INTERNAL REVENUE SERVICE MISMANAGEMENT AND IDEAS FOR IMPROVEMENT

HEARING

BEFORE THE

SUBCOMMITTEE ON GOVERNMENT MANAGEMENT, INFORMATION, AND TECHNOLOGY

OF THE

COMMITTEE ON GOVERNMENT REFORM AND OVERSIGHT HOUSE OF REPRESENTATIVES

ONE HUNDRED FIFTH CONGRESS

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INTERNAL REVENUE SERVICE MISMANAGEMENT AND IDEAS FOR IMPROVEMENT

MONDAY, APRIL 14, 1997

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON GOVERNMENT MANAGEMENT,
INFORMATION, AND TECHNOLOGY,
COMMITTEE ON GOVERNMENT REFORM AND OVERSIGHT,
Washington, DC.

The subcommittee met, pursuant to notice, at 10 a.m., in room 2154, Rayburn House Office Building, Hon. Stephen Horn (chairman of the subcommittee) presiding.

Present: Representatives Davis of Virginia, Sununu, and Maloney.

Also present: Representative Sanders.

Staff present: J. Russell George, staff director and counsel; Anna Miller and John Hynes, professional staff members; Andrea Miller, clerk; and David McMillian and Mark Stephenson, minority professional staff members.

Mr. HORN. The Subcommittee on Government Management, Information, and Technology will come to order.

Today, the subcommittee revisits the issue of management at the Internal Revenue Service, IRS. The problem before us is the apparent inability of the IRS to adapt to the information and accountability demands of the late 20th century.

One year ago, this subcommittee held a hearing on financial management at the IRS. At that hearing, we discussed the IRS' revenue accounting system, which is in such disarray it cannot even be audited. We also reviewed the IRS' problems with collections, management of accounts receivable, filing fraud and fraudulent refunds, records retention, tax lien recovery, and personnel browsing of taxpayer records. It was not a short hearing.

Last September, we held another hearing on IRS financial management. At that session, we received more reassurances that improvements were under way. Yet, here we are today, reading a steady stream of press reports on feeble management, failed automation, and poor customer service at the IRS.

The list of failed projects only grows longer: The tax system's Modernization Project, a $4 billion attempt to modernize the IRS' decades-old computer systems; Cyberfile, a project that would have allowed taxpayers to prepare and electronically submit their tax returns from their personal computers; Integrated Case Processing, a program that would have allowed IRS representatives to access all data needed in order to answer all taxpayer questions over the telephone; the Document Processing System, a system that would

have scanned paper documents and electronically captured data for subsequent processing and retrieval; and even the Service Center recognition/image processing system, the failed document-scanning program that the Document Processing System was designed to replace.

I hope we will not have to add to this list the year 2000 computer software conversion problem. It would be a catastrophe not only for the IRS, but for all other agencies and organizations that depend on IRS information.

A Senate hearing last week focused on the problem of certain IRS employees snooping in the agency's taxpayer computer files. The IRS had previously announced a policy of zero tolerance for this inappropriate browsing and assured Congress that the problem had been solved. Yet the General Accounting Office has just released evidence that personnel snooping continues.

It is attempting to solve many of the problems at the IRS by contracting out various functions, especially those in information technology development. But this will only work if the IRS can specify its objectives and assess the costs and the time it will take. The IRS must also be able to determine whether delays in delivery of components of the system are going to cause delays in the whole implementation process and what the implications of such delays will be. It is not clear that the leadership of the IRS at this point is up to the challenge.

Contracting out is clearly not a panacea. One can hope that the Government Performance and Results Act is forcing top management at the IRS to re-evaluate what they are doing and how they are doing it. Federal agencies right now are supposed to be consulting with congressional committees of jurisdiction to refine their strategic and performance plans and proposals for how they are going to measure results. This is an excellent opportunity to put into place a new approach to doing business. But from what we have seen so far of the plans and performance measures that the IRS is developing, it is still business as usual.

At this point, the subcommittee hopes that improvement will occur. There are several important questions that must be answered: What does the IRS need to do to get its Modernization Project back on track? How is the Treasury going to ensure that IRS embarks on a modernization plan that will work? What sort of milestones or benchmarks should a modernization plan have so that its progress can be monitored? How long do we have to wait to see results? Will the right people be held accountable? How can we overcome obstacles to change, such as the organizational culture of the IRS? How do we modify it? How do we make sure the IRS can manage multimillion-dollar information technology development projects that often amount to several billion before we know they failed, even if such projects are going to be given to outside contractors?

The IRS needs to be accountable. Americans have a right to know whether the agency that collects taxes from their hard-earned money is capable of managing internal operations in an efficient, fair, and accountable way.

The IRS emphasizes the need to maintain taxpayers' faith in the voluntary compliance system. That faith is undermined by stories

of refund fraud and of translators helping illegal aliens to get refunds. We need to know that the IRS has adequate control over refund fraud. We need to know that the information provided in their financial statements is reliable. We need to know that the IRS gives good information to taxpayers in response to their telephone queries. We need to know that the IRS treats all taxpayers fairly and appropriately, and we need to know that the IRS is collecting the proper amount of taxes at the lowest possible cost to the public. These are the measures of success.

We welcome our guests today who will be testifying on a number of these questions. We will be hearing first from Lynda Willis of the General Accounting Office. She is Director for Tax Policy and Administration, and will discuss the progress the IRS has made in acting on recommendations submitted by GAO to improve IRS operations.

Robert Tobias, of the National Treasury Employees Union, will represent the IRS employees' views on how to restore public and congressional confidence in the IRS.

Sheldon Cohen, former IRS Commissioner during the Johnson administration and now a fellow of the National Academy of Public Administration, will tell the subcommittee how the situation looks from his vantage point. He was Commissioner when IRS first started to computerize its operation.

Also testifying will be Shelley Davis, the former IRS Historian, the only one it has ever had. She will present her views on why the IRS is in trouble and what they can do to get back on the track.

The IRS will have an opportunity to tell us about its own plan. Deputy Commissioner Michael Dolan will provide us with testimony on the IRS approach to modernization. Originally Rob Portman, Representative from Ohio, co-chairman of the congressionally appointed National Commission on Restructuring IRS, and a member of this subcommittee, had planned to give his perspective on some of the ideas for how we can make sure the IRS becomes a well-managed agency. Unfortunately, he is detained back in Ohio. The views of the National Commission will be given by Jeffrey S. Trinca, the chief of staff of the commission.

We welcome all of you.

We had also invited Jim Traficant, another Representative from Ohio, to present his views on changing the burden of proof in tax disputes from the taxpayer to the IRS, the proposal that would level the playing field. Unfortunately, Mr. Traficant cannot be with us today, but he has provided us with a written statement that will be included in the hearing record at the end of the opening statements, without objection.

This subcommittee does not like to be unduly pessimistic. For every problem, there are opportunities, not only to solve the problem, but to make things better than they were before.

I have gone on record as advising the President that he should be judicious in his choice of the new IRS Commissioner. It should not be someone who is simply a very bright and outstanding CPA tax accountant. It should not be someone who is simply a very bright and outstanding tax lawyer. It should be someone who has demonstrable management expertise in providing leadership to large, complex organizations.

As we know, the IRS has 106,000 or so employees. Next to the Pentagon, it is really the second largest Federal service, excluding the Postal Service, that is now largely independent.

At this point I would like to yield to Mr. Sununu, the gentleman from New Hampshire, for any opening statement that he has to make.

[The prepared statement of Hon. Stephen Horn follows:]

DAN BURTON, INDIANA
CHAIRMAN

HENRY A. WAXMAN, CALIFORNIA
RANKING MINORITY MEMBER

ONE HUNDRED FIFTH CONGRESS

Congress of the United States
House of Representatives

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"IRS Mismanagement and Ideas for Improvement"

OPENING STATEMENT
REPRESENTATIVE STEPHEN HORN (R-CA)

Chairman, Subcommittee on Government Management, Information, and Technology

A quorum being present, the Subcommittee on Government Management, Information and Technology will come to order. Today the subcommittee revisits the issue of management at the Internal Revenue Service (IRS). The problem before us is the apparent inability of the IRS to adapt to the information and accountability demands of the late twentieth century.

One year ago, this subcommittee held a hearing on financial management at the IRS. At that hearing we discussed the IRS's revenue accounting system, which is in such disarray it cannot even be audited. We also reviewed the IRS's problems with collections, management of accounts receivables, filing fraud and fraudulent refunds, records retention, tax lien recovery, and personnel browsing of taxpayer records. It was not a short hearing.

Last September we held another hearing on IRS financial management. At that session we received more reassurances that improvements were underway. Yet here we are today, reading a steady stream of press reports on feeble management, failed automation, and poor customer service at the IRS.

The list of failed projects only grows longer:

- The Tax Systems Modernization project, a 4 billion dollar attempt to modernize the IRS's decades-old computer systems;
- Cyberfile, a project that would have allowed taxpayers to prepare and electronically submit their tax returns from their personal computers;
- Integrated Case Processing, a program that would have allowed IRS representatives to access all the data needed in order to answer taxpayer questions over the telephone;
- the Document Processing System, a system that would have scanned paper documents and electronically captured data for subsequent processing and retrieval; and even
- the Service Center Recognition/Image Processing System, the failed document-scanning program that the Document Processing System was designed to replace.

I hope that we will not have to add the Year 2000 computer software conversion problem to the failure list. It would be a catastrophe not only for the IRS but for all the other agencies and organizations that depend on IRS information.

A Senate hearing last week focused on the problem of certain IRS employees snooping in the agency's taxpayer computer files. The IRS had previously announced a policy of "zero tolerance" for this inappropriate browsing and assured Congress that the problem had been solved. Yet the General Accounting Office has just released evidence that personnel snooping continues.

It is tempting to solve many of the problems at the IRS by contracting out various functions, especially those in information technology development. But this will only work if the IRS can specify its objectives and assess the costs and the time it will take. The IRS must also be able to determine whether delays in delivery of components of the system are going to cause delays in the whole implementation process and what the implications of such delays will be. It is not clear that the leadership at the IRS is up to this challenge.

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At this point, the subcommittee hopes that improvement will occur. There are several important questions that must be answered. What does the IRS need to do to get its modernization project back on the track? How is the Treasury going to ensure that the IRS embarks on a modernization plan that will work? What sort of milestones or benchmarks should a modernization plan have so that its progress can be monitored? How long do we have to wait to see results? Will the right people be held accountable? How can we overcome obstacles to change such as the organizational culture of the IRS? How do we modify it? How do we make sure that the IRS can manage multimillion-dollar information-technology development projects, even if such projects are given to outside contractors?

The IRS must be accountable. Americans have a right to know whether the agency that collects taxes from their hard-earned money is capable of managing its internal operations in an efficient, fair, and accountable way. The IRS emphasizes the need to maintain taxpayers' faith in the voluntary compliance system. That faith is undermined by stories of refund fraud and of translators helping illegal aliens to get refunds.

- We need to know that the IRS has adequate control over refund fraud.
- We need to know that the information provided in their financial statements is reliable.
- We need to know that the IRS gives good information to taxpayers in response to their

telephone queries.

- We need to know that the IRS treats all taxpayers fairly and appropriately.
- We need to know that the IRS is collecting the proper amount of taxes at the lowest possible cost to the public.

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The IRS will have an opportunity to tell us about its own plans. Deputy Commissioner Michael Dolan will provide us with testimony on the IRS's approach to modernization. Rob Portman, representative from Ohio, co-chairman of the congressionally appointed National Commission on Restructuring the IRS, and a member of this Subcommittee had planned to give us his perspective on some ideas for how we can make sure that the IRS becomes a well-managed agency. He is detained back in his Ohio district. The views of the National Commission will be given by Fred Goldberg, a former IRS Commissioner and a member of the Commission. Welcome to each of you.

We had invited Representative Jim Traficant, also from Ohio, to present his ideas on changing the burden of proof in tax disputes from the taxpayer to the IRS, a proposal that would level the playing field. Unfortunately Mr. Traficant cannot be with us today, but he has provided us with a written statement that will be included in the hearing record at the end of the opening statements, without objection.

This subcommittee does not like to be unduly pessimistic. For every problem, there are opportunities not only to solve the problem, but to make things better than they were before. I have gone on record as advising the President that he should be judicious in his choice of the new IRS Commissioner. It should not be someone who is simply a CPA tax accountant, or a tax lawyer, but someone who has demonstrable management expertise in providing leadership to large, complex organizations.

Mr. SUNUNU. Mr. Chairman, I don't have a full opening statement this morning, but I certainly want to thank the witnesses that are going to be providing testimony today. Certainly your appearance here before the committee is extremely timely. As we move forward toward the 21st century, toward the century change, and look at the technological issues that are facing all of Government's areas of administration, but in particular the Internal Revenue Service and their attempts to improve their operations in such a way as to not just promote efficiency and capability within the organization, but hopefully to restore some public confidence in the integrity of the operations of Government's financial systems. I think there is a tremendous amount of opportunity to bring modern management techniques, information systems, and the kind of changes that will make a difference, as I say, in both, in terms of how we operate Government and also in restoring public confidence to the operations of one of the most important agencies in Government.

I look forward to the testimony today and hope we will have the opportunity to ask some questions that might shed additional light on to where the opportunities for improvement might exist. Thank you.

Mr. HORN. I thank the gentleman.

[The prepared statements of Hon. Carolyn B. Maloney, Hon. Bernard Sanders, and Hon. James A. Traficant, Jr., follow:]

Opening Statement of
The Honorable Carolyn B. Maloney on
"IRS Mismanagement and Ideas for Improvement"

April 14, 1997

Thank you, Mr. Chairman, for holding this important hearing on the Internal Revenue Service. We are hearing sounds of alarm from all quarters that the IRS is in serious trouble. The agency, according to some, is barely able to perform its core functions -- administering the tax code, processing tax returns, and accounting for the taxes collected and uncollected.

These same witnesses compare the management crisis of today to that which existed at the IRS in 1952 when the IRS was run by political appointees with little experience in tax law or administration. In 1952 we restructured the IRS to remove political appointees and created an efficient and well run bureaucracy. But that bureaucracy has stagnated, and it appears that we again have an agency in need of serious reform from the top down.

Part of the responsibility for this situation belongs with Congress. Since 1981 we have averaged more than one tax bill a year. Each requiring new regulations to be issued and understood by both citizens and businesses, and if they do not absorb those changes the penalties can be overwhelming.

Part of the responsibility belongs with the management of the IRS. American businesses, large and small, collect over 70 percent of the taxes for the IRS, and the American public pays all of those taxes. When the IRS goes to implement the tax laws, they pay little attention to what the implementation means for businesses or individuals. All too often it seems that the regulations are written for the convenience of the agency and not the public. It is certainly the case that they are written with little consultation with the public or the business community.

We should not, however, blame the rank and file IRS employees for these problems. There have been several successes at the IRS over the last few years. The cost of collection has gone down. Filing fraud has been reduced. New ways of filing have been introduced. Delinquent tax collection has gone up. The implementation of these changes is the result of the hard work of many IRS employees.

I find it somewhat disturbing that the IRS is reducing the size of its workforce, when the agency faces some of the most difficult challenges of the century. I fully believe that the time will come when computers and electronic filing diminishes the need for a number of temporary and full time workers at the IRS. The reports I hear about modernization make it clear that the time for those changes is not yet here.

Today we will hear a number of solutions proposed to solve problems at the IRS. Some would prefer to get rid of the IRS and institute a flat tax. Others recommend a moratorium on tax laws, and that we put our energies into rebuilding the IRS so that it once again is a world class system. Some would have us make the IRS an independent agency with a board of directors from the business community and tax specialists. Still others urge a private sector approach where we do a wholesale replacement of the management staff.

It is not clear what the right solution is for fixing the IRS. What is clear is that we have a crisis on our hands. The IRS spent $3 billion on modernizing its computers and has virtually nothing to show for it. Security at the agency is lax, and the books cannot be audited. If this were a public corporation, the stock would be in a tail spin, and heads would roll.

I look forward to hearing the witnesses today and exploring their suggestions for change. Again, Mr. Chairman, I thank you for calling this hearing.

Statement of Representative Bernard Sanders (I-VT)

House Government Reform and Oversight Subcommittee on Government Management, Information, and Technology

April 14, 1997

Mr. Chairman,

Let me begin by thanking you for holding hearings on IRS management and restructuring. I appreciate the opportunity to speak to what I believe is a serious issue for taxpayers and tax preparers in the state of Vermont and across the country -- and that is the impact of the proposed field reorganization on taxpayer service.

Mr. Chairman,

What we have been hearing from the IRS recently is that their field reorganization, involving the consolidation of 63 district offices into 33 district offices and the dissolution of thousands of positions, is a smashing success. In their March 27, 1997, *Report to Congress*, the IRS in fact states that the reorganization "has not and will not adversely impact service to taxpayers or the Problem Resolution Program."

I cannot speak to the customer service concerns in other parts of the country, but I can say quite clearly that the reorganization in the state of Vermont -- contrary to what we have heard today -- has been a dismal failure. Allow me to explain:

First, last August, the Burlington, Vermont District was one of the 30 IRS District Offices that were consolidated into newly centralized Districts. All of Vermont has become part of the New England District, based in Boston, which also covers the entire states of Maine, New Hampshire, and Massachusetts.

Second, more than one-fifth of all positions in the former Burlington District will have been eliminated or transferred to Boston. In contrast to the premise of the reorganization plan -- to decrease management positions while increasing front line personnel -- during the past year, due in part to a hiring freeze, taxpayer service positions in the Burlington office have been reduced from fifteen to eight. These reductions include decreases in the number of compliance positions, leaving the entire state with only one experienced and well-trained office auditor. Moreover, there is an expected decrease in the staffing level in the Problem Resolution Office, which is the primary point of contact for my office and is widely considered the most effective taxpayer service program in the agency.

Third, the successful Volunteer Income Tax Assistance and Tax Counseling for the Elderly programs -- two community-based, volunteer programs -- are now coordinated out of the Boston Office, which is roughly 300 miles away from most Vermonters.

Fourth, IRS has instructed its taxpayer services personnel to route most telephonic inquiries by Vermont taxpayers to toll-free numbers, staffed by the New England District Office. Until recently, Vermonters had been largely spared from the 1-800 system, and have been able to place intrastate calls to IRS personnel in Burlington. Now, Vermonters who call with questions are now directed to call the 1-800 number.

These changes in operations and staffing levels have had a negative impact on taxpayer services in the state of Vermont.

Mr. Chairman,

In an effort to broaden my understanding of the impact of the reorganization, I wrote on two occasions to all tax preparation services in Vermont to solicit their input relative to this matter. I explained in my letters that I wanted the benefit of their experiences as tax preparers, and I specifically asked whether they had noticed any appreciable change in the service that they had received from the IRS since the dissolution of the Burlington District. The letters were mailed in October of 1996 and in February of 1997.

The response to my letters has been impressive. From the 117 letters I sent, I have received 26 responses -- with only 2 of those responses indicating no change in the level of service. I would like to submit for the record the attached summaries I prepared from these responses.

Allow me to summarize briefly what has happened in Vermont due to the reorganization:

1. Decisions are not being made in a timely manner. Without a District Director in Burlington, the Burlington Office no longer has the authority to make decisions that affect Vermont taxpayers as it did before the reorganization. This change, and the resulting transfer of important functions to the Boston Office, has eroded "local" attention to customer service and impeded timely decision-making. Furthermore, the organization of front line managers answering directly to a District Director has acquired multiple layers to include branch chiefs, division chiefs, assistant division chiefs, and an assistant District Director. All of these changes have made the IRS response to customers slower. Tax preparers and taxpayers are having to wait longer for answers or wait longer in lines at the few IRS walk-up sites available.

2. The Burlington District is now operating with only one experienced staff person in an office audit position. In the past, there have been as many as four or five experienced office auditors to cover the state. Although new auditors have been hired, they lack experience and have only recently received the training necessary to perform their difficult work. This change, due mostly to a hiring freeze, threatens the ability of the IRS to increase voluntary compliance -- which rises only when information and guidance are readily available to taxpayers.

3. Taxpayers and tax preparers are not getting the level of telephone service they did in the past. Let me assure you that any claim that 1-800 services can effectively replace community-based personnel is of no comfort to any taxpayer who has tried to get through to the IRS during tax

season. Additionally, serious deficiencies with the 1-800 system have repeatedly been identified by the GAO. While the IRS has improved its accessibility so far this season, a March, 1996 GAO report placed the IRS telephone accessibility rate at just **20 percent** (GGD-96-99). This change in telephone service marks a major decrease in the level of service for Vermonters, and the majority of tax preparers who have contacted me have been particularly frustrated with the amount of time that they have spent trying to work with the IRS 1-800 system.

Additionally, of particular concern with respect to telephone service is the fact that the IRS is encouraging taxpayers who call for help to "ask their accountant" for service with a taxpayer question. Quite frankly, it appears that the IRS believes that the Burlington District had given out too much customer service in the past and must now reduce that to the level of Boston.

4. Volunteer tax assistance personnel are not receiving the same level of training as in the past, and efforts to recruit new volunteers have diminished. These changes mean that volunteer taxpayer service efforts -- essential to the overall customer service scheme -- are not being supported by the IRS reorganization.

In light of these concerns, I would like to ask the Deputy Commissioner two questions:

1. What is the IRS going to do to increase taxpayer service in the state of Vermont?
2. If, as has been noted, there remains $97 million in the IRS Budget of Fiscal Year 1997, intended for other IRS projects that have been canceled, then why cannot that money be directed to hire additional customer service and compliance personnel in former Districts such as Burlington.

Summaries of Vermont Tax Preparers' Responses to IRS Reorganization

Joseph, C.P.A. from South Burlington, Vt.:
"There is no way to compare this Vermont Service with the long-distance telephone call to Andover Service Center." The change will, "create enmity between honest taxpayers and representatives of the Internal Revenue Service."

Bob, TCE from Arlington, Vt.:
Not bothered if the IRS only cut top managerial positions, but he's worried that the elimination of 12 positions in the Burlington Office will "reduce unreasonably the support Vermonters receive" from the IRS.

Marsha, C.P.A. from Barre, Vt.:
"It's been a nightmare." The Tax Practitioner's Hotline previously operated out of the Burlington Office has been discontinued. Now she has to write Boston, or wait all day on the toll-free line. Either way, she doesn't get timely responses. She and her clients have called up to four different numbers in the Boston office in a single day, only to receive four different recorded lines. She's afraid that there will be a reduction in voluntary compliance if the IRS does not provide decent customer service. In this sense, she believes that the IRS is cutting off its nose to spite its face.

Joan, VITA Program in Bennington, Vt.:
She is concerned that the further downsizing will affect their ability to serve low income Vermonters. They are already overwhelmed.

David, a C.P.A. from Middlebury, Vt.:
Several clients have been affected directly, he believes that it's due to the change in decision-making jurisdiction. He has seen a particular change in resolving matters related to amended or corrected returns -- this used to be a straightforward procedure handled out of Burlington -- now he has to wait for weeks or more to get a reply Boston. He believes that the reorganization will be a serious loss to Vermont.

Maureen, EA from Winooski, Vt.:
She is very "disappointed to learn that the Priority Case Processing Unit was transferred out of Burlington [since it]...had been very helpful many times in resolving problems." She also reports that she has experienced "considerable delay in a recent audit," which she attributes to the cutback in staff.

Raymond, C.P.A. from Williston, Vt.:
Reports that he has already had problems in Burlington due to the realignment of staff. Apparently, it can take up to an hour for walk-ins to be attended to, even if the visit is just to pick up forms. During a recent visit, Raymond's secretary reported that there were only two people attending to the public: one doing electronic filing and the other attending the walk-in window.

Paul, a C.P.A. from St. Albans, Vt.:
Has already noted increased difficulty in reaching IRS staff who are able to dispense forms and general information. He has also experienced an increase in calls from non-clients who have contacted his firm for advice because they are having difficulty getting through to the IRS. He writes that, "it is obvious that the reorganization has made it more difficult for the general population to deal with the IRS locally."

Beverly, TCE Volunteer in Danville, Vt.:
She has noticed a change already in the coordination of the TCE and VITA programs in her area. For the first time in ten years as a TCE volunteer, the IRS didn't provide official IRS instructors - the trainers were volunteers themselves, and although they were good, they did not know the answers to all of the questions. Also, there were no VITA volunteers this year, which she believes may be due to lack of outreach efforts to recruit them.

Joseph, CPA from Essex Junction, Vt.:
Reports that he has been told that she had to contact Boston instead of Burlington, but she can never get through. The Practitioner's Hotline, which was always staffed by human beings in Burlington, is now always busy in Boston, and when you do get through, there's a recorded message. The 1-800 is so busy that it is "useless."

George, CPA from Burlington, Vt.:
The PRO in Burlington has been great in resolving issues in the past. Now the simplest matters -- such as erroneous notices -- are difficult to resolve.

Annette, CPA from Bellows Falls, Vt.:
Reports that the Burlington Office has been "vital in resolving clients' tax problems quickly and efficiently." She laments that about the "busy signals at the Service Centers, and the long waits for an information reply through the mail are exasperating."

Donald, EA, from Newport, Vt.:
Reports that after being told that the Tax Practitioner's Hotline at the Burlington Office had been terminated, he was directed to a 1-800 Hotline in Boston. "What a contrast! And what an inefficient use of my time and energy to deal with the maze of touch tone options and holding period. This is especially disconcerting for those of us who rely on the IRS for problem solving of complex tax situations."

Richard, RPA from Winooski, Vt.:
His experience is that taxpayers' problems that are referred to taxpayers' assistance, collection, or the PRO in Burlington were handled within days, or at most, within a week. He has experienced long delays in receiving the same attention from other offices, especially from the Service Centers. "The general public, in my opinion, has lost confidence in our tax system and it is being reflected in a decrease of voluntary compliance." He has had to contact Buffalo and Boston instead of Burlington to resolve taxpayers' issues, which has added time and expense (which they have to pass on to their clients -- the taxpayers). He reports that the PRO in Burlington had been essential in resolving problems in a timely manner. He also worries

that the increased hassle of communicating with the IRS will lead to increased compliance problems.

Rod, a C.P.A.:
Service has declined recently, especially for Vermont cases pending in Boston. He has had one that has been pending in Boston for a couple of months, with absolutely no action or notification.

Joseph, CPA from Brattleboro, Vt.:
"There is one major change that I have already noticed and that is attitude when dealing with the Internal Revenue Service.... Our office has always had a professional and business relationship with the Internal Revenue Service in the State of Vermont...Both the Internal Revenue Service and the taxpayers of Vermont have benefitted [from this relationship]."

Schuyler, CPA from St. Johnsbury, Vt.:
"Because dealing with the Andover processing center is such a nightmare, we depended upon the Burlington...office...to resolve problems."

Ray, an agricultural consultant from Brattleboro, Vt.:
Believes that the reorganization is a "great disservice to Vermont Taxpayers." He has already seen a real reduction in the service that he has received from the Burlington Office, which had always provided him with excellent responses. He believes that this is a product the reduction of taxpayer assistance staff at the office.

William, CPA from Bennington, Vt.:
"Whereas the Burlington District was wonderful, now it is very difficult to access the Tax Practitioners' Assistance Hotline in Boston."

Testimony of the Honorable James A. Traficant, Jr.

Before the Subcommittee on Government Management,

Information and Technology

Oversight Hearing on Internal Revenue Service Mismanagement

April 14, 1997

Mr. Chairman, I would like to take this opportunity to thank you and the committee for allowing me to submit testimony. I think this committee's work will go a long way toward restoring the American public's trust in the federal government.

Mr. Chairman, as we all know, tomorrow is April 15th, the day all Americans must remit a large portion of their hard earned income to the federal government. It's a date that carries with it negative connotations because of the Internal Revenue Service and the fear those three words strike in every American's heart.

Taxpayer confidence is at an all-time low. In each of the last five years, the General Accounting Office has released what have become annual reports criticizing the IRS for its shoddy record keeping, inability to record receipts to the general fund and the Social Security Trust Fund, frequently giving out incorrect tax filing advice and spending over $4 billion on a computer system that doesn't work.

It's critical that the Congress fix the mess at the IRS because the IRS effects every single American. No other government agency comes close. Only the IRS requires every American to file an annual report with the federal government. To most people, the IRS *is* the federal government. That's why it's so important that Congress fix the IRS.

To start, Congress needs to simplify the tax code so that it doesn't take an attorney and a CPA to complete a 1040 form. How can Americans trust the tax law when they're never sure if they paid their fair share? Take two hypothetical neighbors, Mr. Smith and Mr. Jones, with identical families, homes, and incomes. Mr. Smith hires a smart CPA to do his taxes while Mr. and Mrs. Jones spend a few hours doing their taxes on the kitchen table late one night. We know that Mr. Smith paid less in taxes because his CPA was able to manipulate the tax code to his favor. Until the tax code treats everyone fairly, we can expect to see a continuation of the anti-government sentiment that pervades this country.

Another problem with a complex tax code is that increases the chances that an innocent error will come back to a taxpayer. My office receives thousands of letters a year from people who have made honest mistakes. They're not tax cheats or criminals. But the IRS treats them as if they were pushing heroin in a school yard. They get hit with penalties and interest and soon they owe thousands of dollars on a simple mistake.

For the past 12 years, I have been fighting to rein in the IRS and restore some basic rights to American taxpayers. Congress has enacted into law some important changes in the way IRS agents operate, including my idea to establish a special training program to teach IRS agents how to respect taxpayer rights. Last year Congress enacted into law the "Taxpayer Bill of Rights II" which included several measures I championed for years. One was increasing the penalty for IRS agent misconduct from $100,000 to $1 million. This committee has taken important steps forward in protecting and enhancing taxpayer rights, and in changing the culture at the IRS. But much more needs to be done.

In January, I reintroduced legislation, H.R. 367, to shift the burden of proof in a

civil tax case from the taxpayer to the IRS. My bill:

* Clarifies that in the administrative process leading up to a civil trial, the burden of proof remains with a taxpayer. However, once a civil tax case goes to court, the bill requires that the burden of proof be on the IRS.

* Requires a 30-day notice and judicial consent before the IRS can seize property.

* Directs the General Accounting Office to conduct a one-year study of possible ways to offset projected revenue losses caused by shifting the burden of proof.

The bill is simple. It ensures that the sacred American principle of "innocent until proven guilty" is extended to every hard-working, honest taxpayer. Most Americans don't have the financial means or the fortitude to fight IRS accusations in a court battle. When the IRS points its finger at you, it does not have to provide evidence substantiating the charges. The IRS does not have to prove the taxpayer's guilt, the taxpayer has to prove his or her innocence. My bill will correct this injustice.

All too often, the IRS terrorizes and threatens taxpayers. Too many lives have been ruined unjustly, and it's time to rein in the IRS and ensure that it respects the rights of every taxpayer. The IRS should not be above the law. It should be required to play by the same rules as any other government entity. That's what my bill is all about.

By separating the administrative process from the actual court process, H.R. 367 addresses concerns that have been raised by some members of the committee. Namely, that

my original bill would handcuff the IRS and aid so-called "tax protesters". The independent study provision is intended to address concerns others have raised over the loss in federal revenue that could result if the burden of proof requirements were changed.

In the last Congress, I described at length on the House floor the cases of average American families whose lives were ruined without cause by the IRS. I received thousands of letters from all over the country from people who told me their IRS horror stories. H.R. 367 will protect your constituents from being unjustly bankrupted or ruined by the IRS.

Recently, I read a story about an agent who saw a Rolls Royce parked at a restaurant where he was eating lunch. He jotted down the license plate, tracked down the owner of the vehicle, and levied their accounts for tax evasion. Since when did the ownership of a luxury car because a suspicious criminal activity? The IRS must reign in it's overzealous and intrusive agents.

I find it interesting, to say the least, that some would complain that shifting the burden of proof to the IRS would be too costly. Since when do we put a price tag on basic rights? If some bureaucrat had analyzed the Constitution and determined how much things like jury trials would cost, would we have a democracy today? Democracy and justice do not come cheap. But they are dear. The basic tenet of American justice, innocent until proven guilty, should apply to all Americans -- especially those who face the overwhelming and intimidating resources of the IRS.

Earlier this year, I also introduced H.R. 853 to require the GAO to study the effects of a modest flat tax coupled with an national sales tax. Proponents of the flat tax, and there

are many, argue that a flat tax would be more fair to Americans than a progressive income tax. Meanwhile, the proponents of the consumption tax tout the elimination of the Internal Revenue Service as a chief benefit. All Americans agree that a simplified tax code would eliminate loopholes and complex deductions only a tax attorney and CPA understand.

Since coming to Congress, I have supported the idea of a simplified tax system. There's no question in my mind that more Americans would pay their taxes if they understood what they owed and they didn't feel they were missing out on some obscure break they overlooked. If you honestly felt that you were paying your fair share, you would have more confidence in the system. Imagine the savings to Americans in tax preparation, not to mention money spent on antacid.

