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"THE STRATEGIC PLANS AND BUDGET OF THE IRS"

STATEMENT FOR THE RECORD

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Mr. Chairman and Members of the Committees, I appreciate the opportunity to appear before you today to discuss the progress made by the Internal Revenue Service (IRS) in complying with the IRS Restructuring and Reform Act of 1998 (RRA 98). My comments will also address several significant challenges facing the IRS including its ability to modernize computer systems, improve customer service and increase productivity.

The mission of the IRS is critical. It processes over 233 million tax returns and collects over $2 trillion annually to fund the nation's government. The IRS also implements tax law changes and must enforce tax laws to ensure that the taxpaying public pays the proper amount of tax. To accomplish these responsibilities, the IRS relies on extensive computer-processed data. Substantial damage to IRS computer systems security, and employee safety or security can cause disruption in tax administration and adversely affect the United States economy.

In 1998, the IRS undertook a course of dramatic change. The changes were prompted both by issues the Congress identified in a series of hearings and through opportunities imagined by the new Commissioner and the Secretary of Treasury who worked closely with key congressional committees. The changes consisted of reforms, fundamental organizational design alterations and a desperately needed modernization plan for the IRS' outmoded computer systems. The organizational design plan would take the IRS from an old-line governmental hierarchy to a modern customer-focused organization. The reforms were designed to address taxpayer rights and to strike at abuses. The business modernization was to catch up with technology and to support the emerging organization in an imaginative fashion.

These important and fundamental changes faced serious challenges. The culture of the organization, for good and for bad reasons, was very resistant to sudden change. Secondly, decisive changes needed to occur despite the fact that the organization was nearly blinded by a lack of management information systems, meaningful research capacity or performance metrics. The early course of the changes, to date, has had some success. A comprehensive strategy for the future was constructed and a broad fronted implementation plan was set in motion. Through this effort, problems were honestly identified and solutions were constructed. Also, credibility was restored and a positive and constructive relationship was established between the agency and the Congress, largely as a result of the efforts and leadership of the Commissioner. The IRS succeeded in achieving an unbroken record of successful filing seasons, despite a growing workload and fewer resources. However, the changes did not repair all of the problems and some of the changes have occurred at an agonizingly slow pace.

The IRS has made substantial progress on one front. TIGTA audits showed that all four IRS business units substantially completed the five critical elements needed for putting into effect (or standing up) their respective organizational structures. Although the IRS has reorganized structurally, additional actions are needed in the areas of staffing and modernization initiatives. For example, the Government Entities (GE) organization, although officially created in December 1999, is still trying to reach its projected optimal staffing levels. Responsible IRS executives have expressed concerns with the resource levels and acknowledged that the full implementation and establishment of the GE organization is being delayed through Fiscal Year (FY) 2003. As a result of the resource limitations, the GE organization is still in the process of identifying its customers and their unique customer service issues. The Taxpayer Education and Communication organization within the Small Business/Self-Employed operating division is also only at two-thirds of its projected staffing level.

TIGTA has also expressed concerns as to the IRS' ability to address taxpayer issues involving more than one operating unit. During FY 2001, TIGTA reported the need for the IRS to coordinate among its functional areas to implement the IRS-wide workforce-planning model that would identify strategic workforce requirements and be used in developing the strategic plan and budget. TIGTA also identified other reorganization/human resource issues including program managers that did not have direct control over field employees in another IRS functional area. For example, the lack of direct workload control in the Innocent Spouse Program contributed to significant inventory backlog and the possibility of misdirected program resources, inaccurate measurement of program accomplishments and reporting of inaccurate program results.

Filing Season

Many programs, activities and resources have to be planned and managed effectively for the IRS filing season to be successful. For the 2002 filing season, TIGTA determined that the IRS appropriately addressed significant issues prior to commencement of the filing season. Specifically, tax law changes emanating from the Economic Growth and Tax Relief Reconciliation Act of 2001 and the Taxpayer Relief Act of 1997 were implemented. This included updating computer systems, revising the Internal Revenue Manual (IRM) and preparing training materials for employees.

