we determined that the IRS data we are reporting are sufficiently reliable for assessing IRS's filing season performance. Data limitations are discussed where appropriate.

We conducted our work at IRS headquarters in Washington, D.C., and New Carrollton, Maryland; the Wage and Investment Division headquarters and Joint Operations Center (which manages telephone service) in Atlanta, processing centers in Atlanta and Cincinnati, and a telephone call site in Atlanta; and walk-in locations in Georgia and Ohio. We selected these offices for a variety of reasons, including the location of key IRS managers, such as those responsible for telephone and walk-in site services.

Background

The majority of taxpayers have their tax returns prepared by professional preparers. In fiscal year 2005, about 59 percent of individual tax returns were prepared by paid tax preparers. We have noted in previous testimony

⁸GAO, *Assessing the Reliability of Computer-Processed Data*, [GAO-02-15G](#) (Washington, D.C.: Sept. 1, 2002).

that the rate of preparer usage is higher among taxpayers with more complicated returns.⁹

Once returns are prepared, taxpayers can file their returns by mailing paper returns to one of IRS's submission processing centers or submitting the returns electronically. Both taxpayers and paid tax preparers can submit paper returns directly to IRS. However, taxpayers cannot submit electronic returns directly to IRS. Instead, only paid tax preparers and tax preparation software companies that IRS has designated as electronic return originators can transmit tax returns electronically to IRS which may involve a fee to the taxpayer. In addition, the Free File program is offered by 20 companies that make up the Free File Alliance, a consortium of tax preparation companies that agreed to offer free return preparation and electronic filing for taxpayers that meet certain criteria. Taxpayers can access the Free File program via IRS's Web site (see app. I for further detail on the Free File program).

For 7 years, IRS has been modernizing its aging tax processing and business systems. The BSM program is a high-risk, highly complex effort critical to supporting IRS's taxpayer service goals. For example, the program includes projects to allow taxpayers to file and retrieve information electronically. To date, IRS has deployed releases of modernized systems that have delivered benefits to taxpayers and the agency, including e-Services (a new Web portal and electronic services for paid tax preparers), Modernized e-File (a new electronic filing system), and the Customer Account Data Engine (CADE), which is the new taxpayer information database. CADE is intended to eventually replace IRS's antiquated Master File legacy processing system that contains the agency's repository of taxpayer account information and, therefore, is the BSM program's cornerstone and highest priority project. CADE facilitates faster refund processing and more timely response to taxpayer inquiries (see app. II for more details on CADE).

In addition to processing tax returns, IRS provides a variety of taxpayer services, including providing tax law assistance, account resolution, limited return preparation, tax forms and publications distribution, outreach, and education. IRS provides these services mainly via telephone, its Web site, and face-to-face assistance. IRS automatically routes

⁹GAO, *Paid Tax Return Preparers: In a Limited Study, Chain Preparers Made Serious Errors*, GAO-06-563T (Washington, D.C.: Apr. 4, 2006).

taxpayers' calls from one of three toll-free lines—tax law, accounts, or refunds. Depending on how taxpayers respond to menu choices, questions are answered by a recorded message or taxpayers are directed to CSRs located at 25 call sites around the country. Calls are centrally routed to the site with the shortest wait times among CSRs assigned to answer particular tax law, account, or refund status questions.

For face-to-face assistance, IRS has 400 walk-in sites where taxpayers can ask basic tax law questions, get account information, receive assistance with their accounts, and have returns prepared if annual income is \$38,000 or less.¹⁰ Also, low-income, elderly, and qualifying military taxpayers can get returns prepared at over 12,000 volunteer sites run by community-based coalitions that partner with IRS. In addition, IRS identifies and selects community partners, such as AARP, that meet taxpayer needs, such as assistance for the elderly, and helps train, provides resource materials, and oversees operations at these partners' facilities. In some cases, IRS awards grants, trains and certifies volunteers, and provides reference materials, computer software, and computers.

IRS provides many Web services that have become popular, such as "Where's My Refund" which enables taxpayers to use IRS's Web site to determine whether the agency received their tax returns and processed their refunds. Taxpayers can also download forms, instructions, and publications; research their own tax law issues through Frequently Asked Questions or Tax Topics; and receive help with specific tax law questions and procedural questions via e-mail using Electronic Tax Law Assistance (ETLA). One benefit of the Web site is that it reduces the number of phone calls received.

IRS's 2006 filing season activities and associated workload volumes are depicted in figure 1.

¹⁰According to IRS, this limitation approximates the amount set in the Internal Revenue Code for claiming the Earned Income Tax Credit. IRS has required appointments for most taxpayers seeking this assistance since 2003.

Figure 1: IRS's 2006 Filing Season Activities

	Returns processing	Paper returns 59 million @ 6 paper processing centers
		Electronic returns 72 million @ 5 electronic processing centers
	Taxpayer assistance	Toll-free calls 71 million @ 25 call sites and automation
		Walk-in contacts 5 million @ 400 walk-in and more than 12,000 volunteer sites
		Internet downloads 170 million @ IRS Web site

Source: GAO analysis of IRS data, IRS (images).

Note: The number of paper and electronic returns and refunds are estimated for the time period January 1, 2006, to September 15, 2006; toll-free calls for the time period January 1, 2006, to July 15, 2006; walk-in contacts, which includes returns prepared at volunteer sites, for the time period December 25, 2005, to April 22, 2006; and Internet downloads for the time period January 1, 2006, to August 31, 2006. We used different dates for the various areas that best reflect IRS's filing season workload in that area.

IRS evaluates taxpayer service against performance measures such as timeliness and quality of telephone responses. IRS's definitions for some of those measures vary. For example, IRS measures accuracy for telephone and face-to-face assistance, but because of differences in the methodologies used to collect the data, comparisons between the two types of assistance are not possible. IRS also considers volume important when assessing service delivery and recognizes that volume does not necessarily reflect actual demand for services, but can reflect changes in taxpayer behavior, such as more willingness to use IRS's Web site to receive services. Finally, IRS uses other means to collect information, such as surveys on taxpayer satisfaction.

Opportunities Exist to Generate Savings by Encouraging Electronic Filing; Processing Performance Continued to Improve

The growth rate of electronic filing is important because electronic filing eliminates costs associated with processing paper returns. IRS's performance processing the paper and electronic returns it received in 2006 improved compared to earlier years.

Electronic Filing Continues to Grow, but at a Slower Rate, Which Limits Opportunity to Achieve Additional Savings

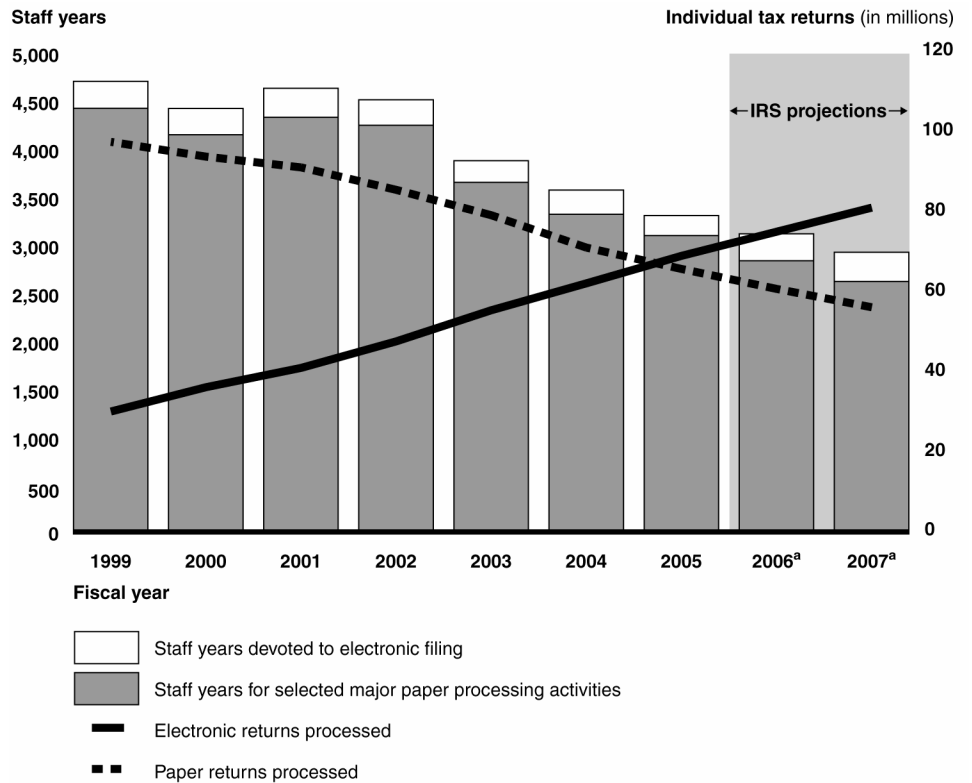
As of September 15, 2006, IRS processed 131 million individual income tax returns. Of those returns, 72 million or 55.1 percent were filed electronically and the remaining 59 million returns were filed on paper. The number of returns filed electronically increased by 6.3 percent over the last year, which was less than the 9 percent increase forecasted by IRS and less than last year's 11 percent increase, the 12 percent increase in 2004, and the nearly 17 percent increase in 2003.

The growth rate has slowed and, according to IRS officials, it is getting harder to convert additional taxpayers to electronic filing because those who might convert most readily have already done so. Slower growth limits IRS's progress toward achieving the goal set by the Congress in RRA 98, which was for IRS to have 80 percent of all federal tax and information returns filed electronically by 2007. We and IRS have previously reported that IRS likely will not meet the 80 percent goal, but that the agency did not want to abandon it because it serves as a symbol of IRS's determination to increase electronic filing.¹¹

Growth of electronic filing is important because it generates savings from reductions in staff needed for labor-intensive paper processing and associated space. As shown in figure 2, as electronic filing increased between fiscal years 1999 and 2006, IRS has greatly reduced the number of staff years devoted to paper and electronic processing by 1,586, or 34 percent.

¹¹GAO-06-51.

Figure 2: Number of Individual Returns and IRS Staff Years for Individual Paper and Electronic Processing, Fiscal Years 1999–2007



Source: GAO analysis of IRS data.

Notes: Staff years and FTE are units of measurement that are often used interchangeably. As noted in the figure, staff years for paper filing are for selected major activities only.

^aFiscal years 2006 and 2007 are IRS projections.