In my view, the best way to simplify the tax system, reduce the intrusiveness of the IRS and maintain current levels of revenues is the establishment of a low flat income tax on individuals and businesses, coupled with a modest national sales tax. This plan would incentivize savings, reduce interests rates, drive new business, and generate more economic activity while still maintaining our present level of revenues.

My bill calls for the Comptroller of the General Accounting Office to study the effects of the flat tax/consumption tax idea, including possible deductions for interest on a home mortgage, college tuition, and a per child deduction. My bill won't change the tax code, only require a study of the effects of a change. I am so confident in this plan that I think after the GAO study is complete, the advantages will become apparent.

I also believe that should Congress adopt my flat tax/consumption tax plan, it should be

coupled with legislation mandating that any tax increase be approved by a two-thirds vote of the House and Senate. Such a provision would make it difficult for Congress to raise the flat tax and the sales tax once they are in place.

It is my understanding that the Ways and Means Committee will bring a bill to the floor tomorrow to punish IRS agents who snoop into tax files. It was revealed last year that IRS agents were looking into the files of neighbors, relatives, ex-spouses, and celebrities. I am happy to see this criminal behavior penalized. It's an important step in the right direction.

I would like to outline several solutions for ending the current Internal Revenue Service nightmare.

Margaret Millner Richardson, the current commissioner of the IRS, has stated she will step down at the end of this tax filing season. Historically, this position has been filled with a tax attorney. It's imperative that the Clinton Administration appoint a new Commissioner with managerial experience.

The IRS must be made independent of the Treasury Department and the Administration to remove any question of politically motivated tax audits against conservative organizations. It is well known that former President Richard Nixon attempted to use the IRS to go after his enemies. This should never be allowed to happen again.

The IRS has to make sure that all information disseminated by its agents and telephone operators is correct. Take the case of Southern University in Louisiana. They

received a notice from the IRS directing them to changed the scheduling of their payroll tax deposits. They did so and now they face a fine of $124,736.02. It turns out the circular didn't apply to them and while the IRS admitted it was wrong they won't relinquish the penalty charge.

The phone and computer systems at the IRS must be upgraded to 21st century standards. Phone calls to the IRS must be answered by courteous and helpful agents. The present computer system mess must be fixed so that when a taxpayer calls, they don't have to be routed across the country to have a simple question answered. The number one complaint I hear regarding the IRS is not being able to talk to a human being. Number two is not being able to reach that same person on a follow-up call.

Last month, an agent called my office anonymously to tell me that agents prefer the old computer system to the new one because it's easier to use. So far, Congress has appropriated over $4 billion on a computer system that doesn't work and no one likes. This is an outrage. Stories like these do nothing for the American peoples faith in the government.

Mr. Chairman, you could say that the IRS has an impossible job: collecting the taxes and doing it in a professional and courteous manner. No doubt some people will cheat the system. But the current IRS mentality seems to treat everyone like they are criminals. One of the top priorities of the IRS should be teaching, on a constant basis, their employees to treat all taxpayers wit respect and courtesy. Most tax cases are simple misunderstandings by taxpayers who don't understand the complexity of the tax law. Most are civil penalties that can be taken care of administratively. So why do so many agents treat American taxpayers

like lowly criminals? Why do I keep getting phone calls and letters, hundreds a week, from taxpayers who describe the rude and harassing manners of agents? It's a sad day for our democracy when Americans are afraid of their own government. As I noted earlier in my statement, for many Americans the IRS is the only federal agency they ever deal with. Is it any wonder confidence in the federal government is so low?

Two cases come to mind that vividly illustrate what's wrong at the IRS.

In 1995, Montana Air Force captain William Pell Thompson had his refund seized because of a mistake by a North Carolina county office seeking a deadbeat dad named William P. Thompson. Captain Thompson once spent less than a day in North Carolina on a tour of Air Force bases. The Thompsons were in the process of trying to buy a house and any lien would negate their chances at obtaining a mortgage. In all the confusion of trying to clear their name and records, Mrs. Thompson was brought to tears by an IRS agent that suggested her husband was leading a double life.

The popular Virginia Beach restaurant *The Jewish Mother* was closed down when the IRS swooped in with rifles and drug-sniffing dogs to remove truckloads of evidence including the computers and cash registers. Five months later all their belongings were returned. It turned out their informant was lying and no criminal charges were filed. Owners of *The Jewish Mother* never received an apology.

I also see many areas where small changes could go a long way toward restoring the faith in the federal government. First of all, the IRS needs to stop using the word "voluntary" to describe our tax compliance system. Too many people believe it means if

you don't have to pay if you don't feel like it. A voluntary tax compliance system signifies the method a taxpayer uses to settle his obligation. In an involuntary system, the government remands the money by force on any given day. Our "voluntary" system requires the taxpayer to submit the information on April 15th.

I am also deeply disturbed by accounts in the newspaper about taxpayers afraid to claim the home office deduction because it sends a red flag to the IRS and triggers an audit. This is wrong and it defeats the purpose of the deduction. When taxpayers are afraid to take advantage of deductions, Congress needs to understand that undermines the intent of the deduction.

The IRS also needs to change the computer system that generates delinquency notes to taxpayers. If you have ever seen one of these you know they can be very intimidating. The IRS needs to change to a more readable print with a less condescending tone.

The IRS does respond to criticism and pressure from Congress. In 1996, after Congress and the American public objected, the IRS cancelled it's plans to enact random economic reality or "lifestyle" audits. These super audits were designed to get into the minds of the criminal elements who cheat on their taxes. In reality, these audits were intrusive and unnecessary. Taxpayers would have been asked what kind of food they eat, what kind of restaurants they eat at, where do they go on vacation, how much did they spend on their daughters wedding. Call me crazy, but wouldn't it be easier to question tax cheats in jail and not law-abiding taxpayers? I raise this last point to inspire Congress to

Mr. HORN. Now we will swear in the panel witnesses, Lynda D. Willis, Director of Tax Policy and Administration, General Government Division, U.S. General Accounting Office. She is accompanied by Rona B. Stillman, the Chief Scientist for Computers and Telecommunications, U.S. General Accounting Office.

[Witnesses sworn.]

Mr. HORN. Both witnesses have affirmed, the clerk will note.

Please proceed, Ms. Willis. As you know, the routine is we would like you to summarize your statement. We all have the statement, and had it in advance, but this is an important subject. If you go over 10 minutes in summary, I am not going to be offended, because I would like you to get out your key points on the record.

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

Ms. WILLIS. Thank you, Mr. Chairman. We will submit our written statement for the record.

We are very pleased to be here today to testify before this subcommittee on GAO's high-risk work. A key factor in understanding IRS' ongoing difficulties in the high-risk areas is the realization that its major processes and systems were developed and implemented decades ago and were not designed to address the critical needs and vulnerabilities that confront IRS in the 1990's.

In addition, the problems IRS faces in eliminating its high-risk vulnerabilities are compounded by their interdependencies. IRS' success in addressing the weaknesses in its program areas is clearly linked to the successful modernization of its systems. However, this understanding does not mitigate our concern over IRS' progress in developing a comprehensive strategy or detailed business plan for modernizing its outdated processes and systems.

For years, we have chronicled IRS' struggle to manage its operations and have made scores of recommendations to improve IRS systems, processes, and procedures. In order to achieve its stated goals of reducing the volume of paper tax returns, providing better customer service, and improving compliance with the Nation's tax laws, IRS needs to develop a comprehensive business strategy to ensure that new and revised business processes drives systems development and acquisition.

Solving the problems in the high-risk areas is not an insurmountable task, but it requires sustained management commitment, accurate information systems, and reliable performance measures to track IRS' progress and provide the data necessary to make informed management and oversight decisions. There are four long-standing high-risk areas at IRS: tax systems modernization, financial management, accounts receivable, and filing fraud. In addition, two of the new governmentwide high-risk areas also directly affect IRS' operations: information security and the year 2000 problem or century date change.

Turning to each of these, I would like to briefly discuss the progress IRS has made and the measures IRS must take to resolve the issues.

In July 1995, we reported that IRS, one, did not have a comprehensive business strategy to cost effectively reduce paper tax return filings; two, had not yet fully developed and put in place the requisite management, software development, and technical infrastructure necessary to successfully implement its ambitious world-class modernization; and, three, lacked an overall systems architecture, or blueprint, to guide the modernization development and evolution. At that time, we made over a dozen recommendations to the IRS Commissioner to address these weaknesses.

In 1996, we reported that IRS had initiated many activities to improve its modernization efforts, but had not yet fully implemented any of our recommendations.

Since then, IRS has taken additional steps. For example, a new Chief Information Officer has been hired, as well as additional technical expertise. IRS also created an investment review board that has re-evaluated and terminated several modernization development projects that were found to be not cost effective. IRS has also updated its systems development life-cycle methodology, and is developing a systems architecture and project sequencing plan for the modernization.

While we recognize IRS' actions, we remain concerned because much remains to be done to fully implement essential improvements. It will take both management commitment and technical discipline for IRS to accomplish these tasks.

Furthermore, despite persisting weaknesses in both software development and acquisition capabilities, IRS continues to request hundreds of millions of dollars for systems modernization efforts. In its fiscal year 1998 budget request, IRS and the administration are seeking $131 million for systems development initiatives, and $500 million in each of the next two fiscal years for yet to be specified modernization efforts. However, the requests do not include credible justifications for the spending and are not based on analytical data or derived using formal cost estimating techniques. Accordingly, we believe that Congress should consider not funding either request.

Turning to financial management, our audits of IRS' financial statements have outlined the substantial improvements needed in IRS' accounting and reporting in order to fully comply with the requirements of the CFO Act. The audits for fiscal years 1992 to 1995 have described IRS' difficulties in, one, properly accounting for its tax revenues, in total and by reported type of tax; two, reliably determining the amount of accounts receivable owed for unpaid taxes; three, regularly reconciling its fund balance with Treasury accounts; and, four, either routinely providing support for the receipt of goods and services it purchases, or, where supported, accurately recording the purchased item in the proper period.

IRS has made progress in addressing problems in these areas and has developed an action plan, with specific timetables and deliverables, to address the issues our financial statement audits have identified.

IRS has been working to position itself to have more reliable financial statements for fiscal year 1997 and thereafter. To accomplish this, especially in accounting for revenue and related accounts receivable, IRS will need to institute long-term solutions involving reprogramming software for its antiquated systems and developing new systems as required.

Follow-through is essential to complete corrective measures if IRS is to solve its financial management problems. IRS' ability to effectively address its accounts receivable problems is seriously hampered by its outdated equipment and processes, incomplete information needed to better target collection efforts, and the absence of a comprehensive strategy and detailed plan to address the systemic nature of the underlying problems.

IRS' collection efforts have also been hampered by the age of the delinquent tax accounts. In the past 2 years, IRS has undertaken several initiatives to overcome its deficiencies. Specifically, it has efforts under way to correct errors in its master file records of tax receivables, develop profiles of delinquent taxpayers, and study the effectiveness of various collection techniques. It has also streamlined its collection process, placed additional emphasis on contacting repeat delinquents, made its collection notices more readable, and targeted compliance-generated delinquencies for earlier intervention.

In part due to these efforts, IRS reported collecting more in delinquent taxes in fiscal year 1996 than it ever has, almost $30 billion. Despite these positive results, IRS needs to continue the development of information data bases and performance measures to afford its managers the data needed to determine which action or improvements generate the desired changes in IRS' programs and operations.

Mr. Chairman, this is not a short-term commitment. It will take some time before the full results of the new initiatives are realized. IRS must take deliberate action to ensure that its problem-solving efforts are on the right track. It needs to implement a comprehensive strategy that involves all aspects of IRS' operations and that sets priorities, accelerates the modernization of outdated equipment and processes, and establishes realistic goals, specific timetables, and a system to measure progress.

Turning to filing fraud, when we first identified filing fraud as a high-risk area in 1995, the amount of filing fraud being detected by IRS was on an upward spiral. Since then, IRS has introduced new controls and expanded existing controls in an attempt to reduce its exposure. These controls are directed toward either preventing the filing of fraudulent returns or identifying questionable returns after they have been filed.

IRS' efforts have produced some positive results. For example, IRS' efforts to validate Social Security numbers on paper returns produced over $800 million in reduced refunds or additional taxes.

IRS was less successful in identifying fraudulent returns, identifying over 65 percent fewer fraudulent returns in 1996 than during a comparable period in 1995. IRS believes this decrease is attributable to a 31 percent reduction in its fraud detection staff and the resulting underutilization of its electronic fraud detection system, which enhances the identification of fraudulent returns. However,

IRS does not have the information it needs to verify that the decline was the result of staff reductions or by a general decline in the incidence of fraud. Given the decrease in the fraud detection staff, it is critically important for the IRS to optimize the electronic controls that are intended to prevent the filing of fraudulent returns and maximize the effectiveness of available staff. Modernization is key to achieving both of these objectives.

Turning now to the two new governmentwide, high-risk areas, IRS is vulnerable to problems in both. Related to information security, as the result of our work at IRS, we believe that the vulnerabilities of IRS' computer systems may affect the confidentiality and accuracy of taxpayer data and may allow unauthorized access, modification, or destruction of taxpayer information.

IRS does not have a pro-active, independent information security group, that systematically reviews the adequacy and consistency of security over IRS' computer operations. In addition, computer security management has not completed a formal risk assessment of its systems to determine system sensitivity and vulnerability. As a result, IRS cannot effectively prevent or detect unauthorized browsing of taxpayer information by its employees and cannot ensure that taxpayer data is not being improperly manipulated for personal gain. IRS needs to address its information security weaknesses on a continuing basis, impressing upon its senior managers the need to conduct regular, systematic security reviews.

The year 2000 problem at IRS is such that it could create a disruption of functions and services that could jeopardize all of IRS' tax processing systems. It could effectively halt the processing of tax returns and return-related information, the maintenance of taxpayer accounts, the assessment and collection of taxes, the recording of obligations and expenditures, and the disbursement of funds.

To avoid the crippling effects of a multitude of computer systems simultaneously producing inaccurate and unreliable information, IRS must assign management and oversight responsibility within its senior executive corps to define the potential impact of such systems failure and develop appropriate renovation strategies and contingency plans for its critical systems.

Mr. Chairman, IRS and Congress face many challenges in moving the Nation's tax system into the next millennium. The funding limits and program tradeoffs faced by IRS in fiscal year 1997, and anticipated for fiscal year 1998, are likely to continue for the foreseeable future. The administration's out year projections actually reflect a decline in IRS funding when inflation is considered. At the same time, IRS is faced with competing demands and pressures from external stakeholders, including Congress, to improve its operations and resolve long-standing concerns.

In recent years, Congress, including a big role played by this committee, has put in place a statutory framework for helping Congress and the executive branch make the difficult tradeoffs that the current budget environment demands. This framework includes the Chief Financial Officers Act, the Clinger-Cohen Act, and GPRA.

GPRA requires each agency to develop a strategic plan that lays out its mission, long-term goals and strategies for achieving those goals. GPRA requires agencies to consult with Congress, as you

noted, as they develop their strategic plans. For IRS, these consultations provide an important opportunity for Congress, IRS and the Treasury to work together to ensure that IRS' mission is focused, goals are specific and results oriented, and its strategies and funding expectations are appropriate and reasonable.

The consultations may prove difficult as they are likely to underscore the competing and conflicting goals of IRS programs, as well as the sometimes different expectations of the numerous parties involved.

In summary, Mr. Chairman, for years IRS has struggled to collect the Nation's tax revenues, using outdated processes and technology. To address these high-risk problem areas, IRS needs an implementation strategy for modernizing its systems that includes developing cost-benefit analyses and reasonable estimates of the timeframes and resources required. Above all, IRS management needs to sustain an agency-wide commitment to solving the agency's high-risk problems.

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

Mr. HORN. Well, I thank you for that excellent statement and the really fine work that your staff has done over the years. It certainly is reflected in your statement, which is put in the record the minute we introduce you.

[The prepared statement of Ms. Willis follows:]

Statement of Lynda D. Willis, Director, Tax Policy and Administration Issues, General Government Division

Mr. Chairman and Members of the Subcommittee:

We are pleased to be here today to assist the Subcommittee in its review of the Internal Revenue Service's (IRS) efforts to improve the management and operation of its high-risk areas. A key factor in understanding IRS' ongoing difficulties in the high-risk areas is the realization that its major processes and systems were developed and implemented decades ago and were not designed to address the critical needs and vulnerabilities that confront IRS in the 1990s. In addition, the problems IRS faces in attempting to eliminate its high-risk vulnerabilities are compounded by the interdependency of the high-risk areas. For example, IRS' success in addressing the weaknesses in its program areas is clearly linked to its success in modernizing its business processes and information systems. However, without a comprehensive strategy or detailed business plan to guide its modernization efforts, IRS cannot hope to successfully modernize its outdated processes and systems or to, ultimately, resolve the problems in its high-risk areas.

OVERVIEW

In February 1997, we issued our third series of reports on the status of high-risk areas across the government.[1] One report in the series discussed the four long-standing high-risk areas at IRS: tax systems modernization, financial management, accounts

[1]GAO/HR-97-20SET.

receivable, and filing fraud.[2] Another report in the series designated five new high-risk areas, two of which have governmentwide implications and directly affect IRS' operations: information security and the computer-related year 2000 problem.[3]

Today, we will briefly discuss the problems IRS faces in these six high-risk areas, the progress IRS has made recently in addressing these problems, and the measures IRS must take to resolve the problems in its high-risk areas. This testimony is based on our prior reports, which are listed in Appendix I, and recent information obtained from IRS.

IRS' HIGH-RISK AREAS

For years we have chronicled IRS' struggle to modernize and manage its operations, especially in the high-risk areas, and have made scores of recommendations to improve IRS' systems, processes, and procedures. It is clear that in order to achieve its business vision of reducing the volume of paper tax returns, providing better customer service, and improving compliance with the nation's tax laws, IRS must successfully modernize its systems and operations. To accomplish this modernization, however, IRS needs to develop comprehensive business strategies to ensure that its new and revised processes drive systems development and acquisition.

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[2] IRS Management (GAO/HR-97-8, Feb. 1997).

[3] Information Management and Technology (GAO/HR-97-9, Feb. 1997).

Solving the problems in the high-risk areas is not an insurmountable task, but it requires sustained management commitment, accurate information systems, and reliable performance measures to track IRS' progress and provide the data necessary to make informed management decisions.

Tax Systems Modernization

Over the last decade, IRS has been attempting to overhaul its timeworn, paper-intensive approach to tax return processing. At stake is the over $3 billion that IRS has spent or obligated on this modernization since 1986, as well as any additional funds that IRS plans to spend on the modernization.

In July 1995, we reported that IRS (1) did not have a comprehensive business strategy to cost effectively reduce paper tax return filings; (2) had not yet fully developed and put in place the requisite management, software development, and technical infrastructure necessary to successfully implement its ambitious, world-class modernization; and (3) lacked an overall systems architecture, or blueprint, to guide the modernization's development and evolution.[4] At that time, we made over a dozen recommendations to the IRS Commissioner to address these weaknesses.

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

Pursuant to subsequent congressional direction, we assessed IRS' actions to correct its management and technical weaknesses. We reported in June and September 1996 that IRS had initiated many activities to improve its modernization efforts but had not yet fully implemented any of our recommendations.[5] We also suggested to Congress that it consider limiting modernization funding exclusively to cost-effective efforts that (1) support ongoing operations and maintenance; (2) correct IRS' pervasive management and technical weaknesses; (3) are small, represent low technical risk, and can be delivered quickly; and (4) involve deploying already developed and fully tested systems that have proven business value and are not premature given the lack of a completed systems architecture.

IRS has taken steps to address our recommendations and respond to congressional direction. For example, IRS hired a new Chief Information Officer. It also created an investment review board to select, control, and evaluate its information technology investments. Thus far, the board has reevaluated and terminated several major modernization development projects that were not found to be cost-effective. In addition, IRS has developed a plan for shifting modernization development and deployment to outside contractors. IRS reports that the percentage of contractor

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[5]Tax Systems Modernization: Actions Underway But IRS Has Not Yet Corrected Management and Technical Weaknesses (GAO/AIMD-96-106, June 7, 1996); and Tax Systems Modernization: Actions Underway But Management and Technical Weaknesses Not Yet Corrected (GAO/T-AIMD-95-165, Sept. 10, 1996).

employees, as opposed to IRS employees, working on tax systems modernization has increased from 40 to 64 percent over the last 2 years.

IRS is also finalizing a comprehensive strategy to maximize electronic. It is also updating its system development life-cycle methodology and is working across various IRS organizations to define disciplined processes for software requirements management, quality assurance, configuration management, and project planning and tracking. Additionally, IRS is developing a systems architecture and project sequencing plan for the modernization and intends to provide this to Congress by May 15, 1997.

Although we recognize IRS' actions, we remain concerned because much remains to be done to fully implement essential improvements. Increasing the use of contractors, for example, will not automatically increase the likelihood of successful modernization because IRS does not have the technical capability needed to manage all of its current contractors. To successfully implement the essential improvements, IRS must also continue to make a concerted, sustained effort to fully implement our recommendations and respond effectively to the requirements outlined by Congress. It will take both management commitment and technical discipline for IRS to accomplish these tasks.

Furthermore, despite persisting weaknesses in both software development and acquisition capabilities, IRS continues to request hundreds of millions of dollars for systems modernization efforts. Specifically, in its fiscal year 1998 budget request, IRS is seeking $131 million for system development initiatives. However, the request does not include a credible, verifiable justification and states that IRS does not know how it plans to spend these funds because its modernization architecture and deployment plan have not yet been completed. In addition, the Administration is proposing to establish an Information Technology Investments Account to fund future modernization investments at IRS. It is seeking $500 million in each of the next two fiscal years ($1 billion in total) for "yet-to-be-specified" modernization efforts. This request is also not based on analytical data or derived using formal cost estimating techniques. Accordingly, Congress should consider not funding either the $131 million request for system development or the $1 billion capital account until the management and technical weaknesses in IRS' modernization program are resolved and justifications completed.

Financial Management

Our audits of IRS' financial statements have outlined the substantial improvements needed in IRS' accounting and reporting in order for IRS to comply fully with the requirements of the Chief Financial Officers Act of 1990 (CFO Act). The audits for fiscal

years 1992 through 1995 have described IRS' difficulties in (1) properly accounting for its tax revenues, in total and by reported type of tax; (2) reliably determining the amount of accounts receivable owed for unpaid taxes; (3) regularly reconciling its Fund Balance With Treasury accounts; and (4) either routinely providing support for receipt of the goods and services it purchases or, where supported, accurately recording the purchased item in the proper period.

IRS has made progress in addressing problems in these areas and has developed an action plan, with specific timetables and deliverables, to address the issues our financial statement audits have identified. In the administrative accounting area, for example, IRS reported that it has identified substantially all of the reconciling items for its Fund Balance With Treasury accounts, except for certain amounts IRS has deemed not to be cost-beneficial to research further. It also has successfully transferred its payroll processing to the Department of Agriculture's National Finance Center and has begun designing both a short-term and a long-term strategy to fix the problems that contribute to its nonpayroll expenses being unsupported or reported in the wrong period.

In the revenue accounting area, IRS' problems are especially affected and complicated by automated data processing systems that were implemented many years ago and thus not designed to support

the new financial reporting requirements imposed by the CFO Act. Therefore, IRS has designed an interim solution to capture the detailed support for revenue and accounts receivable until longer term solutions can be identified and implemented. Some of the longer term actions include (1) implementing software, hardware, and procedural changes needed to create reliable subsidiary accounts receivable and revenue records that are fully integrated with the general ledger; and (2) implementing software changes that allow the detailed taxes reported to be maintained separately from the results of compliance efforts that would not be valid financial reporting transactions in the masterfile, other related revenue accounting feeder systems, and the general ledger.

Over the past 4 years, we have made numerous recommendations to improve IRS' financial management systems and reporting, and IRS has been working to position itself to have more reliable financial statements for fiscal year 1997 and thereafter. To accomplish this, especially in accounting for revenue and the related accounts receivables, IRS will need to institute long-term solutions involving reprogramming software for IRS' antiquated systems and developing new systems as required.

Follow-through to complete necessary corrective measures is essential if IRS is to ensure that its corrective actions are carried out and effectively solve its financial management problems. Solving these problems is fundamental to providing

reliable financial information and ensuring taxpayers that the government can properly account for their federal tax dollars. The accuracy of IRS' financial statements is vital to both IRS and Congress for (1) ensuring adequate accountability for IRS programs; (2) assessing the impact of tax policies; and (3) measuring IRS' performance and cost effectiveness in carrying out its numerous tax enforcement, customer service, and collection activities.

Accounts Receivable

IRS routinely collects over a trillion dollars annually in taxes, but many taxpayers are unable or unwilling to pay their taxes when due. As a result, IRS estimates that its accounts receivable amounts to tens of billions of dollars. Unfortunately, IRS' ability to effectively address its accounts receivable problems is seriously hampered by its outdated equipment and processes, a lack of the complete information needed to better target collection efforts, and the absence of a comprehensive strategy and detailed plan to address the systemic nature of the underlying problems.

IRS' collection efforts have also been hampered by the age of the delinquent tax accounts. Because of the outdated equipment and processes used to match tax returns and related information documents, it can take IRS several years to identify potential delinquencies and then initiate collection actions. In addition, according to IRS, the 10 year statutory collection period generally

precludes it from writing off uncollectible receivables until that period has expired. As a result, the receivables inventory includes many relatively old accounts that will never be collected because the taxpayers are deceased or the companies defunct.

This is not to say, however, that IRS has not been trying to overcome its deficiencies. In the last 2 years, IRS has undertaken initiatives to correct errors in its masterfile records of tax receivables, develop profiles of delinquent taxpayers, and study the effectiveness of various collection techniques. It has also streamlined its collection process, placed additional emphasis on contacting repeat delinquents, made its collection notices more readable, and targeted compliance-generated delinquencies for earlier intervention.

IRS reported that as a result of taking these actions, its collection employees took in more money in 1996 than they classified as "currently not collectible" and that the amount of money collected immediately following the revision of its collection notices increased by almost 25 percent over a comparable period in 1995. In addition, IRS reported collecting more in delinquent taxes in fiscal year 1996 than it ever has, almost $30 billion.

Despite these positive results, IRS needs to continue the development of information databases and performance measures to

afford its managers the data needed to determine which actions or improvements generate the desired changes in IRS' programs and operations. And, this should not be looked upon as a short-term commitment. It will still take IRS a number of years to identify the root causes of delinquencies and to develop, test, and implement courses of action to deal with the causes. Furthermore, once the analyses and planning are completed, it will still be some time before full results of the new initiatives are realized.

Therefore, IRS must take deliberate action to ensure that its problem-solving efforts are on the right track. Specifically, it needs to implement a comprehensive strategy that involves all aspects of IRS' operations and that sets priorities; accelerates the modernization of outdated equipment and processes; and establishes realistic goals, specific timetables, and a system to measure progress.

Filing Fraud

When we first identified filing fraud as a high-risk area in February 1995, the amount of filing fraud being detected by IRS was on an upward spiral. Since then, IRS has introduced new controls and expanded existing controls in an attempt to reduce its exposure to filing fraud. Those controls are directed toward either (1) preventing the filing of fraudulent returns or (2) identifying questionable returns after they have been filed.

To deter the filing of fraudulent returns, IRS (1) expanded the number of up-front filters in the electronic filing system designed to screen electronic submissions for selected problems in order to prevent returns with those problems from being filed electronically and (2) strengthened the process for checking the suitability of persons applying to participate in the electronic filing program as return preparers or transmitters by requiring fingerprint and credit checks.

To better identify fraudulent returns once they have been filed, IRS placed an increased emphasis in 1995 on validating Social Security Numbers (SSN) on filed paper returns and delayed any related refunds to allow staff time to do those validations and to check for possible fraud. IRS also revised the computerized formulas it used to score all tax returns on their fraud potential and upgraded the research capabilities of its fraud detection staff.

IRS' efforts produced some positive results. For example, the number of SSN problems identified by the electronic filing filters quadrupled between 1994 and 1995, and about 350 persons who applied to participate in the electronic filing program for 1995 were rejected because they failed the new fingerprint and credit checks. IRS' efforts to validate SSNs on paper returns produced over $800 million in reduced refunds or additional taxes. Unfortunately, IRS

identified many more SSN problems than it was able to deal with and released about 2 million refunds without resolving the problems.

IRS identified over 65 percent fewer fraudulent returns in 1996 than during a comparable period in 1995. IRS believes this decrease is attributable to a 31-percent reduction in its fraud detection staff and the resulting underutilization of its Electronic Fraud Detection System, which enhances the identification of fraudulent returns and lessens the probability of improperly deleting accurate refunds. However, IRS does not have the information it needs to (1) verify that the decline was the result of staff reductions or (2) determine the extent to which the downward trend may have been affected by changes in the program's operating and reporting procedures or by a general decline in the incidence of fraud.

Given the decrease in fraud detection staff, it is critically important for IRS to (1) optimize the electronic controls that are intended to prevent the filing of fraudulent returns and (2) maximize the effectiveness of available staff. Modernization is the key to achieving these objectives, and electronic filing is the cornerstone of that modernization. Officials at the Department of the Treasury estimate that 19.2 million Americans will file their returns electronically in 1997, a 63-percent increase over the number who filed electronically in 1995. But even at this rate of increase, IRS will fall far short of its goal to have 80 million

electronically filed returns in 2001. To achieve its goal, IRS must first identify those groups of taxpayers who offer the greatest opportunity to reduce IRS' paper-processing workload and operating costs if they were to file electronically. IRS must then develop strategies that focus its resources on eliminating or lessening impediments that inhibit those groups from participating in the program.

Information Security

Malicious attacks on computer systems are an increasing threat to our national welfare. The federal government now relies heavily on interconnected systems to control critical functions that, if compromised, place billions of dollars worth of assets at risk of loss and vast amounts of sensitive data at risk of unauthorized disclosure. Increasing reliance on networked systems and electronic records has elevated our concerns about the possibility of serious disruption to critical federal operations.

As a result of our recent work at IRS, we believe that the vulnerabilities of IRS' computer systems may affect the confidentiality and accuracy of taxpayer data and may allow unauthorized access, modification, or destruction of taxpayer information by IRS employees.[6] The overriding problem at IRS is

[6] IRS Systems Security: Tax Processing Operations and Data Still at Risk Due to Serious Weaknesses, (GAO/T-AIMD-97-76, Apr. 10, 1997); and IRS Systems Security: Tax Processing Operations and Data Still

that information security issues are addressed on a reactive basis. IRS does not have a proactive, independent information security group that systematically reviews the adequacy and consistency of security over IRS' computer operations. In addition, computer security management has not completed a formal risk assessment of its systems to determine system sensitivity and vulnerability. As a result, IRS cannot effectively prevent or detect unauthorized browsing of taxpayer information by its employees and cannot ensure that taxpayer data is not being improperly manipulated for personal gain.

IRS needs to address its information security weaknesses on a continuing basis. More specifically, IRS needs to impress upon its senior managers the need to conduct regular systematic security reviews and risk assessments of IRS' computer systems and operations. The weaknesses identified by these reviews and assessments then need to be corrected expeditiously by personnel who have the technical expertise to effectively implement, manage, and monitor the necessary security controls and measures.

The Year 2000 Problem

For the past several decades, computer systems have used two digits to represent the year, such as "97" for 1997, in order to conserve electronic data storage and reduce operating costs. In this

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at Risk Due to Serious Weaknesses, (GAO/AIMD-97-49, Apr. 8, 1997).

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format, however, the year 2000 is indistinguishable from the year 1900 because both are represented as "00." As a result, if not modified, computer systems and applications that use dates or perform date- or time-sensitive calculations may generate incorrect results beyond 1999.

For IRS, such a disruption of functions and services could jeopardize all of its tax processing systems and administration and could result in millions of erroneous tax notices, refunds, and bills. It could effectively halt the processing of tax return and return-related information, the maintenance of taxpayer account information, the assessment and collection of taxes, the recording of obligations and expenditures, and the disbursement of refunds. At the very least, IRS' core business functions and mission-critical processes are at risk of failure, as are numerous other administrative and management processes.

To avoid the crippling effects of a multitude of computer systems simultaneously producing inaccurate and unreliable information, IRS' Chief Information Officer has established a year 2000 project office with responsibility for assessing, converting, and testing IRS' computer systems. The project office is analyzing the potential impact of such a systems failure and is developing appropriate renovation strategies and contingency plans for its critical systems. However, at this point most of the project office's efforts are being directed at IRS' large, mainframe

computer systems while greater numbers of personal and portable computers are being largely ignored. Modifying IRS' critical computer systems, converting and testing software applications, and acquiring additional hardware for expected capacity increases are massive undertakings whose success or failure will, in large part, be determined by the quality of IRS' executive leadership and program management.