IRS data show that, overall, the 2002 filing season has been successful. Through April 19, 2002, the IRS received approximately 118 million returns and processed approximately 89 million tax returns. Approximately 46 million of these returns were filed electronically, up from approximately 40 million electronic returns received during last year's filing season. The average dollar amount of refunds issued was $1,937 up from an average refund amount of $1,714 last year. In addition, the number of refunds deposited directly into taxpayers' accounts increased by nearly 17 percent from this same time last year.

Business Systems Modernization

The IRS has made progress in modernizing its systems, but at a much slower pace than originally planned. For example, some benefits to taxpayers have been delivered, such as improvements in the capacity to handle and route taxpayers' telephone calls. In addition, the IRS has continued to increase the level of detail in its Enterprise Architecture blueprint, which will help guide the modernization as it progresses. However, most modernization projects have experienced cost and schedule overruns and have delivered less than expected. These setbacks are particularly threatening in light of the fact that so many other reforms are dependent on modernized computer systems.

TIGTA has seen some improvements in the management of systems modernization, particularly in the recognition of deficiencies that need to be addressed, and in the formulation of plans or steps to address the deficiencies. The IRS Business System Modernization Office has taken steps to improve processes such as configuration management, risk management, schedule and cost estimation, requirements management, and quality assurance. Holding the PRIME contractor accountable will be another critical success factor in the modernization effort. To that end, the IRS is becoming more proactive in requiring certain types of skills at the highest levels in the PRIME organization. This essential step is coming late in the overall business modernization initiative and the Chief Information Officer has had to take remedial action.

TIGTA has not yet seen major improvements in the actual implementation of these actions at the project level. Lessons learned in previous projects are not being consistently applied to other projects that are experiencing the same issues or problems. It appears that the project teams are still focused on trying to meet promised delivery dates rather than implementing improvements in the development processes. The IRS will have invested approximately $1 billion in systems modernization by the end of 2002. Several major deliverables are planned for later this year or early next year, including the first iteration of replacing the antiquated taxpayer account master file. If weaknesses in management disciplines are not overcome in the next several months, these deliverables could be in jeopardy.

Security of the IRS

The terrorist attacks on September 11, 2001, and the subsequent anthrax scares highlighted new vulnerabilities in many businesses and government agencies. Although the IRS has traditionally been security conscious because of the very nature of its work, security of IRS employees, facilities, and information systems is now considered a major challenge facing IRS management.

Employees and Facilities - The IRS has long recognized that physical threats to its employees and infrastructure could be detrimental to tax administration and had developed disaster recovery plans. However, these plans generally addressed the risk of only one site shutting down and did not address the potential loss of key personnel. The terrorist attacks of September 11 and subsequent anthrax hoax mailings and bomb threats to IRS facilities caused the IRS to realize that multiple sites could go down simultaneously. Since the terrorist attacks of September 11, TIGTA has investigated a total of 56 incidents involving suspicious biological or chemical substances identified or received at an IRS lockbox or facility. TIGTA special agents have arrested 2 individuals in separate cases involving anthrax hoax mailings to IRS facilities.

Since September 11, the IRS has worked to gain an understanding of, and plan for, these new risks. A new high-level committee headed by the Deputy Commissioner has been convened to focus on security issues. The committee took swift actions to mitigate the threat of bio-terrorism during the current tax-filing season at its major processing centers. For example, mail opening and sorting processes were relocated away from IRS main facilities, security screening of persons was heightened, and vehicles were inspected more thoroughly. In addition to these short-term actions, the IRS is developing plans to combat terrorism and maintain continuity of operations going forward. Completing these actions is important because the IRS is the nation's primary revenue collector and any disruption of collection activities could have a detrimental effect on the economy.