In addition to generating savings by reducing FTEs, IRS can and has achieved ancillary space cost savings from the closing of submission processing centers.¹² IRS estimates that the elimination of the Brookhaven Submission Processing Center in 2003 resulted in savings of \$5.5 million in annualized rent and related savings. In addition, IRS closed the Memphis Submission Processing Center in 2005, and IRS is projecting annualized rent and related savings equal to \$1.3 million beginning in fiscal year 2007. IRS plans to close the Philadelphia Submission Processing Center in 2007,

¹²According to IRS, an FTE is the equivalent of one person working full-time for 1 year with no overtime.

although IRS will not realize space savings until late 2011 because the Service cannot close the entire facility or move other operations into the space vacated by paper processing operations.¹³

Two other factors that contributed to this year's slower growth in electronic filing were (1) changes in the Free File program, which reduced the number of taxpayers eligible to file electronically for free this year, and (2) termination of the TeleFile program, which had allowed taxpayers to file their returns electronically via telephone. Through August, IRS processed about 4 million returns filed through the Free File program, which is a decrease of about 23 percent from the same period last year. This decline is inconsistent with IRS's projection that it would receive 6 million tax returns filed through the Free File program, or almost a million more than received last year, when some members of the Free File program provided free electronic filing to all taxpayers. In 2005, IRS renegotiated and amended the agreement with the tax preparation companies participating in the Free File program. Among the important changes was a new income limitation of \$50,000 or less that resulted in 30 percent of the nation's taxpayers not being eligible for the Free File Program. This change left 92 million taxpayers eligible for the program and 39 million taxpayers ineligible.¹⁴

IRS also terminated the TeleFile program. IRS expected that eliminating TeleFile would reduce electronic filing, but justified the decision because of declining usage and relatively high costs. The number of taxpayers using the TeleFile program had been decreasing—from approximately 5.7 million in 1999 to 3.3 million in 2005. IRS estimated the cost per tax return submitted through TeleFile, typically Form 1040EZ, to be about 74 percent more than it costs IRS to process a return filed on paper, largely due to telecommunications and other costs. IRS officials stated that the reason for this year's increase in the number of 1040EZ returns filed on paper is, in part, the elimination of TeleFile. According to IRS officials, approximately 1.3 million or 40 percent of taxpayers who formerly used Telefile in 2005 filed on paper in 2006.

¹³Without being able to move the remaining offices or functions to a new location, IRS will have to pay for unused space from the closure of the Philadelphia processing center amounting to \$3.8 million per year.

¹⁴These calculations are based on IRS data on the number of filed returns. A return may represent more than one taxpayer.

Over the years, IRS has taken numerous actions to encourage electronic filing by taxpayers and tax practitioners. In addition, IRS has responded to many of our recommendations to increase the use of electronic filing.¹⁵ Despite these actions, and as we have already noted, growth in electronic filing has slowed as IRS's recent efforts have not resulted in converting a large portion of tax filers from paper to electronic filing.

Nevertheless, IRS continues to look at options for increasing electronic filing. A recent proposal is aimed at converting taxpayers and paid tax preparers who prepare individual income returns on computer, print them out, and then send them to IRS—a process known as V-coding—to electronic filing. According to IRS officials, converting these taxpayers could be an important step to reduce the number of paper returns filed. Between January and May 2006, IRS estimates that nearly 39 million, or 72 percent of all paper returns filed were V-coded returns. To help convert V-coders, IRS officials stated that the agency is considering creating a secured electronic mailbox where tax preparers could send in a return, the taxpayer could review and sign it, then submit it to IRS electronically, or return it to the preparer for additional work and subsequent electronic filing to IRS. According to IRS officials, this initiative would be part of e-Services.¹⁶ Further, this and other proposals to expand electronic filing and capitalize on new technologies will be contained in an update to its E-Strategy for Growth, which is a long-term vision for providing ways for taxpayers to interact electronically with IRS. While the proposal may be an important tool for paid tax preparers and taxpayers, participation remains on a voluntary basis as part of e-Services, IRS officials did not have estimates as to its effect on reducing V-coding, and it covers only practitioners and not taxpayers.

¹⁵See for example, GAO, *Tax Administration: Opportunities to Increase the Use of Electronic Filing*, GAO/GGD-93-40 (Washington, D.C.: Jan. 22, 1993).

¹⁶The e-Services system, offered to paid tax preparers who have filed at least 100 electronic returns, gives them the ability to conduct business, such as electronic account resolution and transcription delivery, with IRS electronically 24 hours a day 7 days a week.

Mandates Have Demonstrated Success in Increasing Electronic Filing, but IRS Lacks the Authority to Impose Mandates for Individual Taxpayers

For the first time, in the 2006 filing season IRS mandated that corporations with assets over \$50 million file their corporate tax returns electronically. As of September 15, 2006, over 12,000 large corporations electronically filed their returns, up from 131 in 2005. Next year, corporations with over \$10 million in assets will be required to file their returns electronically. Perhaps in anticipation of the mandate, over 16,000 of those corporations filed electronically, compared to just over 1,100 in 2005. According to the IRS Commissioner, electronic filing by large corporations will cut many months off the audit process and will allow IRS to develop analytical tools to better select areas of audit inquiry. Consequently, those corporations will benefit by having uncertainties on their tax returns resolved sooner, and the government will benefit by more promptly identifying and responding to areas of noncompliance.

Last year we reported that state mandates for electronic filing of state tax returns also encourage electronic filing of both state and federal tax returns.¹⁷ Of the 50 states, 12 had electronic filing mandates for paid tax preparers in effect for the 2006 filing season. These mandates require preparers who meet certain criteria, such as filing 100 individual state tax returns or more, to file individual state returns electronically (see app. III for more information on state mandates).¹⁸

State mandates have increased the electronic filing of federal individual income tax returns. According to IRS officials, this increased growth is because paid tax preparers converted their entire practice to electronic filing. Nine states had electronic filing mandates in effect in 2005 or earlier. In eight of these nine states, the growth rate of electronically filed federal returns increased the year the mandate was implemented. For one state, Virginia, the growth rate declined by 11 percent.¹⁹ Four states had increases of between 7 and 48 percent in their growth rates. Four other states had their growth rates more than double including California, which nearly tripled.

¹⁷GAO-06-51.

¹⁸The mandates differ in their implementation dates and schedules, thresholds for filing, and penalties. These differences between mandates may affect the magnitude of electronic filing increases in each state.

¹⁹The decrease in the percent change in Virginia's electronic filing rate of growth may be due in part to 2-D barcodes, which are attached to the paper tax return. IRS does not consider paper returns filed with 2-D barcodes as being electronically filed.

An alternative comparison of state growth rates to the nationwide growth rate also shows the benefits of state mandates. For eight of the nine states that have imposed a mandate, the growth rate of federal returns electronically filed from that state was greater than the national growth rate for the year the mandate took effect.

In the past, some tax preparers have voiced concern regarding the costs and burdens associated with converting their businesses to electronic filing. As a result, last year we recommended to IRS that it develop better information about the costs to preparers and taxpayers of mandatory electronic filing of tax returns for certain categories of preparers.²⁰ According to an IRS survey, cost was not the primary factor cited by preparers for not converting their businesses to electronic filing; instead, the major factor was that their clients did not ask for or want electronic filing. However, once over the initial barrier of having converted to electronic filing, several state tax officials we consulted with, including New York and Minnesota, reported receiving very little negative feedback from preparers. In fact, one state official noted that a substantial number paid tax preparers have reported how easy electronic filing is compared to filing returns on paper. Given the current rate of growth in electronic filing of federal returns, mandates represent an important option for realizing further growth.

Because mandates drive significant electronic filing increases, the Electronic Tax Administration Advisory Council (ETAAC) recently recommended a federal mandate for paid tax preparers that prepare individual tax returns.²¹ ETAAC estimated that if preparers filed all individual returns electronically, IRS would be only 5 percentage points below the 80 percent goal set by the Congress, instead of being 25 percentage points below the goal as it is currently.

IRS, however, is prohibited by law from requiring electronic filing of income tax returns for individuals, estates, and trusts.²² Because IRS lacks the statutory authority to mandate electronic filing of individual tax

²⁰ [GAO-06-51](#).

²¹ ETAAC provides input and a forum for discussion of electronic tax administration issues. ETAAC provides an annual report to the Congress on IRS's progress meeting the goals for electronic filing of tax returns set forth in the IRS Restructuring and Reform Act of 1998. ETAAC, *Annual Report to Congress* (Washington, D.C.: June 2006).

²² 26 U.S.C. § 6011(e).

returns, it has not developed any plans or proposals for doing so. Any proposal would likely have to consider such factors as to whom the mandate should apply, thresholds for such mandates, if penalties should be assessed for noncompliance, and the length of time needed to develop the capacity to receive additional electronically filed returns.

State and federal experiences with mandates demonstrate that mandated electronic filing can generate savings. By not requiring electronic filing by paid preparers, IRS is missing an opportunity for generating savings and efficiencies. IRS estimates that it saves \$2.38 on every return that is processed electronically.²³ Using IRS's estimates, if 90 percent of returns submitted by preparers that are currently filed on paper were filed electronically, IRS would have saved an estimated \$68.5 million per year.²⁴

Senate bill S. 1321 shows Congressional interest in increasing use of electronic filing for preparers.²⁵ This bill provides IRS with the authority to require tax preparers to file individual income tax returns electronically.

Processing of Paper and Electronic Returns Continued to Improve, Although IRS Lacks a Refund Timeliness Measure for Its New Processing System

In addition to processing 131 million tax returns, IRS has issued almost 99 million refunds, totaling over \$218 billion. Over 56.4 million or more than half of the refunds were directly deposited, up nearly 8 percent over the same period last year. This increase is important, because direct deposit is faster, more convenient for taxpayers, and less expensive for IRS than mailing paper checks.

Of the nine processing performance measures listed in table 1 used by IRS to assess performance, the agency met or exceeded eight out of its nine of its 2006 goals, and equaled or exceeded its 2005 performance for seven of the nine measures (see app. IV for further details). For one measure, the letter error rate, IRS's performance declined and the 2006 goal was not

²³We could not independently verify this estimate using data from IRS's cost accounting system because, in the past, IRS did not have such a system—see GAO, *Financial Audit: IRS's Fiscal Year 2005 and 2004 Financial Statements*, [GAO-06-137](#) (Washington, D.C.: Nov. 10, 2005).

²⁴IRS is able to process virtually all returns filed electronically with its current processing system, exceptions being amended and prior year returns, which the current system cannot process. With Modernized E-File, IRS will be able to handle the amended and prior year 1040 returns, and also have the ability to accept returns with attachments. IRS estimates that it will begin implementing Modernized E-File for 1040s in 2009.

²⁵S. 1321, 109th Cong., § 309 (2006).

met. IRS officials said that computer system errors were partially to blame for the higher letter error rate, along with some errors as a result of the lack of training of new employees at one submission processing center. More importantly, however, IRS's processing performance has significantly improved for all nine measures compared to 2001 or for measures not in existence in 2001, compared to their first year in existence.

Table 1: IRS Processing Performance Measures

Measure name	Definition
Deposit error rate	Percentage of payments applied in error by, for example, reimbursing a taxpayer who overpaid when the taxpayer wanted any overpayment credited to next year's tax bill.
Deposit timeliness—paper	Interest foregone by not depositing monies the business day after receipt, per \$1 million in deposits. Measure assumes an 8 percent interest rate.
Letter error rate	Percentage of letters issued to taxpayers with errors (includes systemic errors).
Notice error rate	Percentage of incorrect notices issued to taxpayers (includes systemic errors).
Refund error rate—individual (paper)	The percentage of refunds with IRS-caused errors in the entity information (e.g., incorrect name, Social Security number, or refund amount); includes systemic errors.
Refund interest paid	Amount of refund interest IRS paid per \$1 million of refunds issued.
Refund timeliness—individual (paper)	Percentage of refunds issued within 40 days or less for returns filed on paper.
Productivity	Weighted volume of documents processed per staff year expended at the processing centers.
Individual Master File efficiency	Measure of individual Master File returns processed per staff year expended.

Source: GAO analysis of IRS data.

In addition to the processing measures results, representatives of the tax preparer industry reported that returns processing went well. Groups and organizations that we talked to included the National Association of Enrolled Agents and the American Institute of Certified Public Accountants. In addition, TIGTA testified and later reported no significant

problems during the filing season.²⁶ IRS officials corroborated the view that returns processing went smoothly.