A COMPREHENSIVE IMPLEMENTATION STRATEGY

IRS cannot hope to resolve the problems in its high-risk areas without a detailed business plan and a comprehensive implementation strategy. For example, a principal goal of IRS' business vision is to reduce the number of paper tax returns it must process by significantly increasing, by 2001, the number of electronically filed tax returns. Our analysis of recent filing trends indicates that IRS will fall far short of its goal because its electronic filing strategy has targeted a limited portion of the taxpaying population--those who use a third party to prepare and/or transmit simple returns, are willing to pay a fee to file their returns electronically, and are expecting refunds. Taxpayers who prepare their own tax returns using personal computers, have more complicated returns, and/or owe tax balances have been largely overlooked. IRS needs to better target its efforts on reducing the cost to taxpayers of filing electronically and on eliminating the impediments that discourage electronic filing by those taxpayers

who offer the greatest opportunity to reduce IRS' paper processing workload and processing costs.

In addition, IRS' efforts to improve customer service and increase taxpayer compliance depend in large measure on increasing the use of its information systems. Not only do customer representatives need easy access to the information necessary to answer taxpayers' questions, but enforcement staff also need timely access to reliable information to do their jobs. However, IRS has not identified all the data elements that customer service and enforcement staff need, nor has it fully defined the business requirements for the systems that will provide this timely access to greater amounts of on-line taxpayer data. It also does not have a cost-effective strategy for accessing the needed data.

SUMMARY OUTLOOK

For years, IRS has struggled to collect the nation's tax revenue using outdated processes and technology. The result has often been inefficient and ineffective programs and operations that are vulnerable to waste, fraud, abuse, and mismanagement. Of particular concern to us have been IRS' efforts to modernize its tax systems, manage its administrative and revenue accounting systems, identify and collect taxes owed the government, detect and prevent the filing of fraudulent tax returns, protect the

confidentiality of taxpayer information, and prevent the future disruption of tax services due to the year 2000 computer problem.

In recent years, Congress has put into place a statutory framework that can assist IRS in resolving the operational and technological problems it faces. This framework includes the Chief Financial Officers Act of 1990, the Government Performance and Results Act of 1993 (GPRA), and the Clinger-Cohen Act of 1996. These acts require congressional and executive branch decisionmakers to (1) clearly articulate their agencies' missions and the results-oriented performance goals that measure their success in carrying their missions; (2) establish a detailed business plan or comprehensive implementation strategy to meet their performance goals; and (3) develop and use accurate, reliable, and timely program performance and cost data to evaluate their progress in achieving their performance goals.

In addition, GPRA requires each agency to consult with Congress and to consider Congress' views and the views of other stakeholders when developing its strategic plan. For IRS, these consultations provide an important opportunity for Congress, IRS, and the Department of the Treasury to work together to ensure that IRS' mission is focused, its goals are specific and results oriented, and its implementation strategies and funding expectations are appropriate and reasonable.

In order to resolve the problems in its high-risk areas, IRS needs, at a minimum, an implementation strategy that includes both performing cost-benefit analyses and developing reasonable estimates of the extent, time frames, and resources required to correct its high-risk vulnerabilities. IRS also needs to develop performance measures that will allow its managers, Congress, and us to track its progress. And, above all, IRS management needs to sustain an agencywide commitment to solving the agency's high-risk problems.

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Mr. Chairman, this concludes my prepared statement. We will be glad to answer any questions that you or the Members of the Subcommittee may have.

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Mr. HORN. Dr. Stillman, any comment you want to make?

Ms. STILLMAN. No separate comments, sir.

Mr. HORN. We thank you.

I am now going to yield 10 minutes to the gentleman from New Hampshire, Mr. Sununu, to question the witnesses.

Mr. SUNUNU. Thank you, Mr. Chairman.

I thank you very much for your testimony. I don't know quite where to begin, given the litany or the length of the issues that you have raised and that were originally raised with the high-risk series in which you have done such a fine job of following the implementation of some of the original recommendations and some of the newer recommendations as well.

It is a source of frustration to me that a number of the problems that you cite, particularly those in important areas of fraud detection and recovering collectibles, are areas where given the reputation and, in fact, the implementation of what many feel are intrusive and aggressive attitudes on the part of people at the IRS. Despite that intrusiveness, it seems that the area of collections and of fraud detection and of ensuring high rates of compliance have not been very successful.

You raised a number of obviously very important and critical areas. What I would like to do is try and focus on just a couple of those areas, specifically the collections and the fraud detection. I apologize for any repetition that might occur here, but I think there are certain areas that are worth emphasizing and that I would like you to go into a little bit more detail, if at all possible.

Speaking about the receivables backlog and the collection of overdue receivables, could you talk a little bit more about the scope of the backlog and what its age characteristics are? Specifically, would you speak about the collections of delinquent receivables?

Your report shows that delinquent collections have increased somewhat from 1995 to 1996 by 15 or 20 percent. I would like to know why, if there is any reason for optimism for the increase in collection of overdue receivables, and how the collection rate compares to what historic success rates have been?

Ms. WILLIS. Congressman Sununu, the accounts receivable problem at IRS is one we have been concerned about since we initially issued the high-risk series early in the 1990's. There are a multitude of things that contribute to the problem. Right now IRS is sitting with just over $200 billion in gross accounts receivable. But that number reflects not only the amount that are what we call financial receivables or receivables that we acknowledge are due the Government, but also compliance receivables which are in our nomenclature, placemakers for actions IRS has taken regarding moneys that may or may not be owed the Government. When you get down to the amount of money that IRS believes or estimates is actually collectible out of that, we are talking under $50 billion. It is still a substantial amount of funds.

Problems that IRS has faced in addressing the receivables problems run across the full gambit of its operations, from inaccurate data that is entered when a return is processed, which then turns into a receivable that is inaccurate on the record, to having problems with the age of the receivables, which is a big issue in terms of their collectibility.

Right now it can take IRS 2 to 5 years after the filing date of a return before an additional assessment because of its enforcement programs is actually posted to its books. In our society, as mobile as it is today, 2 to 5 years is a very long time in terms of finding the taxpayer, having a corporation that may now be defunct, and being able to actually collect that money. That is one of the reasons why we believe very firmly that IRS needs to modernize the systems that support the collection of its receivables, one, so that we know more about how effective specific programs are.

We don't collect very good data right now on what works in particular cases, and we also need to understand more about how we can get these receivables on the books earlier when the accounts are newer, when the private debt collectors tell us the success rate for actually getting the money in the bank is much higher.

But all of that takes a comprehensive look at the causes and the underlying problems behind the receivables and the development of a strategy to both modernize the systems and the processes that support receivables, and bring in new ways of doing business to collect the money that is truly due the Government.

Mr. SUNUNU. Do you mean to suggest that the IRS doesn't actually know why the collection of delinquent receivables increased from 1995 to 1996?

Ms. WILLIS. We have some general ideas, the IRS has some general ideas in terms of specific programs that took place. But they are more estimates than numbers that can be readily validated. So while we have a sense of what is bringing money in, for example, sending notices out earlier and being able to contact the taxpayer more quickly, it is hard to be precise about how effective that particular effort is and how that effort would compare to other alternatives in terms of picking the most efficient way to increase collections.

Mr. SUNUNU. Explain for me what the difference is between the $50 billion that you earmarked as collectible receivables and the $200 billion figure that the IRS currently has logged in as accounts receivable?

Ms. WILLIS. The number is actually under $50 billion. I can't recall right off the top of my head what this year's number is, but the difference between the two numbers is—the $200 billion is the gross receivables, and that includes everything that is in there that may be a compliance assessment, like I said, as well as a financial assessment.

Mr. SUNUNU. Is that a euphemism for a fine?

Ms. WILLIS. No. Compliance assessment, for example, is if you did not file a tax return and I did a substitute for a return and I determined based on information that was available that you owed a certain amount of money and I could not contact you or you did not respond, IRS has the ability to go ahead and seize that money while pursuing the taxpayer to determine how much is actually due.

When the return is actually filed, that number may be reduced to zero or the taxpayer may even need a refund. But based on the information IRS has available to it at the time, it appears to be a receivable. Once you take the compliance receivables out of there, then you get down to the financial receivables, only a portion of

which are actually perceived to be collectible, and noncollectible receivables could be from defunct corporations, deceased taxpayers, hardship cases, but money that right now we don't believe is within the purview of the collection efforts to actually go after.

Mr. SUNUNU. On the issue of older receivables, to what extent is it realistic to keep the older receivables on the books, and in answering the same question, could you talk a little bit about the success or lack of success that the agency, the IRS, has received or seen in the use of subcontractors to handle some of the debt collection?

Ms. WILLIS. The question of how long we keep the receivables on the books is one that has been discussed extensively. Right now, IRS keeps the receivables on the books until the expiration of the 10-year statute of limitations.

I think it is less important whether they keep the number on the book. It is more important that we understand how much of the money is affected by the 10-year statute of limitations, how much of the money is actually collectible. That is why the financial accounting systems become so important, because those systems, properly done, would allow us to know how much of this money ages into different categories, so we would be able to determine in terms of reporting those numbers out to the Congress and the public, what boxes they fall into and which ones are reasonable to collect.

Mr. SUNUNU. And how about the effectiveness of some of the trial programs, using subcontractors? What are the privacy issues there? How can we be sure to the extent the IRS relies on private debt collection organizations that the privacy of taxpayers is respected?

Ms. WILLIS. IRS is moving now into the second phase of the private debt collection initiative, the first years. Basically, what we have discovered so far is not surprising, that private debt collectors are running into the same problems collecting IRS accounts, they are old, the people are difficult to find, that IRS employees are having.

Improving the quality of the information in the accounts would not only enhance the ability of private collectors or subcontractors to collect the money, but would also help IRS employees be more productive.

In terms of privacy, the same taxpayer privacy requirements are imposed upon private debt collectors as are imposed upon IRS employees. The taxpayer data is treated with the same level of confidentiality.

One of the things that IRS is tracking and is very interested in, as is the Congress, is whether there are any problems that evolve because of the use of subcontractors or private debt collectors in this experiment. I think that is a very critical policy issue that is before the Congress, is how far do we want to go in making taxpayer data available to individual contractors doing a variety of different tasks.

Mr. SUNUNU. Thank you very much. Thank you, Mr. Chairman.

Mr. HORN. You are quite welcome.

I now recognize the ranking Democrat on the committee, Mrs. Maloney of New York. I might add, the quorum was established be-

fore Mr. Sununu spoke. We are delighted to have the gentlewoman from New York.

Mrs. MALONEY. On my flight here from New York this morning, several constituents mentioned a program that was on television last night, I didn't see it, that talked about United States taxpayers using tax havens as a means of hiding their income, Grand Cayman accounts. It also noted that the IRS was cutting back its overseas unit that tracks moneys that may be moving overseas that should be taxed in the United States.

I would like your comments on that. The Grand Cayman accounts, what are you doing to track these accounts? Could you talk briefly about your overseas unit and operation in tracking moneys that should be coming to the U.S. Treasury?

Ms. WILLIS. Congresswoman Maloney, Deputy Commissioner Dolan, who is going to be testifying shortly, would be in a better position to talk about any shifts that IRS is making in terms of the resources addressing issues associated with taxpayers moving money overseas.

What I can say is that the movement of money out of this country into tax havens in other parts of the world is not a new phenomenon, but it is one that we have increasing concern about because of the use of the Internet and the difficulties that cyberspace present us in terms of audit trails and being able to track where the money was actually generated or the revenue was generated and where it should properly be taxed.

I know IRS is aware of these issues, but I am not familiar right now with either the program that you spoke of or specifically what is happening with them in terms of the staffing of those operations.

Mrs. MALONEY. In terms of staffing, you have been cut, you testified, 10,000 employees; is that correct?

Ms. WILLIS. IRS has been cut about 10,000 employees over the past 2 years.

Mrs. MALONEY. What is that impact on your ability to collect delinquent taxes and collect taxes owed the public, the Treasury of the United States?

Ms. WILLIS. When we, GAO, have looked at the IRS budget cuts, one of the things that we have been very concerned about, as I alluded to in my formal statement, is the cut in the resources that have gone to things such as the questionable refund program, the program that is designed to identify filing fraud. We believe, or IRS reports, that part of the reason that the number of fraudulent returns that have been identified is down is because of staffing cuts in that program.

I think both of these areas, both the international issues, as well as the filing fraud issues and the staffing cuts that have taken place, identify some of the very marked challenges that IRS is going to be facing over the next years as we move beyond the year 2000 in providing not only the compliance resources that are needed to effectively implement the programs but also to increase the quality of customer service that is provided to the taxpayer.

Mrs. MALONEY. There has been a considerable discussion about the appropriateness of the IRS using random audits to update its audit programs. What is GAO's position on these audits? Will or have you looked at it?

Ms. WILLIS. We have looked at IRS random audits in terms of the research audits to identify taxpayer noncompliance, and we believe that IRS needs a tool to identify noncompliance that may be occurring in places that we are not expecting it. We have not found a comprehensive replacement for the taxpayer compliance measurement program, which was supposed to take place in 1994, but which has been indefinitely delayed.

One of the concerns that we have is, unless we come up with a new way of measuring compliance and measuring compliance in such a fashion that we can identify it in places where we are not expecting it, that we will undermine the total compliance of the tax system. I know that IRS is working on this and recently has accepted a report from Price Waterhouse on the measuring of taxpayer compliance, and where random audits will fit into that entire program in the future, I am not sure.

Mrs. MALONEY. There have been a number of proposals on restructuring the rules and the GAO in a series of your own audits have pointed out failures in management. Some people have argued moving the IRS out of the Treasury, and some have argued that Treasury should have more of an oversight of the IRS. The IRS has always been sort of a completely independent unit, and when you talk to Treasury, they say they are totally separate.

What is your feeling on the structure of the IRS? Should there be more of an oversight by Treasury? Should it be moved to someplace else? What are your feelings about correcting some of the faults actually that your agency, GAO, has pointed out in the failure to meet management goals?

Ms. WILLIS. Congresswoman Maloney, there are a variety of public policy issues that have to be addressed when we look at the structure of the IRS, and there is attention between the independence that we want in this country for the Nation's tax collector to have, to be free from political intrusion or political persuasion, and the need for proper agency management and oversight.

We believe that Treasury's new role or more enhanced role in terms of providing oversight of IRS is necessary right now in light of the management difficulties and the long-standing problems and their magnitude. However, providing proper management oversight while remaining outside and keeping the independence of the IRS is a critical dilemma that the Congress faces and would need to be considered regardless of what the structure is. But, regardless of what the structure is, key to making improvements at the IRS is using the tools that we have to hold IRS accountable for the moneys that it spends and the effectiveness of its programs. And we think that the three acts that Congress has passed over the past few years, Clinger-Cohen, GPRA, and the CFO Act——

Mr. HORN. I want to interrupt, some people don't know what GPRA is.

Ms. WILLIS. Government Performance and Results Act.

Mr. HORN. Probably one of the most significant acts passed by Congress.

Ms. WILLIS. Absolutely. Absolutely. An act which if properly implemented will give us the ability to track the effectiveness of various programs within the IRS and in achieving efficient mission goals and determine which ones work the best. So I think all of

those things need to remain in place and be applicable to whatever structure is used to collect the Nation's taxes.

Mrs. MALONEY. In your testimony you recommended that Congress should consider not funding either the $131 million for system development or the $1 billion capital account. At the same time, Mr. Tobias testified about an experiment in compliance funding that returned considerably more than projected.

Would you recommend that the system development and capital fund money be invested in compliance efforts?

Ms. WILLIS. I think those are basically two different decisions. Our concerns with the system development request is that the money has not been properly justified, that the methodology used to develop the numbers is not adequate, and we have no guarantee that this money will be spent any better than the money that has been spent in the past in terms of systems development. That is basically why we recommended that Congress consider not funding that money.

In terms of the compliance initiative money that was funded in 1995, there are a couple of concerns that we would have about future appropriations. One is that the money be fenced. By that I mean that IRS be required to spend the money for the specific compliance initiative programs that the Congress charters. In the past, before 1995, when it was not fenced, we found that the money generally was not spent on improving compliance.

In 1995, that was not the case. We are currently looking at the numbers and the methodology used to derive those numbers in terms of the return on that investment. And it appears that IRS did bring in more money than they expected to in the first year of that compliance, or first and only year of that compliance program. We need assurances that the money, if properly spent, we will also be able to account, however, for the additional revenues that come in. That has been a problem from a data perspective historically.

Mrs. MALONEY. One of your earlier audits criticized the $3 billion spent by the IRS supposedly on modernizing its computers. Your report showed that they had virtually nothing to show for it.

Do you have any other comments on their efforts to modernize and update their computer technology and the specific audit that I mentioned that came out, I believe, last year from GAO?

Ms. WILLIS. Let me turn that question to Dr. Stillman, our Chief Scientist for Computers at GAO.

Ms. STILLMAN. The basic problem with the $3 or $3½ billion expended on TSM is that IRS cannot demonstrate benefits or return on investment exceeding the $3.5 billion. We have reported that they cannot do that, and that in investments in the future, they should be much more careful to analyze their investments consistent with GPRA and Clinger-Cohen to avoid repetition of that kind of thing.

Mrs. MALONEY. In other words, you are saying they wasted the $3.5 billion?

Ms. STILLMAN. Wasted in general is a poorly defined term. IRS has testified it feels what it would call waste is somewhere in the area of $400 to $500 million. The key question, I think, is can it demonstrate benefit in excess of the $3.5 billion expended, and in

fact it cannot come close to demonstrating benefit anywhere near $3.5 billion expended.

Mrs. MALONEY. So they cannot run their own computer system?

Ms. STILLMAN. They have done a poor job developing new computer systems.

Mrs. MALONEY. What would you suggest we do? Do we have another agency come in and develop their computer system? What are your suggestions?

Ms. STILLMAN. Actually, we have made well over a dozen specific recommendations detailing what IRS can do better in the future. Among the things they can do better in the future, first, they can formulate a comprehensive business strategy so that they know how they want to do business better in the future, relying more on electronic submissions of returns and less on paper. First, they have to know what they are doing.

Second, they have to correct the underlying infrastructure weaknesses. They do not now have disciplined processes in place for developing software and systems or for acquiring software and systems. Until they do, they should not be in the business of doing either to any major degree.

They should also be careful to measure progress on an incremental basis so that we don't have the big bang theory that Mike Dolan has testified in the past has not worked for him, and in all fairness has not worked for any agency and not worked in private industry.

Mrs. MALONEY. Well, that is a very heavy criticism of the IRS.

One area where they appear to have made some progress is an area where the chairman and I have worked very hard in the last year, and that is in collecting delinquent taxes, that which is owed the American people, and apparently their collection is up 17 percent from last year. They had $30 billion delinquent; now they are $25 billion delinquent.

Why do you think they have improved that collection?

Ms. WILLIS. It is hard to say specifically what actions led to what level of improvement, but there are a number of things that IRS has done over the past year, including earlier intervention in the collection of accounts that appears to have enhanced the collections, changes, making notices more readily so when people get them they understand better what the Government needs from them and expects from them, moving different people and people into different, more productive types of positions within IRS, so that the taxpayers can be contacted in the most efficient fashion. All of those things have provided incremental levels of improvement to the collection of tax debts. But they have not solved the underlying problems.

Mrs. MALONEY. Thank you.

Mr. HORN. I thank the gentlewoman from New York.

Let me just pursue a few closing questions here.

One, I am curious, in the degree to which GAO is the Congress' program and financial auditor, you have looked at the pilot programs that were issued by IRS in terms of the collection of debt. The Debt Collection Act that I and Mrs. Maloney authored last session applies to everybody but IRS. We are awaiting the Ways and Means Committee action in this area. But it was IRS that got me into this when I saw they had written off, in quotes, over $100 bil-

lion beginning first under the Bush administration, accelerating greatly under the Clinton administration. Then they said, well, we have another $64 billion that we think we can collect.

What I am curious about is, what is your assessment of the pilot projects, some of which I hear offered, 5-year-old debt to collect? Now, what that meant to me as I heard about that, if that is correct, and I wonder if you could verify it, is that IRS doesn't want the private debt collectors to succeed, because 5-year-old debt is almost impossible for everybody in the world to collect. People are dead, they have forgotten there is a debt and so forth. So what is the reading of GAO in looking at those pilot programs?

Ms. WILLIS. We are kind of in the middle of looking at the pilot programs. IRS did face some difficulty initially in getting the cases out to the debt collectors that were selected as the subcontractors for that program. When the cases were sent out, they were old. Some of them were 5 years old, there is no question about that.

I would hesitate to say that was because IRS didn't want the pilot to succeed, in part because those are the same cases being sent out to IRS collectors. The other thing with the pilot program is that it is limited to the private collectors contacting or attempting to locate the taxpayer, attempting to explain their obligations to them, and asking them to contact IRS. So there are a variety of ongoing things. We expect to be finished early in the summer, in terms of what we are doing for Ways and Means, and to have a better sense of where we need to go on the second phase, the second $13 million part of the private debt collection program.

Again, my understanding is that IRS is beginning to look at what sort of mid-course corrections need to be made to get a better sense from the program on whether private debt collectors can be effectively used and what we can learn from them.

Mr. HORN. I gather from your testimony that they seem to have solved the problem of confidentiality when they put these pilots together. Is that correct?

Ms. WILLIS. I think that is an open issue. The same requirements that face IRS employees are imposed upon the private collectors. There have been fire walls built around the information, et cetera. But one of the things that is being tracked is whether there are difficulties with maintaining the privacy.

Mr. HORN. I would think—and I told this to the Commissioner when I listened to all the confidentiality nonsense, which I thought was just a red herring to avoid collecting debt—what seems to me is you give them the amount owed and the address and say, go to it. That is what I had not seen in the IRS' own collection efforts. It seems to me if they want to collect in the IRS, they ought to be moving on these debts within 30 days of the delinquency, when it is discovered, because pretty soon people forget it is a debt. Students certainly do. They think the loan has become a grant, and it seems to me the sensitivity of this is simply to let them have the address, let them have the amount. If they have to quibble, let them quibble with IRS, not the debt collector.

But the debt collector ought to work out a deal to get something they are not getting. When they let it run up to $100 billion, that is a national scandal, as far as I am concerned, and they are not organized. Do you detect any way now that these pilots will make

some sense in terms of getting them to organize, to collect debt, and work cooperatively with private debt collectors as the indication may be?

Ms. WILLIS. I think we, IRS, will learn a variety of things from the pilot in terms of how to use more modern processes and operations in order to track down and find taxpayers who owe the Government money. The pilot will not, however, address the underlying problems that lead to it being 3 to 5 years after the date of the tax return being filed before the additional assessment is imposed. So even if IRS were to move out within 30 days of the delinquency being assessed, even at that point we are 3 to 5 years beyond the time when the taxpayer incurred the liability.

Mr. HORN. So it is 5 years at the start of all this.

Ms. WILLIS. In some cases, yes. At that point we have also had interest building up on the amount owed, but the private debt collection pilot will not address those issues beyond, I suspect, confirming our sense already that the older the debt, the more difficult it is to collect.

Mr. HORN. Has the IRS got any way of tracking people that declare bankruptcy to avoid payment of taxes? Has GAO ever looked at that?

Ms. WILLIS. It has been a number of years since we have looked at IRS' efforts to track people that are in bankruptcy, and that would have been long before the surge that we have seen in bankruptcies through the 1980's and into the early 1990's. It is an area of concern for any debt collector, for any person who is owed money, the number of bankruptcies that are out there, but I can't testify at this point on the current effectiveness of IRS programs in that area.

Mr. HORN. Let me move to the year 2000 issue which you brought up. As you know, this committee started the interest in it. Has GAO looked at the degree to which IRS is trying to solve this, and in looking at IRS, are they behind most other agencies in this regard? We know that Social Security started in 1989, on its own initiative without congressional prodding, and we know that a lot of agencies, such as Energy and Transportation, in the case of Transportation, everyone but the Federal Highway Administration didn't really know it was a problem. They had started also in 1987, but their management system didn't get that information to the top, so the Secretary knew it and knew it was a department-wide problem.

So do you have any reading as to the degree which IRS stands in marching toward the solution before there is a lot of chaos on midnight of the year 2000?

Ms. WILLIS. Mr. Chairman, I am not in a position to tell you where IRS stands as it compares to other Federal agencies in dealing with the year 2000 problem.

We are looking at IRS' efforts, and I am in a position to tell you that the problem is serious. IRS is in the assessment phase of looking at its systems. It has divided its various systems into the tiers, with the tier one being the largest, biggest systems, and I think they are well aware of the magnitude, the challenge that they face in bringing very large, very fragile, very old systems into compliance by the year 2000.

They have laid out an aggressive schedule for bringing the tier one or the major tax processing systems into compliance, and we would expect that they would begin testing that sometime in the year 1999, in order to determine whether we are going to be successful. But I don't think it is an issue that anybody can relax their vigilance on until we know the systems have been made compliant.

IRS also faces a problem in having systems that cannot be made compliant, that are so old they are going to have to be replaced. In dealing with some of the issues that Dr. Stillman discussed with systems acquisition-systems development, they are going to have to be addressed in the year 2000 process as well as any modernization effort.

Mr. HORN. As you look across the Federal Government in terms of how automation is effectively implemented, to what extent have you found the tradeoff of personnel positions to incremental moves toward automation, and is IRS ahead or behind in that issue? Do they simply come up and want more money, isolated solely for automation, or do they do what the rest of us have done when we head large organizations, and that was simply try to work an incremental tradeoff and make some progress in that area? What is your sense of that?

Ms. WILLIS. Successful modernization of the IRS systems will allow it to do more with fewer people. The tradeoffs that have been made so far have been limited in part because we have not successfully modernized the systems, in terms of being able to deliver the additional capability that will make IRS employees more productive, have better access to information, and do things more electronically as opposed to by paper.

This year's IRS budget request included both additional money for systems modernization as well as additional funds for new positions and terms processing. While there have been tradeoffs made, obviously there have been requests for additional funds in both areas.

Mr. HORN. One last question. I will pursue the rest with IRS, and we will also send you some questions.

But in testimony before this committee in its March 1996 hearing, a witness reported that the Internal Revenue Service is not logging, tracking or able to report the number, location or dollar value of the liens they have placed; and they are not redeeming those properties with IRS liens against them when they are foreclosed on by a bank, a savings and loan or an investor. It has been estimated that over $100 billion in these liens has been written off, and another $60 billion is ready to be abandoned.

The witness said that in her experience, the IRS has failed to redeem approximately 99 percent of these properties and, therefore, to recover billions of dollars in Treasury tax dollars. Instead, the IRS property tax liens are simply allowed to expire and disappear. What do you suggest should be done to restore confidence in the IRS' ability to effectively manage the program and has that come within GAO's review?

Ms. WILLIS. Mr. Chairman, we are currently in the process of looking at the issue of liens for the Senate Finance Committee. We have just begun this work, and I can tell you there are problems

in identifying all of the liens that IRS has either imposed or has standing in the courts against taxpayers.

Some of the questions that were raised by the statement by the witness have been raised by others, especially as it relates to downsizing restructuring of IRS activities and whether this will impact on their ability to release liens, et cetera. These are issues that we will be looking at over the next few months for Senate Finance. Right now, I am not prepared to comment on that particular statement.

Mr. HORN. I understand the IRS has no nationwide data base of liens, is that correct?

Ms. WILLIS. That is my understanding as well.

Mr. HORN. Well, I thank you. We will have a number of questions, if you don't mind answering, that we will put in.

Ms. WILLIS. I will be happy to.

Mr. HORN. We welcome to the committee a member of the full committee, Mr. Sanders of Vermont, who has asked to sit with us and without objection we will permit Mr. Sanders to ask questions.

Mr. SANDERS. Thank you, Mr. Chairman.

The major concern I have is to try to understand the impact of the new organization under New England and specifically under Vermont, because we are hearing a whole lot of concerns about that.

Before we get to that, I would like to ask Ms. Willis and Dr. Stillman a question and see if they can give us a response from GAO's perspective.

Yesterday, there was an article in the Boston Globe, and let me just quote from it, and I would appreciate it if you might comment. This is what the globe writes: "Because of the shift in IRS priorities, audit rates for high-income taxpayers have plummeted in recent years while the rate for people earning less than $25,000 has more than doubled."

Later on they say, "Only a few years ago, wealthy taxpayers in any part of the country were far more likely to be audited than they are today. In 1988, the IRS audited better than 11 percent of returns filed by people with $100,000 or more in income. By 1995, the audit rate had fallen sharply to less than 3 percent. Meanwhile, the audit rate doubled for people with income under $25,000, going from about 1 percent of returns in 1988 to 2 percent in 1995."

My understanding is that, in terms of higher income people and corporate America, there are tens and tens of billions of dollars of unpaid taxes out there. So my question from the GAO perspective—and I wonder if you have done any research on this—why is it there seems to be a tremendous interest in going after and auditing people making less than $25,000 but not quite that interest in going after billionaires and large corporations?

Ms. WILLIS. Congressman Sanders, we issued a report last year that looked at IRS audit rates and coverage; and it is true that IRS audit rates have fallen; and we did find some of the same trend lines that you mentioned. But I'd like to explain a couple of things we found that affect those lines. Because the reduced resources, the audit rate overall declined and continues to decline.

But IRS has also been doing a variety of audits as relates to the earned income credit which are typically people under the $25,000

threshold that you're talking about. And those audits have been put in place because of concerns of the Congress, GAO and others regarding the high level of reported noncompliance within that credit. And so, as those programs have taken off, as IRS has attempted to identify where the noncompliance and the level of noncompliance within the earned income credit is, that has put additional resources and additional emphasis on taxpayers in the under $25,000 income range.

So I think when you combine the cut in resource that reduces the overall audit rate and add to that the increases in the earned income credit, you see that trend lines where higher income are audited less often, lower income are audited more often.

Mr. SANDERS. So, basically, you are confirming what the article indicated, that there is more of an emphasis on going after lower income people who might take advantage of the EITC and less interest in going after upper income people.

If the argument is there are simply not resources available? One might ask if, as I have heard—you might want to correct me if I am wrong—I've heard there is an estimate of over $100 billion a year in unpaid taxes from corporate America and wealthy individuals. Some may want to know why there is not an emphasis in going after those folks but we are going after folks making less than $25,000.

Ms. WILLIS. Well, there is an emphasis in terms of the corporate side. The numbers that you typically see cited address corporate rates as opposed to individual audit rates, and IRS has an ongoing corporate audit program for the largest corporations in this country, the 1,700 largest. So the numbers that I'm talking about are for individual taxpayers. And I would suggest that our work shows that IRS has an interest in going after low income more than high income, but rather because of different drivers behind the compliance programs as well as the resources that are available, that when you look at the numbers, the trends on one are down and the trends on the other are up.

Mr. SANDERS. Thank you for your response.

But, Mr. Chairman, I would suggest that at a time when over the last 15 or 20 years this country has given huge tax breaks, lower taxes for upper income people and large corporations, there is something wrong in the priorities of the IRS that they seem to be focusing on low-income people and ignoring tens of billions of dollars of potential tax revenue we could bring in from upper income people and large corporations.

Thank you very much, Mr. Chairman.

Mr. HORN. Thank you. You have raised an interesting question and I think we will pursue it with the IRS management.

But as I read your full testimony and GAO's work in this area, does it mean essentially there is a greater percentage of fraud in the earned income tax credit program based on what we know? Or is that level of fraud—as I saw it, it seemed to be just dependents added to the form to get more money under the income tax credit. Is that about the same level of fraud as you find in the upper income?

And I say that for this reason. It seems to me the people that pay the taxes in this country are the middle class in the aggregate,

because there's more of the middle class than there is of the so-called corporate barons. And when you get an earned income tax credit which has millions of people eligible, that aggregate is going to add up to quite a bit of money if there's substantial fraud. Has GAO looked at the relative fraud potential of these various programs?

Ms. WILLIS. Yes, we have; and we reported in 1994 and 1995 to the Senate Finance Committee, I think, a couple of interesting statistics. When you look at the amount of noncompliance—and I say noncompliance because we don't always know when there's a problem with a return, especially an earned income credit return, whether it's intentional fraud or unintentional noncompliance. The earned income credit can be an extremely complicated credit, especially for the group of taxpayers that it's targeted toward.

But when you look at the noncompliance rate for the earned income credit, it is not higher than the reported noncompliance rate, for example, for sole proprietors; and it is much lower than if you look at the noncompliance rate for people that we call informal suppliers or the people who sell wood in your neighborhood who essentially work the cash economy. So, from a tax program perspective, there are other programs that have equally concerning areas of noncompliance.

Part of the problem with the earned income credit in terms of compliance is that it is a refundable credit, and so it is not covered by money that is withheld or is simply not paid to the Government. It is money that actually flows out of the Government Treasury as a supplement to the income of these families. And so we are concerned about the noncompliance and also concerned about how we can efficiently reduce that noncompliance; and IRS has done a number things that have been effective, especially as it relates to the electronically filed returns and moving more into the paper returns and identifying people with dependents or who don't have the proper filing status.