TIGTA continues to participate in IRS security efforts to combat terrorism. TIGTA meets daily with the Federal Bureau of Investigation (FBI) to stay abreast of new threats and is acting as the primary conduit of threat information to the IRS. Although it received no supplemental funding to do so, TIGTA participates in dozens of FBI Joint Terrorism Task Forces around the country. TIGTA has also created a headquarters unit to coordinate investigations and to be a centralized repository and dissemination point of threat information to the IRS. TIGTA, and its predecessor agency, the IRS Inspection Service, has a 50-year history of investigating threats to the IRS and its employees. Since October 1998, TIGTA's Office of Investigations (OI) has completed an average of 675 investigations each year involving written or oral threats directed at the IRS or its employees. For example, five individuals were recently charged in connection with an arson at an IRS office. TIGTA's Office of Audit is also working in coordination with the General Accounting Office to provide a comprehensive evaluation of IRS security initiatives. Interim briefings are being provided to interested congressional groups.

Information Systems – Another consequence of the organizational redesign has been that computer security has often taken a back seat to other priorities and has left the quest for adequate security levels a distant one. TIGTA's recent audits and investigations indicate that, despite some impressive recent progress, the IRS is still vulnerable to outside hackers and to internal abuses. TIGTA identified significant weaknesses in controls over external access to Internet gateways, and weaknesses in the IRS' network operating system controls, physical security, and systems access privileges. In addition, 68 percent of the IRS sensitive information systems have not been certified as meeting the minimum security standards outlined by the Department of Treasury.

Since October 1997, TIGTA's OI has investigated an average of 425 cases per year involving IRS employees who have allegedly improperly accessed confidential taxpayer information. For the same period, 78 IRS employees have been prosecuted and another 515 employees have been removed or resigned for misusing taxpayer information. Unauthorized accesses to tax information (UNAX) violations continue despite training and knowledge of criminal penalties.

TIGTA attributes these computer security weaknesses to:

- Policies and procedures to address most aspects of security have often been ineffectively implemented.

- A reluctance of functional managers to take responsibility for the security of the systems they operate. The CIO's Office of Security has primary accountability, contrary to Office of Management and Budget policy and law, which states that functional managers are responsible for the security of the systems they operate.

- Many IRS employees with key security responsibilities do not have the requisite knowledge and skills.

- Many IRS employees are not aware of security risks and their attendant responsibilities. For example, posing as Help Desk employees, we telephonically contacted 100 employees and asked them to temporarily change their password to one that we had created. Of the 100 employees contacted, 71 agreed to compromise their password. This means that rank and file IRS employees and managers are potentially the weakest link in protecting the security of IRS computer systems and data.

Although aggressive actions discussed previously have been taken or initiated to address the security risks posed by terrorism, the IRS needs to address the weaknesses cited above to reduce the risk of data loss, theft or unauthorized disclosure of taxpayer information.

Tax Compliance Efforts

The IRS' goal of providing world-class service to taxpayers hinges on the theory that, if the IRS provides the right mix of education, support, and up-front problem solving to taxpayers, the overall rate of voluntary compliance with the tax laws will increase. The compliance program (examining tax returns and collecting tax liabilities) would then address those taxpayers who purposefully did not comply. The challenge to the IRS management is to establish a tax compliance program that identifies those citizens who do not meet their tax obligations, either by not paying the correct amount of tax or not filing proper tax returns.

Enforcement actions against individuals and businesses that purposefully conceal tax liabilities or even refuse to submit tax returns have fallen dramatically low, despite concerns that tax cheating remains at high levels. The following chart exhibits the fact that, since FY 1996, the level of IRS enforcement activities has significantly declined.

Enforcement Action	**Overall Decline FY 1996 - FY 2001**
Face-to-Face Audits	72%
Correspondence Audits	56%
Liens	43%
Levies	86%
Seizures	98%

The overall decline in enforcement actions has been primarily attributed to a long-term reduction in enforcement staffing, to redirection of resources to customer service functions during the filing season, a decline in direct examination time, and to IRS employees' concerns over the mandatory termination provision in Section 1203 of RRA 98.

IRS management and many stakeholders have been concerned about the decline in enforcement activities. However, the IRS has not conducted Taxpayer Compliance Measurement Program audits since 1988. Therefore, it currently has no reliable method to measure voluntary compliance or the effect that increased customer service and diversion of compliance resources are having on voluntary compliance. TIGTA believes that the planned National Research Program is a much-needed first step for providing the information necessary to gauge compliance levels and direct IRS compliance resources towards areas where attention is most needed.