CADE, the cornerstone of IRS's investment in systems modernization, also performed well. For the 2006 filing season, CADE processed about 7.4 million, or 5.6 percent, of the 131 million income tax returns filed electronically or on paper, and disbursed about 6.6 million refunds totaling over \$3.4 billion.²⁷ While the percentage of returns CADE processed is modest, CADE is important because it is ultimately expected to replace IRS's antiquated Master File legacy system, which contains the agency's repository of taxpayer account information.

A major benefit of CADE is that it is much faster compared to the Master File legacy system, partly due to CADE's daily processing cycle, compared to the Master File's weekly processing cycle. For example, according to IRS officials, direct deposit refunds are issued by CADE 1–5 business days faster than the current system, and paper check refunds are issued 4–8 business days faster. The benefits of CADE, in terms of faster processing, are likely to expand to more taxpayers because the next release of CADE is expected to process an estimated 33 million returns in 2007, over four times more than the number processed through CADE in 2006. Because CADE processes returns and refunds more quickly, it can help minimize the need for Refund Anticipation Loans (RAL).²⁸ Reducing the need for RALs matters because of the high interest rates that taxpayers are often charged for these short-term loans, making them controversial.

²⁶See written statement of Treasury Inspector General for Tax Administration, J. Russell George, before the Committee on Appropriations, Subcommittee on Transportation, Treasury, and Housing and Urban Development, the Judiciary, District of Columbia, and Independent Agencies, U.S. House of Representatives, Hearing on the Internal Revenue Service's Fiscal Year 2007 Budget, Washington, D.C., Mar. 29, 2006, and Treasury Inspector General for Tax Administration, *Individual Tax Returns Were Timely Processed in 2006, but Opportunities Exist to Improve Verification of Certain Tax Deductions*, Reference No. 2006-40-164 (Washington, D.C.: Sept. 20, 2006).

²⁷CADE had the ability to process 13.5 million returns this year. However, approximately 42 percent of those returns were returned to the Master File legacy system for processing. IRS officials stated this was not unexpected because certain returns that CADE should have been able to process had changes, such as in filing status, had schedules, or had balances due, which CADE cannot process without additional functionality.

²⁸Refund Anticipation Loans are very short-term loans offered by some paid tax preparers while taxpayers wait for their refunds.

Systems modernization has been a key part of IRS's efforts to improve taxpayer services. CADE is a major investment, with almost \$200 million spent on development and implementation through fiscal year 2006, and the cornerstone of IRS's systems modernization program. CADE is only partially completed, and IRS estimates that over \$500 million more is required to fully implement the individual tax return processing part of the system.

In its proposed fiscal year 2007 budget request to the Congress, IRS did not report the benefits from CADE to date in terms of faster refund timeliness. IRS had not established separate processing performance measures for CADE that report the total time it takes CADE to process a return and issue a refund. According to IRS officials, this was due to the newness of CADE's implementation, the difficulty in separating CADE and Master File processing information, and IRS's desire to keep performance measures to a vital few. The refund timeliness measure included in table 1 covers only returns filed on paper, not electronically, and combines refund timeliness information for all paper returns together.

Because of the substantial costs associated with fully implementing CADE, the Congress could find information about the benefits useful. We have previously reported the value in knowing estimates of benefits when making decisions about whether to fund large investment programs.²⁹ The actual benefits received from CADE may be useful as an indication of both the magnitude and likelihood of the future benefits from full implementation. As discussed above, IRS officials are aware of benefits from CADE. Reporting such benefits in future budget requests could be done without necessarily making changes to IRS's current refund timeliness measure.³⁰

²⁹ [GAO-05-416T](#).

³⁰ We have previously noted that IRS lacks a refund timeliness measure for electronically filed returns, and recommended it adopt such a measure (see [GAO-06-51](#)). At that time, IRS stated that a measure would not enhance performance and, in fact, might be counterproductive if disappointed taxpayers who had to wait longer than expected to receive their refunds were to call or seek face-to-face assistance. Our position remains that such a measure could help IRS better monitor and evaluate electronic filing performance and determine the effect of initiatives intended to increase electronic filing.

Access to IRS's Telephone Assistors Was Comparable to Last Year and Accuracy Improved, but IRS Has Excess Space at Its Call Sites

Taxpayers' access to IRS's telephone assistors and the accuracy of answers are both key indicators of IRS's filing season performance because of the volume of calls and labor costs associated with answering them.

Telephone Access, as Indicated by Three Performance Measures, Was About the Same as Last Year

Taxpayers' access to IRS's telephone assistors, as indicated by three IRS performance measures, was more or less comparable to last year's, lower than in 2004, but better than in 2002, as shown in table 2. The percentage of taxpayers who wanted to talk with a CSR and actually got through and received service—referred to as the CSR level of service or telephone access—was 81 percent through mid-July as compared to 82 percent over the same period last year—and slightly less than its 2006 goal of 82 percent. This translated into 22.3 million calls being answered by CSRs. Taxpayers gain access to a CSR depending on their responses to telephone prompts. Some go through an automated system to determine if a CSR is needed, while other taxpayers, such as those seeking tax law assistance, are screened and transferred to a CSR who is trained to respond to their questions.

Other access measures showed improvement, such as the average speed of answer and the abandon rate, also shown in table 2. IRS reported that, through mid-July, the average speed of answer, the time taxpayers wait to get their calls answered, was nearly 4 minutes, which is an 11.4 percent decrease from last year. The abandon rate, or the percentage of callers who hang-up after reaching the queue to wait for an assistor, was 10.5 percent, down from 12.2 percent from last year. The table below indicates that as the average speed of answer decreases from 2005 to 2006, so does the number of taxpayers who abandon their calls to IRS. However, this relationship may be influenced by other factors as well, such as call volume, staffing, or efficiencies, as well as an increased number of what IRS refers to as courtesy disconnects. According to IRS, the Agency disconnects some callers when wait times become excessive for particular types of questions in order to improve taxpayers' experiences overall. IRS disconnected 1.7 million calls through mid-July. While this is a 93 percent increase for the same period over last year, courtesy disconnects

represent only about 2 percent of the total call attempts, although IRS has not estimated the impact of disconnects on call volume overall.

Table 2: IRS Telephone CSRs Accessibility Performance, 2001–2006 Filing Seasons

Accessibility measures ^a	2001	2002	2003	2004	2005	2006	Fiscal year
	Actual	Actual	Actual	Actual	Actual	Actual	2006 goals
CSR level of service (in percent) ^b	66	69	87	86	82	81	82
Average speed of answer (in minutes) ^c	5.7	4.5	2.8	2.8	4.4	3.9	5.0
Abandon rate (in percent) ^d	16.1	14.3	8.3	8.4	12.2	10.5	n.a.

Source: GAO analysis of IRS data.

Notes: n.a. = not applicable.

^aBased on actual counts from January through mid-July for 2001, 2002, 2003, 2004, 2005 and 2006. The composition of Customer Accounts Services has changed, but prior year data represented here are comparable.

^bThe percentage of callers wanting to speak to a CSR who get through and receive service.

^cAverage number of minutes a taxpayer waits in queue for a CSR.

^dThe percentage of callers who hang up while waiting in queue for a CSR.

The level of service, average speed of answer, and other dimensions of access experienced by individual taxpayers are likely to vary depending on the time of year, type of call, and other factors. Consequently, aggregated or annualized results may mask fluctuations in performance and taxpayer experiences may vary (see app. V for further discussion)

IRS officials had planned to reduce toll-free telephone service from 15 to 12 hours a day this year because 93 percent of calls come in between 8 a.m. and 8 p.m. IRS created work plans under the assumption of a reduction in telephone assistance hours.³¹ Because of a congressional directive,³² IRS had to adjust its work plans for a 15-hour day close to the start of the filing season. According to a recent TIGTA report, after being unable to implement the service hour reduction, IRS had insufficient time to train new seasonal CSRs, resulting in a decline in the number of

³¹The TIGTA recently issued a report on this matter. See Treasury Inspector General for Tax Administration, *The Savings Used to Recommend Reducing Toll-Free Telephone Hours of Operation Are Not as Significant as Projected*, Reference No. 2006-40-169 (Washington, D.C.: Sept. 21, 2006).

³²Pub. L. No. 109-115 (2005) and Pub. L. No. 109-148 (2005).

assistors able to answer calls.³³ Nevertheless, according to IRS officials, lower call volume during the filing season mitigated the potentially negative effect on service they had expected from maintaining a 15-hour day.

Accuracy of Responses to Telephone Inquiries Improved since Last Year and More So since 2001

The accuracy of telephone CSR responses to tax law and account questions either met or exceeded IRS's goals and past performance, as shown in table 3. Most notably, accounts accuracy and tax law accuracy have improved since 2001 and now both are 90 percent or over, which is a statistical improvement over last year. IRS officials said accuracy improved because of their focus on identifying and informing the call sites of the top defects made by CSRs, directing accounts inquiries away from calls sites with a focus on tax law applications, and limited forms and tax law changes.

Table 3: IRS Telephone CSRs Accuracy Performance, 2001–2006 Filing Seasons

Accuracy measures ^a	2001	2002	2003	2004	2005	2006	Fiscal year
	Actual	Actual	Actual	Actual	Actual	Actual	2006 goals
Tax law accuracy rate (in percent) ^b	79.1	84.9	81.3	79.5	89.5	90.6	90.0
	+/- 0.6	+/- 0.5	+/- 0.7	+/- 0.8	+/- 0.6	+/- 0.6	
Accounts accuracy rate (in percent) ^b	88.1	90.5	88.6	89.0	91.3	93.3	92.0
	+/- 0.6	+/- 0.4	+/- 0.4	+/- 0.5	+/- 0.4	+/- 0.3	

Source: GAO analysis of IRS data.

^aBased on representative samples and from January through June for 2001, 2002, 2003, 2004, 2005, and 2006.

^bThe percentage of calls in which telephone CSRs provided accurate answers for the call type and took the appropriate action, with a 90 percent confidence interval.