I think it's important that we focus across the board in all the areas of noncompliance and ways that either IRS administratively or Congress statutorily can improve compliance.

Mr. HORN. Well, I thank you very much for that statement; and we'll followup with some more specific questions. You've done a fine job, and we thank you very much for appearing.

Ms. WILLIS. Thank you very much.

[Followup questions and responses follow:]

RESPONSES TO FOLLOW-UP QUESTIONS FOR GAO

1. Collection industry experience shows that the older a debt becomes, the more difficult it is to collect. A high proportion of the IRS's accounts receivable are more than 5 years old. What are the causes of this and what is being done to address the problem?

GAO RESPONSE: One of the main reasons for these older accounts is the fact that it may take IRS up to three years from the due date of the tax return to assess delinquent taxes. These compliance generated delinquencies from nonfilers, underreporters, and examinations/audits can make collections more difficult from the start and furthermore, these accounts can remain in the inventory for up to 10 years with little chance of ever being collected.

A related problem is an IRS legal interpretation that it cannot write off an account as uncollectible before the expiration of the 10-year statute of limitations on delinquent accounts. Thus, IRS' inventory includes many accounts of deceased taxpayers and defunct corporations which are truly uncollectible and would not be carried on most businesses' accounts receivable. In addition, many delinquent accounts remain in the inventory of tax debts because IRS for whatever reason has not been able to fully work and resolve them.

IRS' tax systems modernization program, with its focus on improving IRS' computer systems and overhauling its paper-intensive approach to tax return processing, can have far reaching effects on IRS' delinquent tax collection process. In that regard, quicker processing of tax returns and return information will allow for earlier identification of potential tax delinquencies. That coupled with speeding up the collection process by sending fewer bills and attempting to contact delinquent taxpayers sooner can lead to reducing the age of delinquent accounts and improving the collectibility of those accounts in the tax debt inventory.

2. While the IRS has taken steps to correct management and technical weaknesses and more recently began to put the brakes on TSM development spending, what does the IRS need to do now to get the modernization back on track?

GAO RESPONSE: As we noted in our recent high risk reports addressing TSM,[1] IRS needs to continue to make concerted, sustained efforts to fully implement our recommendations and respond to the requirements outlined by Congress. These efforts should include (1) limiting information system projects, both in house and

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[1] IRS Management (GAO/HR-97-8, Feb. 1997) and Information Management and Technology (GAO/HR-97-9, Feb. 1997).

contracted out, to small, low risk, near term projects that IRS has the ability to successfully develop or acquire; (2) improving IRS' system development and acquisition capabilities; (3) finalizing the architecture and ensuring that all IRS system projects conform to it; (4) instituting disciplined investment processes to ensure that all information technology investment decisions (e.g., project selection, control, evaluation) are based on reliable, objective, and, whenever possible, quantitative data including cost and risk adjusted return on investment; (5) reengineering IRS business processes, focusing on electronic filing, and using these improved processes to determine those information technology investments needed to support the new process; and (6) ensuring that all future IRS information systems budgets are determined by IRS' performance as specified in the Clinger-Cohen Act.

These efforts will take both management commitment, follow-through, and technical discipline by IRS in partnership with the Treasury Department, OMB, and the Congress. Once these essential improvements are made, IRS should have an effective implementation strategy for achieving its business vision, the capacity to make sound investments in information technology, and the necessary technical foundation for effectively modernizing its processes and systems.

3. The most recent statistics from the IRS's Questionable Refund Program show that the number and dollar amount of fraudulent refunds have declined significantly. Does this mean that the IRS has turned the corner and that refund fraud is on the decline?

GAO RESPONSE: We do not know what it means and neither does IRS. When the numbers were increasing, we always cautioned that no one really knew whether the increase meant that fraud was on the rise or IRS was doing a better job of detecting it. Similarly, there is no way of knowing whether the lower numbers mean fraud is on the decline or IRS is doing a worse job detecting it. When we talked to the persons directly responsible for the Questionable Refund Program (QRP) last year about the declining statistics, they said that the most significant cause was a 31-percent staffing reduction--from 553 full-time equivalent staff in 1995 to 379 staff in 1996. It is interesting to note however, that there was about a 60-percent decline in the number of fraudulent returns detected in 1996 compared to 1995, which would suggest that there were other factors involved besides a 31-percent staffing decrease. In that regard, program officials cited two other causes for the decrease in results: (1) the impact of enhanced upfront filters in the electronic filing system that prevented bad returns from getting into the system and (2) a decision to focus QRP efforts on certain kinds of cases.

The Earned Income Credit (EIC) is one particular area of the tax code that has historically been a major contributor to refund fraud. IRS recently issued a report on its study of EIC noncompliance (which is a combination of intentional and unintentional errors) on tax year 1994 returns. As reported by IRS, the

study showed a significant decrease in EIC noncompliance since the last comprehensive review of that area as part of the 1988 Taxpayer Compliance Measurement Program. We will be assessing that study at the request of the House Committee on Ways and Means.

4. How will the IRS know when it has adequate control over refund fraud? What assurance does the IRS have that after controls are tightened in one area (as was done with the Earned Income Credit), other areas don't become more vulnerable to fraud?

GAO RESPONSE: Periodic studies of specific areas of noncompliance, such as the EIC study referred to in our response to question #3, are the best way for IRS to assess its progress in controlling known areas of fraud and to identify continuing vulnerabilities. The second part of the question is key, however. IRS must remain alert to emerging areas of fraud as it works to tighten its controls in other areas. We realize that IRS can only do so much with available staff, but there are apparently automated techniques that can be used to help in this effort. To that end, IRS entered into a multi-year contract with the Los Alamos National Laboratory in 1993 that, as we understand it, was to result in the testing of algorithms that could be used to detect anomalies in filed returns. We do not know the status of that effort. In our opinion, however, any such effort will be hampered by the fact that IRS does not have the ability to electronically capture data on paper returns. Thus, the Electronic Fraud Detection System (which is used by IRS' Questionable Refund Program staff to detect and research filing schemes and which would be the vehicle for any anomaly detection techniques) is primarily used on electronic returns.

5. After four years of financial audits at the IRS and your experience during the current year's audit, what do you think the future holds? What does the Congress need to do to ensure that the IRS remains committed to the goals of the CFO Act and continues to address and correct its widespread financial management problems?

GAO RESPONSE: IRS has made some incremental progress towards improving its financial management problems over the four years its financial statements have been subjected to audits. However, much still remains to be done. IRS' efforts towards its goal of having its auditor render an unqualified "clean" opinion on its financial statements will be directly tied to the level of priority and sustained commitment to this goal by IRS' management. Our experience across government is that agencies often take years to get their financial records and practices improved to a point to provide auditable financial statements where the auditor can render a clean opinion. IRS could be one to significantly more years away from its goal of a clean opinion, depending on the actions it takes to correct the underlying problems.

Congress needs to persist with continued diligent oversight over IRS' efforts to correct these problems. The Congress' efforts should focus on whether IRS is making progress on the remaining outstanding recommendations from GAO's audits and assess IRS' progress in implementing its related action plan to do so, and taking actions the Congress concludes are warranted based on IRS' progress or the lack thereof.

6. What implications would a failure to address these problems at the IRS have on the goal of providing an audited government wide financial report to the public? What actions could the Congress take to ensure that the IRS's financial management problems are resolved?

GAO RESPONSE: IRS' failure to correct its financial management problems to a point where auditable financial statements are possible would preclude auditable governmentwide financial statements from occurring. The tax revenues collected by IRS represent close to 95 percent of the federal government's funding.

As previously mentioned, Congress needs to persist with continued diligent oversight over IRS' efforts to correct these problems. That oversight should focus on whether IRS is making progress on the remaining outstanding recommendations from GAO's audits and assess IRS' progress in implementing its related action plan to do so, and taking actions the Congress concludes are warranted based on IRS' progress or the lack thereof.

Mr. HORN. Next panel, panel two will please come forward. We have Shelley Davis, former IRS Historian; Sheldon Cohen, IRS Commissioner during the Johnson administration, fellow of the National Academy of Public Administration; and Robert Tobias, the president of the National Treasury Employees Union.

[Witnesses sworn.]

Mr. HORN. All right. All three have affirmed.

We welcome you, and we will start just the way it is on the roster.

Shelley Davis, Ms. Davis, the former IRS Historian, if you would summarize your statement in about 10 minutes. We won't hold you completely to it, but as you know your full text goes in at this point in the record. We'd like to hear the basic thrust of it for about 10 minutes.

STATEMENTS OF SHELLEY DAVIS, FORMER IRS HISTORIAN; SHELDON COHEN, IRS COMMISSIONER DURING THE JOHNSON ADMINISTRATION, FELLOW, NATIONAL ACADEMY OF PUBLIC ADMINISTRATION; AND ROBERT TOBIAS, PRESIDENT, NATIONAL TREASURY EMPLOYEES UNION

Ms. DAVIS. Sure, thank you Mr. Chairman, members of the committee. I'm pleased to be here before you today as you attempt to understand and ultimately improve the IRS.

As the only person to ever serve as the Historian for the IRS, I would like to focus my testimony on the subject with which I am most familiar, the evolution and history of the IRS. As a Historian, I have to admit to a professional bias to the need to understand the past in order to move intelligently into the future.

My testimony before you will consist primarily of two parts, and I will give you your history lesson as quickly as possible. The first part, I will discuss what I call flash points of IRS history, those events which had a defining influence on the tax collector, and I will briefly outline the congressional response to some of these flash points.

The first flash point in IRS recent history is 1952. Thirty-five years ago, on March 15, 1952, the IRS was officially reorganized into the structure with which we are familiar today. This was not a reorganization dreamed up by the IRS. Rather, the 1952 reorganization was forced upon a reluctant IRS by President Truman and a Congress fed up after years of reports of problems with the tax collector, pledges from the IRS to clean up its act, and a glaring failure of the agency to be able to implement change by itself.

Recent cries from current Commissioner Margaret Milner Richardson that the IRS is undergoing some of the greatest attacks in its history today, in my opinion, demonstrate the lack of awareness of its own history that the IRS reflects, because compared to the outcry that faced the IRS in 1952, the IRS today is really having a picnic in the park, at least so far.

Moving to the second flash point requires a jump of 20 years, to 1973. That was the year, in June 1973, when White House Counsel John Dean revealed that the White House had developed what he called an "enemies list". He also revealed that the IRS had set up a small secret staff to collect information on dissidents and malcontents in American society. In the media frenzy that followed

these revelations, these two references became forever jumbled in the American psyche; and the enemies list became forever linked with the IRS, with the general assumption being that the IRS was guilty of auditing and chasing after President Nixon's enemies.

The problem was that the IRS wasn't guilty. At least they weren't guilty of auditing Nixon's enemies. The bigger problem though, for the IRS at least, was that the IRS was guilty of assembling its own enemies list, far more substantial and far more dangerous than anything President Nixon ever dreamed of.

So in mid-1973, the IRS knew that it had a big problem. It knew it hadn't audited President Nixon's enemies, but it couldn't very well go out waving a flag with this pronouncement because it knew its own internal actions were far more dangerous and its own list was far more extensive than Nixon's. Just as a matter of perspective, the IRS list had over 11,000 taxpayer names on it. All the various compilations of Nixon's enemies list had around maybe 600, at the most, names. So what did the IRS do in 1973? It remained mute. The IRS learned that by simply keeping its mouth shut, by biding its time, that events would eventually calm down and normalcy would resume.

The third flash point of recent IRS history jumps forward a decade to 1985, the year of the great IRS meltdown of which we have all heard so much recently. This was the year the IRS installed new computer hardware and software in its 10 processing centers around the country. When the new systems had trouble keeping up with the sheer workload of tax processing, the IRS workload became quickly overwhelmed and the service flooded with stories of IRS employees stuffing tax returns down toilets and into ceiling tiles and into wastebaskets just to get them off their desks in front of them.

The final flash point I want to address is actually more of a fizzle than a flash, but it's important nonetheless. The final example demonstrates how the lessons the IRS took from these earlier flash points have succeeded, that its best defense is often silence, that the waiting game is usually the winning strategy for the IRS.

The flash point fizzle that I refer to happened between 1989 and 1992, and involves the investigations launched by former Congressman Doug Barnard into allegations of misconduct by senior IRS executives. In all, during those 3 years of hearings, Barnard revealed some serious abuses on the part of at least 25 top-level IRS executives. But of these 25 cases, only one individual received even a modicum of punishment, that being a 10-day suspension. The pain of that suspension, though, lessened when this man's fellow executives took up a collection to reimburse him for his lost pay for that period of suspension.

The value of the lessons learned from the previous flash points became immutable truths for the IRS after the Barnard hearings. By verbally pledging to clean up its act, by shifting the players to avoid accountability, by remaining mute, the IRS emerged from the most painful public hearings into its integrity since the 1952 hearings with nary a scratch.

And now, just for a moment, about the congressional response to these various flash points. As I already pointed out, in 1952 Congress acted by reforming and restructuring the IRS. This is the

only time in the recent history of the IRS that Congress has taken decisive action which resulted in significant change inside the tax collector.

And what of the Watergate years? Well, because the IRS was successful in hiding the real story of what was going on, Congress fixed the wrong problem. In 1976, asserting that the IRS had become what was called a "lending library" of tax returns to the White House, Congress moved to tighten the privacy restrictions on tax return information, enacting the most restrictive provisions in the history of the Tax Code to access to tax information.

The result of this was that Congress actually handed the IRS the best defensive weapon it has ever had. By continually citing restrictions on access to taxpayer information, the IRS has perfected the art of blunting criticism and deflecting blame. Rather than putting real restraints on the IRS, Congress inadvertently gave the IRS even more power to operate without accountability.

And what of 1985, the great tax meltdown? Well, there's nothing like cries from constituents to bring about change. After the dust settled, Congress essentially gave the IRS a blank checkbook in 1985 and told the agency to fix its computers forthwith. We have all heard the results of that.

What about the flash point fizzle of Congressman Barnard's hearings, which finally concluded in 1992? Nothing. Congress did not enact a single reform or take any action at all at the end of 3 years of very painful investigations by Congressman Barnard. Fizzle.

So the circle begun in 1952 was now complete 40 years later. From an era when Congress was appalled with ethical problems inside the IRS and took decisive action to an era when Congress was deaf and dumb to revelations of unethical behavior and mismanagement inside the tax collector, the IRS completed its learning curve that the best defense is to promise that studies will be made, pledge to fix existing problems and convince Congress to leave it untouched.

The IRS executive cadre of today is filled with employees who are steeped in the culture of secrecy, who believe that running the tax system is too important a job to be left in the hands of anyone but a member of their private club, who have learned to wait out every storm, rearranging the deck chairs after every public revelation of mismanagement or financial bungling.

I will digress for a minute and talk about the IRS news story of the week, which is browsing by IRS employees, which shows that, once again, I believe Congress is attacking the wrong problem. Rather than focusing on low-level, poorly trained, in many cases not very highly educated IRS employees, the more important question is what is being done about the IRS executives who promised, who pledged to Congress 4 years ago that they would implement a no-tolerance policy for browsing when this issue was raised.

Accountability on the part of IRS executives is where Congress needs to be looking. The browsing story ultimately plays directly into the hands of the IRS, which wants to be able to proudly stand tall and claim they are protecting taxpayers, all the while skirting the more important issue of accountability.

The IRS simply doesn't hold the members of its own executive club accountable for their actions. By drumming out an occasional low-level employee, by protecting its top-level bureaucrats, the IRS has once again succeeded in duping Congress and the American taxpaying public.

So what can be done? Well, I believe that we and you, Members of Congress, can no longer wait for the IRS to fix its own problems. With historical parallels to 1952, IRS' plans and reorganizations of recent years have not corrected the problems that we all know are there.

I believe that Congress should look to 1952 for suggestions on where to go from here. The problem today, like that of 1952, is one of leadership; and not just leadership at the very top of the IRS in the position of the Commissioner, but leadership throughout the entrenched secret society of IRS executives.

Congress excised the problem 45 years ago by replacing both the Commissioner and the entire top tier of IRS executives. Today, I believe that same type of action is necessary to recreate the IRS into the premier organization that it has been and that it can be again in the future.

Thank you.

Mr. HORN. We thank you for that marvelous statement, and in the question period we will get into it more and your own experiences with IRS as Historian.

Is your book out yet?

Ms. DAVIS. Yes. Sure. It should be in any bookstore.

Mr. HORN. OK. What's the title of it?

Ms. DAVIS. "Unbridled Power: Inside the Secret Culture of the IRS."

Mr. HORN. You and I have a similar title. I had a book called "Unused Power: The Work of the Senate Committee on Appropriations." Unused and unbridled.

OK, Bernie, what is yours? Is yours out?

Mr. SANDERS. Oh, it is coming up.

Mr. HORN. OK. That's very fine.

[The prepared statement of Ms. Davis follows:]

Statement of
Shelley L. Davis, former historian, IRS
before the
Subcommittee on Government Management, Information and Technology

April 14, 1997

I am pleased to testify before you today in your effort to understand and ultimately improve the Internal Revenue Service (IRS). For over seven years, from 1988 to 1995, I served as the first and only professional historian inside the IRS. I was also the last historian of the tax collector. The IRS abolished my position upon my public and publicized departure from the agency 15 months ago.

As the only person to ever serve as the historian for the IRS, I would like to focus my testimony on the subject with which I am most familiar—the evolution and history of the IRS. As a historian, I must admit a professional bias to the need to understand the past in order to move intelligently into the future. I hope my testimony will give you insight into historical issues and patterns you may wish to consider as you develop plans to improve the IRS. Due to time limitations, I will limit my testimony to recent history. This is also where the most important lessons for the future may be gleaned for your purposes.

My testimony consists of two parts. The first part will discuss what I call "flashpoints" of IRS history—those events which had a defining influence on the behavior of the tax collector. I will then briefly outline the congressional response to some of these flashpoints and other IRS issues.

The first flashpoint is 1952.

Forty-five years ago, on March 15, 1952, the IRS was officially reorganized into the structure we are familiar with today—a headquarters with a single political appointee at the top; field offices known as "districts"; tax processing centers known as "service centers"; and regional offices between the districts and the headquarters. This was not a reorganization dreamed up by the IRS. Rather, the 1952 reorganization was forced upon a reluctant IRS by President Truman and a congress fed up after years of reports of problems with the tax collector, pledges from the IRS to clean up its act, and a glaring failure of the agency to be able to implement change by itself (does this sound familiar?).

The problem that needed to be fixed was different than that which faces you today. In 1952, the problem was that the IRS was one of the most political of all federal agencies. All IRS district directors (then called "collectors") and other executives were political appointees. For example, a typical reward for successfully managing the Tennessee Truman for President campaign was an appointment as IRS collector for Tennessee.

The resulting problems are perhaps obvious—these politically appointed collectors were able to manipulate the tax system to their advantage, auditing their enemies and going easy on their friends (does this sound familiar?); some were unqualified for these important positions; others accepted bribes and failed to pay their own taxes.

Recent cries from current Commissioner Margaret Milner Richardson that the IRS is under the "greatest attack in its history," demonstrate the lack of knowledge of its own history which plagues the IRS. Compared to the outcry that resulted once Congress began to get wind of what was happening in the IRS four decades ago, the IRS is having a picnic in the park today.

One aspect that is similar is that for years leading up to the 1952 reorganization of the IRS enacted by Congress, the IRS had been conducting its own studies, making its own plans, reassuring Congress that all was under control and that the IRS could cure its own ills. The shocking revelations of California Congressman Cecil King, who headed a subcommittee of the Ways and Means Committee charged with investigating the functions and organization of the IRS, resulted in a full scale restructuring of the tax collector, including replacement of the organization's leadership, not just at the top but throughout the country.

Thus was born the modern IRS, the IRS we are familiar with today—an IRS that is characterized by leadership provided by career bureaucrats rather than political appointees. In 1952, this was the right fix for the right problem. Congress did a courageous and correct thing in 1952.

What did the IRS learn? The IRS learned that Congress didn't trust it to fix itself. Why bother cooperating with Congress when Congress is going to do what they damn well please no matter what?

Moving forward to the second flashpoint requires a jump of 20 years, to 1973.

In late June of 1973, White House Counsel John Dean revealed in testimony before the Senate Watergate Committee that the White House had developed an "enemies list". Dean also revealed that the IRS had set up a small secret staff to collect information on dissidents and malcontents in American society. In the media frenzy surrounding Watergate, these two references became jumbled and the enemies list became forever linked with the IRS, with the general assumption being that the IRS was guilty of harassing and auditing Nixon's enemies.

The problem was, the IRS wasn't guilty--at least of auditing Nixon's enemies. The bigger problem (for the IRS, that is) is that the IRS was guilty of assembling its own enemies list, far more substantial and dangerous than anything Nixon ever dreamed of. The IRS called the office which managed its own enemies list the "Special Services Staff," leading one to question, special services for what?

So in mid-1973, the IRS had a problem--a big problem. As an organization, it knew that it hadn't audited Nixon's enemies. But it couldn't very well go out waving the flag with this pronouncement, because the IRS knew that its own enemies list was far more extensive than Nixon's list (11,000 versus 600 names). So what did the IRS do? It remained mute. This is perhaps the first time in its recent history that the IRS learned that by simply keeping its mouth shut, biding its time, that events would eventually calm down and normalcy would resume.

What did the IRS learn? Keep your yapper shut and Congress will probably never really figure out what's going on. They didn't.

The third flashpoint of recent IRS history jumps forward a decade, to 1985. The year of the IRS meltdown. Or so it appeared at least from inside the IRS. This was the year the IRS installed new computer hardware and software in its ten processing centers around the country. Not a bad thing to do on the surface. But the IRS pulled out the old computers before installing the new, leaving no backup capability.

Thus, the meltdown. When the new systems had trouble keeping up with the sheer workload of tax processing, the IRS workforce became quickly overwhelmed and stories flooded the country of tax processors stuffing tax returns into ceiling tiles, down toilets, and into waste baskets just to get them off the table in front of them. Although the actual

problems resulting from this fiasco affected a very small percentage of taxpayers, the media onslaught forged an image of an inept, even stupid IRS. Cries for reform (and refunds) flooded congressional offices.

What did the IRS learn? That mismanagement of a major computer program could have good results for the IRS, as long as you were willing to wait out the storm. For after the storm comes recovery and with recovery comes money.

Also, as an aside, according to an IRS executive who served as my mentor inside the agency, the explosion of the space shuttle challenger that knocked the IRS computer problems off the front page—another lesson for IRS executives is that if you wait out a problem it will just go away (or at least give you time to move into a new position and thus, remain blameless for any prior failings).

The final flashpoint I wish to address is more of a fizzle than a flash, but it is an important marker nonetheless. This final example demonstrates how the lessons the IRS took from these earlier flashpoints have succeeded for many years--that the best defense is often silence; that the waiting game is usually the winning strategy; that problems will eventually dissipate as other news takes over. Explosions, bombings, disasters, war, airplane crashes—all serve to knock stories about processing tax returns off the front pages. The worst thing for the IRS is a slow news day.

The flashpoint fizzle I refer to occurred from 1989 through 1992, and involves the investigations by retired Congressman Doug Barnard into allegations of misconduct by senior level IRS executives. The stories brought into the public eye by Congressman Barnard ranged from the spectacular to the mundane, from the now infamous story of the

IRS raid of Jordache Jeans to tales of IRS investigators joyriding in a speedboat seized in a drug bust.

In all, Barnard revealed some very serious abuses on the part of at least 25 top IRS executives. Pretty shocking, no? No. Of these 25 cases, only one individual received even a modicum of punishment, a ten day suspension. The pain of this singular suspension was lessened when this IRS executive's fellow executives passed the hat for their co-worker at a conference held just weeks before the suspension was set to take effect, thus blunting even this minor monetary punishment.

The value of the lessons learned from the previous flashpoints became immutable truths for the IRS after the Barnard hearings. By verbally pledging to clean up its act, by shifting the players to avoid accountability, by remaining mute, the IRS emerged from the most painful public hearings into its integrity since the King hearings of 1952 with nary a scratch. Believe me, the IRS was laughing all the way home.

And now, to the Congressional response to these flashpoints.

As I already pointed out, in 1952 Congress acted by reforming and restructuring the IRS. This is the only time in the recent history of the IRS that Congress has taken decisive action which resulted in significant change inside the tax collector.

What of Watergate? Because the IRS was successful in hiding the real story—that the problem wasn't the White House directing politically-motivated audits but the IRS itself—Congress fixed the wrong problem. In 1976, asserting that the IRS had become a "lending library" of tax returns to the White House, Congress moved to tighten the privacy restrictions on tax return information, enacting the most restrictive provisions in the history of the tax code on access to such data.

Congress apparently did not realize the impact of its action. The result was that Congress actually handed the IRS the best defensive weapon it has ever had. By continually citing restrictions on access to taxpayer information, the IRS has perfected the art of blunting criticism and deflecting blame. Rather than putting real restraints on the IRS, Congress inadvertently gave the IRS even more power to operate without accountability.

And what of 1985, the year of the great tax meltdown? There is nothing like cries from constituents to bring about change. This time, Congress realized that floods of calls from angry taxpayers whose returns were missing or refunds delayed wasn't a helpful scenario at all. Thus, after the dust settled, Congress essentially gave the IRS a blank checkbook and told the agency to fix its computers forthwith. The IRS grabbed the checkbook and began writing checks. In the intervening decade, the IRS bought lots of fancy plans with spectacular bells and whistles, but they didn't end up buying a computer system that works any better than it did a decade ago, even two decades ago.

And the flashpoint/fizzle of Congressman Barnard's hearings which finally concluded in 1992? Nothing. Congress did not enact a single reform, take any action at all. Fizzle.

The circle begun in 1952 was now complete 40 years later. From an era when Congress was appalled at ethical problems inside the IRS and took decisive action to an era when Congress was deaf and dumb to revelations of unethical behavior and mismanagement inside the tax collector, the IRS completed its learning curve that the best defense is to promise that studies will be made, pledge to fix existing problems, and convince Congress to leave it untouched.

The problems of 1952 and 1992 are similar but not identical. In 1952, the problems were rooted in overwhelming presence of politically appointed tax collectors. As I have said, Congress's action in 1952 to remove these political appointees and turn the IRS into a bureaucracy run by career civil servants was the right fix for that time. The problem is that times change and nothing lasts forever.

Forty years later, the career bureaucrats who run the IRS have created their own unique problems. They have created an insular, secretive culture which is in its own way as dangerous as the political appointees of 1952 were. The IRS executive cadre of today is filled with IRS employees who are steeped in the culture of secrecy, who believe that running the tax system is too important a job to be left in the hands of anyone but a member of their private club, who have learned to wait out every storm, rearranging the deck chairs after each public revelation of mismanagement or financial bungling. More than anything, the IRS has learned to protect its own, the members of its club, while silencing any potential critics. It has learned to destroy its paper trail, so that there will be no evidence of mismanagement, no evidence of unethical behavior, no evidence of where billions of dollars were actually spent. Without a paper trail, Congress is left to accept the word of the IRS that it has done no wrong, at least not intentionally. There is no way to connect the dots, to find the needle in the haystack, to find the smoking gun.

You cannot find a better example of this than in the IRS news story of the week: browsing in tax files by IRS employees. Once again, I believe that Congress is attacking the wrong problem. Browsing is not good, but browsing is not the biggest problem at the IRS. In fact, without the IRS and media spin on this issue, the fact that the IRS only fired 23 employees over several years for browsing violations is a pretty fantastic track record.

The more important question is what is being done about the IRS executives who pledged "no tolerance" for browsing when Senator Glenn raised this issue several years ago. After the IRS made this pledge, did they actually do anything to enact it? Where are the documents to show us what action the IRS took? Where are the minutes of meetings held, briefings given, reports prepared? These documents will show us whether or not the IRS was serious when it pledged "no tolerance."

Again, accountability on the part of IRS executives is where Congress needs to be looking—what programs did the IRS put in place to prevent browsing? How good were those programs? What criteria was used by IRS executives to select which cases to go after? Congress must ask the right questions rather than grabbing convenient tax time headlines. The IRS is snookering Congress again. The browsing story plays directly into the hands of the IRS, which wants to be able to proudly proclaim that they are "protecting taxpayers", all the while skirting (again) the more important issue of accountability.

I find two aspects of the browsing story to be most revealing. In response to cries for tougher policing of its own employees, IRS executive Dave Mader said last week, "we ought to start with the assumption that we're going to fire them and then look at the circumstances." Translation: let's check out who the team players are and protect them and ferret out anyone who might criticize the agency. I should know. I was labeled a "problem employee" by Mader after breaching IRS internal protocol and reporting illegal activity to IRS Internal Security and the Treasury Department Inspector General. I was drummed out of the IRS by a trumped up investigation brought with malice rather than merit.

The second revealing aspect of this story involves a confidential GAO report which apparently indicates significant security problems at select IRS service centers. If problems with browsing are more severe at, say, three of the ten centers, shouldn't the IRS executives leading these centers be replaced? Shouldn't they be held accountable for lack of leadership, lack of action?

The IRS simply doesn't hold the members of its executive club accountable for their actions. By drumming out an occasional low-level employee while protecting its top-level bureaucrats, the IRS has once again succeeded in duping Congress and the American people. I am only aware of one IRS executive who was fired by the agency in recent years, and this executive apparently received a large cash settlement, along with secrecy clauses, to go quietly into the night.

As the new IRS commissioner in 1989, Fred Goldberg testified before the Barnard subcommittee that "the foundation on which all else rests is the integrity of our employees and the public's confidence in our ability to detect, investigate and deal with the mistakes that will inevitably occur."

Sounds good.

But Goldberg continued, saying that he didn't believe that dwelling on the details of specific cases brought forward by Congressman Barnard would do much good. Goldberg testified, "...we have already seen enough to know there is a problem....rather than take the next six months to dot the i's and cross the t's, we know you are right."

I say it's time to dot the i's and cross the t's. Nearly eight years after Goldberg said these words to Congress, the IRS appears even less willing to recognize that all is not well within its ranks. Congress should have held the IRS's feet to the fire in 1989. They

didn't, allowing the IRS to burrow deeper into its shell, relying on the argument that attacks on the IRS are dangerous to the integrity of our tax system.

Last week, while sharing a panel sponsored by the Heritage Foundation with former IRS Commissioner Shirley Peterson, I was confronted with the argument that those who criticize the IRS are "acting irresponsibly." Mrs. Peterson then threw down the gauntlet of the Oklahoma City bombing in an apparent effort to drive home her point.

But reasoned and factually-based criticisms of the functioning of the IRS are essential to ensuring that American taxpayers will enjoy the benefits of a tax system that is fair and fairly administered. Reasoned critiques of the tax agency will not incite bombings. If anything, they will convince a disgruntled American public that Congress can take action to address and correct serious problems at the IRS.

What can we do? We can no longer wait for the IRS to fix its own problems. With historical parallels to 1952, IRS plans and reorganizations of recent years haven't corrected the problems we all know are there. By glossing over problems, by rearranging the deck chairs, by renaming offices, the IRS has ignored the warning signs of an internal cancer. Today, that cancer has metastasized and must be excised if the IRS is to be saved.

I believe Congress should look to 1952 for suggestions on where to go from here. The problem today, more than anything—like that of 1952--is one of leadership. Leadership not just at the very top in the position of the Commissioner, but leadership throughout the entrenched secret society of IRS executives. Congress excised problem 45 years ago by replacing both the Commissioner and the entire top tier of IRS executives. Today, the same action is necessary to recreate the IRS into the premier organization that it has been and it can be again.

Biographical Data

Shelley L. Davis

Shelley L. Davis was the first, last, and only professional historian to work for the Internal Revenue Service. Hired in 1988, Davis served in this position until the end of 1995. Since then she has written a book about her experiences inside the IRS, Unbridled Power, Inside the Secret Culture of the IRS, published by HarperBusiness, 1997.

Prior to joining the IRS, Davis worked for nine years as an historian for the United States Air Force and the Defense Mapping Agency. She is a graduate of the Department of Defense Executive Leadership Program and recipient of an Air Force achievement medal for her work at the 12th Air Force at Bergstrom AFB, Texas. She has been selected as the recipient of the 1997 Alumni Achievement Award for outstanding public service by the University of Nebraska.

Davis is a member of the Board of Directors of the Treasury Historical Association and served for four years as a member of the Executive Council for the Society for History in the Federal Government. She received both her Bachelor's and Master's degrees in history from the University of Nebraska. She is a native of Lincoln, Nebraska and lives in Manassas, Virginia.

Mr. HORN. Let me go to former Commissioner Sheldon Cohen, who was Commissioner of the IRS during the Johnson administration, now a fellow of that distinguished body known as the National Academy of Public Administration. Thank you for coming.

Mr. COHEN. Thank you, sir.

I should start by saying the views I express today are my own. They are not attributable to my law firm nor the National Academy, which did send me here but did not review what I was going to say. I will try to summarize.