Customer Service

Customer service, especially in the area of tax law guidance, needs major improvement. When taxpayers have a problem with their account or need assistance in interpreting tax laws they have two primary vehicles for contacting the IRS. They can speak with an IRS representative either in person at one of the IRS' 414 Taxpayer Assistance Centers (TAC) or over the telephone. During this year, TIGTA assessed the service provided by representatives at the IRS' TACs and through its Toll-Free Telephone System. Customer service continues to be below expectations and the IRS still has several challenges ahead before it reaches the world-class level of service it strives to deliver. During our review of the TACs, TIGTA personnel visited 77 centers and posed 314 questions to IRS representatives. Results of our review are synopsized in the following chart:

	Response Rate	**Percentage**
Correct Answers	158	50
Incorrect Answers	91	29
No Answer Provided – Referred to Publication In Lieu of a Response	63	20
Service Denied	2	<1

The IRS' performance on the Toll-Free side was relatively better. Our reviewers performed on-line monitoring of 736 taxpayer calls and determined that the IRS representative correctly answered the taxpayer's question in 78 percent of the cases.

IRS Performance Measures

In the past year, TIGTA has conducted reviews of the IRS' business results measures and found that the IRS' critical performance measures do not address all of the major components of tax administration. The IRS' performance measures were selected due to their direct relation to the taxpaying public. This emphasis by the IRS on serving the taxpayer has resulted in a December 2001 customer satisfaction rating report which showed that the IRS' customer satisfaction rating has increased by 22 percentage points over the last 2 years. While we do not discount the IRS' emphasis on customer satisfaction, the IRS should also continue to develop its balanced measures program to ensure that its critical performance measures cover all of the major components of tax administration. For example, the IRS breaks down its budget by appropriation[1] and within some of the appropriations by budget activity. We found that three of the five appropriations do not have performance measures linking results to the money requested. Those appropriations are Information Systems, Business System Modernization (BSM), and Earned Income Tax Credit. In the remaining two appropriations, there were no performance measures for three of the six budget activities within those appropriations. Those budget activities are Shared

[1] The five appropriations are Processing, Assistance, and Management; Tax Law Enforcement; Information Systems; Business Systems Modernization; and Earned Income Tax Credit Compliance.

Services Support, General Management and Administration, and Research. The funds budgeted to these areas should have performance measures to justify the budgeted amount or the costs should be associated with the program that it benefits, thus giving a truer cost of that particular program.

Furthermore, performance measures that the IRS reports to the Congress do not address 5 of the 10 strategies listed in the IRS' FY 2000-2005 Strategic Plan. For example, two strategies with which we could not link critical performance measures were "Deal Effectively with the Global Economy" and "Recruit, Develop, Retain a Quality Workforce." The IRS is in the process of developing measures that would address its strategy relating to the global economy. The lack of performance measures prevents the IRS from reporting its overall level of success in achieving its mission.

The IRS Restructuring and Reform Act of 1998 (RRA 98)

Due to the comprehensive nature of this reform law, the IRS has dedicated significant attention and resources toward implementing the RRA 98 provisions. The RRA 98 included fundamental changes to tax law procedures and 71 provisions that increase or help protect taxpayers' rights. The IRS has taken several actions to improve compliance with these provisions. For example, in some instances the IRS added a higher level of managerial review of work, implemented new computer controls to prevent certain violations from occurring, and provided additional training and guidance to help employees and managers understand the requirements of the provisions. The RRA 98 required TIGTA to review 10 of the 71 taxpayer rights provisions, as well as 2 other taxpayer rights provisions in prior legislation. TIGTA is currently in the fourth review cycle assessing the mandatory RRA 98 provisions. In addition to the mandatory reviews, TIGTA has reviewed other taxpayer rights provisions within the RRA 98.