While IRS Expects Telephone Demand to Continue Declining, Telephone Service Remains Important

IRS received almost 71 million calls on its toll-free telephone lines through mid-July 2006 compared to 72 million in 2005. Of those calls, about

- 30.9 million were from callers trying to obtain information on the status of their tax refunds,

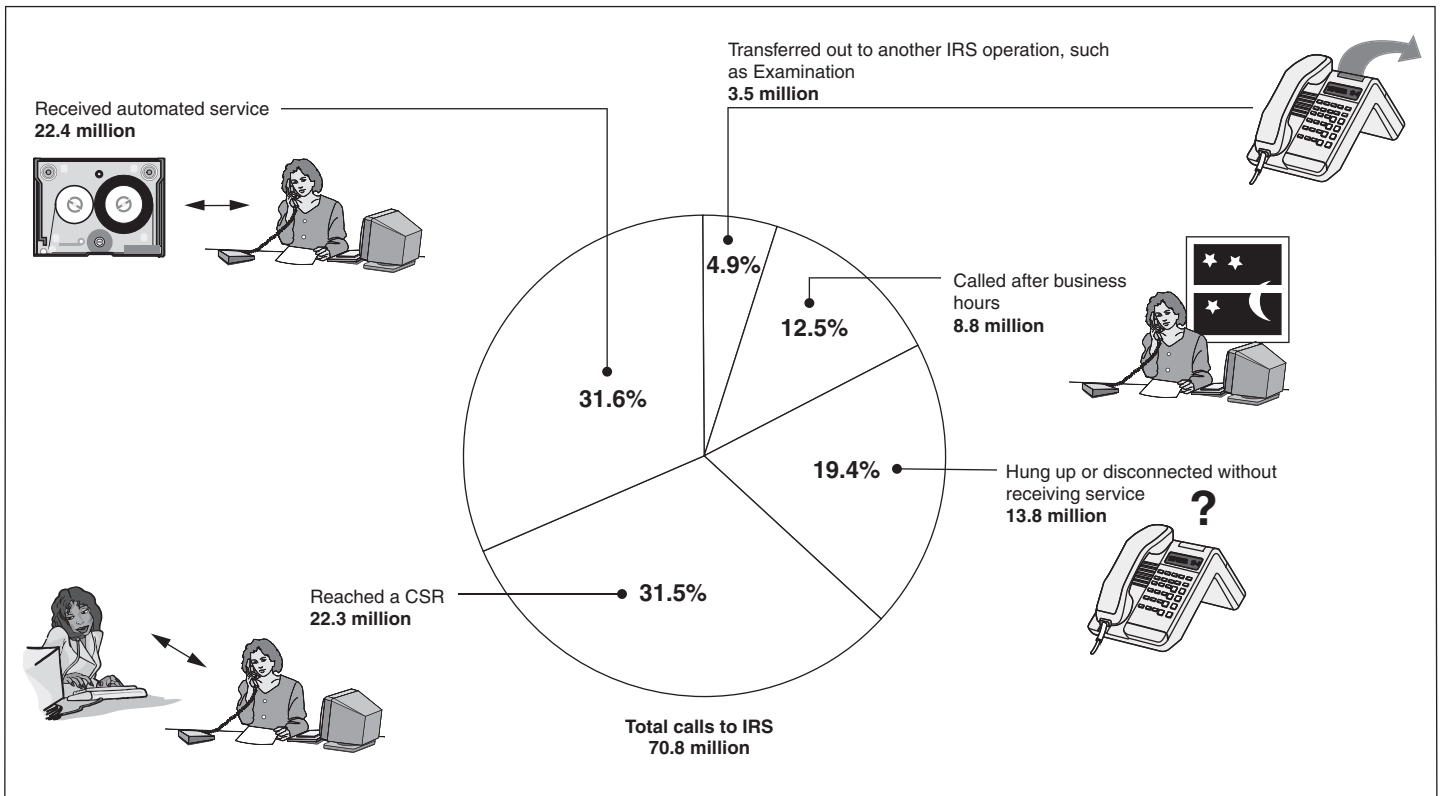
³³Treasury Inspector General for Tax Administration, *Appropriate Actions Were Taken to Maintain Taxpayers' Level of Service, but Access is Lower than in Prior Years*, Reference No. 2006-40-162 (Washington, D.C.: Sept. 14, 2006).

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- 20.5 million were from callers seeking information about their accounts,
 - 14.4 million were about tax law questions, and
 - 4.9 million were miscellaneous inquiries to extensions, such as the National Taxpayer Advocate (NTA) and Tax Fraud Hotline.

IRS officials stated that this year's slight decline in call volume may be due in part to more taxpayers getting through to a CSR the first time they call, thus reducing the need for taxpayers to call again. According to IRS officials, call demand will continue to decline, continuing a pattern since 2002. Call volume is important because once staffing levels are determined prior to the filing season, unexpected changes in call volume affect IRS's ability to meet goals.

Figure 3 shows how IRS handled the 70.8 million calls. Toll-free telephone calls from taxpayers typically are routed through IRS's telephone system based on taxpayers' response to prompts and are then answered by CSRs or automated recordings. Both the number of calls answered by IRS's automated service and calls answered by CSRs were fairly consistent with IRS's projections and slightly less than in 2005.

Figure 3: How IRS Handled Calls during 2006



Source: GAO analysis of IRS data and Art Explosion (images).

Note: Data cover the period January 1, 2006, through July 15, 2006. Due to rounding, percentages may not add to 100.

A recent study indicates that the telephone is still the most preferred communication channel for all age groups—especially if the inquiry is complex or urgent.³⁴ Additionally, the NTA’s 2007 Report to Congress states that the NTA is concerned with IRS’s continued movement toward self-service, rather than individualized assistance from an IRS employee, unless taxpayers can get assistance elsewhere.³⁵ To meet the demand for

³⁴ *Citizen Service Levels Interagency Committee Report: Proposed Performance Measures, Practices and Approaches For Government-wide Citizen Contact Activities*, General Services Administration’s USA Services e-Gov, 2006.

³⁵ National Taxpayer Advocate Service, *National Taxpayer Advocate’s 2007 Objectives Report to Congress* (Washington, D.C.: June 30, 2006).

telephone service, IRS devotes significant resources to providing telephone assistance. In fiscal year 2006, IRS planned to use almost 8,000 FTEs to handle telephone calls, which were similar to 2005, but 7 percent less than in 2004.

IRS Has Excess Space at Its Call Sites, but Lacks a Strategy for Consolidation

In a recent testimony we noted that IRS might have the potential to close several more of its remaining 25 call sites.³⁶ This is because IRS officials had determined that during peak staffing they had 850 unused CSR workstations spread across IRS's 25 call sites. Moreover, we have noted that call volume declined slightly this year and IRS officials forecast that the decline will continue. This excess capacity represents substantial costs without providing any benefits to IRS or taxpayers.

IRS could achieve savings through eliminating the excess workstations without negatively affecting taxpayer service even at peak times. IRS distributes all incoming calls through one central routing system and, therefore, the actual location of call sites does not affect the service received by taxpayers, particularly when other factors, such as the overall number of CSRs and call volume, remain equal.

According to IRS officials, the agency is undertaking a workload analysis designed to reevaluate telephone staffing levels, associated call site locations and capacity. According to the Wage and Investment Commissioner, the study has been expanded to include call site consolidation, although IRS has not determined which factors should be considered or when the study will be completed.

IRS could eliminate underutilized space by consolidating or closing call sites. For example, a small IRS call site can have as few as 200 CSRs. With 850 empty workstations, this means that IRS could consolidate or close as many as four sites without eroding taxpayer service.

³⁶ [GAO-06-499T](#).

IRS's Web Site Use Grew Substantially and Is Now a Major Component of Taxpayer Service

Use of IRS's Web site (IRS.gov) increased substantially this filing season compared to last year based on the number of visits and downloads. From January 1 through August 31, 2006, IRS's Web site was visited 161 million times by visitors (a nearly 9 percent increase), who downloaded 170 million forms and publications (a nearly 36 percent increase).³⁷ Where's My Refund, which allows taxpayers to check the status of their refunds online, was accessed by 31.3 million taxpayers as of September 10, 2006, an 11.9 percent increase over the same period last year. As we have reported, the increased usage of IRS's Web site is consistent with IRS's strategy to improve taxpayer service by providing taxpayers options for automated interaction with IRS.³⁸ The Web site can be used at taxpayers' convenience and can be used 24 hours a day.

IRS reconfigured its Web site for the 2006 filing season in order to improve customer service through easier navigation and a more effective search function. The Web site is performing well based on various data including the following:

- A Brown University Study that ranks federal agency's Web sites shows that IRS has improved its ranking from 25th in 2005 to 6th in 2006, based on such factors as the number of publications and online services provided.³⁹
- An independent weekly study by Keynote, a company that evaluates Web sites, reported that IRS's Web site repeatedly ranked second out of 40 government agencies evaluated in terms of average download time through mid-April 2006, and first out of the most commonly accessed government-related Web sites for response time and success rate through May 2006.⁴⁰
- The American Consumer Satisfaction Index, which tracks trends in customer satisfaction, noted an increase in IRS's Web site consumer

³⁷We cannot make comparisons before 2005 because in October 2004, IRS changed the way that it collects and analyzes Web site data in order to provide a more accurate count of visits and downloads.

³⁸GAO-06-51.

³⁹Darrell M. West, *State and Federal E-Government in the United States, 2006*, Taubman Center for Public Policy, Brown University (Providence, Rhode Island: August 2006).

⁴⁰Keynote Systems, *Keynote Government 40 Internet Performance Index and Keynote E-Government Web Transaction Performance Index*.

satisfaction score from 68 percent to 72 percent after IRS reconfigured the site.⁴¹

- As of August 31, 2006, the number of Web site searches has decreased by almost half, from 181 million to 95 million this year. Typically, search functions are used when users fail to find information through links. According to IRS officials, the decrease in the number of searches indicates that users are finding the information that they need faster.

IRS added features to its Web site this year including the following:

- Electronic IRS: IRS reconfigured the IRS's Web site and made it easier to locate items, as evidenced by the decline in searches.
- Help for Hurricane Victims: This is a special link that provides victims of the recent hurricanes with information on special tax relief, assistance and how to get help with tax matters.

In addition to the Free File and Where's My Refund programs, discussed earlier, IRS's Web site has other important features including the following:

- ETLA, where taxpayers can ask IRS general tax law questions through its Web site. From October 1, 2005, through August 31, 2006, IRS received 17,511 emails requesting ETLA (down over 41 percent compared to last year) and estimated the accuracy rate of its responses to be 85.5 percent, comparable to 2005. We have previously reported that the ability of one taxpayer to forward an IRS e-mail response to many other taxpayers makes the accuracy of responding to inquiries submitted via e-mail important.⁴² The average number of days that it took IRS to respond to tax law questions submitted via the Web site was 2.2 days, compared to 1.5 days in 2005 and IRS's goal of 3 business days.
- E-Services, which is a suite of Internet services that enable paid tax preparers to conduct business, such as electronic account resolution

⁴¹American Consumer Satisfaction Index, *Special Report on e-Government Satisfaction*, National Quality Research Center, University of Michigan (Ann Arbor, Michigan: Mar. 21, 2006).

⁴²[GAO-05-67](#).

and transcript delivery, with IRS electronically 24 hours a day, 7 days a week. IRS is promoting e-Services to increase electronic filing among preparers.

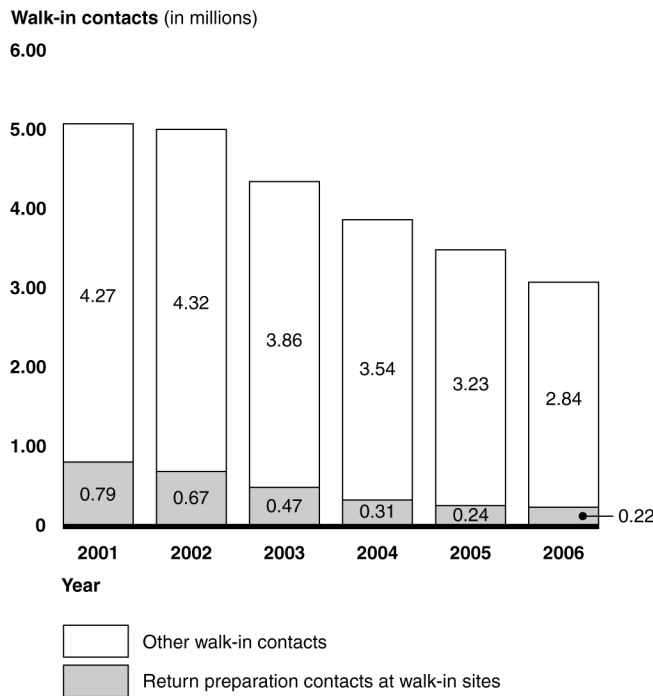
Continuing Past Trends, Fewer Taxpayers Used IRS Walk-in Sites and More Used Volunteer Sites, but Data on Services Provided Remains Incomplete for Both

Shifting taxpayers from IRS walk-in sites to community sites staffed by volunteers is part of IRS's strategy for reducing the costs of providing taxpayers with face-to-face assistance, while providing taxpayers with additional, and perhaps more convenient, options.