I am somewhat familiar with the King and Kean hearings because I was there. I was recruited to the IRS in the fall of 1952, just as the reorganization was in full swing. So I do subscribe to some of what Ms. Davis has said but not all.

I would admonish the committee that a page of history is worth a volume of logic, so you need to look to where you have been to see where you are going. There are some suggestions I have heard recently that we should repoliticalize the IRS. That is, we need more political responsiveness. That's the lesson we learned in 1952, that we don't want.

So I would go through this by saying that when I came to the tax law, the Internal Revenue Code was as thick as my thumb; and the regulations were somewhat smaller than that. I measured them on my desk the other day when I prepared my statement, and the Internal Revenue Code is now about 4½ inches thick, and the regulations are now in six volumes rather than one, and they measure something over 9½ inches wide.

That's not the choosing of the Internal Revenue Service. That's the choosing of the complexity of the society and the feeling of the Congress, that it has to respond to that complexity in some way or another. And so the complexity of the rules does create many of the problems, not all, but many of the problems that we're dealing with.

You have alluded to the fact that earlier in its history, back in the late 1950's, early 1960's, through the 1970's, the Internal Revenue Service was thought of as one of the best administrative agencies in the Government, and that is so. I should say that, as a preface or a footnote to that, that the cost of collection in the United States is still the lowest cost in the developed world.

So we are doing some things right. There are many things we're doing wrong, but we're doing some things right.

One of the problems that we find, and I think the restructuring commission has alluded to this publicly a number of times, is that the Congress never saw a problem which it couldn't address with a tax solution.

My first job was as a legislative draftsman. I can draft any appropriations bill as a tax law, and you have done it in spades over the years. Not just this group, of course, but the Congress, over the last 35 or 40 years that I have been watching it, has put in the earned income tax credit that we were talking about 10 minutes ago. That credit is a welfare provision that happens to be in the Internal Revenue Code. It doesn't belong there, and so the Internal Revenue Service catches the heat for administering a provision that should be in the welfare system.

And we could go on. I could spend the rest of the day discussing chapter and verse of other illustrations of that.

Change itself is complex. One of the simplest things I can advise you—and I've seen other tax experts up here try to say the same thing—is leave the tax law alone for 3 to 5 years and we would all get used to it. At least we will learn the rules. We wouldn't be dealing with a constant change of rules which makes it very difficult.

Last year, as I say in the statement, I was delivered 700 pages of explanation and law, and it was a quiet year. I am presumed—I did read it all, but I don't think you want to impose on the Revenue Service the jobs of collecting school loans, of finding wayward parents or fathers or mothers or going out and dealing with organized crime. Each one of these issues is probably meritorious, but each one adds to the complexity of the management of the job.

And I don't think anybody up here, including the oversight committees, has taken the time to say what is the overall effect of each of these piling on of layers of work. And of course we see now that result. We're looking at that result right now. We are looking at the result of a deteriorating system come about by the layering on of additional responsibilities.

Stability of work force. You can't give them 5,000 or 10,000 people today so you can score it for budgetary purposes, take it away next year and not have a deleterious effect. That is a negative, not a positive effect on the organization. You have geared up to hiring them, you've trained them, and then they are gone, and that's just demoralizing.

The cuts that come, when you say cut the Internal Revenue Service, well, you can't cut producing returns, you can't cut processing returns, you can't cut depositing checks. Well, where does a cut come from? It comes from training. Well, that makes the work force less responsive. It comes from auditing, comes from collection, comes from answering telephones. I mean, somebody—the Commissioner and the staff have to decide what are we going to cut, and what you cut really is the most productive work you do. And so it is that you will see the deleterious effects when you have these kinds of cuts.

I was lucky. We were living in different times, and I didn't have to face many of those problems, although I did face some of them. There were some freezes and those kinds of things when I was there.

One of the things just alluded to was the audit rate. The audit rate was something on the order of between 4 and 5 percent when I was Commissioner. The audit rate is presently they say between 1.5 percent and 1.6 percent but really it's less than 1 percent because they have redefined what an audit is in order to get the numbers up.

Well, you all drive as I drive out on the suburban highways. If we see a policeman once in a while, we tend to stay close to the speed limit. If we don't ever see a traffic policeman, we all bear a little heavily on the accelerator. And so it is with taxpayers. I think everyone who has ever worked in this business knows that, and so the deteriorating audit rate is just not acceptable, I don't think, in this kind of a system.

Now, I talked about the fact that we put in the computer system. We were lucky. The Congress didn't know what we were doing; and by the time anybody looked at it, it worked. It took a long time.

The system that I put in in the middle 1960's was designed in 1959, 1960 and 1961 by my predecessor. What happens is the Commissioner puts in the program that's designed by his or her predecessor and is responsible for planning for the programs that are going to be put in by the next one.

One of the things that has attrited in the last 10 or 15 years and attrited seriously is the IRS planning staff. The IRS had a premier research and planning staff. And of course when you start cutting back on their resources, they start cutting back; and somebody says, that's fat, well, it goes. And then goes your capability of producing the good plan, as Ms. Willis said, for your computer system—that computer system that was put in in the mid-1960's was designed mostly in-house, although some out-house work, but mostly in-house by a small group of 8 or 10 people.

One of the problems we have, of course, is I lived in a period of can-do Government. Today, we have Government being dumped on. And one of the problems I see is you would never see a commercial company—General Motors' chairman would never say, "we make lousy cars," although a few years ago they did. He would say, "we make great cars. We're going to make better ones if we all work together."

Unfortunately, we have had dumping on Government. Government is the source of every problem in the world. The Government has a lot of problems, but it also has a lot of solutions. And the revenue system, as I said in my paper, does produce more revenue at a lower cost than any system in the world and is a model for most of the rest of the world. It can be improved dramatically, but we have got to recognize that.

Ms. Davis is right, the revenue service was not responsive to the enemies list. I represented a taxpayer who was audited under TCMP during Watergate. He was one of the top 10 persons on the enemies list. And there were no problems. He never had a serious problem.

TCMP is an essential ingredient. Ms. Willis avoided answering your question, but there is no substitute at the moment. If there is no substitute, then we need a sample program. If nobody has got a better one, it would be a shame to let this one die; and as the data that is used to develop that program withers because of age, it becomes useless.

The program actually is designed to help taxpayers, not to harm them. Because when we started TCMP, about 50 percent of individual audits resulted in no change. By the time we finished, I think last year I saw the data for it, it was about 15 or 16 percent no change. That is, the computer selected a return, it looked like it had an error, it didn't. That's a big change from 50 percent down to 15 percent. Without that kind of data, you are just by guess and by God; and when you go into individual selection techniques, it uses up the most important resource you've got, people.

I am going to skip a lot of this, because you will I am sure read it, if you like. I will talk about a couple of the ideas that have been suggested. They are not new.

The idea of separating the IRS from Treasury has been suggested as long ago as 30, 35 years. I think it's a bad idea. If I were Secretary of Treasury, I would find it abhorrent that the most important revenue function of the Government does not report to me. That's not to say that the Secretary of the Treasury ought to have much in terms of management control. The Commissioner is the equivalent of an Under Secretary and ought to be left alone and ought to be responsible for doing the job. But there are tax policy issues and there are monetary and fiscal issues involved in the creation and the operation of a tax system, and the Secretary should have a voice in those, if need be.

The idea of a board of directors doesn't sit well with me; and, Mr. Chairman, you indicated that you want a manager for the Commissioner of IRS. Yes, you do. You want a good manager. But whether that manager is a CPA or a lawyer or a businessman is a hard question to answer.

Because, as I say in the statement, I wrote speeches when I was a kid for the last Commissioner of Internal Revenue, who was a nontechnician. He happened to be a CPA, but he happened to be a manager. He knew nothing about the tax system. He was a nontechnician. And he would come out congressional committees or he would go out and make a speech, and he would answer a question, and he would answer it logically. Well, the tax system isn't necessarily logic. The tax system is what the Congress says it is.

Then we would have to explain why he was wrong. Well, we would never admit he was wrong—why he was misquoted or similar problems. If you have a nontechnician sitting here today and you ask him a technical question, he or she has got to have enough nerve to say, "I don't know the answer to that question. Ms. Jones or Mr. Brown will answer it." It is a little hard in this context. So you may get what you wish for in this world, and that's kind of tough.

I think that's a pretty good summary. I'd say that, as I indicated to you, if you had a perfect tax plan right now, if you had a system that you thought was perfect in the Internal Revenue Service and you began to put it in today, it would take you 6 or 7 years to get it in.

So don't have an illusion that somebody is going to come up in the next 6 months with a magic bullet to make this thing work and work beautifully. It's going to take a lot of people and a lot of money and a lot of planning.

And one of the notes I handed Ms. Willis is she ducked your question. You asked her what kind of a system she would put in, and she doesn't know. Well, they don't know either. They ought to know, but they need enough money to think about it. And you want to hold them closely and make them produce the thing, but you have got to give them enough money to plan it. Because it isn't going to produce itself; and nobody outside the Revenue Service, without the cooperation of the Revenue Service, can produce that plan, because nobody knows what they need to do except themselves.

Mr. HORN. We thank you very much for that statement. I am sure we're going to be pursuing a number of questions with you.

[The prepared statement of Mr. Cohen follows:]

Mr. Chairman and Members of the Committee:

I am Sheldon S. Cohen, a Partner in the Washington, D.C. office of Morgan, Lewis & Bockius LLP and a former Commissioner of the Internal Revenue Service (1965-1969). Thank you Mr. Chairman for inviting me here today to provide the Committee testimony on the history and background of some of the present IRS administrative problems. I have provided the Committee my career resume for its information. I appear here today at your request and the request of the National Academy of Public Administrators of which I have been a member and officer for about 20 years. The views I express today are my own and not those of my law firm, any of its clients or of NAPA.

For background, I am a CPA and a lawyer and graduated from law school in 1952. My first job was in the Treasury Department and the IRS in the fall of 1952 as a legislative and regulation draftsman. I worked at the IRS for about four years during which I helped draft the 1954 Code and numerous regulations and legislation. Then I left for private practice and teaching in 1956. During my time in the government I saw the King and Kean hearings of the 1950's dealing with the corruption of the IRS which had existed prior to 1952. I also saw President Truman's "Blue Ribbon" reform which took the IRS completely out of politics. I should tell you that in evaluating where you are today, you need to know where you have been. In the words of Oliver Wendell Holmes, "A page of history is worth a volume of logic."

Before 1952 every Collector of Revenue for each district was selected politically and confirmed by the Senate. The IRS had over 70 politically-approved executives. This was what made the old Bureau of Internal Revenue so susceptible to political fixing. As a result of the investigation and resulting reorganization, the Commissioner and Chief Counsel are the only political appointees and everyone else is chosen through an excellent civil service merit system.

When I came to the Revenue Service in 1952 the Internal Revenue Code was about 3/4ths of an inch thick, and income regulations were in a bound volume about 2 inch thick. Now, 45 years later, the Code is in two volumes about 4-1/2 inches thick and the regulations are in six volumes about 9-1/2 inches thick.

The exponential growth in the law caused the growth in regulations. Regulations interpret new law. In the tax field regulations ordinarily do not make law; they explain it and make it operational. So the Congress must look to itself for the complication of the new law. Indeed, many of the changes were necessitated by changes in our dynamic economy. In order for a tax system to work it needs to conform to the economic system. Ours is a very dynamic economic system.

The IRS from the mid 1950's through the early 1980's was considered to be one of the very best administrative agencies in the government. One of its strong suits was its undoing.

It was so good at making complex legislation administrable,[1] that the Congress was not inhibited and passed more and more of it. Then various administrative agencies heaped more and more administrative jobs on the IRS, thus overburdening the system.

I have said before other oversight bodies up here; that any appropriation can be drafted as a tax law change. The Congress never hears a sad story without thinking of a tax law change to cure it. Each exception, while applying only to a narrow group, requires explanation and a place on the forms. Thus, while the exception may only apply to a small number of taxpayers, everyone will have to work through the explanation since the IRS has no way of limiting the form to a set group of people. Change itself is complicated. If you would ask your brothers and sisters to leave the statute alone for two or three years it would simplify the law, because we would all learn to work with a stable law; a constantly changing law is hard to learn. After the last session of the 104th Congress, I had delivered to my desk 700+ pages of law and explanation; and that was a relatively slow year.

Then you ask the IRS to collect college loans; you ask them to find wayward parents; you ask them to participate is in organized crime drives, etc., etc. Each of these ideas may be good, or not, but they each have little to do with collecting taxes and do distract the IRS from its main mission.

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[1] As an example, I use the old tax averaging statute. It was so complex that no one understood it. The IRS drafted a form which, while complex, led you through the statute a step at a time and as a result the law worked as intended. Although very few people understood it.

Stability of the work force is also of concern. You cannot increase the IRS by 5,000 in one year; and reduce it by a similar amount the next year and have it working well. You authorize more people and use that authorization to score it for budget purposes; I do not see you reversing the scoring when you reduce personnel at the IRS. These ups and downs are very hard on morale; it is bad for program development, it disrupts training and thus is counterproductive. Another idea prevalent in Washington is that training is fat and can be cut without harm. That is nonsense. Training is essential to keep the workforce sharp and ready to use new concepts and thus be more productive.

When you cut the IRS, the cut generally comes from muscle. The Service must prepare and distribute tax returns, it must process returns and deposit checks. Auditing, collection and servicing are really elective. How much of these very productive things are done is dependent on how much money you give the Service. Then the Congress sends mixed signals. Sometimes you say the IRS is too easy on deadbeats and must tighten up to bring in the collections. At other times many of you say they are too tough and should be nice to all people, including deadbeats. You cannot have it both ways at once. The IRS cannot with a given budget answer every telephone call on the first ring, without giving up a great deal of auditing and collection activity. Wonderful service with less auditing and collection activity will not bring in the revenue you expect to collect. We need a balance. People react in the tax field in a manner similar to motorists on a super highway. If I go on I-270 and do not see a police car, I will exceed the speed limit, or be tempted to do so. If I see a patrol car once in a while I will behave by driving more careful. So it is that we need auditing and collection activity to keep

the taxpayer in reasonable compliance.

I was lucky; President Johnson appreciated the difficulty of collecting taxes and took a personal interest is in getting the IRS the needed funds while I was Commissioner.

I was privileged to have put in the existing computer system. Unfortunately, the system I put in is the system still there. It is too old, too out of date to do the job today. Before I left in 1969 I left a plan called "The System For the 70's" which was designed to be installed in 1975 or so. You all will remember that was the post-Watergate period; and the Congress would not appropriate funds to do the necessary job. Again, a new system was designed for the IRS in 1980's and again it was not put in.

So we have 1969 technology in 1997. We are all to blame; not just the IRS. It is hard to move from one generation of equipment to the next; it is almost impossible to move and leap from over three or four generations.

When we installed the present system is in the 1960's, we ran the paper system parallel for the first year. We moved 20,000 plus people from 68 district offices to 7 service centers. I was lucky it worked; or at least it worked by the time Congress took a look at it.

I had continuity of staff. In the four years I was Commissioner: January 1965- January 1969, there were 15 top executives is in the IRS: 1 Deputy Commissioner, 7 Assistant

Commissioners and 7 Regional Commissioners. My Deputy became the Deputy Director of OEO and I moved up an Assistant Commissioner to Deputy and only one field official retired. Thus, there were only two changes in my top executives in four years. Today they have a 50 percent turnover in executives every two to three years. This turnover is partly because of Government salaries; we had salary comparability in the 60's. Government salaries were close to the comparable outside salaries. Also, today we have a negative attitude towards government. It was "can do" in the 60's. We seem to have the attitude today that Government is in the way; so we treat it badly. We also do not discriminate between core government, like the IRS, and other government agencies. I go to developing countries for the U.N. and lecture them that there is no real sovereignty until you can finance yourself, so we need a working tax system. The last year the U.S. had a balanced budget was the last year I was in office.

We seem to beat up on the government worker, then expect good service. That is not going to happen. The Chairman of the Board of General Motors would never say: "We make bad cars." He would say: "We make great cars and we would make them better if we all worked together." Yet some people in this town seem to love to beat on the Government worker as the cause of every problem. They do this for both the Republican and Democratic Administrations without concern as to the effect on the work force. Let me assure you, it has an effect on the work force, for the worst, not the best.

The IRS survived the Watergate period because of its integrity and good management system. In fact, the unacknowledged hero of the Watergate period was the career bureaucracy.

The President was wounded and did not function domestically for a couple of years, and yet the government functioned. Yes, Nixon's White House had an enemies list, but the Secretary of the Treasury and the Commissioner of IRS ignored it, so that no evil came from this most evil concept. In fact, I can state that I represented one of those in the top 10 on the "enemies" list and he came up for a TCMP audit during that time. I asked an old friend, an Assistant Commissioner of IRS about this oddity; he assured me and I believe him that it was a computer selection. In fact, the audit resulted in diminimus adjustments. I could have raised political issues in public, but I did not believe that was warranted, and my client concurred.

The Congress seems to be having a difficult time with TCMP (Taxpayer Compliance Measurement Program). I think it would help if you understand that the system was designed to help taxpayers, not harm them. When I installed the computer system in the 1960's we came to understand that we needed a better method of selecting returns for audit. We audited about two million individual returns then (between 4-1/2 percent and 5 percent of all individual tax returns were audited), but about 40 percent to 50 percent of those audits resulted in no change. We were then using selection techniques which required a great deal of time from the IRS' best personnel, and yet one-half of those selected were not productive. So we set off to devise a computer selection method to improve our selection. In order to do that we devised three or four different formulas and picked samples to audit under each technique. The cost of this experiment was hundreds of millions of dollars of opportunity costs in 1966 dollars. I was extremely concerned as to whether the Appropriations Committee would allow me to do that. They did, we used outside mathematical experts and a terrific in-house team. The experiment

resulted in the DIF formula which has been used since the mid-60's; updated every three to five years by new TCMP data. The system only works with good-recent tax data.

As a result of TCMP the no-change rate went down to less than 20 percent and the yield per audit hour went up dramatically. Thus, we improved compliance and audited the people who deserved it or needed it. We did not audit people who would result in "no change."

Recently the Congress has refused to renew the TCMP program. Perhaps the IRS was asking for too great an expansion of TCMP, but it was foolish, in my opinion, to jettison this most useful program. There is no TCMP data after 1988. The formula is now out of date, and audit results will deteriorate accordingly. Thus, the Appropriations Committee took action last year which it viewed as helping taxpayers, but which seriously harms the tax system and most taxpayers.

I mentioned earlier that I have represented a taxpayer who was subject to a TCMP audit. It is not fun, but it is not oppressive and it saves the majority of people time and money. We must have data from which we make management judgments. You cannot withhold the data, and then complain about the management results.

In the 1960's the IRS had what was called a performance budget. The Hoover Commission had recommended all of the government should function under such budgets. Thus, I gave the Congress my plan, they appropriated the money, then I had to perform as I said I

would. If I reprogrammed money, I reported that to the Appropriations Committee and we could discuss this. Now the budget comes in various segments and line items and so these are straightjackets to good administration. You cannot easily reorient money to needs which come up later in the year. Congress seems to feel that this line item approval gives them more control, and it may. However, it violates all good management concepts which require a reasonable degree of flexibility to meet changing situations.

I have been involved in assisting other nations in development of good tax systems, both policy and administration. In the 1960's I was on the organization committee which started CIAT (the Inter-American Center of Tax Administration) under the Alliance for Progress. It was realized by both Presidents Kennedy and Johnson that in order to revitalize the Latin American governments, an important element was a sound tax system. Thus, I had over 20 teams working in Latin America and elsewhere in the world to bring tax policy and administration to a modern level. I always say that the first indication of sovereignty is the ability to finance your government. So good tax administration is critical. CIAT has now been in existence for over 30 years and is the premier tax administration organization in the world. The United Nations Development Program and IMF and other organizations have now been using similar organizations to help improve tax administration all over the world. I have consulted with the U.N. and other international organizations to assist in these programs. While you hear much dismay about our tax system lately, we are still the model for much of the world. I was in Gaza and the West Bank for the U.N. advising the Palestinian Authority on its tax administration. They are using many of our techniques which they learned via the use of them

by the Israelis. I have also been in Africa, again sponsored by the U.N. In addition, I have been to Asia and have talked with many of those working in eastern Europe.

Many years ago I entertained a delegation of members of Parliament from the UK; they came here to study our self-assessment system. The British system, while good, is terribly inefficient. When I was Commissioner, they had a work force almost as big as ours, while their population was only one-third of ours. That 1960's study team recommended the British go to our type of self-assessment system. Mrs. Margaret Thatcher, then a backbencher, was a part of the team. With typical British efficiency, they moved slowly, it is only recently that they are really moving toward our system. Thus, while we hear much criticism of the IRS, nevertheless, the IRS is still about the best administrative tax agency in the world. I don't mean to say it could not be improved, and could not be better. It can, but we must understand the real situation and not deal with imaginary problems.

There are several related ideas being discussed: an independent IRS; a Board of Directors; a non-technical Commissioner -- (a pure manager). I will try to deal with each of these ideas separately, but they are all interrelated.

People have from time to time over the years suggested the IRS ought to be an independent agency, not part of the Treasury. In my time, I opposed that idea as simplistic. The IRS is about 2/3rds of the Treasury Department in terms of people. The tax collection function is critical to running our government, indeed any government. It would be hard to not understand a government which has a tax system that is not a part of the Treasury. This is a

true in all of the developed countries of which I am aware. When tax policy issues arise, they have administrative and technical issues, but, of course, they also affect policy issues (monetary and fiscal) that are the essence of being Secretary of the Treasury. I do not believe the IRS should be independent of the Treasury.

On the other hand, the Commissioner's rank is equal to an Undersecretary (Grade III, Presidential rank) and he/she should be and is treated as such. Thus, the Commissioner answers only to the Secretary and Deputy Secretary, and not through an Undersecretary or Assistant Secretary as in the other constituencies of the Treasury. In fact, the Secretary usually has only a light hand in dealing with the IRS and it does act virtually as an independent agency. I would hope that this would continue. No Secretary, or Deputy Secretary should even be involved in deciding cases or getting into the nitty-gritty of the IRS. To my knowledge each Secretary in modern times has pledged not to get involved in this.

I don't believe a Board of Directors is helpful or necessary for the IRS. We need a responsible Commissioner who will do a first rate job in administering our tax laws. We should hold the Commissioner responsible for a first rate job, if he or she fails, we should get a new one. There is a Board of Directors; it is the Congress. The IRS is not a corporation without a charter, it has a charter and it is the Internal Revenue Code, in which the Congress directs what it wishes done.

Agencies run by multi-member Boards have different rules about public disclosure and public meetings. What the IRS does is not something you want debated by a group with the press in the back of the room. Such a session would be invasion of privacy, or a license to commit tax fraud. If you tell me publicly what your plans are, you are also telling every tax evader, tax shelter operation, or cheat how to avoid detection. I think that if you really think about good administration, you would stick pretty close to what you have now; it is pretty much the world model.

There is also discussion of what type of Commissioner we want after Commissioner Richardson leaves at the end of the month. Some say we do not want a practicing lawyer or accountant as we have generally had in the past. They say we need only a good manager. I agree, and I disagree. There is much to be said on both sides of the issue. I wrote speeches for a Commissioner who was a non-technician. T. Coleman Andrews came to the IRS in 1953 from a CPA firm and the GAO, but he had no tax background. I used to write speeches for him. Often my boss would call me in to ask me how I could let the Commissioner make this or that statement in one of those speeches or in answer to a question asked in public. I would show them my draft which did not have the erroneous language. Commissioner Andrews would answer the question before public groups and Congress based on logic, but not always in accord with the Internal Revenue Code. Yes, a good manager could run the IRS, after all it is a large factory and a manager can run a factory, but he needs to test the product every once in a while or otherwise it will be like a Soviet factory which puts out a product which is no good and no one wants. Also is he/she would have to be disciplined enough to say: "I don't know" when

asked a key question before a Committee such as this one. I doubt you would tolerate that very long.

I can tell you how I did it. From my background you can see I have a business administration and accounting degree, as well as a law degree. My father was in a small business and I worked in his business from the time I was 14 or 15 through law school. I was the partner-in-charge of finance, etc. at Arnold, Fortas and Porter. When I became Commissioner (after a year as Chief Counsel, where I hope I was effective as an administrator); the first thing I did was to have a seminar for me and my top staff put on by a professor of business from the Harvard Business School. He put on a seminar for the 16 or 17 of us over a 4-day period; 14 hours a day. We understood each other at the end of that session and we could go out and feel comfortable with each other. Then I had two super deputies. One, Bert Harding served me one year and was selected by the President as Deputy Director of OEO (a Presidential appointment). He won the Rockefeller Award as the outstanding career official in government. Bert was followed by Bill Smith, who had worked with Bert as Assistant Commissioner for planning and had been on the team which designed the computer system. Bill also won a Rockefeller Award a few years later. Both Bert and Bill were excellent administrators; they were not great technicians, but they had experience with the tax law. I told both of them that they had charge of all appointments below Assistant District Director, and on most administrative matters, while I dealt with all executive appointments and some administrative matters, as well as all technical issues. We spent 30 to 45 minutes each morning dividing up the work for the day, and visited also at the end of the day: 6:30 - 7:00 p.m. to

review what happened so we each knew what the other knew. When one of us was out of town, the other covered. I made it a rule never to be out of D.C. more than 3-4 days a month. If you are in an airplane, someone else is Commissioner. Thus, I hope I did a good job, some people say so, and in retrospect, we put in the computer system, we put in centralized filing, we moved over 20,000 people to do all this, with no layoffs, we closed down four or five Districts and one Region, and it all worked. Yet, I consider myself a tax technician and I practiced tax law all my life and taught it for 25 years. In spite of all that, we had a balanced budget in my last year as Commissioner.

So I would say pick a technician with a flair for and like of administration. If you don't find someone like that, then pick a good manager. But if you do that you will have to fill in all around him/her with top rate technicians and make a system to coordinate everything. This is easier said than done. You pay your money and you take your choice.

There have been some people who want a super majority for tax increases. Some people have suggested that in order to keep the Congress from raising taxes we should require a super majority, like 60 percent or even 2/3rds. However, they then worry a little and put in an exception or two. For example, they say that when the country is at war a majority vote would do. This is passing strange in a democracy that we would allow a minority to control the fate of the country or that we would have the confidence that the Congress could enact a law which is so perfect that it needs no changes.

Let me hypothesize a situation which arises fairly often. Congress enacts a provision which it estimates would raise X but after six months it is clear they made a mistake and it only raise 1/2X. Now to raise the tax we need a 60 percent vote (or in a new proposal 2/3rds); so the 40 percent controls (or 1/3rd); is this the type of democracy we want?[2]

I could be cute and suggest that this is a perfect analogy to the movie many of you may recall: "The Mouse That Roared." You will recall the small, broke Duchy declares war on the U.S. so it can lose and then get something like the Marshall Plan. Here I would suggest we declare war on Grenada (as we once did). Declaring war only needs a majority vote. Then at war we can raise taxes with only a majority vote. You and I know I am being silly; but I hear grown men and women making statements not too dissimilar to those I have made here.

Thus, I would strongly recommend such super majority ideas are not constructive. There are means of accomplishing a political end; they are not constructive means of improving the governance of the U.S.

I guess my bottom line is that the tax administration system is good, not as good as it ought to be, but nevertheless good. It needs to be better. Particularly in the TSM, we need a new computer system. After all, the old system is now over 30 years old. What can be done by computers today was impossible when we put in our system. Do not believe there is a magic bullet. If you had the perfect plan today (and you don't) it would take 6-7 years or more to

[2] I understand the House adopted a rule in the 104th Congress which required a 60 percent vote to increase taxes. That rule has been in effect for several years and has been waived six times.

implement the plan. We are all too impatient; we want instant satisfaction. We need patience, goodwill, concern, and lots of money and good people to cure this problem. Each Commissioner in my experience implements the plan started by his/her predecessor, and hopefully leaves good plans which can be implemented by his/her successor. In a large agency like the IRS, four or five years in an instant. You need a longer perspective.

Mr. HORN. The last witness on this particular panel is Robert Tobias, president of the National Treasury Employees Union. Mr. Tobias.

Mr. TOBIAS. Good morning, Mr. Chairman. Thank you very much for allowing me to testify.

As all of us in this room know, the IRS has been bashed and battered by some Members of Congress, by the press and the public. Now, some of that criticism is justified. But much of the criticism ignores the IRS successes, and there are many.

IRS collected $1.36 trillion in revenues in fiscal year 1996. It is projected to collect $1.47 trillion in fiscal 1997 and projects it will collect $1.57 trillion in fiscal year 1998. In addition, in fiscal year 1996 IRS collected $38 billion through its enforcement efforts, revenue voluntarily paid and revenue from enforcement actions headed up through fiscal year 1996.

And in response to some of the questions Congressman Sununu raised, the IRS knows why those enforcement dollars are up. They are up because of the compliance initiative that was initiated by Congress in 1995, which allowed for more people to be involved in collecting taxes and in auditing taxes. The audit rate went up from 1.02 percent to 1.6 percent. And the number of people actively engaged in reducing the accounts receivable led to collecting in the first year of the compliance effort $800 million, notwithstanding the fact that the IRS promised $300 million in the first. Now, Congress killed that initiative in 1996, and I believe you are going to see a reduction in the enforcement revenue as a result.

Now, in contrast, the cost of collecting revenue is headed down. In fiscal year 1997, the cost to collect $100 of revenue—excuse me, in 1992, was 60 cents, 50 cents in 1997 and it's projected to be 47 cents in 1998, or an 18 percent drop in 4 years. Most democracies spend $1.25 to $1.70 per $100 of revenue collected. No tax collection agency anywhere comes close, much less matches the IRS cost per dollar of revenue raised.

While costs are declining, work is increasing. More returns are processed, more refunds distributed and more telephone calls answered. In the 1996 filing season, the IRS answered only 9 million calls of the 42.3 million made. Using roughly the same period, January 1 through February 24, 1997, the IRS answered 11.3 million calls or 2.3 million more of the 21.6 million calls attempted.

It's also important to note that fewer calls are being made this year, primarily because of IRS attempts to reduce unnecessary notices which, in turn, stimulate telephone calls. More revenue, more work performed and decreased costs should be the basis for at least mild applause from those who would evaluate the Internal Revenue Service based on a comparison to the private sector.

Despite these successes, the conflicting pressures imposed by Congress, the administration and the Federal deficit threaten to exert too costly a burden to the IRS and, in turn, the compliant taxpayer. Left unresolved, these pressures will result in lower levels of compliance, greater costs per unit of revenues collected and an erosion of the public confidence in the fairness of our tax administration system. As such, the Congress and the administration must immediately forge a new consensus on the mission of the Internal Revenue Service.

I believe that the IRS must make it a priority to provide the taxpayers who already comply or those who are seeking to comply with the services they need. At the same time, the IRS must increase enforcement activity upon the noncompliant to restore the confidence of the already compliant taxpayers in the system. The noncompliant have the right to be treated with respect, but the compliant taxpayers have a right to expect the IRS to enforce the law against the noncompliant. The compliant have a right not to expect to subsidize the noncompliant taxpayers in this country.

Now, the IRS management's proposed field reduction in force is a prime example of its moving away from its obligation to provide customer services to compliant taxpayers. The RIF plan will reduce customer service to those trying to comply, reduce net revenues and cause several hundred low-paid, mostly female employees to lose their jobs.

As the subcommittee is aware, the IRS scrapped the plans jointly developed to implement the field reorganization. The regional and IRS field offices had approved these carefully drafted plans but unilaterally rejected them and directed that a RIF of 2,371 employees would occur and 1,312 employees would be hired doing the same work in new locations.

The IRS continues to assert that the proposed RIF "has not and will not adversely impact service to taxpayers." I emphatically disagree with that. From May 1996, to April 14, 1997, the IRS failed to complete a plan to perform work with 1,059 fewer employees; and no new working processes has been created; and no new technology has been introduced. There is no question that taxpayers will have less service under the plan the IRS is proposing to implement.

The IRS has no data and no plan to refute the logical inference that 1,012 new inexperienced employees cannot provide the same level of customer service as 2,371 experienced employees. There can be no question that taxpayers, compliant taxpayers and those seeking to be compliant, will not receive the service they need and deserve; and the IRS cannot absorb the downsizing by detailing experienced employees or creating dual-position descriptions to solve the problem.

As was pointed out, the Internal Revenue Service has lost some 10,000 employees over the last 2 years. I identify in my testimony the specific kinds of actions that taxpayers will suffer as a result of this: delays in the release of tax liens; increased interest costs to taxpayers from delays in processing liens; late case closure, resulting in an increased notice of unwarranted notices of deficiencies; increased errors by inexperienced replacements; reduced problem resolution service; reduced taxpayer education programs to help targeted groups; reduced information systems personnel to maintain computer and telephone systems; and fewer individuals to help taxpayers interested in electronic filing.