The IRS' compliance with the RRA 98 provisions varies from achieving full compliance to significant non-compliance. TIGTA has reported that the IRS has fully implemented three taxpayer rights provisions - *Mitigation of Failure to Deposit Penalty, Seizure of Property and Taxpayer Advocate-Hardships.* The IRS is generally compliant with two other provisions – *Illegal Tax Protestor Designation and Collection Due Process for Liens and Levies.*

Additionally, the IRS needs to improve its compliance with the RRA 98 provisions by completing actions recommended in TIGTA audit reports issued in FY's 2000, 2001 and 2002. We found the IRS is not yet compliant with the following taxpayer rights' provisions:

- *Notice of Levy* – The systemic control designed to ensure that taxpayers receive the required 30-day notification before levy can be circumvented. All revenue officers have the capability to revise the final notice date. As a result, the IRS cannot be certain that all taxpayers were provided the required 30-day notice before levy actions were taken.

- *Restrictions on the use of enforcement statistics to evaluate employees* – TIGTA determined that the performance or related supervisory documentation could contain violations of RRA 98 Section 1204 (a) for an estimated 452 enforcement employees in the continental United States, and violations of RRA 98 Section 1204 (b) for an estimated 3,170 enforcement employees, out of an estimated population of 45,300 enforcement employees in the continental United States.

- *Notice of Lien* – An estimated 11,500 lien notifications, out of a population of 137,258 lien notices, were not mailed to the taxpayer, the taxpayer's spouse, or to the taxpayer's business partners; or were not mailed to the taxpayer's or spouse's last known address. Taxpayer rights could be potentially affected because the taxpayer not receiving a notice or receiving a late notice might not be aware of the right to appeal or could have less than the 30-day period allowed by the law to request a hearing.

- *Collection Statute of Limitations* – TIGTA identified 16 taxpayer accounts where the IRS obtained collection statute extensions without also securing the related installment agreement or levy release as required by law. In addition, the IRS is at risk of writing off approximately 7,300 taxpayer accounts with $291 million in tax liabilities because of incorrect statute calculations or not following internal procedures.

- *Assessment Statute of Limitations* – An estimated 460 taxpayer accounts nationwide do not include documentation that the IRS advised taxpayers of their rights regarding assessment statute extensions, out of an estimated population of 9,800 taxpayers, for the period April to September 2000.

- *Innocent Spouse* – The IRS is effectively educating taxpayers about the requirements that need to be met to qualify for Innocent Spouse relief. The IRS also has made significant improvements in the Innocent Spouse Program at the Cincinnati site; however, problems continued to exist in managing the resources that evaluate the claims assigned to the field. Additionally, the receipt of open claims continues to grow and old claims remain in inventory for extended periods of time.

- *Offer in Compromise Determinations* – The IRS has taken several steps to expand access to the offer in compromise program and has complied with the RRA 98 provision. However, the IRS could do more to educate taxpayers about the verification process used to evaluate an offer, provide additional flexibility regarding the consideration of taxpayers' equity in assets, revise guidelines to encourage taxpayer access to the appeal process, and establish a management information system to monitor offers accepted based on special circumstances and on the independent administrative review process.

- *Denials of Requests for Information Under the Freedom of Information Act* – TIGTA identified an estimated 615 responses to Freedom of Information Act or Privacy Act requests where information was improperly withheld, out of 5,725 requests for information that were denied in whole or part, or where the IRS replied that responsive records were not available. There was also an estimated 733 responses to Internal Revenue Code (I.R.C.) Section 6103 requests where information was improperly withheld out of an estimated population of 10,539 requests that were denied or partially denied or requesters were told that records could not be located.

- *Dual Notices for Joint Filers* – Separate notices were not being sent to joint filers as required by the law.

- *Uniform Asset Disposal Mechanism* – This provision was effective July 22, 2000. In TIGTA's first review of this provision, there were three seizure cases in which it was not clear whether revenue officers participated in prohibited activities during the sale of the property.