Fewer Taxpayers Received Assistance at Walk-in Sites, and IRS Continues to Lack Comprehensive Management Data and a Reliable Method for Assessing Quality

Fewer taxpayers used IRS's 400 walk-in sites than last year. As reflected in figure 4, the total number of contacts at IRS walk-in sites declined 12 percent from the previous year, continuing a decline of approximately 40 percent since 2001. The largest decrease since last year was in tax law assistance, which declined by approximately 39 percent. Return preparation assistance declined by more than 8 percent since last year and more than 70 percent since 2001. In the past 2 years, IRS has not reduced the types of assistance offered at its walk-in sites, so the decline in usage is due to other factors. For example, IRS officials attribute the decrease to taxpayers' receiving alternative assistance from tax preparation software and IRS's telephone service.

Figure 4: Assistance Provided by IRS Walk-in Sites, 2001–2006 Filing Seasons



Source: GAO analysis of IRS data.

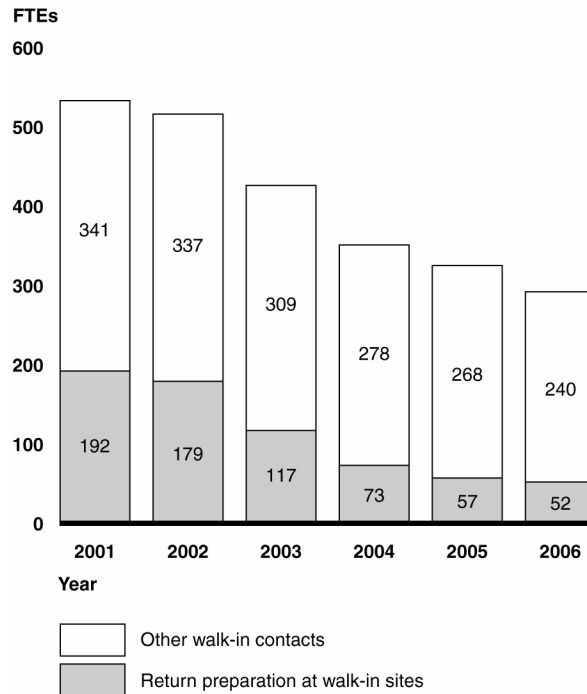
Note: For walk-in sites, “Other walk-in contacts” includes assistance for account notices, tax law inquiries, forms, and other in-person contacts, but not return preparation. The time periods covered are December 31, 2000, through April 28, 2001; December 30, 2001, through April 27, 2002; December 29, 2002, through April 26, 2003; December 28, 2003, through April 24, 2004; December 26, 2004, through April 23, 2005; and December 25, 2005, through April 22, 2006.

Accounts assistance was the only area of service that increased since last year, up 66,000 contacts, or 7 percent, continuing an upward trend since 2004. IRS officials attribute the increase in accounts assistance to IRS’s increased enforcement efforts in recent years.

This year, IRS used walk-in and volunteer sites to provide relief efforts for federally-designated disaster zones such as in hurricane-affected areas. IRS developed a Disaster Referral Services Guide and new training materials for employees to better equip them to address disaster-related issues. In addition to the expanded services for disaster victims at IRS walk-in sites, volunteer sites performed outreach and agreed to accept referrals from IRS of disaster victims needing tax return preparation assistance.

The decline and shift of taxpayers from walk-in sites to other service options is important because it has allowed IRS to transfer time-consuming services, such as return preparation, from IRS to other less costly alternatives that can be more convenient for taxpayers. This has allowed IRS to devote fewer FTEs to providing return preparation services. As figure 5 shows, direct FTEs decreased approximately 45 percent between 2001 and 2006, roughly proportional to the decreases in usage shown in figure 4.

Figure 5: Direct FTEs Used for Assistance Provided at IRS Walk-in Sites, 2001–2006 Filing Seasons



Source: GAO analysis of IRS data.

Note: The time periods covered are December 31, 2000, through April 28, 2001; December 30, 2001, through April 27, 2002; December 29, 2002, through April 26, 2003; December 28, 2003, through April 24, 2004; December 26, 2004, through April 23, 2005; and December 25, 2005, through April 22, 2006.

In the past, we⁴³ and TIGTA⁴⁴ reported that IRS lacked (1) detailed management data on the services offered its walk-in sites and (2) a reliable method for assessing the quality of services offered at the sites. With such information, IRS managers could make more informed decisions about staffing and business operations including which services to offer and where improvements are needed. TIGTA has recently reported some improvement in service quality at walk-in sites.⁴⁵ And, to its credit, IRS is in the process of taking steps intended to provide better data on the services provided at walk-in sites and the quality of those services. The steps include the following:

- **Q-Matic:** IRS installed one of three versions of Q-Matic, its automated customer tracking system, at all 400 walk-in sites in time for the 2006 filing season. According to IRS officials, in addition to helping control customer traffic, once this data is fully integrated with IRS's other management information systems IRS managers will have detailed data on the number, type, and duration of taxpayers' contacts.
- **Contact Recording:** As we have previously reported, contact recording is a method for assessing quality at all walk-in sites.⁴⁶ For the 2007 filing season, IRS plans to deploy contact recording at approximately 126 walk-in sites, which would cover approximately 45 percent of IRS's total walk-in contacts. According to IRS, when fully implemented, contact recording should enable IRS to standardize its employee evaluation and quality assessment processes, establish performance baselines, and reliably assess the accuracy of the services it provides at its walk-in sites.

⁴³See, for example, [GAO-05-67](#) and [GAO-06-51](#).

⁴⁴See, for example, Treasury Inspector General for Tax Administration (TIGTA), *Customer Service at the Taxpayer Assistance Centers Is Improving but is Still not Meeting Expectations*, Reference No. 2005-40-021 (Washington, D.C.: Dec. 28, 2004) and *Taxpayer Service Is Improving, but Challenges Continue in Meeting Expectations*, Reference No. 2006-40-052 (Washington, D.C.: Feb. 17, 2006).

⁴⁵See, for example, TIGTA *Customer Service at Taxpayer Assistance Centers Showed Improvement During the 2006 Filing Season*, Reference No. 2006-40-122, (Washington, D.C.: Aug. 30, 2006).

⁴⁶[GAO-06-51](#).

More Taxpayers Continued to Receive Return Preparation Assistance at Volunteer Sites, yet Quality of Service Remains Unknown

In contrast to walk-in sites, the number of returns prepared at over 12,000 volunteer sites grew to 1.8 million returns. Although IRS has changed the methodology it uses to count returns electronically filed from volunteers sites, this still represents an overall increase over last year.⁴⁷

As with its walk-in sites, IRS continues to lack complete data on the quality of return preparation at its volunteer sites. We and TIGTA have reported concerns about the quality of return preparation assistance provided at volunteer sites and have made recommendations to remedy the concerns.⁴⁸ At the same time, we have noted that IRS has had several initiatives to improve the quality of services provided at volunteer sites.⁴⁹ However, these initiatives have changed in purpose and scope as IRS's efforts to centralize its partnerships with volunteers have evolved. Furthermore, IRS has not always fully implemented these initiatives. For example, in 2005, IRS intended to use observation reviews to assess tax return preparation accuracy by watching volunteers prepare taxpayers' returns. However, IRS cancelled observation reviews due to concerns raised by some of its partners and the NTA, noting that observation reviews violated taxpayer privacy and unfairly targeted low-income taxpayers.

The Volunteer Return Preparation Program Quality Improvement Process is IRS's newest initiative to promote return preparation quality at its volunteer sites. As part of this initiative, IRS conducted two types of reviews—site and return reviews—to monitor and evaluate quality of return preparation at volunteer sites. IRS used site reviews to measure volunteer sites' adherence to IRS's quality standards, but the results could not be generalized across volunteer sites because IRS did not use a statistically valid sample. Return reviews, which are limited in scope, compared the information taxpayers provided on the intake sheet to the filing status, exemptions, and credits claimed on the completed return. However, according to IRS officials, the results from the return reviews

⁴⁷ According to IRS officials, IRS previously relied on volunteer sites to manually enter their Site Identification Number on returns they filed electronically or by paper which was then extracted from the Master File. However, in May 2005, IRS changed its methodology to use an automated data-based system to identify returns filed electronically at volunteer sites. For paper returns, IRS retains this information in the Master File data base.

⁴⁸ See [GAO-06-51](#) and Treasury Inspector General for Tax Administration, *Oversight and Accuracy of Tax Returns Continue to be Problems for the Volunteer Income Tax Assistance Program*, Reference No. 2006-40-125 (Washington, D.C.: Aug. 31, 2006).

⁴⁹ [GAO-06-51](#).

were too high to help identify specific improvements that may be needed. In 2007, IRS plans to include additional testing of the accuracy of return preparation.

IRS Has Completed the First Phase of the TAB and Has Begun Assessing Taxpayers' Service Needs

A November 2005 law prohibited IRS from reducing taxpayer services until TIGTA could complete a study on the impact of those proposed reductions, and required IRS to consult with stakeholder organizations including NTA, the IRS Oversight Board, and TIGTA, before terminating or significantly reducing any taxpayer service activity.⁵⁰ An additional congressional directive required IRS to work with the Oversight Board and NTA to develop a 5-year plan for taxpayer service activities, which is to include long-term goals that are quantitative and balance enforcement and service.⁵¹ In response IRS is developing the TAB to provide the agency with information on taxpayers' needs and preferences to improve taxpayer service at lower cost as part of a 5-year plan. IRS divided its TAB work into two phases: The Phase I report outlines the results of preliminary research on taxpayer expectations and establishes five strategic priorities for improving service. Phase II research and review is in progress and is expected to be released by early 2007.

Phase I Targets Five Themes for Improving Service

In April 2006 IRS issued Phase I of the TAB, which includes an overview of services provided and volume information for the different service delivery channels. It also contains demographic information on the population of individual taxpayers. Phase I included IRS's research on and analysis of customer needs and preferences for service delivery and outlined the results of IRS work to gather best practices for customer service from other government agencies, nonprofit organizations, and private sector firms. Finally, IRS developed the following five strategic themes for improving taxpayer service:

1. Improve and expand education and awareness activities.
2. Optimize the use of services from community-based partners, paid tax preparers commercial preparers, and software vendors.
3. Elevate self-service options to meet taxpayer expectations.

⁵⁰Pub. L. No. 109-115, § 205 (2005).

⁵¹H. Rep. No. 109-307, 109th Cong. (2005).

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4. Improve and expand training and support tools to enhance assisted services.
 5. Develop short-term performance and long-term outcome goals and metrics.