And to bring this home, Mr. Chairman, consider what would happen to those who cannot get timely assistance from the IRS. Your constituent may be an elderly and infirmed widow who has just discovered she has a tax lien to her house. She needs to sell her home to move into a nursing home. Her health is failing rapidly.

She promptly satisfies the lien, but she cannot complete the sale until the IRS clears the lien.

Instead of clearing the lien in 3 days, as is the current practice, there are IRS locations today where 30 days will pass before her lien is released. Her buyer will lose patience. The sale will fall through. She will, without doubt, be damaged.

While this story is fictional, it illustrates what will happen to countless real people, real taxpayers. Each person affected could needlessly suffer personal hardship and monetary damages resulting directly from the failure of the IRS to provide prompt and accurate customer service.

Mr. Chairman, NTEU fully supported the IRS announcement that it would reduce the number of districts from 63 to 33 and the number of regions from 7 to 4. However, we cannot support the proposed RIF of these employees. NTEU urges Congress to prevent the IRS current proposed method of implementing its reorganization plan.

If the ultimate goal of the field reorganization, as stated in the IRS congressional testimony presented on March 18, 1997, is to ensure, "that salary dollars can be spent instead on front-line operations," NTEU asserts that Congress should transfer the $97 million in fiscal year fiscal 1997 appropriations, which will not be spent as planned on information services' downsizing and several tax systems modernization programs that have been canceled, and use that money to provide more front-line compliance and customer service positions.

In addition, Congress could get the IRS back on the right track and enhance confidence in the tax system by restoring funding for more rigorous compliance activity. While wage earners are 95 percent compliant and 75 percent of taxpayers take a standard deduction, the latest calculation in 1992 of the compliance gap showed $129 billion in taxes went unpaid, $22 billion more than the Federal deficit of $107 billion last year.

Congress conducted an experiment in 1995 which proved the IRS could reduce the noncompliant population and increase revenue for deficit reduction. The IRS geared up, hired and trained people. The IRS promised, as I mentioned, $300 million in marginal revenues and produced $833 million in marginal revenue. Congress withdrew its support for the initiative to save money for other purposes, and the administration has since not renewed its funding request.

NTEU believes it is penny wise and pound foolish to forgo the added revenues which can be collected through investment in compliance activity. Congress could use the added revenue to further realize customers' objectives and reduce the Federal deficit.

Last, NTEU believes that Congress must consider alternative funding mechanisms to provide the IRS with adequate and stable funding resources. Current budget rules do not provide sufficient reliability to allow the IRS to function at its most efficient state.

For example, when Congress decided to end the 1995 compliance initiative, the budget rules scored the $400 million cut in salaries and expenses as a savings and ignored the $9 billion in revenue that the initiative would have brought in over the next 5 years. These rules presumably are intended to conserve our resources, yet

our common sense tells us they do just the opposite. NTEU urges Congress to rethink these rules as they apply to the IRS.

Thank you again, Chairman Horn, for the opportunity to express NTEU's views on the management issues confronting the IRS today. I will be very happy to answer any questions you might have.

Mr. COHEN. Mr. Horn, if I may——

Mr. HORN. I thank you very much for your testimony.

[The prepared statement of Mr. Tobias follows:]

Chairman Horn, Ranking Member Maloney and Members of the Subcommittee, my name is Robert M. Tobias, and I am the National President of the National Treasury Employees Union (NTEU). On behalf of the men and women who collect the revenue for the federal government, I would like to thank you for this opportunity to present our Union's views on current management issues confronting the Internal Revenue Service.

It is obvious to all here today that the Internal Revenue Service (IRS) faces significant criticism. Many problems do exist for which the agency itself is responsible. However, many criticisms of the IRS and its employees are unfounded or overstated for political purposes unrelated to tax administration.

I believe it is important to recognize that many problems people have with the tax administration policies of the IRS cannot be resolved if the debate remains mired in political controversies surrounding tax policy. Fortunately, key Members of Congress as well now recognize that the scorn some have for our tax policy ought not be injected into the debate regarding the ongoing restructuring of the IRS. As Ways and Means Chairman Archer clearly articulated in a recent hearing on the IRS budget, ". . . as long as we have an income tax, we must have an IRS that has the resources and the tools to perform the mission it has been given by Congress. That means the IRS must receive adequate funding."

Before I move onto the problems in the IRS I believe should be addressed, I would note that the IRS is performing quite well in some areas. IRS collected $1.36 trillion in revenues in Fiscal Year 1996; $1.47 trillion in FY 97; and projects it will collect $1.57 trillion in FY 98. In Fiscal Year 1992, the cost to collect $100 of revenue was 60 cents, 54 cents in FY 96, 50 cents in FY 97 and in FY 98, the cost should drop to 47 cents. Most democracies spend $1.25 to $1.70 per $100 of revenue collected. No tax collection agency anywhere comes close, much less matches the IRS cost per dollar of revenue raised.

The IRS has made significant improvements in telephone accessibility as well. In the 1996 filing season, the IRS answered only nine million calls of the 42.3 million attempted (21.3 percent). Using roughly the same period, January 1 through February 24, 1997, the IRS answered 11.3 million calls of the 21.6 million calls attempted (52.3 percent).

NTEU also applauds IRS efforts to increase electronic processing. As of March 7, 1997, the number of electronic filings by telephone and computer had increased by 24 percent over the prior year. As of March 21, 1997, the IRS had received more than 12.1 million standard electronic returns. The IRS estimates that 19.2 million Americans will file electronically in 1998, up from 11.8 million taxpayers in 1995. Thus, significant cost savings from this promising alternative should be possible.

Despite these successes, the conflicting pressures imposed by Congress, the Administration and the federal deficit threaten to exert too costly a burden upon the IRS, and in turn, the compliant taxpayer. Left unresolved, these pressures will result in lower levels of compliance, greater costs per unit of revenues collected and a further erosion in public confidence in the fairness of our tax administration system. As such, the Congress and the Administration must immediately forge a new consensus on the mission of the IRS.

I believe that the IRS must make it a priority to provide the taxpayers who already comply and those who are attempting to comply with the services they need. At the same time, the IRS must increase enforcement activity upon the noncompliant to restore the confidence of the already compliant taxpayers in the system. The noncompliant have the right to be treated with respect, but the compliant taxpayers have a right to expect the IRS to enforce the law against the noncompliant. The compliant have a right not to expect to subsidize the noncompliant.

The IRS management's proposed field reduction in force is a prime example of its moving away from its obligation to provide customer services to compliant taxpayers. The RIF plan will reduce customer services to those trying to comply, reduce net revenues and cause several hundred low paid, mostly female employees to lose their jobs.

As the Subcommittee is aware, the IRS scrapped the plans jointly developed by IRS and NTEU

to implement the field reorganization. The regional and IRS headquarters offices had approved these carefully crafted plans. However, the IRS unilaterally renounced the jointly created plans in May of last year and announced that the support work currently performed in the non-continuing districts would be performed in the headquarters offices of the continuing districts. The IRS dictated that it would RIF 2,371 employees in non-continuing positions and rehire 1,312 new employees doing the same work in continuing districts.

The IRS continues to assert that the RIF "has not and will not adversely impact service to taxpayers." I emphatically disagree. From May 1996 to April 14, 1997, the IRS failed to create a plan to perform its work with 1059 fewer employees. No new work processes have been created and no new technology has been introduced.

The IRS has no data and no plan to refute the logical inference that 1312 new, inexperienced employees cannot provide the same level of customer service as 2371 experienced employees. There can be no question that taxpayers -- compliant taxpayers and those seeking to be compliant -- will not receive the service they need and deserve.

And the IRS cannot absorb this downsizing by detailing experienced employees or creating dual position descriptions to solve its problem.

The post-RIF proposed IRS FTE level this year will drop to 102,000 from 112,000 in FY 95. In FY 1992, the IRS FTE was 116,000, roughly 12 percent above the proposed FY 1998 level. There are no available employees to fill the gap between what taxpayers need and what the IRS will provide if it is allowed to proceed.

The RIF will result in delays in the release of tax-liens; increased interest costs to taxpayers from delays in processing liens; late case closure resulting in an increase in unwarranted notices of deficiencies; increased errors by inexperienced replacements (with fewer experienced staff to correct these errors); reduced problem resolution service capacity and productivity given insufficient experience levels; reduced taxpayer education programs to help targeted groups, including small business owners; reduced information systems personnel to maintain computer and telephone systems, and fewer individuals to help taxpayers interested in electronic filing.

Consider what could happen to those who cannot get timely assistance from the IRS. Your constituent may be an elderly and infirm widow who has just discovered she has a tax lien on her house. She needs to sell her home to move into a nursing home - her health is failing rapidly. She promptly satisfies the lien, but she cannot complete the sale until the IRS clears the lien. Instead of clearing the lien in three days as is the current practice, there are IRS locations today where thirty days will pass before her lien will be released. Her buyer will lose patience - the sale will fall through. She will be damaged.

What will happen to the hardworking small businessperson who seeks in good faith to appeal a tax ruling involving a substantial sum of money? This constituent is among the majority of business filers who dutifully file and pay on time year after year. He disagrees and wants to appeal, but the persons who issue the "bill" will be RIF'd. While he waits, his interest costs accumulate as his outstanding liability remains unresolved. In addition, he cannot expand his business, hire any new employees or attend to the financial needs of his family given the delay. He will be damaged.

While these stories are fictional, both illustrate what will happen to countless real people, real taxpayers. Each person affected could needlessly suffer personal hardship and monetary damages resulting directly from the failure of the IRS to provide prompt and accurate customer service.

Mr. Chairman, NTEU fully supported the 1994 IRS announcement that it would reduce the number of district offices from 63 to 33 and the number of regions from seven to four. After the 1994 announcement, IRS and NTEU worked hard and developed transition plans that fully carried out the announced vision of the reorganization. NTEU remains committed to the reorganization of IRS, but cannot support the IRS method of implementation -- a proposed field reduction in force of 2371 field employees.

Mr. Chairman, our opposition to the IRS-proposed RIF also stems from our concern for those IRS employees who will lose their jobs. NTEU believes most are women and/or minorities. NTEU has requested this data from the IRS on several occasions, but the IRS has not produced it. Our anecdotal evidence suggests that nearly 80 percent of the IRS employees affected by the RIF are women and/or minorities.

NTEU urges Congress to prevent the IRS' current proposed method of implementing its reorganization plan. If the ultimate goal of the field reorganization as stated in the IRS Congressional testimony presented on March 18, 1997, is to ensure "that salary dollars can be spent instead on front line operations, " NTEU asserts that Congress should transfer the $97 million in FY 1997 appropriations which will not be spent as planned on Information Services downsizing and Tax Systems Modernization to provide more front line compliance and customer service positions.

NTEU specifically requests that the $61 million intended for a proposed information services reduction in force and $36 million intended for computer modernization be shifted to cover the costs of hiring front line compliance and customer service personnel. This would meet the IRS's goals, allow for the retention of experienced personnel and permit a new IRS Commissioner to be involved in any major reorganization decisions.

In addition, Congress could get the IRS back on the right track and enhance confidence in the tax system by restoring funding for more vigorous compliance activities. While wage earners are 95 percent compliant and 75 percent of taxpayers take a standard deduction, the latest calculation in 1992 of the compliance gap showed $129 billion in taxes went unpaid -- $22 billion more than the federal deficit of $107 billion last year.

Congress conducted an experiment in 1995 which proved the IRS could reduce the noncompliant population and increase revenue for deficit reduction. As you will recall, Congress promised $2.2 billion in funding over five years and the IRS promised a marginal increase in revenue collected of $9.4 billion. The $2.2 billion was to fund 5,000 additional positions for five years.

The IRS geared up, hired and trained people. The IRS promised only $300 million in marginal revenue in the first year because of hiring or training. These new employees collected not $300 million, but $833 million in marginal dollars. In other words, IRS employees nearly tripled projected revenues in the first year of this special compliance initiative. While some dispute exists over the amount returned, no one disputes that the 1995 initiative returned far more than the amount invested. Nor can anyone dispute that had the initiative continued, the return would have been between 400 and 1000 percent.

Congress withdrew its support for the initiative to save money for other purposes and the

Administration has since not renewed its funding request. NTEU believes that it is penny wise and pound foolish to forgo the added revenues which can be collected through investment in compliance activity. Congress could use these added revenues to further realize customer service objectives and reduce the federal deficit.

Lastly, NTEU believes that Congress must consider alternative funding mechanisms to provide the IRS with adequate and stable funding resources. This is also something that the National Commission on the Restructuring of the Internal Revenue Service is looking at. Current budget rules do not provide sufficient reliability to allow the IRS to function at its most efficient state. For example, when the Congress decided to end the 1995 compliance initiative, the budget rules scored the $400 million cut in salaries and expenses as a savings and ignored the $9 billion in revenue that initiative would have brought in over the next five years. These rules presumably are intended to conserve fiscal resources, yet our common sense tells us they do just the opposite. NTEU urges Congress to rethink these rules as they apply to the IRS.

Thank you again, Chairman Horn, for this opportunity to express our Union's views on the management issues confronting the IRS today. This concludes my testimony. I would happy to answer any questions you may have for me.

Mr. COHEN. I left one thing out. Ms. Davis mentioned 6103; and I need to tell the committee, 6103 was amended in 1976 at the request of the Senate Government Operations Committee.

Mr. HORN. Do you want to translate 6103?

Mr. COHEN. 6103 is the privacy section of the Code. It requires confidentiality. And the Administrative Conference of the United States was requested to make a study. The chairman of the Administrative Conference at that time was Nino Scalia—excuse me, Antonin Scalia, the Supreme Court Justice; and I was the co-chair. So it was done for a valid purpose. It may not have been done right, since one can argue about public policy, but it was done carefully by a careful committee.

Mr. HORN. Let me make another translation for those who read this transcript. We heard a lot about the TCMP. What it translates to in day-to-day English is the Taxpayer Compliant Measurement Program, in case anyone is wondering about that.

I now yield 5 minutes to Mr. Davis, the gentleman from Virginia.

Mr. DAVIS OF VIRGINIA. Thank you very much.

Mr. Tobias, what is the morale like among the rank and file? There has been a lot of bashing against the IRS. Has it filtered down to the employee level and—with the planned RIFs? Could you give us a reading on that?

Mr. TOBIAS. The morale of the Internal Revenue Service employee is very low, certainly in connection with the planned RIF and certainly in connection the bashing they have taken over the last 2 years primarily; and that translates not only into problems in the workplace, but also I think a lack of respect by taxpayers toward the IRS and the legitimate actions that IRS takes. I mean, all too often, the Internal Revenue Service employees are blamed for the laws that you all create.

Mr. DAVIS OF VIRGINIA. That's so often the case.

I was interested in your comments on the RIF. The IRS thinks that it won't adversely impact services, taxpayers. You obviously take a different view on this. Do any of you have any evidence that women and minorities aren't going to be disproportionately treated?

Mr. TOBIAS. We have been trying to get that information from the IRS since May of last year, and we still haven't been able to get the information. The anecdotal evidence is, yes, they will be adversely impacted and perhaps illegally so. But the kinds of jobs that are adversely impacted are, primarily, based on the anecdotal evidence and my travels around the country, are women and minorities.

Mr. DAVIS OF VIRGINIA. Anybody else on the panel have anything about that?

Let me ask, why do you think that walking into a local office and making a local telephone call is preferable to calling a 1–800 number? Is it more productive, do you think, in terms of customer satisfaction or comfort in terms of the calling up? Any studies on this?

Mr. TOBIAS. Certainly, the Internal Revenue Service can't supply enough people in every office to satisfy walk-ins, and a 1–800 number is critically important. But it's also critically important to have someone in a location to release a lien, or to answer a question, or

take a check when someone does walk in an office. So both are necessary. One can't be advanced to the exclusion of the other.

The Internal Revenue Service has attempted to characterize this dispute in terms of taxpayer service, traditional 1–800 taxpayer service. I believe the issue is whether or not customer service, service to taxpayers in general, will decline with this proposed RIF. And I don't think there's any question, there can be no doubt that this will occur.

Senator Kerrey did some hearings out in Nebraska just last week where practitioners, IRS employees and the public all came and testified that they were not receiving the service that they had received 3 months, 6 months, 9 months ago. And I think you will find that to be true across the country.

Mr. DAVIS OF VIRGINIA. You talked at length about the release of liens and the widow who may need to release a lien and how difficult that may become. We heard from a witness in a prior hearing that the IRS didn't do a very good job of working on taxpayer liens anyway. Do you have a different impression or are you saying if it didn't before it's going to be worse under this?

Mr. TOBIAS. It's going to be worse. It's going to be worse in those districts, in those noncontinuing districts, the districts who have been identified as noncontinuing districts. There used to be 63, now there are 33. There are 30 noncontinuing districts, and in those districts, there will be problems.

Mr. DAVIS OF VIRGINIA. OK. Thank you very much.

Ms. Davis, let me ask you. In your opinion, if the IRS contracted out for a new state-of-the-art computerized information system with bells and whistles such as access and other security controls, had it installed and saw it was working perfectly, would that mean that Congress, GAO, the Treasury, the IG and all the other IRS stakeholders could rely on the IRS information from then on? Would the current staff be capable of taking it from there and running with it?

Ms. DAVIS. I'm not sure I understand the question.

Mr. DAVIS OF VIRGINIA. If you had a system that was up and working perfectly, could we then rely on the IRS information from then on or are there other inherent problems?

Ms. DAVIS. Well, it's a hard theoretical question to answer. I guess one thing, as far as contracting out a computer system—I know this isn't really what your question is getting at—I don't think the confidentiality flags that get waved in the air every time something is talked about getting contracted out are really a severe problem to be concerned about. So you could potentially even contract out the entire computer system as well as the operation of the computer system, and that may be where the best answer lies.

I think that if the IRS had a completely wonderful new computer system placed in its hands—I think the vast majority of IRS employees who are out there across the country in the field offices running the computer systems, processing the tax returns are doing the best job they possibly can. I think that would be fine.

As I said in my statement, I really believe that already every problem that the IRS is saddled with today emanates from the headquarters of the IRS, from the executives. So I think if you put a new computer system in the hands of the IRS employee around

the country, I think you might very well have a much smoother running system.

Mr. DAVIS OF VIRGINIA. That's a very good endorsement. I am sure Mr. Tobias would agree the problems here aren't generated from the rank and file employee.

Mr. TOBIAS. They are not.

Mr. DAVIS OF VIRGINIA. Mr. Cohen, any observations on that?

Mr. COHEN. That's a little too simplistic. If you had a perfect computer system—and you wouldn't ever have it, because the moment it's perfect, it's out of date as soon as you put it in. So you can't stop. You can't stop planning for tomorrow because you have got—things are going right today, because that's a recipe for disaster.

We're entitled to a fair trial in the United States. We're not entitled to a perfect trial. We are entitled to a fair tax system, not a perfect tax system. And so we have got a very good one.

We have got a lot of defects. There has been some managerial fall-down, not to the extent Ms. Davis says, and so you can't design this system with the thought that this is the last time you are going to design a system. That's the problem. We designed the system 30 years ago, which was a fine system. It is not a fine system today.

Mr. DAVIS OF VIRGINIA. Thank you, my time is up. I appreciate that.

Mr. HORN. Thank you. Five minutes to the ranking Democrat, Mrs. Maloney of New York.

Mrs. MALONEY. Thank you. Mr. Cohen, you indicated in your testimony, the changing laws, Tax Code laws, are a problem. What do you suggest we do about it?

Do you suggest we have a 2-year moratorium on changes in the Tax Code?

Mr. COHEN. I do that, really, as a joke. I think the Congress is like every other body in the United States. It needs an internal discipline also. You need an internal discipline here, and you need someone who is going to say—well, I will give you an illustration.

I used to say for the Assistant Secretary for Tax Policy—he was a close friend, a premiere tax attorney in the United States, a professor—I said, Stanley, you understand it; I almost understand it. How in the world do I explain it to the rest of the people? Someone here has to say the same thing; that this is a good rule. It may be better than the existing rule, but it is—for example, the alternative minimum tax is a rule that was enacted up here. Now, it seems to be the current kicking boy. Everybody is kicking the alternative minimum taxes being the most complex rule in the Internal Revenue Code.

What was it designed to do? It was designed to help a Congress avoid facing limitations on individual deductions, which, when put together, gave some taxpayers unusually large deductions, and, therefore, they paid no tax. So, instead of addressing the problem directly, as it should have, Congress said let's take this pill. This pill is called the alternative minimum tax, and that tax has been in here since 1968 or 1969, and you diddled with it, but after you diddled with it, you made it worse, not better.

Mrs. MALONEY. What do you suggest we do about it? Do you suggest that possibly we informally have a collaboration with IRS professionals on what the consequences of certain tax changes have in the implementation?

Mr. COHEN. It is a nice idea, I kind of like that.

Mrs. MALONEY. It is a serious suggestion that you have on the constantly shifting tax policy, which is problematic not only for the IRS, but certainly for the American businesses, and certainly the trade of the world that we are involved in, and the constant—you know, we now have a certain budget cycle. Maybe we should have a tax cycle of 2 years so that people have a chance to sort of understand the ramifications, and that you are not constantly going into situations, which you pointed out, the IRS goes into.

One day they have a certain set of employees, the next day they have a certain set of employees. It is hard to plan and implement. With all the cutbacks, maybe we should have the same type of planning restrictions not only on personnel in the job, but also on changes of policy, so that the business community, the trade community and the IRS professionals themselves could catch up with it.

And, also, I want to very quickly throw in another question with response to your testimony. You mentioned, we train them, we spend time with them and then they leave. Why are they leaving? You were talking about the personnel.

Mr. COHEN. Let me answer in the order that you asked them. The chairman of the Ways and Means Committee many years ago was a fellow by the name of Wilbur Mills, who was a Harvard Law School graduate and a first grade technician. And he had an interest in the technical aspects of the tax law.

Most Congress people don't have that. They, you know, they are interested in the policy, but they are not interested in technical aspects. Somebody here has to ask the question once in a while, what does this do to the tax law?

Wilbur had a plan at one time. It was never implemented because he couldn't get anybody to go along with it. He would divide the Code into sections and he would study over a period of 4 to 5 to 6 years. Each year he would study different elements and try to improve them.

Now, that would take up the full power of the Ways and Means Committee and it wouldn't be able to do all the other things it does, but at the end of a 4 or 5-year period, you would have a much better law. That is why it never got done, because it would have diverted them from doing the little diddles that help each one of the Members of Congress do what they would like to do.

One of the things I have suggested, and I have heard other people suggest on occasion, is each time somebody suggests an improvement or change in the Internal Revenue Code, they be required to submit to you how that be reflected on a tax return because that would be very telling. Where is the space on the return? What would the instructions look like?

Mrs. MALONEY. Also, Mr. Cohen, you could add to that thought having the IRS comment on how they would implement it.

Mr. COHEN. You don't ever ask them. Again, I used to be a staff person, so I drafted legislation, and it was rare to come up here.

Now, Mr. Mills would invite me in private. I would come in and tell him what I thought, but it would be rare that I testified in public hearings because I wasn't invited. Policy wasn't my bag, so I mean, it can be done because Mr. Mills used to do it, but both of those ideas withheld.

Now, why do people leave? Government is unattractive now. When I was Commissioner, and it didn't have anything to do with me being Commissioner, President Johnson passed a Comparability Act and Government salaries were within about 85 percent of going rate in the area. The work was good, so good people came and they enjoyed it.

As I indicated to you, I had the 15 top people on my staff and only 2 of those people changed in a 5-year period of time. You got a 50 percent turnover in less than that right now. That is because the pay isn't up to snuff and because they get beat around the head fairly often.

Mrs. MALONEY. Well, as you know, our Nation was founded on a tax revolt, and certainly no one wants a meddlesome "Big Brother" approach in our taxes, but we should at least demand, from an important Government agency, that they be competent and efficient. They should certainly be as competent and efficient as American Express, or Citicorp. Yet, by all accounts, they are not.

Mr. COHEN. Citicorp picks its clients. The IRS doesn't pick its clients.

Mrs. MALONEY. Well, that is true. But, certainly, the management, not just the clients, the management——

Mr. COHEN. See, the client is involuntarily dealing. If I go to the bank to borrow money or to have a credit card arrangement, it is benefiting me. If I go to the IRS to pay them taxes, it is hurting me. The definition of a tax is that it's an enforced exaction of a State. That is the definition of a tax.

Mrs. MALONEY. Yet by all accounts, the GAO reports, repeatedly, your testimony and others, there has been, shall we say, not especially efficient or consistent management, or effective management at the IRS, and I would like to come back to your testimony. I am out of time, he is telling me.

Mr. HORN. I thank the gentlelady from New York. The gentleman from New Hampshire, Mr. Sununu.

Mr. SUNUNU. Thank you.

Mr. Tobias, we have all read by now a number of accounts about information systems, numbers in the computers, what has been spent and how effective it has been. But my perspective is that while a computer is a good information system and is important, technology is a poor substitute for good people and good training.

But having said that, I would like to hear your perspective on what opportunity there is to improve the tools and equipment that is in the hands of the people on the front lines? What kind of changes or modifications and opportunity for improvement is there, that certainly the members of your employment group would like to see, as we go about trying to repair and amend some of the technology implementation plans that we have.

Mr. TOBIAS. I would start at the most basic tool and that is the human resource tool. The amount of dollars spent on basic training and advanced training of the IRS, I believe, was cut $21 million

from—in 1996. So continuing education was not part of the 1996 IRS effort because Congress cut funds and training was cut. So I think basic training is critically important.

For the customer service representative Congresswoman Maloney was speaking of just a moment ago, they need the tool to be able to have the return come up on their screen so that they can provide an instantaneous response to the question that the taxpayer asks, and the tax system's modernization effort was to provide that kind of information, to integrate the data bases so that questions could be answered and adjustments made at the time the first telephone call was made.

Those kinds of tools, to customer service representatives, would, in my view, significantly enhance the credibility of the IRS and provide the information compliant taxpayers need to remain compliant.

Mr. SUNUNU. Where, in your mind, have the shortcomings been, though, in trying to implement the modernization programs? I mean, there have been clearly shortcomings, clearly failures, and I don't know if it is a question of setting expectations that are too high with regard to what technology can do, or failure at the management level or failure in not being inclusive enough in taking into consideration people at the customer service level and design of the systems. Where, in your mind, has the failure been?

Mr. TOBIAS. I think the IRS bit off more than it could chew. I think that the IRS recognized that the technologies of the sixties and seventies wasn't going to be good enough for the technology of the nineties. It had tried, like private sector corporations, on several occasions, to introduce new technology.

It would get up to the brink of implementation, Congress pulled the plug on the funding, and so there came to be a consensus that the IRS had to have new technology and the IRS', I believe, mentality was we have to go for broke because we don't know how long this funding will last.

There was no idea of stable funding, so I believe the IRS tried to do too much. It did not integrate the 23 separate programs. And the several millions of dollars, hundreds of millions of dollars it was projected to spend, it didn't have infrastructure. It didn't have architecture, and as a result, it was not managed properly.

Mr. SUNUNU. Mr. Cohen, maintaining the line of inquiry on technology, you talked about the system designed in 1960, 1961, and then put into place when you were Commissioner. To what extent is that venerable computer system still utilized in the activity today?

Mr. COHEN. Unfortunately, much of it is still utilized. Some of the hardware has changed, but, basically, the basic thrust of the program is the same in technology, of course. We had no random access. If we wanted to find Sheldon Cohen's tax return, we had to go through a roll of tape and run it until it got to my Social Security number and it would stop and produce my information. But no random access.

I mean, my little personal computer has more random access than their big computer down at Marksberg. We put in three IBM 360's and 370's, which were state-of-the-art in the mid 1960's, absolutely top line. I doubt if Congress would have let us do it if they

had known what we were doing. We were going for broke because we knew we had one shot to put it in there.

And Mr. Tobias is absolutely right. You have this instant gratification mentality. This is a long program, as I say, if you knew what you wanted. I talked to Mr. Gross. We had lunch a few weeks ago, and if you had a program today that was as good as you could get, close to perfect, you were talking about 6 or 7 years to put it in, and you are talking about 2 or 3 years at least to design it, so you are talking about a 7 or 8-year program. Life was simpler then. It was designed in 1959. We began installation in 1964 or 1965, so, you know, the machines were simpler, the context was simpler.

And, by the way, the first thing we had to learn, then, was that we had to have our paper system working as good as it could possibly work before we went into computers. You can't leapfrog. So you need to take the present system and make it work as perfectly as you can make it and move into the new system. You can't leapfrog, and they are trying to leapfrog two or three generations. That is awfully hard.

Mr. SUNUNU. Thank you. Thank you, Mr. Chairman.

Mr. HORN. Thank you very much, Mr. Sununu. Let me pursue a few questions with each of you.

Mr. Cohen, I noticed in your remarks that citizens are entitled to a fair trial. You are a lawyer by background. A lot of citizens and a lot of Members of Congress say if that is true, why don't we switch the burden of proof to the client, the taxpayer, and away from the IRS, right? Right now the IRS does not have to prove its case. The taxpayer has to prove the case. Why hasn't that changed?

Mr. COHEN. Because you would make the IRS more intrusive if you did. If you think about the system as it exists, we are dealing in the civil system, not a criminal system. In a criminal system, the IRS has the burden of proof. The plaintiff in a civil trial, he is proposing the idea, he has the burden of proof. Why, because he has all the information. If I have to prove my medical deductions, I have them. I have all the doctor bills. I have all my checks, I can do it. The IRS doesn't have it.

All they can say is we don't see from your return that your medical deductions look right, please show them to us. That is why I have the burden of proof, so it is with business records or anything else. If we want to make audits more intrusive, then the IRS will have to demand all the records. They will become much more intrusive. They will be less productive, but everybody forgets that I have the tax records, they are in my possession. I ought to produce them if I am making an assertion. There are problems that come up around the edges.

I am not saying there aren't taxpayers who don't feel abused, and a few of them are right, but the question is, which of those techniques will burden more of the taxpayers, and clearly the burden of proof on the Government will burden more taxpayers because the Government is then in a position of saying produce all your records. You will have to subpoena them or summon them or use some technique to make you bring them in, in order to see if they have a case or not.

Mr. HORN. Mr. Tobias, do you have any comment on that question?

Mr. TOBIAS. Only that we have a voluntary tax system. People say what it is they owe and what deductions they are going to claim, and I would just mirror what Mr. Cohen said. If I am a taxpayer, I have the information, and, therefore, I should have the burden, in a voluntary tax system, of showing why I owe $10 instead of $20.

Mr. HORN. Ms. Davis, do you have any comment on this part, based on your review of IRS?

Ms. DAVIS. Just very quickly, I wasn't involved in personal audits, but I had conversations with IRS employees. Believe it or not, many of them talk to me openly. One of the things a recently retired IRS executive pointed out to me was that he believed that the IRS approaches virtually every taxpayer as though they are cheating on their taxes, you know, if they can cheat, they will, or if they can scam, they will. They are going to go into an audit situation with that kind of negative attitude, rather than approaching taxpayers as though they are doing everything they can to comply with this outrageously complex system we have all been saddled with.

So I think it is probably more of an attitude question than anything, and if you change, even that cultural perspective on the part of the IRS, I suppose you could even accomplish what you want to accomplish by changing the burden of proof, by changing the way in which taxpayers are approached on the initial instance by the IRS, that we are trying to comply. I filed my tax return as a self-employed person for the first time this year, and I have never seen such a mind-boggling mess of paperwork in contrast to the simple returns I used to have.

Mr. HORN. I did suggest about 3 or 4 years ago when I first came here that we ought to pass a resolution in the Congress. We all as Members have to sit on the floor of the House on April 15, no tax attorneys, no tax accountants with us and we have to fill out our own form. I suspect there would be great reform that followed that immediately, but we have now turned it over for $750 or $1,000 to an accountant and we don't worry. We just sign and then you worry and hope it's right. But let me ask you, Mr. Tobias. You are familiar with the Debt Collection Act we authored last year?

Mr. TOBIAS. Yes, I am.

Mr. HORN. Elements of that are now before the special subcommittee of Ways and Means. As to apply in that act, to IRS, it is the only part of the Federal Government that it's not been applied to, because we have the interest of Ways and Means, which I certainly can thoroughly understand, who have jurisdiction over that.

On the other hand, we have lost a year. Now, does the union that you were president of have any feelings on that legislation one way or the other?

Mr. TOBIAS. I believe, Mr. Chairman, that contracting out the collection of taxes to the private sector is unwise for a number of reasons. First and foremost, I believe the IRS employees can and do and will be proven that they collect dollars owed, faster, better, and cheaper than the private sector, and that the answer to reducing the accounts receivable inventory is to provide the IRS the re-

sources they need to collect more taxes, not contract it out to the private sector.