Prior to July 2000, IRS management became concerned that not all requirements could be met by the effective dates imposed by the RRA 98 and informed the Congress that additional time would be needed to implement three provisions. The Congress extended the deadlines for these three requirements with the passage of the Community Renewal Tax Relief Act of 2000.[2] For one of the three provisions, *Annual Installment Agreement Statements,* the deadline was extended to September 1, 2001, to provide annual statements to taxpayers with active installment agreements. The IRS has indicated it is now in compliance with this provision. TIGTA has not yet validated the IRS' compliance with this provision.

Additional actions are still needed before two provisions will be fully implemented. These two provisions are:

- *Notice of Penalties Imposed* – Deadline extended to July 1, 2003, for providing the detailed notice. TIGTA reported that the IRS computer programming was not in place to send notices to 8.7 million taxpayers.
- *Notice of Interest Assessed* – Deadline extended to July 1, 2003, for providing the detailed notice. TIGTA reported that the IRS computer programming was not in place to send notices to the same 8.7 million taxpayers that also had penalties imposed.

[2] Pub. L. 106-554 (December 21, 2000).

Finally, because the IRS did not have management information systems to track the specific cases, neither TIGTA nor the IRS could evaluate the IRS' compliance with the following four provisions.

- Restrictions on directly contacting taxpayers instead of authorized representatives.
- Taxpayer complaints.
- Separated or divorced joint filer requests.
- Fair Debt Collection Practices Act (FDCPA) Violations – the IRS does track potential FDCPA violations on its computer systems; however, we determined that data on one system may not always be complete and accurate.

Section 1203 Violations

In addition to our audit responsibilities, the RRA 98 charges TIGTA with investigating Section 1203 violations. Section 1203 provides that the IRS Commissioner shall terminate the employment of any IRS employee found guilty of misconduct as defined by ten acts or omissions. TIGTA assists in the protection of taxpayers and their rights by investigating allegations of misconduct by IRS employees. Since the passage of Section 1203, approximately 5,000 complaints involving an allegation of a Section 1203 violation have been received.

Shortly after the passage of the RRA 98, there was initial uncertainty in what the public and IRS employees thought constituted a true violation of Section 1203. Since February 1999, TIGTA has seen a high of 94 complaints in August 1999 to only 12 complaints received in February 2002. This is a significant decline and is credited, in part, to:

- Public and employee education in Section 1203;
- The IRS' aggressive response to implement Section 1203 legislation; and
- Decline in IRS enforcement activity.

The vast majority of Section 1203 complaints received by TIGTA have alleged an IRS employee violated a provision of the IRM or I.R.C. in order to retaliate against, or harass someone. The second category, by volume, involves constitutional and civil rights/Equal Employment Opportunity (EEO) violations. The IRS receives and adjudicates numerous Section 1203 allegations where no TIGTA investigation is needed. Where TIGTA involvement is warranted, our focus is to determine the intent. As of February 2002, the IRS has notified us that 54 employees have been fired and 106 employees have resigned or retired as a result of TIGTA and IRS investigations.

TIGTA and the IRS are working together to re-engineer the 1203 process. Beginning March 1, 2002, a streamlined process was implemented which will enable an early determination to be made in order to separate the valid 1203 allegations from those that are not. As a result, TIGTA will be able to devote its resources to the investigation of bona fide 1203 allegations and other misconduct.

In closing, I would like to comment that the Commissioner's approach in identifying risks associated to IRS business operations and his attempt to encourage IRS personnel to embrace cultural changes that, in the past, detracted from the agency's ability to provide effective customer service, are extremely noteworthy. During the past four years, the IRS has made considerable progress in the implementation of some of the taxpayer rights provisions. As a result, taxpayer rights have been addressed and better protected, and IRS employees and stakeholders are engaged in addressing critical tax administration issues. The IRS is now entering a very challenging period. Much of the IRS' progress, credibility and unwavering march toward reform is attributed to the leadership of the Commissioner, whose term will expire in November. It is particularly essential that his replacement continue his legacy and possess outstanding qualifications as a change manager and reformer. The IRS needs to continue to focus its limited resources on making long-term improvements that ultimately affect the American taxpaying public.