The theme of elevating self-service options is consistent with IRS's new long-term goal for increasing taxpayer self-assistance, introduced in 2006, as well as its strategy of matching services with taxpayer technological proficiency. As previously noted, IRS's efforts to increase taxpayer self-assistance is of concern to the NTA.

IRS Reports Phase II in Progress with Expected Report Release by Early 2007

Phase II of the TAB includes additional research to build on the strategic improvement themes. IRS officials reported that to address the congressional directive that the plan balance service and compliance, Phase II includes a research agenda on the effect of taxpayer service on compliance. The studies also include an analysis addressing respondents' preferences among service delivery channels when other attributes change, such as convenience or cost of service to the taxpayer.

IRS officials anticipate that the TAB Phase II report will be released to the Congress by early 2007. They also confirm that it will include a multiyear plan for taxpayer service activities and improvement initiatives; the TAB team has identified over 70 projects for improving taxpayer services, although none will be implemented in time for the 2007 filing season.

IRS anticipates that key outcomes of its Phase II work will be a process for assessing customer preferences and subsequent research on those preferences, because demographics are constantly changing. Furthermore, taxpayer expectations are likely to shift with the advent of new technology, as exemplified by the exponential availability and use of Internet-provided services in recent years.

Conclusions

IRS continues to make significant improvements in its filing season performance. In an environment of tight budgets and demands to improve service while maintaining or increasing enforcement activities, generating savings by operating more efficiently is crucial. We have identified two such savings opportunities.

First, despite numerous IRS initiatives to increase electronic filing, there remains considerable room for further growth. Some states, federal tax

experts, and even IRS have recognized that mandatory electronic filing can generate savings by reducing paper filing. However, IRS lacks the statutory authority to expand its use of mandates. Requiring certain paid tax preparers to file individual returns electronically could increase electronic filing and generate savings for IRS.

Second, IRS could achieve efficiencies by reducing unnecessary spending on the excess capacity at its telephone operations—without negatively affecting taxpayer service—by consolidating its call sites.

In addition, IRS continues to implement CADE. As more taxpayer accounts are put on CADE, the benefits to taxpayers will grow and more facts regarding those benefits, such as information on refund timeliness and improved taxpayer service, are likely to sustain congressional support. However, IRS is not reporting on one of the chief benefits already realized from CADE, issuing refunds faster. The Congress could benefit from knowing this information as it makes decisions about funding the completion of CADE.

Matter for Congressional Consideration

Given the efficiencies to be gained, the Congress should mandate electronic filing by paid tax preparers meeting criteria such as a threshold number of returns filed.

Recommendations for Executive Action

We recommend that the Commissioner of Internal Revenue direct the appropriate officials to

- timely develop, validate, and implement a plan to consolidate call sites, and
- report to the Congress refund timeliness for CADE compared to the Master File legacy system.

Agency Comments and Our Evaluation

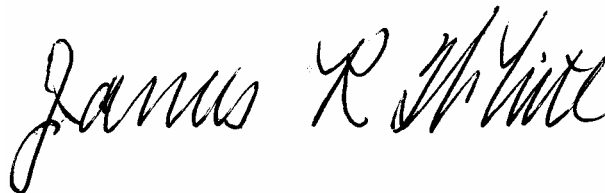
The Commissioner of Internal Revenue provided written comments in a November 3, 2006, letter. With respect to the matter for congressional consideration, the Commissioner said he appreciated our acknowledging that the current statutory limitation impedes electronic filing growth. The Commissioner agreed with both of the report's recommendations to IRS. In responding to our first recommendation, the Commissioner stated that

IRS would take steps to develop plans, including updating data and projections, conduct a full cost analysis to determine projected savings, and formulating a consolidation timeline and workload redistribution plan. The Commissioner responded to the second recommendation stating that IRS would develop a measure to show refund timeliness for CADE based on its current sampling methodology. However, because the current methodology includes only paper returns, the new measure would necessarily show CADE's benefits for only paper returns, not all returns.

As agreed with your office, unless you publicly announce the contents of this report earlier, we will not distribute it until 30 days from the date of the report. At that time, we will send copies of this report to the Chairmen and Ranking Minority Members of the Senate Committee on Finance, the House Committee on Ways and Means, and the Ranking Minority Member, Subcommittee on Oversight, House Committee on Ways and Means. We are also sending copies to the Secretary of the Treasury; the Commissioner of Internal Revenue; the Director, Office of Management and Budget; and other interested parties. We will also make copies available to others on request. In addition, the report will be available at no charge on the GAO Web site at <http://www.gao.gov>.

If you have any questions regarding this report, please contact me at (202) 512-9110 or at whitej@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. Key contributors to this report include Amanda Arhontas, Paula Braun, Amy Dingler, Evan Gilman, Tim Hopkins, Kathryn Horan, Hillary Loeffler, Paul Middleton, Karen O'Connor, Cheryl Peterson, Neil Pinney, Stephen Sallan, and Joanna Stamatiades.

Sincerely yours,

A handwritten signature in black ink that reads "James R. White". The signature is written in a cursive style with a large initial "J" and "W".

James R. White
Director, Tax Issues
Strategic Issues

Appendix I: Differences between the 2002 and 2005 Free File Agreements

In 2002, the Internal Revenue Service (IRS) entered into a 3-year agreement with the Free File Alliance, a consortium of 20 tax preparation companies to provide free electronic filing to taxpayers who access any of the companies via a link on IRS's Web site. The 2002 Free File Agreement stated that, as part of the agreement, IRS would not compete with the Alliance members in providing free, online tax return preparation and filing services to taxpayers.

IRS stated that the original purpose of the Free File Alliance was to increase electronic filing, and at the same time, assist low-income taxpayers with filing their taxes electronically. One of the benefits for Alliance members of belonging to the Free File Alliance is the ability to advertise their software programs and products through IRS's Web site, which receives heavy traffic each year.

In 2005, IRS renegotiated and amended the agreement. Key differences between the agreements are

- a new income limitation of \$50,000;
- new language that states the Alliance members must disclose early-on if state tax return services are available, and if so, whether a fee will be charged for such services; and
- Alliance members must provide the necessary support to accomplish a customer satisfaction survey.

Another change is that new language pertaining to the marketing and offering of Refund Anticipation Loans (RAL) stated that no offer of free return preparation and filing of an electronic return in the Free File program shall be conditioned on the purchase of a RAL.¹ Also, RALs are to be offered with clear language indicating, for example, that they

- are loans, not a faster way of receiving an IRS refund;
- must be repaid even if the IRS does not issue a full refund;
- are short-term loans with high interest rates and, therefore, customers may wish to consider using other forms of credit; and

¹Refund Anticipation Loans are very short-term loans issued while taxpayers wait for their refunds.

- may be offered but not promoted.

IRS tests each Alliance member's software to ensure it is in accordance with the Free File provisions before allowing a link to IRS's Web site. In addition, IRS officials monitor complaints about the Free File program received via IRS.gov, including allegations regarding false, deceptive, or misleading information or advertising. While IRS does not track the number of complaints it receives, according to IRS officials, most of the complaints received thus far were a result of the taxpayer either not carefully reading or not following instructions, or incorrectly entering information. GAO conducted limited testing of the Free File program and found that Alliance members were complying with the terms outlined in the amended Free File agreement pertaining to RALs.² In addition, according to IRS, 9 of 20 Free File companies offer RALs.

The amended Free File agreement contains provisions that enable IRS to monitor taxpayer participation beginning in the 2006 filing season, unlike prior years where Alliance members self-reported filing figures. IRS also tracks the number of Free File users who are accepting any financial products, such as RALs. As of April 17, 2006, IRS reported that 207,814 free file returns accepted financial products. This represents about 5 percent of all returns filed through the Free File program.

The number of taxpayers using Free File to electronically file their individual income tax returns has increased steadily from 2.8 million in 2003 to 5.1 million in 2005. The substantial growth between 2003 and 2005 was due to, in part, several Alliance members offering free filing to all taxpayers through the Free File program regardless of their income in 2005. However, according to IRS officials, the lack of income limitation created conflict as it put pressure on all Alliance members to offer free service, which may not have been economically feasible for some. Competition would be reduced if Alliance members were to drop out of the Alliance.

²We conducted limited testing on 13 out of 20 companies participating in the Free File program using a scenario we constructed that represented a low-income worker. Purposes of the testing included examining some potential experiences of taxpayers, such as the length of time to complete a return and whether any financial services, such as RALs, were marketed during the filing of the return, examining what happened if we declined the services, and evaluating our experience compared to the Free File agreement.

IRS projected that over 6 million taxpayers would use Free File in 2006. However, this projection was overstated, because through August, IRS processed about 4 million returns filed through the Free File program, which is a decrease of about 23 percent from the same period last year. According to IRS officials, the new income limitation contributed, in large part, to this decline despite the fact that the income limitation provides coverage to 70 percent of the nation's taxpayers, or more than 92 million people, and includes taxpayers with an adjusted gross income of \$50,000 or less. Moreover, IRS officials stated that it was this income limitation that contributed to the overall lower rate of growth in electronic filing this year.

Appendix II: Status of CADE Implementation and Future Releases

The IRS is developing and deploying its Customer Account Data Engine (CADE) incrementally in multiple releases over several years, as shown in table 4. IRS is planning for semiannual subrelease deployments in July and January prior to each filing season. The July subreleases (x.1) focus on new CADE functionality with some tax law changes, while the January subreleases (x.2) contain primarily filing season and tax law changes with minimal new functionality. Each incremental release builds upon and expands the functionality contained in the prior releases. For example, during the 2006 filing season, CADE Release 1 processed Form 1040EZ, 1040, and 1040A tax returns with no schedules for single taxpayers with no dependents. Release 2 is planned to add the capability to process Form 1040 and 1040A tax returns with various schedules and supporting forms for taxpayers filing as single, married, or head of household in 2007. With the deployment of Release 7 in 2012, CADE is expected to fully replace the Individual Master File and process all individual tax returns.

Table 4: Schedule of CADE Releases and Related Functionality

Release	Sub-release	Release date	Tax return types	Filing status	Account characteristics	Estimated number of returns (millions)
1	1.1	July 2004	Form 1040EZ	Single	Refund or even-balance returns	n.a.
	1.2	January 2005		(never married, no dependents)	No account issues (open or closed)	1.4 (actual)
	1.3.1	September 2005			Address changes	
	1.3.2	January 2006	Forms 1040 and 1040A No schedules		Refund or even-balance returns Closed prior account issues Extensions without payments	7.4 (actual)
2	2.1	September 2006	Form 1040 Schedules A, B, and R and supporting forms Form 1040A Schedules 1 and 3	Single Head of Household (no dependents)	Extensions with payments full-paid Name change (first name)	33

**Appendix II: Status of CADE Implementation
and Future Releases**

Release	Sub-release	Release date	Tax return types	Filing status	Account characteristics	Estimated number of returns (millions)
	2.2	January 2007	Form 1040 Schedules C, E, F, and SE (without Employer Identification Number [EIN]) and supporting forms Schedule D and supporting forms	Single Head of Household Married (joint) Married (separate) (no dependents or clean dependents)	Married only once	
3	3.1	July 2007	Form 1040	Single	Name change (last name)	50
	3.2	January 2008	Schedule EIC and supporting forms Decedent returns Full-paid with remittance Credit election Additional schedules and forms (TBD) Form 1040A Schedule 2 Form 1040-ES Form 1040-V Form 1040X Form 4868 with or without remittance	Head of Household Married (joint) Married (separate) Surviving Spouse	Split Refunds Dependents expanded	
4	4.1	July 2008	Form 6251	Single	Power of Attorney	70
	4.2	January 2009	Additional Form 1040 schedules and forms (TBD)	Head of Household Married (joint) Married (separate) Surviving Spouse	Centralized Authorization File Balance due returns Math error returns	

**Appendix II: Status of CADE Implementation
and Future Releases**

Release	Sub-release	Release date	Tax return types	Filing status	Account characteristics	Estimated number of returns (millions)
5	5.1	July 2009	Form 1040	Single	Delinquent returns	90
	5.2	January 2010	Schedules C, E, F, and SE (with EIN) and supporting forms Additional schedules and forms (TBD) Forms 940 and 720 payroll, unemployment, and excise tax returns for Form 1040 self-employed filers	Head of Household Married (joint) Married (separate) Surviving Spouse		
6	6.1	July 2010	Form 1040NR	Single	First-time filers	110
	6.2	January 2011	Form 1040-PR Form 1040-SS Additional Form 1040 schedules and forms (TBD)	Head of Household Married (joint) Married (separate) Surviving Spouse		
7	7.1	July 2011	All additional individual returns	Single	Foreign Address	135
	7.2	January 2012		Head of Household Married (joint) Married (separate) Surviving Spouse	Open account issues Taxpayers with history of multiple marriages	

Source: GAO analysis of IRS data.