I believe collecting taxes is an inherent governmental function, not to be contracted out. Second, I think there are issues of privacy about providing information to the private sector. As you were speaking this morning, those who are involved in this experiment receive only a name and the amount owed, but what the IRS is finding is that these people can't find taxpayers any easier than the IRS can, and that in some substantial number of cases, the amount owed is disputed, which means they have to hand it back to the IRS to close the case, or to do a part pay agreement. So I think there is inherent inefficiency, and I believe, based on that 1995 tax compliance initiative, the IRS proved it could collect money if it were given resources. I don't think the private sector is the answer in this case.

Mr. HORN. When you have 100,000 plus employees and you let the debts run up to $100 billion plus, why can't 100,000 employees be so organized that they reduce that debt? That is a scandal of the IRS, to let $100 billion accumulate in lost revenue.

Mr. TOBIAS. I think perhaps it is a scandal for the IRS, but I think Congress shares some of that responsibility. When the IRS proves that with more resources, it can decrease those accounts receivable and then Congress says, sorry, I am not going to fund it in 1996. Even though you are successful in 1995, I think Congress bears some of that responsibility. And it is easy to say, well, there are 100,000 people and why can't they collect the money, but those 100,000 people are also processing 200 million returns, issuing, I don't know, I think it is $190 billion in tax refunds. So they are not all in fault in accounts receivable. If the IRS had 5,000 more people focused on that issue, it could maybe produce more.

Mr. HORN. Well, I am willing to give the first 30 days, but if they can't produce, I think it ought to be turned over to somebody who can produce.

Mr. TOBIAS. I will take that 30 days with the resources and whatever test you want to create. I think we will beat whoever is at the starting line.

Mr. HORN. I think the fact is, with 100,000 people, and I don't blame you, I blame management for not organizing themselves so they can make that 30-day call. They haven't been making the 30-day calls and pretty soon, people forget, as I said earlier, that it's a debt. They think, gee, it is a grant, it is my money, they have forgotten me.

Mr. TOBIAS. One of the problems the IRS had to decide just this year was, well, we don't have enough money to do audits of small businesses, and so—and at the same time, increase the level of access for compliant taxpayers, so we are going to move people who otherwise do audits to answering telephones.

Well, as a result, my prediction is, there is going to be less revenue in fiscal year 1997 than projected. There will be more happy compliant taxpayers, who everyone speculates, but no one can prove will pay more taxes because they know what it is they owe and will pay that money. But in the meantime, I project that there will be a hearing next year about why the IRS has less enforcement revenue in 1997 than they did in 1996 and when the answer

is, well, we answered more phones, Congress won't be satisfied with that.

Mr. HORN. Well, no one is talking about moving trained auditors. What we are talking about is training people who are not auditors to followup on the results of the audit.

Mrs. Maloney, 5 minutes.

Mrs. MALONEY. Thank you very much. Following up on your questions, Mr. Chairman, I would like Mr. Tobias to get back to the committee and write a projected pilot project that we could put forth with IRS employees, where they are given the resources to get off the phones, to do the collections, what resources would you need, and I would like it to be a pilot project that we could possibly compare to the pilot project we are having now with contracting out to private sources. I don't want to use my time with your explanation. I would like to get it back in writing and we will look at it. We have a strong working relationship together productively.

I would like to ask a question of Mr. Cohen that follows up on the exchange of what we just heard about confidentiality. Mr. Tobias raised a concern, and one that I share, on confidentiality. I truly believe that tax collection is one of the most sensitive and important jobs of Government, and it has to be done fairly and well, or the trust between people and their Government will not be there, and I am very concerned about confidentiality, not only within the IRS on individual tax returns, but I am very troubled about the idea of contracting out to private firms and on the confidentiality situation.

Also what troubles me, what if a private firm acts in a way that is irresponsible? Then that reflects back on Government and may undermine the confidence that people have in their Government. And as a followup on it, you talked about section 6103, which you helped write, and, again, I would like to request that possibly you may get your comments back to me in writing of any changes that you think should take place in section 6103 to protect confidentiality of American citizens, while helping Government be more efficient and effective in doing their job.

Mr. COHEN. One of the problems that was discussed earlier in the hearing was the browsing. Now, in the early sixties before we had the computer system, because everything was on paper, so if you locked the cage, only people who had authorization to go look for returns could look for returns. Now, that is not to say there wasn't browsing.

If Sheldon Cohen's return was next to President Clinton's return—it doesn't happen to be—it happens to be filed in the Commissioners office, but they could look at the returns, but it was much more difficult. However, with a computer, it is easier, and that is a problem that is going to exist every day of every year, no matter what your rules are.

You have to impose strong management controls and you do have to enforce them. You do have to make people suffer when they break those rules because they shouldn't be rummaging through returns. They will, and then you will have to discipline them again. The more people that have access, the more difficult it will be, so if you introduce private contractors to this, it will be, and it will be more difficult.

You will also find the private contractor does work that is at conflict with the Government work, so they will have to build fire walls, but they won't build fire walls. Someone, somewhere on a private contract will use the information he got from the IRS information to help his boss do something else and then there will be a scandal, and then the IRS will be blamed for leakage of the information from one side of the collection system to the other side, it will happen. I mean, that is why erasers are on the end of pencils, because errors do occur. So you do need to know, no matter how careful you are, errors will occur. You have to build a system that corrects as many of them as possible.

Mrs. MALONEY. I would like all the panelists to either comment or get back to me in writing. I am particularly interested in your comments, Mr. Cohen, with your experience as a tax lawyer and your former experience in Government, on Friday, 20/20 ran a special on United States citizens evading their taxes, and 20/20 infiltrated a tax seminar in Cancun, Mexico, that taught 300 individuals, American citizens, on how to set up, "personal sham banks" offshore. The banks only need to have a mailing address, since international banks do not have to pay taxes in the United States. These citizens could possibly evade billions in taxes.

What could we do to the IRS code or to Government laws to make sure that this does not take place? It obviously is taking place, and they ran an entire special of it, I have a film on it. I would be glad to get it to any of you, and then I have one other brief question and my time is almost up.

Mr. COHEN. My comments on the banks, I get this literature all the time in my office, do this, do that, your clients will avoid this or that, and what I do is I send them to Mr. Dolan. I take them and stick them in another envelope and write Mr. Dolan on a memo and say turn this over to the appropriate people.

There are lots of silly, illegal ideas out there. It is a free country. You can say any screwy thing you want to say. Unfortunately, some people fall into these patterns and I am sure the IRS can tell you what techniques they design and they do design, they clip the newspapers, they watch the television, they pick up the stories and set up programs to try to pick them up. Now, most of the time it works, but not always.

Mrs. MALONEY. Any other comment? Over the weekend, Speaker Gingrich stated that he felt that Americans that have overdue taxes, that they should be given a 1-year amnesty to pay up without penalties, and he says it's an idea that would bring in billions of dollars in extra revenue, and I would like to ask the panelists if they would like to comment on the idea. Do you believe it would bring in extra revenue, and do you think it would work?

Mr. TOBIAS. I am not so sure that it would work. I think there has been some success with tax amnesty efforts in State governments, but it was primarily related to States where there wasn't real active tax enforcement.

At the Federal level, there is no question that there has been knowledge and enforcement, so the idea that somebody could go years without paying and then suddenly be relieved of all of that liability, and be relieved of all of that liability through a tax amnesty period, I think would punish those who have tried to be com-

pliant over the years, and force them, once again, to subsidize the noncompliant. I don't think it is a good idea.

Mr. COHEN. The worst thing that could happen to you is you would be successful, and the reason I say that is you would then be tempted to do it a second time and then you would ruin the whole tax system. It would absolutely ruin your discipline, so I go along with Mr. Tobias' comments. That is, in any State where it has had any degree of success, it has been associated with a markedly increased enforcement effort. They announced we are going to do it today, and as of tomorrow, we are going to have this new and impressive enforcement effort. You have a reasonably good enforcement effort in the United States right now.

Also, Congress is cutting the IRS' budget. Is the IRS going to get a 10 percent increase next year because they are going to have an increased effort? No. So you don't have any credibility on that side. And you have more downside than upside. You stay home—as my grandmother used to say, "when in doubt, stay home."

Mr. HORN. Thank you very much. I just have two questions to round out the panel. I might ask on the last question, that it seems to work with overdue books at libraries, and it sounds a little—your remarks, Mr. Cohen, and I think you might be right about that, much like the amnesty for illegal immigrants, and it doesn't solve the problem.

I have one question for Ms. Davis, which is, you have heard a lot this morning. The GAO, your colleagues on this panel, is there anything you would like to say based on your experience, being from on the inside of the IRS?

Ms. DAVIS. I think it is a reiteration of what I said in my testimony. I think if we are going to bring any significant change, we have to forget this broken record of GAO reports, congressional hearings, the litany, on and on and on of bringing out this broad array of significant problems with the IRS, and actually begin to take significant action.

One of the things that I did, as the historian for the IRS, was I looked at a long view of GAO reports. I didn't just look at last year's GAO reports, the most recent, even the last 5 years, but I looked at a 20-year span.

One of the first projects I took on that was squelched by IRS management very quickly when they learned what I was planning to do was to do an overview of the history of how the IRS implemented its initial computer system Mr. Cohen had spoken of back in the early 1960's, and its plans to modernize that system over the history of the years.

One of the things I also did, in addition to pulling every GAO report that had been written over this 20 to 25-year span, was I tried to collect all IRS internal audit reports because that function of the IRS, which is supposed to evaluate internal progress for their own programs, has done report after report about the modernization program also.

The first problem I encountered was when I asked for this broad range of internal audit reports of a 20-year span, they looked at me like I was crazy. This was early in my tenure of the IRS when I realized they had no systematic way to keep the reports. We went all around the country with a request, and we managed to come

up with 60 percent of the audit reports. But the point being, when I reviewed those 20 years of internal audit reports by the IRS; and 20 years of GAO audit reports, the same problems were repeated over and over and over again, so we are facing another 20 years of more GAO reports, more hearings, more internal audit reports without any significant change, unless someone in Congress gets serious about really getting to the heart of this issue.

Mr. HORN. Well, we thank you.

That leads to my next question. Besides getting serious by some in Congress, I think we have enough that want to be serious this time. A Dear Colleague letter from our colleague from northern Virginia, Frank Wolf, talks about his legislation, H.R. 1224. And this is a question I want to direct to Mr. Cohen and Mr. Tobias, it will just summarize what it's about.

H.R. 1224 does two important things. First, it establishes a set 6-year term for the Commissioner, thereby providing an important degree of independence from the President. Second, it establishes a new objective selection process for the Commissioner. Prior to the expiration of the Commissioner's term or when a vacancy occurs, a special election is considered to elect potential candidates. The commission then submits to the President a slate of qualified candidates, and the President selects the nominee from that slate.

H.R. 1224 insures that strong, qualified candidates are selected for IRS Commissioner, further insures the Commissioner is afforded necessary insulation and distance from an attempt to make the IRS a tool for the party in power at the White House.

I believe that legislation is greatly needed to ensure integrity and objectivity of the IRS. How do you feel about that, Mr. Cohen?

Mr. COHEN. I do spell out a little bit of my views for the Commissioners in my written statement, but I haven't addressed all of these issues.

There is no involuntary servitude in the United States. That was abolished in the 13th and 14th amendments. I see all the commissions around town with 4-year terms, 5-year terms, 15-year terms, whatever they happen to be. I rarely see anybody serve that period of time.

I mean, I served over 4 years as Commissioner of the IRS, a few years as chief counsel, 5 years in the one agency. That is a long time. The reports, as I have seen them, say about 2, 2½ years is probably more normal. I think that more years is important. It was important for me, because I could get something done. It was important for the agency, because it had some continuity.

Mr. HORN. Mr. Cohen, I might remind you, we have a 10-year tenure for the Director of the Federal Bureau of Investigations.

Mr. COHEN. And no one has ever served it.

Mr. HORN. There is hope they will.

Mr. COHEN. I will bet you $5 that will not happen.

Mr. HORN. We also have the Comptroller General of the United States, and I think you will agree most Comptroller Generals, unless they have died in office, have served out that term.

Mr. COHEN. You have only had two serve under that term, and I have served on the advisory committee for both of them. And the Comptroller General is in a completely different spot because the

Comptroller General is a quasi-legislative employee. He really is a legislative employee. He is not an executive branch employee.

I am not a constitutional scholar, so I won't regale you now with the constitutional problem of having the chief revenue official of the United States, who is part of the executive branch of the United States, chosen without regard to the President of the United States. I don't want to get into that right now because that is a long discussion.

Mr. HORN. Mr. Wolf provides that that nominee would come from the President of the United States, but there would be a list of very qualified people, and for those of us——

Mr. COHEN. Can he send the list back and say I want more?

Mr. HORN. Well, he perhaps can. But if you are saying let us get some people in there that know something about management and are not simply tax technicians, with all due respect to all the fine people that have been Commissioners, the fact is, that agency of over 100,000 people needs somebody like a Jim Webb.

Mr. COHEN. I knew him very well.

Mr. HORN. Administrator of NASA.

Mr. COHEN. And he was chosen by the President of the United States.

Mr. HORN. Fine. But we have had numerous Presidents not choose somebody that could run an agency. We have a long list of them. And the failures of the agency I would blame partly on the fact we don't have a management structure and somebody that knows how to run a large organization.

Mr. COHEN. I am not going to differ with that assessment. As I have said in my testimony, the IRS is like running a large spaghetti factory. It is more important that the person run the spaghetti factory have management know-how than it is that he or she know how to make spaghetti. On the other hand, they better know how to taste spaghetti. Otherwise, they are going to produce something like a Soviet factory that will put out a blah product that nobody will ever eat.

So you can't make this a little narrow point, because there is a whole variety of talent that is needed. And I am not sure, it may be your selection technique will produce the only two people that are introduced—that have those kinds of terms.

The FBI Director has those terms, although he is chosen by the President. He is not chosen by slate. The GAO has it where the Congress sends a panel of names, but that is because it is an officer of the Congress that is being chosen, not an officer of the executive department.

Mr. HORN. And we are not talking about officers of Congress in this.

Mr. COHEN. This is an officer of the executive department that is nominated by people who are not of the executive department. I should say, I am a lawyer, but I am not a constitutional lawyer. I will leave that to your friends on the Judiciary to argue out. I wouldn't want to be selected under such a technique.

If a Commissioner of the IRS doesn't have sufficient internal—intestinal fortitude—my statement used to be, people would ask me, and I said, if you don't threaten to resign at least twice a year over an important issue, you oughtn't be in the job.

There are times you say, no, I will not do that. I did that to the Secretary. I did that to the President. I didn't do it very often. If you do it too often, you wouldn't be there either. But if you are going to have independence, you are going to have independence. If you are not, this technique is not going to help.

Because if you are there when there is a Secretary of Treasury of a different persuasion and a President of a different persuasion, your life is going to be impossible. You are never going to get a budget through. You will never get your personnel through the Office of Personnel Management. There are a million other problems that will come up every day to make your life miserable.

Mr. HORN. Mr. Tobias.

Mr. TOBIAS. Mr. Chairman, I think one of the key problems with the IRS is the fact Commissioners turn over too frequently. I like the idea of a 5-year or a 6-year term, but I do not believe hiring a Commissioner with a 5-year term, however that person is nominated or selected, is the silver bullet.

I think that no matter how well a person with a 6-year term planned, if there isn't a steady stream of funds from the Congress in order to allow a plan to be created, implemented and evaluated along the way without the circumstances changing, it won't matter, really, who is in charge of the IRS. It will be great public relations, but if we don't have appropriate funding, you know—second, I think the Internal Revenue Service, both in terms of its ability to obtain more credibility and its ability to plan long-term, needs some help. The Commission To Restructure the IRS is considering several different options. One is strengthening the role of getting information, and the other is to create a more independent IRS. The board of directors and those members would be from—the people from outside with managerial expertise.

That report would be due on July 1st. But, clearly, the IRS has to be thinking more long-term than just 1 year to the next.

Mr. HORN. We thank you all, Ms. Davis, gentlemen. We appreciate the time you have taken here and having the perspective you provide, based on your experience. Thank you for coming.

[Followup questions and responses follow:]

FOLLOW-UP QUESTIONS FOR SHELDON COHEN

1. Legislation proposed in this Congress would prevent the IRS from using random audits. I understand that is an important component of the Taxpayer Compliance Measurement System (TCMP). Would prohibiting the use of such audits impair the IRS's compliance enforcement efforts?

2. You stated that in the sixties the IRS had what was called a performance budget. Do you think that it is ready now to use performance budgeting again?

3. How would you estimate total tax liability? There is a general feeling that many people do not file tax returns, do not report their tax liability, work in a cash only manner, and in other ways cheat on their responsibility to pay taxes. This has the effect of reducing voluntary compliance because people feel resentment that they have to pay when the "other guy" does not. If we could ascertain the amount of taxes nonfilers ought to be paying, we could better estimate the IRS's success in collections. How would you go about trying to estimate this?

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May 21, 1997

Ms. Andrea Miller
Subcommittee on
Government Management,
Information and Technology
Congress of the United States
House of Representatives
B-373 Rayburn House Office Building
Washington, D.C. 20515

Dear Ms. Miller:

Enclosed is the edited transcript of my testimony for the hearing held on April 14. If you or the staff have any problem with my changes, please give me a call.

As to the questions asked:

1. Legislation proposed in this Congress would prevent the IRS from using random audits. I understand that is an important component of the Taxpayer Compliance Measurement System (TCMP). Would prohibiting the use of such audits impair the IRS's compliance enforcement efforts?

   TCMP audits are the baseline for data from which returns are selected for audit. They also provide important information to the Service and Treasury allowing for more accurate estimating of revenue and audit efforts, tax gaps and the like. At present there is no adequate substitute.

2. You stated that in the sixties the IRS had what was called a performance budget. Do you think that it is ready now to use performance budgeting again?

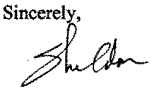
   Performance budgeting is what was recommended by the Second Hoover Commission. It puts the onus on the administrator to use his/her money wisely. There is no excuse that the appropriation process requires us to use the money in a certain way. It provides for more flexibility and thus if used wisely, allows for more efficiency. However, since

it allows more flexibility it requires more oversight. I believe these issues can be worked out by mature people and good oversight such as your Committee is capable of.

3. How would you estimate total tax liability? There is a general feeling that many people do not file tax returns, do not report their tax liability, work in a cash only manner, and in other ways cheat on their responsibility to pay taxes. This has the effect of reducing voluntary compliance because people feel resentment that they have to pay when the "other guy" does not. If we could ascertain the amount of taxes nonfilers ought to be paying, we could better estimate the IRS' success in collections. How would you go about trying to estimate this?

   Total tax liability can only be estimated by use of TCMP-like data; other data from Treasury and Commerce, Bureau of Labor Statistics, etc. Many people do not file honest returns; some people work for cash. These issues can only be caught by a good and effective audit system; good statistical data and good planning. If you allow the IRS sufficient money for a good TCMP program and good research staff, they can give us fairly reliable data on the level of tax compliance. Without TCMP and with audit levels falling, it will be very difficult to deal with these issues.

Sincerely,



Sheldon S. Cohen

SSC/bsj
Enclosure

Mr. HORN. The next panel is panel three: Michael Dolan, the Deputy Commissioner, primarily for management of the Internal Revenue Service; accompanied by Jim Donelson, the Chief Compliance Officer; Tony Musick, Chief Financial Officer; Arthur Gross, Chief Information Officer; and David Mader, Chief, Management and Administration.

[Witnesses sworn.]

Mr. HORN. All five witnesses affirmed the oath; and we will start with Michael Dolan, Deputy Commissioner of the IRS.

STATEMENTS OF MICHAEL DOLAN, DEPUTY COMMISSIONER, INTERNAL REVENUE SERVICE, ACCOMPANIED BY JIM DONELSON, CHIEF COMPLIANCE OFFICER; TONY MUSICK, CHIEF FINANCIAL OFFICER; ARTHUR A. GROSS, CHIEF INFORMATION OFFICER; AND DAVID MADER, CHIEF, MANAGEMENT AND ADMINISTRATION

Mr. DOLAN. Good morning.

Mr. HORN. Thank you very much for coming, Mr. Dolan.

Mr. DOLAN. Thank you very much for having us.

I was sitting out here thinking about batting cleanup on April 14th with the people who preceded us was kind of a tough spot to be in, until I heard you talk about what might have been a tougher spot on April 15th in the well of the Congress doing tax returns. So, I will assume we got the better of the deal.

And what I would do, with your permission, Mr. Chairman, I prepared a longer statement that I know you will accept into the record. What I would like to do in the interest of time and getting to your questions is to briefly make some of the points.

Mr. HORN. Feel free for a 10-minute summary. In your case, if you would like 15 minutes, please feel free. Because you have heard a lot here, and you obviously have the experience to know a tremendous number of the basic questions that have been asked.

Mr. DOLAN. Thank you.

I would say, for starters, that one of the things I think we all feel is important is the opportunity to talk about and respond to some of your questions in several of the areas raised this morning. Because, to say the least, some of the observations were interesting. To say it a little more aggressively, there are some places where that we would like very much to be able to correct some misperceptions. And I start with conceding your basic point. We are here talking at your invitation about high-risk areas.

Mr. HORN. Right.

Mr. DOLAN. Risk by definition means that there are opportunities and requirements to improve. And so I stipulate to that. Not for a minute do we shrink or shirk from that.

But the second thing I wish my colleagues at the GAO might have made a little stronger point in their testimony that would accompany the point they made in the documents is, in each of the four areas we identified as high-risk, there has been considerable progress. So I would like to believe we are sitting before you today not with some set of promises about what we are going to do in the future, but with some established track record in each of the four areas where we have tried very hard and with some success to make progress against each of the four areas.

Third, and you made the point, Mr. Chairman, several times, in the context of looking at the IRS and looking at its management challenge, clearly, it strikes me that any enterprise our size or the size of any large corporation is, by definition, going to have some risk. And so I assume what you want from us is not a guarantee that we will never run a risk, but I assume what you want from us is what you would want from any major enterprise—some conviction that we are capable of mitigating risk and capable of creating systems, that in the first instance, identify the risk and then that we do our level best to manage that risk. Not in some theoretical context, but in the context of our business.

And one thing I was particularly appreciative of in Mr. Tobias' testimony, is that we found ourselves in pretty much of a chorus of commentary here in the last 2 years. Some of that commentary is very well informed, very much on the mark and very much with an aspiration, I think, of improving tax administration.

There is another part of that chorus that you no doubt have heard some of yourself, where you are less sure the chorus is well-informed and you are less sure that the outcome of the rhetoric is designed to improve the system, as opposed to making some rhetorical points or trying to play with a different kind of agenda.

So, one of the things I think Mr. Tobias did, that my longer statement does at some length, is make the point that, notwithstanding being here to talk about four risk areas, if you look at the four risk areas in the context of the operation of the organization, there are a tremendous number of things that are going well, not only at the level that Mr. Tobias talked about, in terms of some macro measure of how much it costs to collect $100, but today is April 14th, most people relate that to April 15th, which most people relate to a filing season.

This is a filing season, and I think by any measures people impose on us today is a filing season of good news for the taxpayer and good news for the system; and most people's encounter with us is during this 4-month period. Most people think a filing season is January to April. As you well know, Mr. Chairman, it started last fall.

As Mr. Cohen said, there was no tax legislation at the end of the last session of Congress. However, we got 700 pages of tax instructions about those three bills that passed at the end of the year. Hundreds of changes at the end of August and September went on line. About the time we reach August 15th's peak of this year's extension, we will be back through the cycle again. So, in practical terms, a filing season is a year-long business.

And, this year, I think there are things, if you look at from a standpoint of the taxpayer, and you yourself gave a litany and others gave litanies about programs, that aren't what we would like them to be and some programs that were underleveraged. But, as Mr. Tobias said, we are going to process 211 million individual and business returns this year. From the period of 1993 to 1996, we did that and we were almost 11 percent more effective and more efficient with fewer staff years than we did in the 1993 timeframe. TeleFile which, for my money, is one of the most significant retail technological options offered to assist in this country. It's the op-

portunity for a taxpayer, in an 8- to 10-minute telephone call, to completely satisfy a tax obligation.

I have heard a lot of ballyhoo about people who can apply for this or apply for that or get a piece of information downloaded, but in terms of accomplishing your entire transaction with your Government on something as sensitive as meeting your tax obligation, 25 million Americans this year are capable of doing that in an 8- to 10-minute telephone call.

At this point in the year, over 4 million have done it. Over 17 million at this point of the year have filed in a variety of electronic forms. Those, I think, are evidences of things that are working well.

Last month, we made available to some small businesses in 14 States the opportunity to file their 941, a quarterly tax return, by TeleFile. That historically was a very convoluted process for big or small businesses because it represented sending us a coupon and hoping that the coupon and the dollars got posted correctly to their account.

Now again, in those 14 States, a million employers are capable—whether I'm a pizza shop with 7 people and I don't want to go to the bank or I am a bigger enterprise, I can pick up and use the touchtone phone, and in the course of a few minutes, make my quarterly tax obligation.

Assisting taxpayers better—several people talked about this conflict in our mission or balance in our mission. Clearly, Mr. Chairman, you have made it real clear from the outset, accounts receivable is a passion with you. It is with us as well, but it's just one of the pieces of our mosaic that we try to balance each year.

This year, we came into the year fully aware that for the last 2 years, one of the metaphors of our performance has been can we answer our phones? Because it didn't make any difference if when we were answering our phone, we were answering at 94 to 95 percent quality. The fact that half our customers couldn't get to us was too easy a metaphor for the entire organization. So we went to huge efforts this year to try to beg, borrow and steal and try to tip that balance, if you will, to the service side, with the outcome that, this year, rather than half the people being served, nearly three quarters of the people are being served.

If I am running a business, I am not bragging about only three quarters of my customers being served; so we know we have a long way to go. But I think, as measured in the context of actual operations, it is a fairly significant commentary on the organization's ability to respond to its customers in a way that is important.

People talk about the GAO, sort of rolls off their tongue, that we are using old systems, and the implication left is that we are nonmodernized and still in the knuckle-dragging ways of the past. I dare say that anybody who has decided to take its information from us on the Web site in the last couple of years find that to be a remarkable way to do something that you only used to be able to do at the IRS office, the bank, or the post office, and that would have people consistently scrambling this week. Instead, 100 million times this year, multimillion forms and publication have been drawn down.

I don't know about you. I can't go to a soccer field or church over the weekend without somebody saying, I was looking for my extension form or this arcane past form and I pulled it down on your Web site. Is that the whole ball game? Not by any means. It is that plus the CD-ROM that we now put in the hands of practitioners, and for anybody that wants it, the fax capability to come to us any hour of the day and get a form back by fax. Those, to me, are not commentaries of an organization, it is trying to do its business like it did in the 1960's and insulate from its customers' expectations.

You heard a little bit this morning about some of the rest of our business. I would like for there not to be 200 plus billion dollars in accounts receivable. I think, upon questioning, we will probably realize it is a number that is clearly able to create a couple different impressions—several of them not exactly on the money.

But I will tell you, one of our key compliance requirements is to collect the amount of money, not only because it is there to collect but because, as several of the witnesses said, that is a common element of fairness of the entire system—that you pay yours and I pay mine. If the people to the left and right of us see that, they are confident in the system. If they see the people to the left and right of them not paying, then there is an unfairness, and that's in addition to the obvious financial interest the Government has in collecting its receivables.

Last year was the single most successful year we've had in our history of collecting the dollars in accounts receivable. One part of it was a function of still being able to capitalize on the revenue initiative that came in 1995, but another part of it again was a function of looking at many, many aspects of our processes, not being content to use 1960's, 1970's, 1980's processes but looking at the whole notice stream and eliminating notices that: were confusing the taxpayers, were in of producing the outcome; changing our bills to look like a bill that comes from a credit card; accentuating our telephone operations; accentuating business taxpayers who we can get; not always in the 30-day timeframe you mentioned, but while they are in business and while they are still capable of resolving their issues instead of downstream.

We have done things that, by traditional standards, would have been viewed as lax on enforcement. We have substantially utilized both the installment agreement process and the offer and compromise process as a way to take taxpayers, who might not be able to pay fully, but are trying to get in or stay in the system. And I think you could go up and down a variety of other initiatives that would reflect on the way we have attempted to improve our collection processes.

The four risk areas GAO talked about this morning, they clearly are not all equal. I think you point out, Mr. Chairman, quite aptly, really, that technology, the ability of us to modernize our technology infrastructure is—I think it was Senator Thompson said the other day, over on the other side, it's the long pole and tent—clearly the most significant of the risks. If we are capable of mitigating that in a way I think we are well-positioned to do, then the concerns we have with respect to the accounts receivable, the concerns we have with respect to data security, the concerns we have with

respect to getting a clean audit opinion, will indeed be buttressed by our ability to modernize our infrastructure.

My statement goes to some length and I guess at this hour of the day you probably would prefer that I not go into much length on the modernization punch list, but there really are a tremendous number of things that have happened since the last time the IRS was before you.

At my left is Art Gross. You will get an opportunity in questioning to speak a little more directly to some of those that you are interested in. Suffice it to say, we have tried to include in our long statement the road map, as we see it, for addressing not only the latest round of General Accounting Office issues, but as we can best determine, the set of outside feedback and commentary from the National Research Council, from within Treasury, and from the various bodies of Congress that have looked at modernization over the 20-plus years that you detailed in your statement.

We do believe that we have positioned ourselves at a point in time now to do what is the long pull, to do what won't happen overnight and be a silver bullet, but to do the kind of improvement in the technology infrastructure that not only the system, but our customers require.

I also included in my longer statement a fair amount of information about the so-called browsing. I think none of us sits at this table at all happy that the condition prevails. It is a circumstance that is unacceptable to us, as it should be to the American taxpayer. People who have access to tax information and work for the IRS have access for one purpose and one purpose alone, and that is to pursue their job responsibilities. Any use beyond that is unacceptable.

The difficulty we have is in the computer infrastructure we have today, it is much more difficult on the front end of those systems, identifying exactly who has a work unit that involves access to a particular piece of taxpayer information. As a consequence, we find ourselves doing after-the-fact running of audit trails and developing scenarios that will detect abuse and then dealing with that abuse as it is detected.

Our modernized infrastructure will deal with that fundamentally. It is not only possible, but a goal of us on the front end of the modernized systems, to be able to move and work precisely and specifically with a particular employee, based on a particular assignment, and not, as is done today, based on a range of assignments and based on a range of authorities.

In the interim, we know it is our responsibility to step up the even more redoubled effort to train, educate, communicate, and to discipline, and to make the discipline be severe and make the discipline be consequential when abuses continue.

What I would offer for your observation is, there is a whole lot more I could talk about here, and probably I would serve your needs and mine both better by letting you go in the areas that you would like to question us. I got off the track here in a kind of rude way and didn't introduce my colleagues.

So if you wouldn't mind, if I could spend a minute recognizing on my far left Tony Musick, who I know has been before you before. He is our CFO. To my immediate left is Art Gross, our Asso-

ciate Commissioner and CIO. Dave Mader is our Chief, Management and Administration. On Dave's right is John Dalrymple, who is our deputy in our essential operations function.

With that, I will close and instead invite your questions, and hopefully we can be responsive to those.

[The prepared statement of Mr. Dolan follows:]

Statement of Michael P. Dolan
Deputy Commissioner
Internal Revenue Service

Before the
Subcommittee on Government Management, Information and Technology
House Committee on Government Reform and Oversight

April 14, 1997

Good morning, Mr. Chairman and distinguished members of the Subcommittee. I appreciate the opportunity to be here today to discuss the Internal Revenue Service's (IRS) efforts to improve the efficiency and effectiveness of the program areas identified by the General Accounting Office (GAO) as high-risk. With me this morning are Arthur Gross, Associate Commissioner and Chief Information Officer; Tony Musick, Chief Financial Officer; Jim Donelson, Chief Taxpayer Service and Acting Chief Compliance Officer; and Dave Mader, Chief Management and Administration.

As you know, GAO's latest high-risk report discusses four high-risk areas at the IRS: Tax Systems Modernization (TSM); financial management; tax accounts receivable; and tax filing fraud. GAO credited the IRS with making some progress in all four areas but outlined significant challenges to continuing this progress.

I agree that these four areas require focused attention by the IRS, Treasury and the Congress. Today I would like to summarize our efforts in each area and provide some perspective on statements made in the report. Before doing so, however, I would like to put the high-risk report in a broader perspective.

Achievements of the Internal Revenue Service

Congress, GAO, and the media have severely criticized the Service for

weaknesses in the development, implementation and management of its technology modernization efforts. We listened and acted by going outside the IRS to strengthen and improve our overall management of modernization efforts. This intense focus on an area of weakness was helpful. However, our weakness in managing technology has been used to cast aspersions about our basic business -- processing returns and payments; issuing refunds; assisting taxpayers; and ensuring all taxpayers pay the proper amount of tax.