Notes: n.a. = not applicable. TBD = to be determined.

List of forms included above:

Form 720—Quarterly Federal Excise Tax Return

Form 940—Employers Annual Federal Unemployment Tax Return

Form 1040—U.S. Individual Income Tax Return

Schedule A—Itemized Deductions

Schedule B—Interest and Ordinary Dividends

Schedule C—Profit or Loss from Business

Schedule D—Capital Gains and Losses

Schedule E—Supplemental Income and Loss

Schedule EIC—Earned Income Credit

Schedule F—Profit or Loss from Farming

Schedule R—Credit for the Elderly or the Disabled

Schedule SE—Self-Employment Tax

Form 1040A—U.S. Individual Income Tax Return

Schedule 1—Interest and Ordinary Dividends for Form 1040A Filers

**Appendix II: Status of CADE Implementation
and Future Releases**

Schedule 2—Child and Dependent Care Expenses for Form 1040A Filers

Schedule 3—Credit for the Elderly or the Disabled for Form 1040A Filers

Form 1040-ES—Estimated Tax for Individuals

Form 1040EZ—Income Tax Return for Single and Joint Filers with No Dependents

Form 1040NR—U.S. Nonresident Alien Income Tax Return

Form 1040-PR—Puerto Rico Resident Income Tax Return

Form 1040-SS—U.S. Self-Employment Tax Return

Form 1040-V—Voucher

Form 1040X—Amended U.S. Individual Income Tax Return

**Form 4868—Application for Automatic Extension of Time to File U.S. Individual Income Tax
Return**

Form 6251—Alternative Minimum Tax—Individuals

Appendix III: State Mandates for Electronic Processing

Twelve states had electronic filing mandates for paid tax preparers in effect for the 2006 filing season (see fig. 6). State mandates differ but require preparers who meet specified requirements, such as filing 100 individual income tax returns per year, to file individual income tax returns electronically.

Figure 6: States with Electronic Filing Mandates for Paid Tax Preparers



Sources: GAO analysis; Copyright © Corel Corp. All rights reserved (map).

Nine states had electronic filing mandates in effect in 2005 or earlier. In eight of these nine states, the mandates increased the growth rate of electronically filed federal returns (see table 5).

Appendix III: State Mandates for Electronic Processing

Table 5: Electronic Filing Rates of Growth in Federal Returns for States with Mandates Compared to National Averages

Percent					
Tax year when state mandates were implemented	State	Electronic filing rate of growth prior to the tax year the mandate was implemented ^a	Electronic filing rate of growth in the tax year the mandate was implemented ^b	Percent change in electronic filing rate of growth ^c	Nationwide electronic rate of growth the year the mandate was implemented
2004	Alabama	9.9	14.6	48.0	11.2
	Massachusetts	11.2	28.1	150.9	11.2
	New Jersey	12.7	35.0	176.5	11.2
	Virginia	12.4	11.0	-10.6 ^d	11.2
2003	California	14.8	55.7	276.7	12.3
	Michigan	14.2	40.3	184.1	12.3
	Oklahoma	8.9	12.6	42.0	12.3
2002	Wisconsin	23.4	29.6	26.6	16.6
2000	Minnesota	32.6	34.9	7.2	13.6

Source: GAO analysis of IRS data.

^aThe rate of growth compares the 2 years prior to the year the mandate was implemented.

^bThe rate of growth compares the year prior to the mandate's implementation to the year the mandate was implemented.

^cThe percent change in electronic filing rate is based on the change from the year the mandate was implemented to year prior to implementation.

^dThe decrease in the percent change in Virginia's electronic filing rate of growth may be due in part to 2-D barcodes, which are attached to the paper tax return. IRS does consider paper returns filed with 2-D barcodes as being electronically filed.

According to a June 2005 study by the Federation of Tax Administrators,¹ many state tax administrators view electronic filing as a means to improve tax return and refund processing, improve customer service, and reduce the number of seasonal workers in part by making better use of staffing resources. According to New York, California, and Minnesota officials, given tight budget constraints, the opportunity to generate savings was the main reason behind their decisions to implement mandates. For example, in 2001 Minnesota estimated it saved \$2.45 per return by mandating

¹Federation of Tax Administrators, *Electronic Filing Mandates: Lessons Learned* (Washington, D.C.: June 2005).

electronic filing for paid tax preparers.² Other states also reported savings from electronic filing mandates.

While Minnesota was the first state to implement a mandate for individual income tax returns, more states have adopted mandates and some have used different methods to encourage electronic filing of state returns. Some notable examples include the following:

- **Filing thresholds:** States with mandates often differ in the minimum number of returns a paid tax preparer must file before having to comply with an electronic filing mandate. In most states, the threshold is often lowered gradually over time, increasing the base of preparers that fall under the mandate. For example, in New Jersey in 2005, preparers who prepared more than 200 individual state income returns in the prior year had to electronically file all returns they prepared in the current year. The threshold will drop to 100 returns in 2007 and 50 returns in 2008.
- **Penalties:** Some states do not impose penalties on noncompliant paid tax preparers; however, those states that do levy penalties for noncompliance often differ in amount and level of enforcement. For example, some states waive the penalty if a taxpayer chooses to opt-out of having their return electronically filed. In fact, most states include “opt-out” clauses in the legislation that allows a preparer to file a customer’s return on paper at the customer’s request. In contrast, if a preparer files a return on paper, absent of the customer’s request, they could be subject to upwards of a \$100 fine. Alternatively, the state of Minnesota charges a \$5.00 fee for returns filed on paper returns prepared by mandated preparers regardless of the circumstances.
- **Including 2-D Barcodes as Electronic Filing:** State mandates also vary in what they consider an electronically filed return. Utah, Alabama, and Virginia consider a paper return with a 2-D barcode produced by tax preparation software as an electronically filed return. New York also considered paper returns with 2-D barcodes as electronically filed returns for the 2006 filing season.

In its June 2005 report, the Federation of Tax Administrators noted that many states reviewed existing state mandate legislation for guidance and ideas, or best practices, prior to implementing their own mandates. For

²We did not verify this estimate.

example, New York officials said they used the experiences reported by California when deciding what provisions their mandate should or should not include. The Federation of Tax Administrators reported several lessons learned about implementing mandates, including,

- having a phased-in approach over a period of several years,
- providing the ability for a taxpayer to opt out of electronic filing if he or she chooses instead to file a paper return, and
- having penalties for failure to file electronically.

Finally, the states' experience with mandates has shown the following

- Communication and taxpayer education are vital. For example, California scheduled presentations and panels on mandatory electronic filing for tax professional organizations in order to achieve buy-in from the paid tax preparer community.
- Lead time for implementation and the definition for the scope of the mandate are important. Most states currently use the federal Employer Identification Number (EIN) to define "paid tax preparer" and treat any office or branch of an entity operating under a single EIN as a "paid tax preparer" subject to the mandate.
- Coordination between IRS and Electronic Return Originators is essential.³

³Electronic Return Originators originate the electronic submission of income tax returns to the IRS and may originate the electronic submission of income tax returns that are either prepared by the originator or collected from the taxpayer.

Appendix IV: IRS's Processing Performance Relative to 2001–2005 Performance and 2006 Goals

IRS met or exceeded eight of the nine processing performance goals for 2006 as table 5 shows. For seven measures (i.e., deposit error rate, deposit timeliness, notice error rate, refund interest paid, refund timeliness, productivity, and efficiency), IRS exceeded its goal. For one measure (refund error rate), IRS met its goal.

For one measure, the letter error rate, IRS's performance declined and the 2006 goal was not met. The letter error rate is calculated as the percentage of letters issued to taxpayers with errors. IRS officials said that computer system errors were partially to blame for the higher letter error rate this filing season; however, most of those errors were caused by one programming error that was corrected in the beginning of March. In addition, according to IRS officials, most errors caused by employees were attributed to one submission processing center, which had many new employees.

Comparing actual 2006 performance to 2005 shows that IRS's performance improved or remained about the same for eight of the nine measures in effect in 2005. Table 6 also shows that IRS processing performance in 2006 has significantly improved compared to prior years.

**Appendix IV: IRS's Processing Performance
Relative to 2001–2005 Performance and 2006
Goals**

Table 6: IRS's Processing Performance, Fiscal Years 2001–2006

Measure name	Definition	Fiscal year	Fiscal year	Fiscal year	Fiscal year	Fiscal year	Fiscal year	Fiscal year
		2001 actual ^a	2002 actual	2003 actual	2004 actual	2005 actual	2006 actual (through July)	2006 goal
Deposit error rate ^b	Percentage of payments applied in error by, for example, reimbursing a taxpayer who overpaid when the taxpayer wanted any overpayment credited to next year's tax bill.	5.0%	4.8% +/-0.3%	4.2% +/-0.3%	3.5% +/-0.31%	2.2% +/-0.26%	1.7% +/-0.28%	2.0%
Deposit timeliness—paper	Interest foregone by not depositing monies the business day after receipt, per \$1 million in deposits. Measure assumes an 8 percent interest rate.	Not comparable because of revisions to the measure.	Not comparable because of revisions to the measure.	Not comparable because of revisions to the measure.	\$407	\$390	\$365	\$390
Letter error rate ^b	Percentage of letters issued to taxpayers with errors (includes systemic errors). ^c	Not comparable because of revisions to the measure.	7.4% +/-0.6%	7.1% +/-0.5%	6.6% +/-0.38%	3.1% +/-0.30	3.6% +/-0.36%	3.0%
Notice error rate ^b	Percentage of incorrect notices issued to taxpayers (includes systemic errors). ^c	Not comparable because of revisions to the measure.	18.7% +/-2.4%	9.4% +/-1.2%	9.5% +/-1.31%	9.2% +/-1.6%	5.6% +/-1.08%	8.6%

**Appendix IV: IRS's Processing Performance
Relative to 2001–2005 Performance and 2006
Goals**

Measure name	Definition	Fiscal year	Fiscal year	Fiscal year	Fiscal year	Fiscal year	Fiscal year	Fiscal year
		2001 actual ^a	2002 actual	2003 actual	2004 actual	2005 actual	2006 actual (through July)	2006 goal
Refund error rate—individual (paper) ^b	The percentage of refunds with IRS-caused errors in the entity information (e.g., incorrect name, Social Security number, or refund amount); includes systemic errors. ^c	9.8%	8.0% +/-0.46%	5.3% +/-0.41%	4.9% +/-0.44%	5.0% +/-0.48%	4.5% +/-0.51%	4.8%
Refund interest paid	Amount of refund interest IRS paid per \$1 million of refunds issued.	Not comparable because of revisions to the measure.	Not comparable because of revisions to the measure.	\$36.29	\$20.55	\$29.21	\$29.88	\$32.00
Refund timeliness—individual (paper) ^b	Percentage of refunds issued within 40 days or less.	95.2%	98.2% +/-0.32%	98.8% +/-0.26%	98.3% +/-0.17%	99.2% +/-0.18%	99.4% +/-0.13%	99.2%
Productivity	Weighted volume of documents processed per staff year expended at the processing centers.	30,133	28,389	30,179	30,405	31,444	33,011	32,000
Individual Master File efficiency	Measure of individual Master File returns processed per staff year expended.	Measure not in existence.	Measure not in existence.	Measure not in existence.	Measure not in existence.	14,965	17,538	15,622

Source: GAO analysis of IRS data.

Notes: The measures for fiscal year 2006 are through July 30, which were the latest data available at the time we ended our audit work. According to IRS officials, the 2006 results through July 30 are reflective of IRS's performance during the filing season. In addition, IRS officials told us that the results for the measures should not change significantly through September 30.

^aAccording to IRS officials, they did not compute a margin of error for these measures in 2001.

^bIRS estimates these measures to have a 90 percent confidence interval.

^cSystemic errors are computer-generated errors over which a particular processing center would have no control.

Appendix V: Telephone Access Varies Depending on the Time of Year and Type of Call

Level of service can vary during different periods of the year. For example, from January 1 through April 22 the level of service was 82 percent, but was 75 percent from April 23 through June 10. Fewer taxpayers called after the filing season deadline and those taxpayers who did received a lower level of service compared to those who called during the filing season. According to IRS officials, their work plans are built to maximize IRS's telephone performance during the filing season when most taxpayers call.

The average speed of answer varies between questions. IRS groups each type of call into different applications, so that they can be answered by a properly trained customer service representative (CSR). Taxpayers' experiences may differ depending upon the availability of CSRs and the number of calls received in the category. For example, according to IRS data as of April 22, taxpayers wanting answers about capital gains and losses on average waited 4 minutes longer than those wanting answers about tax credits.

According to IRS, however, there may be opportunities to address these variances with the implementation of a new workforce management system and full deployment of a single queue for telephone service. The new system should allow IRS to make staffing decisions at the corporate level, rather than relying on the individual sites, and in turn, create benefits from better staffing decisions and more flexible work plans. IRS expects to have the new workforce management system fully implemented in fiscal year 2008. According to IRS officials, implementing a single queue for each application across all call sites, rather than separate queues at each site, will create a consistent average answer time within an application. Currently, two taxpayers with the same question may have different wait times because one waited for a CSR in the Jacksonville call site, for example, while another waited for a CSR in Austin. With a single queue, those taxpayers would wait the same amount of time irrespective of their location. However, the single queue will not improve the variations in wait time between the different applications. IRS officials said that there will still be fluctuations but the new workforce management solution and a single queue should help to better manage variances.

Appendix VI: Comments from the Internal Revenue Service



COMMISSIONER

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

November 3, 2006

Mr. James R. White
Director, Tax Issues
U.S. Government Accountability Office
441 G Street, N.W.
Washington, D.C. 20548

Dear Mr. White:

I have reviewed your draft report entitled "TAX ADMINISTRATION: Most Filing Season Services Continue to Improve, but Opportunities Exist for Additional Savings," and I appreciate your recognition of our significant achievements in successfully delivering the 2006 filing season. As you note, the IRS continued a trend of improving its primary filing season services, including returns processing, telephone, web site, and face-to-face operations.

Processing - Our returns processing activities continued to be highly effective. This year we met or exceeded most of our performance goals, continuing a trend since 2001. Through October 6, 2006, we timely processed 131 million individual income tax returns and issued just over \$219 billion in refunds to our customers. During this same period we also successfully implemented, in some cases on very short notice, significant tax law changes resulting from the Energy Policy Act of 2005, Transportation Equity Act of 2005, Katrina Emergency Tax Relief Act of 2005 and the Gulf Opportunity Zone Act of 2005. The latter was not signed into law until December 21, 2005.

During 2006 we continued to implement our new processing system, the Customer Account Data Engine (CADE). We successfully deployed its fourth release in January 2006 that added functionality necessary to include Forms 1040 and Form 1040A (without schedules) to the previous baseline of Form 1040EZs. As of October 6, 2006, CADE successfully posted over 7.3 million returns, well over our 4 million goal. CADE also issued more than 6.6 million refunds totaling over \$3.4 billion dollars. We plan to deploy additional releases of CADE that will further increase the system's functionality and speed the processing of even more taxpayers' returns during the 2007 filing season.

Electronic filing continued to grow, with more than 72 million taxpayers e-filing this year. E-file is up 6.6 percent over the prior year, with the most significant increase occurring in the number of taxpayers who filed electronically from their home computers. Taxpayers filed over 20.3 million returns from home during 2006, an 18.6 percent

increase over last year. Over 3.9 million taxpayers took advantage of the free online filing services offered by the Free File Alliance. Also notable is the fact that over 59 million taxpayers signed their returns electronically using one of the Personalized Identification Number (PIN) options we offer, further increasing the efficiency with which we process electronically filed returns.

Telephone Service - Even with the delayed decision to retain 15 hours a day of toll-free service, the overall customer experience continued to improve. We focused on increasing efficiency in order to save resources with as little impact to service levels as possible. To ensure we delivered our planned Customer Service Representative Level of Service of 82 percent, we placed additional emphasis on the accuracy of our staffing schedules. Doing so enabled sites to staff, by half hour, in accordance with anticipated demand. By having the right skills in the right place at the right time, we minimized wait time and optimized use of available resources. For example, during FY 2006 we achieved an average speed of answer (ASA) of 242 seconds, a 6 percent improvement over last year and 58 seconds faster than our planned ASA of 300 seconds.

I appreciate your noting the accuracy of our responses to tax law and account questions, as our accuracy rates for the 2006 filing season are the highest we have ever achieved. By continually identifying and addressing common errors in our responses, through September 2006 we achieved a Toll-Free Tax Law accuracy rate of 91 percent. Likewise, our improved quality review process, Contact Recording, which enables managers to review recorded customer contacts and provide performance feedback to employees, helped us achieve a Toll-Free Accounts accuracy rate of over 93 percent, which exceeds our 2006 goal by over 1 percent.

These efforts also produced an exceptional level of customer satisfaction. Survey results reflect that 94 percent of callers were mostly satisfied or completely satisfied with our Toll-Free services.

Web Site - As you note, our website, IRS.gov, continued to be among the most heavily used and highly regarded government websites during 2006. Thus far this year, our website has been visited more than 194 million times, a 9.8 percent increase over 2005, and visits to IRS.gov resulted in more than 1.3 billion page views, a 3.4 percent increase over 2005. Taxpayers and practitioners also downloaded more than 170 million forms, publications, instructions and other documents. In recognition of these accomplishments, IRS.gov was honored with a Government Solutions Center Pioneer Award for "Innovative Use of Technology in Government Programs."

Walk-In Assistance - During the 2006 filing season, the IRS kept open and continued to provide services at all of our 400 Taxpayer Assistance Centers (TAC), as well as through our extensive network of community-based coalitions and partners. We assisted over 6 million taxpayers at our TACs this filing season, and we significantly

3

increased the accuracy of the services we provided in these sites. Tax law accuracy was 83 percent, an all time high and 3.8 percent over our 2006 goal. Customer satisfaction also remained very high this year, with 91 percent of our walk-in customers reporting they were satisfied or very satisfied with the service they received.

IRS-supported volunteer tax services also improved. This filing season, 69,000 volunteers in 12,000 locations provided assistance to the traditionally underserved population that includes individuals with low incomes, the elderly, the disabled, and those who have limited English proficiency. Through September 30, 2006, over 2.2 million returns were filed through our Volunteer Income Tax Assistance (VITA) and Tax Counseling for the Elderly (TCE) sites, an increase of 7.4 percent over the prior year. Of these, 82.6 percent were e-filed, a 14.3 percent increase. To increase awareness of these services, we made more than 397 million outreach contacts through media and non-media channels. In order to serve more taxpayers through these programs, we also expanded our partnerships with community-based coalitions to over 300 in 2006.

Taxpayer Assistance Blueprint (TAB) - The TAB initiative continues to make significant progress toward the development of specific taxpayer service improvement recommendations, with major research initiatives producing a significant body of data that is still being analyzed. A progress update was recently provided to Congressional staff, the Office of Management and Budget (OMB), and the Treasury, and we are working toward completion of the Phase 2 Report. The external stakeholder review process is scheduled to begin in December 2006, with a targeted submission of the report to Congress by the end of January 2007. We are confident that the TAB will be a significant resource to increase taxpayer value, address taxpayer burden, increase voluntary compliance, and improve workforce performance and engagement well into the future.

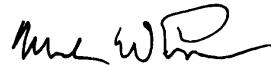
I appreciate your acknowledgement that the current statutory limitation on IRS' authority to mandate electronic filing is an impediment to achieving our electronic filing goals. I also appreciate your recognition of the benefits we are realizing as a result of our implementation of CADE. I also agree that reporting the timeliness of refunds processed through CADE versus those processed through our Master File legacy system may be useful to Congress.

Finally, IRS is committed to operating efficiently and effectively. To that end, we agree with your recommendation to develop, validate, and implement a plan to consolidate call sites. We have already begun a comprehensive Accounts Management workload analysis that will assess the feasibility of further consolidating our sites and the potential impact on our customers.

4

Responses to your specific recommendations are enclosed. I appreciate your observations on the successful filing season for 2006 and if you have any questions, please contact Floyd Williams, Director, Legislative Affairs, at (202) 622-3720.

Sincerely,



Mark W. Everson

Enclosure

Enclosure

Recommendation for the Commissioner

Timely develop, validate and implement a plan to consolidate call sites.

Response

We agree with this recommendation. Beginning in April 2005 and continuing through the 2006 filing season, the IRS has been engaged in a comprehensive Accounts Management (AM) workload analysis. This analysis confirmed a decline in paper and toll-free full-time equivalents, total peak staffing and occupied workstations over the past five years, and validated the feasibility of consolidating one or more AM call sites. Next steps in the process include: developing internal and external communication plans, updating data and projections to reflect the most current information available, conducting a full cost analysis to determine projected savings, and formulating a consolidation timeline and workload redistribution plan.

Recommendation for the Commissioner

Report to the Congress refund timeliness for CADE compared to the Master File legacy system.

Response

We agree with this recommendation. Using the current sample for the refund timeliness measure, we will extract additional information in order to provide an average number of days for refund issuance for CADE-processed returns and Master File-processed returns thereby comparing CADE-processed refunds to Master File-processed refunds. This information will be compiled on a monthly basis.

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