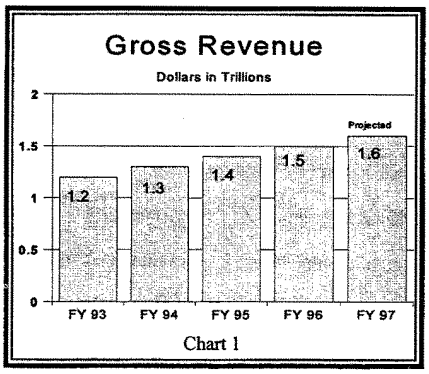


Chart 1

American taxpayers have a right to a very efficient tax administration system supporting this country. I am pleased to report that the Service is still the best in the world at what we do -- collecting the nation's taxes. From 1992 to 1996, gross revenues collected have increased from $1.1 trillion to $1.5 trillion while our cost to collect $100 has decreased from 60 cents to 54 cents. Other taxing authorities world-wide seek our advice and assistance on ways to improve their operations. The Service has not grown complacent. We are continuing to improve services and at the same time reduce costs. Our goal is to remain "best in class."

Processing returns and payments, issuing refunds and assisting taxpayers is

what we call "the tax filing season." Successful delivery of a tax filing season not only goes unheralded -- but has been described this year by the GAO as "uneventful." External attention to the tax filing season is afforded only when there is a problem -- an "event." Describing a filing season as uneventful, while correct on one hand, has a tendency to underestimate the hard work and planning that it takes to produce that uneventful season. The 1997 filing season is on target to be the most successful tax filing season in the last 10 years. This accomplishment coupled with the significant improvements over the past several years in improving our service to taxpayers and reducing costs are noteworthy and are evidence of the dedication and ability of IRS employees. The following are our highlights:

Processing Returns and Payments and Issuing Refunds - Processing tax returns and payments and issuing refunds are the heart of our tax administration system. This year we will process over 211 million individual and business returns and 1.12 billion information documents; and issue more than 88 million refunds. We have increased our productivity in processing returns 10.9 percent between 1993 and 1996, with 1997 projecting to be a 3.5 percent increase over 1996.

One of our goals has been to make it easier for taxpayers to file their tax returns. Significant progress is being made on this front. As of April 4, over 4 million individuals have filed by telephone -- a 57 percent increase over last year at this time. This eight to ten minute telephone transaction which enables citizens to complete their annual tax obligations is one of the easiest and most

available examples of technical support that the government has to offer.

So far, the total number of individual returns filed electronically, including by telephone, has increased 25 percent over last year.

Electronic filing is not just limited to individuals. Employers nationwide can now file their Form 941 (Employer's Quarterly Tax Return) electronically. Almost 363,000 of these returns were filed in this manner for 1996. In addition, beginning in April, businesses in 14 states can now file the simpler Form 941 returns by telephone. Our telephone filing system has received outstanding feedback from taxpayers who use it -- 99 percent of the users like the system and plan to use it again. In the first week, over 4,100 businesses filed their Form 941s by phone calls averaging only 7 minutes each. This system has been honored with six awards from sources such as Government Computer News, National Public Service, and Informix.

Our concept of electronic tax administration means more than just receiving returns electronically; it includes electronic payments as well. Most of the over 88 million taxpayers who will be entitled to refunds this year can have them directly deposited in their bank accounts. Taxpayers enjoy the safety and ease of direct deposit and the government saves the expense of printing and mailing checks. Last year, if a taxpayer wanted a refund deposited directly into a bank account, he or she had to submit a separate schedule. This year, a few extra lines on the Form 1040 will do it. As of April 4 this year, over 13 million taxpayers -- an increase of approximately 48 percent over this same period last

year -- have requested direct deposit of their refunds. As an aside, taxpayers who use Telefile and have their refunds electronically deposited, will typically have the refund in the bank within 21 days from their phone call.

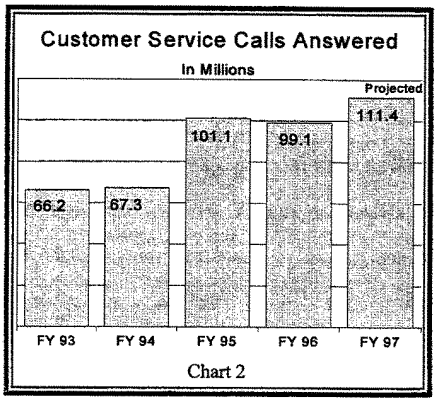


Chart 2

The TaxLink/Electronic Funds Transfer Payment System (EFTPS), used by employers to pay employment and other depository taxes electronically, is also faster, easier, and more accurate for tax collectors and taxpayers alike. In FY 1996, more than $380 billion were deposited electronically, an increase over the $232 billion deposited in FY 1995. Many businesses will be required to begin making deposits through EFTPS on July 1, 1997. At this time, we have more than 960,000 of the required taxpayers enrolled in EFTPS and almost 360,000 volunteer enrollments.

Assisting Taxpayers Better - The majority of taxpayers voluntarily meet their tax obligations each year. We believe that answering the questions of taxpayers who are trying to comply and finding new ways for taxpayers to get forms and information encourages taxpayers to voluntarily enter the system and stay in the system year after year. This year, IRS assistors will answer 60 million toll-free

calls -- an increase of 15 million over last year. Even taxpayers who call after hours can leave their questions on our recorded message system and within two business days, we will contact them with an answer. A new, toll-free number enables taxpayers to quickly determine the status of their refunds without having to speak to an assistor. We have significantly improved our toll-free telephone system, answering over 70 percent of callers. Our efficiency in answering calls will increase 22 percent from fiscal year 1995 through fiscal year 1997 while our accuracy in answering questions will increase almost three percentage points to 93 percent.

Through March 22 of this year, we have assisted over 153,000 more taxpayers at our walk-in sites -- an increase of 7.2 percent over the same period last year. By the end of the year, we project that 6.4 million taxpayers will be assisted at walk-in sites.

Just three years ago, taxpayers needing a publication or form had to call to have the material mailed, or go by an IRS office, their local post office, or library. Not today -- tax forms and publications are now available on CD-ROM and an innovative Tax-Fax. Tax-Fax processes requests for tax forms by fax. So far this filing season over 357,000 forms and instructions have been faxed -- a 352 percent increase over the 79,000 faxed for 1996.

For the 1996 filing season, the Service launched a world-class Internet homepage known as the Digital Daily. The response has been overwhelming. Over 83 million "hits" were logged in FY 1996. So far this fiscal year, over 95

million "hits" have been logged. Over 2.8 million forms, instructions or publications were downloaded last year; over 3.7 million have been downloaded through March. The Digital Daily received over 40 awards in 1996 for its design and ease of use from such sources as Netscape, PBS, Wired magazine, USA Today, Tax World, Money magazine, Microsoft, Harcourt Brace, PC Computing Magazine, and Government Executive magazine. Accolades for the Digital Daily continue this year from sources such as Ernst & Young, Home Office Computing, The Washington Post, and Net magazine.

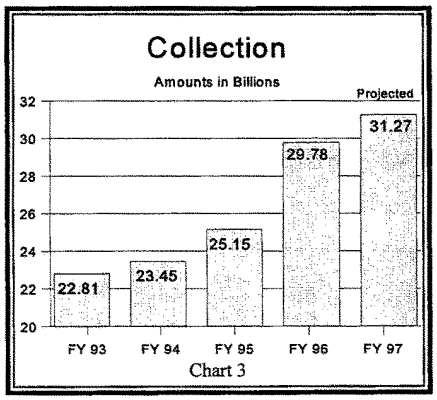


Chart 3

Ensuring all taxpayers pay the proper amount of tax - In addition to improving service to taxpayers, the Service has improved its compliance operations. Taxpayers have an expectation that the system will treat them fairly. To most taxpayers that means they expect others to pay their correct amount of tax and they expect the IRS to identify and deal with non-compliance. For the past three years, we have realized unprecedented increases in collection yield -- an increase of 27 percent. In FY 1997, we are on target to achieve another five percent increase over last year -- collecting in excess of $31 billion. Revenues

collected from all compliance operations increased from $31.4 billion in 1995 to $38 billion in 1996. During this same three year period, telephone collection sites and the Collection field function have realized a 12 percent increase in dollars collected per FTE. The IRS has adopted some of the best practices of the private collection industry. This has resulted in improving and prioritizing "up front" collection operations -- notices and telephone calls -- to deal earlier and more effectively with taxpayers who owe.

The IRS plans to continue to improve its collection results through the use of technology in field collection operations. In FY 1995, our Integrated Collection System (ICS), which provides on-line access to current account information to revenue officers, was used in two districts. In these two districts, productivity increased more than 30 percent, translating directly to additional tax collections "in the bank." Currently, ICS is fully operational in nine districts and is providing a similar improvement in collections.

From FY 1993 through FY 1996, the Service increased the number of examinations closed by 64 percent and audit coverage rose from .96 percent to 1.63 percent. In addition to the increased revenue that has resulted from these efforts, we have substantially increased the amount of the examination assessments that are collected immediately upon the completion of the audit. Examination realized a 30 percent increase in dollars recommended per staff year over this same period.

In FY 1994, we also assumed responsibility for enforcing the new law requiring that diesel fuel be dyed when the excise tax has not been paid. In FY 1996, 114,000 inspections of terminals, fleets, and off-the-road users were conducted resulting in the detection of over 5,000 violations and $8.7 million in assessed penalties. So far this fiscal year, over 13,000 inspections have been performed, detecting over 600 violations and assessing $2.4 million in penalties.

Our compliance efforts are more than just collecting delinquent taxes and traditional audits. Through initiatives like the Accelerated Issue Resolution (AIR) and the Advance Pricing Program (APA), the IRS is stressing early resolution of issues -- a practice that can save everyone money. With AIR, the collection of the largest corporate assessments is accelerated by resolving recurring issues and simply carrying the resolution forward to later years -- reducing the number of issues under examination. Under this procedure, taxpayers have agreed to pay about $1.1 billion between FY 1993 and FY 1996.

The APA program is a new cooperative process between taxpayers and the government for resolving intercompany pricing issues. Taxpayers welcome certainty in a complex area and avoid a lengthy debate with the IRS. At the end of FY 1996, we had entered into 79 APAs.

The Tip Rate Determination Agreement (TRDA) and the Tip Reporting Alternative Commitment (TRAC) are initiatives developed with industry representatives to address the underreporting of tip income. They benefit both employers and employees. Employers benefit from not having significant

unplanned tax liabilities assessed against them. Employees benefit from increased social security benefits, unemployment benefits, retirement plan contributions and worker's compensation benefits. As of the end of 1996, the IRS had received over 3,100 TRAC agreements representing more than 21,000 establishments and more than 800 TRDA agreements with nearly 1,200 establishments. For 1994 and 1995 tip income reported has increased over $2 billion.

We have also developed important partnerships with state tax administration. Through literally hundreds of innovations -- like the joint fed/state electronic return option -- we have been able to leverage the combined federal and state capabilities in ways that serve taxpayers better and enhance the fairness of both the federal and state tax systems.

We are proud to be able to offer the U.S. taxpayer the number of "best in class" capabilities that exist today. However, we know there are many areas that are ripe for further improvement. One of the most profound enablers of that further improvement will be the modernized technology infrastructure that will result from our Tax Systems Modernization effort.

Tax Systems Modernization

Although Tax Systems Modernization is listed as a separate High-Risk Area, it is the common thread in all of the high-risk areas identified within the IRS. In recent testimony before the Subcommittee on Oversight, House Committee on Ways and

Means, GAO stated that IRS' success in addressing the weaknesses in its program areas is clearly linked to its success in modernizing its information systems.

The IRS clearly recognizes that reaping the benefits of technology is central to controlling costs and providing better services and has made progress in addressing the concerns and criticisms of the technology modernization efforts. However, the Service recognizes that there is more work to be done to meet the challenges of updating technology to better serve the American taxpayers.

In its testimony before this committee on March 5, 1997, GAO stated that executive leadership is crucial to the successful management of technology and that qualified Chief Information Officers are needed throughout government. The GAO report credits the IRS with hiring a year ago our Chief Information Officer - Art Gross. Art has significant technical management expertise and an excellent grasp of the tax "business." He reports directly to the Commissioner and me and is working with other senior managers to make clear progress in implementing reforms. Following is a summary of reforms during his first year:

Establish a Detailed Business Plan - In its high-risk report, GAO states that a key factor to successful modernization is to establish a detailed business plan. The IRS is completing its strategic modernization plan, which integrates implementation schedules and establishes completion dates for each of the major components of the plan. The major components are (1) a Systems Life Cycle defined as the standards, policies, procedures and practices employed by the IRS to guide technology investments; (2) a Modernization Blueprint, which

focuses on rebuilding the corporate data bases to enable customer service to resolve taxpayer accounts and improve compliance; (3) a procurement strategy to shift primary responsibility for systems development and integration to the private sector; and (4) linkages among the short-term legacy and operational systems enhancements, the Year 2000 project, and the longer-term modernization sequencing plan. The modernization plan will be submitted to Congress in May 1997.

Systems Life Cycle (SLC) - The IRS has adopted a Systems Life Cycle that provides the policies and processes needed to manage systems development efforts. The Systems Life Cycle is consistent with both the military standard 498 and processes currently employed by major system development and integration contractors. Included in the SLC is an Investment Management Process, described later in further detail.

Systems Architecture - In the past year, the Service has developed the Modernization Blueprint which includes Business Requirements, Functional Architecture, Technical Architecture as well as a Sequencing Plan which provides for a phased implementation of Modernization projects based on prioritized business needs.

Both the Systems Life Cycle and Modernization Blueprint are making extensive use of contractor resources for both design analysis and product development, thereby underscoring the commitment to shift significant aspects of the Modernization efforts to contractors. For FY 1997, 64 percent of information

technology resources are projected to be allocated to the private sector compared with 40 percent for the period 1988 through 1995.

Improved Investment Controls - The IRS has put in place an investment review discipline to assess and prioritize information systems investments, monitor progress of spending against plans, and evaluate the results of those investments. The IRS Investment Review Board (IRB), chaired by me, the Deputy Commissioner, has reviewed all ongoing technology development projects. Projects that failed to demonstrate significant business values or comply with best practices for disciplined systems development have been suspended. Today, the IRB has suspended the Document Processing System, Corporate Accounts Processing System, Workload Management System, and Integrated Case Processing System, resulting in significant future cost avoidance for these projects in excess of one billion dollars. Also, the IRB is overseeing the reallocation of resources from these projects to higher priority investments, in accordance with the principles of the Information Technology Management Reform Act.

Product Assurance - One measure of the effectiveness of an information technology organization is the comprehensiveness of its product assurance program. Between 1992 and 1996, IRS' Information Systems organization downsized by over 2,000 positions, with a disproportionate reduction in the product assurance program where resource levels sank to less than 30 percent of the industry standard. Accordingly, in 1997, the IRS is undertaking a major

rebuilding of this program to mitigate systems acceptance testing deficiencies that have prevented the thorough testing and certifying of principal IRS operating systems.

Recruiting from Outside the IRS - This year, the Service has continued to strengthen its information technology management capabilities with the September 23, 1996, appointment of Sarah Witbeck, Director of the Government Program Management Office (GPMO), who is an experienced systems development program management executive from the New York State Department of Taxation and Finance, and the January 5, 1997, appointment of Len Baptiste, new Director of the Systems Standards and Evaluation Office (SSE), who was formerly with the GAO and has extensive experience in the development of systems life cycle standards, policies and procedures, and information technology program evaluation and oversight.

Also, on March 3, 1997, Mr. William Hadesty was appointed as SSE's Director of Security Standards and Evaluations. Mr. Hadesty's private and public sector computer security experience includes over 10 years with the GAO, where he conducted comprehensive computer security reviews at numerous government agencies, including the review of IRS facilities. He is a recognized security expert in both the public and private sector.

Additionally, the CIO organization has undertaken a nationwide recruitment for fifteen experienced and qualified executive and senior technical managers who are not "...Faint of Heart." The results of that effort yielded 2000

inquiries and 834 applications. Of those, 379 applications were deemed eligible and a second screening is in process to determine "best qualified."

Transferring Significant Aspects of Modernization to the Private Sector - The IRS continues to transfer significant aspects of the technology modernization program to the private sector. The December 1,1996, report to Congress documents the modernization program resource allocation; 64 percent of it is provided by the private sector. The largest and most important initiative for FY 1997 was the contract recently awarded to develop, pilot, and implement the submissions processing manual data entry systems replacement. The IRS also is in the process of competitively acquiring a Systems Engineering and Technical Assistance (SETA) contractor to provide technical, program, and project management guidance to the modernization effort.

Modernization Management Board - The Modernization Management Board has provided strategic direction and policy guidance to the Modernization effort. During FY 1997, the Board reviewed IRS recommendations concerning the study of the feasibility of outsourcing submissions processing, the Electronic Tax Administration strategic plan, the development of a Prime Integration Contractor, RFP, the Systems Engineering and Technical Assistance competitive acquisition and the Information Technology Strategic Plan.

Maintaining the Legacy Systems - As I mentioned earlier, all indicators are that the 1997 filing season will be another success. A key factor in this success is the group of conscientious employees in the Information Systems organization

who continue to update the legacy systems, develop new computer programs to comply with legislative mandates, and manage a complex array of technologies.

Year 2000 Conversion - GAO designated the year 2000 problem, the massive century date conversion project, as a new high-risk area in its 1997 high-risk report. This challenge is not unique to IRS and much has been recently reported in various media about the magnitude of this problem. Most legacy systems are programmed to display "00" in the year fields so that beginning on January 1, 2000, date-based calculations will be based unintentionally on an interpretation of the year field as 1900. Failure to identify, recode, and retest each of these date-based fields could result in the generation of erroneous tax notices, refunds, bills, interest calculations, taxpayer account adjustments, accounting transactions, and financial reporting errors. Put another way -- such a failure could significantly burden the over 200 million taxpayers and IRS resources and jeopardize IRS' ability to carry out its mission. This conversion not only is vital to IRS but also to other organizations with which the IRS shares data, such as the Social Security Administration, Federal Reserve Banks, and most of the states. To date, the Service has identified 62 million lines of computer code in the corporate systems which must be analyzed. The effort to make needed changes may exceed 2000 work years of effort on the part of both the IRS and its contractors to ensure these critical systems are century date compliant by January 1, 1999. In addition, the IRS is actively reviewing all commercial off-the-shelf software and hardware to determine components that must be replaced or

updated to ensure compliance.

With the support of Congress through a $45 million FY 1997 appropriation, the IRS has mounted a massive effort to ensure its systems become century date compliant. Given the broad scope and impact of the Year 2000 Conversion, the Service has made it the number one priority and is diverting significant existing information systems resources to the project, deferring all but critical and legislatively mandated legacy systems changes during FY 1997. The IRS has initiated a comprehensive project approach to manage its century date conversion, including the creation of a Year 2000 Project Office with senior executive leadership reporting directly to the Associate Commissioner/Chief Information Officer and the Deputy Chief Information Officer for Systems Development. This Project Office is responsible for ensuring that all IRS enterprise systems are Year 2000 compliant by January 1, 1999. While much of the conversion work will be performed by the Service's legacy programmers, the Project Office is using contractors to develop the program and project management plan as well as the conversion evaluation and certification strategy. Further, contractors have been tasked to convert systems and/or applications which they have developed and/or support (e.g., Grumman Data Systems shall convert the Service Center Recognition Image Processing System).

The IRS also is aggressively completing the inventory of field based applications, which may require the review of 40 million lines of computer code. To ensure

that these information technology components are compliant, the Service also has created a group of field executives to address Year 2000 Compliance issues associated with customer-owned and field-owned information technology assets. This group will report to the Year 2000 Project Manager and will determine whether these assets should undergo Year 2000 conversion, be retired, or be replaced with already Year 2000 compliant standard hardware/software. With the requested funding for FY 1998, these efforts will be expanded as necessary to ensure that the Service meets its commitment to century date compliance.

Financial Management

The IRS has significantly improved financial management over the last four years as a result of our financial statement audits, but we know there is more to do. As GAO's report stated, the Service has a detailed action plan, developed in cooperation with GAO, that addresses corrective actions and tracks the progress toward correcting deficiencies and implementing GAO recommendations. A copy of that action plan was recently provided to this Committee.

The IRS was one of the pilot agencies under the Chief Financial Officers Act (CFO Act) of 1990 and, as such, was required to submit financial statements beginning with Fiscal Year 1992. Prior to this, the IRS, like all federal agencies, was not required to prepare audited financial statements or to have financial audits. However, the fact that financial audits were not routinely done in the past does not mean that poor

financial management existed. The IRS, like other agencies, was and is controlled by budgets that were appropriated by law and incorporated into our administrative financial system, and obligations and expenditures were monitored against those appropriations. Unlike many other agencies, the IRS also collected substantial amounts of revenue from taxpayers; our custodial financial systems were designed to account for those receipts and to ensure that they were promptly deposited into the Treasury. These requirements and controls still exist in addition to the new requirements introduced as part of the annual audit. Passage of the CFO Act and the introduction of annual financial statements and audits, however, added new rules and standards heretofore non-existent in government. We are using the financial statement audit, and the discipline it imposes, as a blueprint for continued financial management improvements. Following are highlights of these improvements:

Improvements in Management Controls - At the IRS, we take seriously our responsibilities under the Federal Managers' Financial Integrity Act and the Chief Financial Officers Act. We established the Senior Council for Management Controls in December 1992. I chair the Council and serve with the Chief Financial Officer (Vice-Chair), Chief Inspector, and two other senior executives of IRS. The Council is responsible for the following:

- sets policy for implementing the provisions of the Federal Managers' Financial Integrity Act (FMFIA);
- recommends material weaknesses to the Commissioner for inclusion in the annual assurance letter;

- oversees implementation and reviews effectiveness of corrective actions for material weaknesses; and
- identifies emerging issues for the field and National Office to review during the annual assurance process.

Each year we conduct an annual assurance process. All heads of office in the districts, service centers, regions, and the National Office conduct a self-assessment of their operations to ensure that assets are protected and program goals are met. Part of this self-assessment includes identifying potential material weaknesses. We also review the financial statement audit and other audits conducted by GAO, the Inspector General, and Internal Audit to identify material weaknesses. These weaknesses are reported to the Secretary of the Treasury as part of the Commissioner's Annual Assurance Statement.

The responsible Service official prepares the corrective action plan and reports the completion of action items for each material weakness. The Regional Commissioners and Chief Officers monitor progress and the Senior Council oversees the completion of actions for material weaknesses. An action plan is developed to correct each material weakness. Weaknesses cannot be closed until the problem is corrected.

This is a time consuming and intensive process. As I said, we take it seriously. Because we do, we usually report about 20 material weaknesses a year. The irony is that because we do report a number of weaknesses, we are often put on the defensive because we self-disclose a number of problems.

Some years ago, before we intensified and improved our process, we reported far fewer weaknesses. Does that mean our performance has slipped? To the contrary, I would propose it means we have become more vigilant in identifying, reporting, and hopefully correcting our problems.

Improvements In Administrative Accounting - It is important to keep in mind that the Service has two separate financial processes to track funds: the administrative system that handles appropriated funds and the revenue system that tracks tax collections and is used to report on custodial statements. To understand GAO's audit findings, it is important to recognize the distinction between these two systems and what is being done to improve both systems to comply with the CFO Act.

The IRS is proud of the improvements it has made in its administrative accounting system and GAO's high-risk report concludes that improvements are "particularly notable" in administrative accounting operations. Six years ago, the Service had eight separate systems that were not linked to each other. Now the IRS has a single corporate administrative financial system of record that it uses to monitor and control the more than $7 billion the IRS receives annually in appropriated funds. This system, known internally as the Automated Financial System, provides an integrated, auditable, comprehensive accounting and budgeting system that fully complies with the Joint Financial Management Improvement Program core requirements, including the U.S. Standard General Ledger, and other government-wide standards that apply to automated financial

systems.

Even though IRS purchased an off-the-shelf commercial package, it was customized to meet the unique agency requirements, including developing interfaces. For example, the Service transferred payroll to the Department of Agriculture's National Finance Center (NFC) and operates an interface from NFC to provide payroll data to the corporate database. The Service also integrated its procurement system and travel system so data is only entered once and is transmitted electronically.

Since the first audit in 1992, the Service has made significant improvements in administrative financial management, resulting in GAO's FY 1994 and FY 1995 audit reports focusing on just two remaining administrative accounting issues: (1) failure to reconcile IRS accounts with Treasury, and (2) the lack of receipt and acceptance documentation for some non-payroll payments to other federal agencies, such as rent payments to GSA and printing payments to the Government Printing Office (GPO).

Improvements in Accounting for the Revenue the IRS Collects - The challenge with revenue accounting is to develop a financial management system that will provide the organization with the capabilities for (1) controlling financial transactions; (2) collecting and processing transaction-level data; (3) obtaining detailed information on financial position; and (4) providing complete financial information necessary to manage an organization.

While the IRS can, and does, reconcile gross amounts collected, it has

been unable to give GAO auditors the information that they want to reconcile on a transaction-by-transaction basis with the Masterfile database. The challenge has been to augment the revenue accounting information to meet the requirements of the CFO Act.

For the FY 1995 and FY 1996 audits, in cooperation with the GAO, the IRS began extensive analysis and documentation of all revenue transaction flows and source documentation. Detailed flowcharts were prepared to document revenue flows between the Revenue Accounting and Control System (RACS) and supporting feeder systems. Site visits were made with the GAO to all service centers to validate these flowcharts and further document detailed transaction flows that were unique to a service center. Additionally, the IRS now uses its Masterfile to provide detailed transaction data to support its custodial financial statements. This data is reconciled to RACS and Treasury schedules. We fully agree that the IRS should be held to the same standards of record keeping to which taxpayers are held. But context and definition of terms are important to understanding the IRS' financial statement concerns. A disclaimer on the financial statements does not equate to poor tax administration. As the government's primary revenue collector, the IRS has strong systems controls to ensure that taxpayers' individual accounts are confidential and accurate and that tax receipts are not lost or misappropriated. These systems work. Each year, the GAO has verified that more than the $1.4 trillion the Service collects has been properly deposited in the Treasury. The current challenge is to alter these

systems to provide the necessary data to meet the financial requirements of the CFO Act.

Status of the 59 Recommendations - As indicated in the high-risk report, the GAO has made 59 recommendations through their financial statement audits for the last four fiscal years. Of the 59 recommendations, the IRS and GAO agree that the IRS has implemented 17 of them. Of the remaining 42, the IRS believes it has met the requirements on an additional 27. The Service is working with GAO to get agreement before actually closing these items. Of the remaining 15, 11 are scheduled to be completed by the end of the fiscal year; and four have completion dates beyond FY 1997. The IRS is committed to working with GAO to resolve these recommendations and believes that through mutual cooperation and effort this goal will be achieved.

The CFO's Concerns About the Financial Audit - As a result of GAO's recommendations and the Service's intent to have audited revenue information, we have initiated methods of obtaining financial information which can be substantiated from our current systems. Also, to ensure that management and staff are aware of required actions and due dates, the CFO organization has put into place a written action plan for preparation of our financial statements which addresses all key milestones.

Our Chief Financial Officer, Tony Musick, believes that IRS, like many federal organizations, was not prepared for or possibly did not understand what

was needed to be in compliance with the financial audit requirements of the CFO Act. However, after five years, several issues still give him great concern about government auditors performing this type of audit. Mainly because most government auditors have focused on program audits and have introduced numerous elements of a program audit into the financial audit process, in his opinion these auditors have not been performing "true" financial audits similar to those in the corporate world.

Mr. Musick has identified five problems with the current financial audit process based on his own experience which is considerable. Tony is a certified public accountant with a master's degree in business administration from George Washington University with a concentration in Finance. From 1972 to 1983, Tony was an auditor with the public accounting firm of Ernst and Ernst, the General Accounting Office (GAO) and the Environmental Protection Agency. Tony also served as budget director for Virginia Commonwealth University in Richmond and served on Vice President Gore's National Performance Review participating in the "Improving Financial Management Team." I think his ideas are well worth hearing and I would like to discuss them briefly.

1. The Audit Process Needs to be Year-Round - I mentioned earlier that the IRS is a very large and complex organization. We collect over $1 trillion annually with a budget of over $7 billion; process over 200 million tax returns; issue over 88 million refunds; distribute over 300 million forms and publications; send almost 100 million notices and letters to taxpayers; process over 1 billion

information documents; and collect over $31 billion from enforcement efforts. This is done by 4 regions, 33 district offices, 10 service centers, and over 100,000 employees throughout the country. Looking at the corporations on the Fortune 500 list, we believe we would be the number one company when it comes to revenue collected and customer (tax accounts) accounts, and in the top 50 in terms of the number of employees. Moreover, the IRS continues to be compared to a corporation in the way we do business. However, in a corporation of comparable size, the auditors would usually be present year-round doing testing and reviewing controls. Audit Issues could be raised and resolved before the end of the year or agreements could be reached on how the issues could be addressed for financial statement purposes. Currently, very little testing goes on during the year. Audit presence year-round would serve to alleviate the continuing problems we have experienced of not having sufficient time to gather the requested supporting documentation at year end. Additionally, we pull all our transactions at the end of the fiscal year or close to the end of the fiscal year so the auditors can do their testing.

It has been over 25 years since Mr. Musick has done financial audits, but the large accounting firm he worked for had a year-round presence (or close to year-round presence) in some of its larger corporate clients. This is a common practice even for federal agencies that do audit work. When he worked at the Comptroller of the Currency, he knew that bank examiners were in the large National banks most of the year. Also, IRS does this with our large corporate

taxpayers. I believe we need to have this presence because the financial audit needs to become a continuous effort.

2. Auditing Around the Revenue Systems - The current audit process is very paper intensive because the auditors do not rely on any of the existing controls in the current revenue systems. One of the ways in which corporate auditors determine the scope of testing and the amount of testing they would have to do is to determine the reliance they can place on the existing controls in a system, both computer (security profiles) and manual (separation of duties or review of work), and evaluate the risk of a misstatement to ensure that the data going into the system is correct. This would determine, among other things, the amount of testing to be done and provide the auditors a basis for determining how reliable the data is within the system.

Secondly, in accumulating data for the revenue receipts, refunds and receivables, we have been criticized for not having enough documentation. This does not mean a lack of paper, because some of these files are a foot high. Because one document is missing, we have an exception that hinders the auditors from expressing an opinion. A lack of a document could be overcome by a review of the controls that ensure the accounts are correct. Also, another control that seems to be ignored is the taxpayer. If the taxpayer's account is incorrect, I believe that once they receive a contact from us they would ensure the account is corrected, just as you might do if you received an American Express bill for a hotel charge that wasn't yours.

Because we have a large volume of data, the auditors need to test our existing systems of controls. For example, the Master File accounts of taxpayers have detailed data on every transaction processed and the document locator number indicating the reason for the transaction. If the auditors would rely on this system, then some of the 9,000 plus case files we pull could possibly be reduced, and even if a specific document was missing the auditor could rely on the controls over the system to ensure the numbers are correct. Mr. Musick believes the auditors' hesitancy to rely on system controls has greatly increased the amount of data that must be gathered by Service employees.

3. Government Auditors Need to Define the Terms "Reasonableness" and "Materiality" - The corporate standard for the auditor's opinion is that the auditors have reasonable assurance that financial statement numbers are fairly stated. The government auditors seem to be looking for absolute assurance that the numbers are accurately stated. Because of the size of most large organizations, an auditor cannot test or verify the accuracy of every number. The auditor will evaluate and test the control environment, both automated and manual, analyze the accounts (i.e., compare them to prior years) and test to determine if they can be reasonably assured the numbers are fairly stated.

The second issue relates to materiality. Since the auditors can't review everything, and the numbers are not always accurate, the issue then becomes how much of a difference will the auditors accept? Again, this is a question that needs to be answered. Let me give you an example. We are now pulling

detailed transactions from the Master File to develop the financial statements for FY 1996. We have to reconcile those transactions to the RACS system. We may not be able to reconcile every dollar in the Master File to the balance in the RACS system because of timing and other differences. The question is how much of a difference will be considered material enough to distort the numbers on the financial statements? If you assume a 1% error rate, does that distort the fair statement of the numbers? Does it mean that money has been lost or misplaced? No. One reason why these amounts are not reconcilable to the penny is timing differences between fiscal years. RACS captures summary data that may overlap the beginning and ending of a fiscal year. Another problem is that the source systems may key off different dates. For example, RACS records FTD deposits when they get to the Federal Reserve, yet the Master File gives the taxpayers credit when the deposit is made at the commercial banks. This could be a one day difference. Given the time and cost, would it be worth it to get closer?

Additionally, because we are required to keep amounts on our books much longer than a normal business, we are being asked to substantiate these older accounts with paper documents whose retention requirements have long expired. Until these two requirements are brought more in line, IRS is essentially being penalized for following the law.

The question, therefore, becomes what is reasonable for the auditors to determine that the taxpayer's account is accurate? What is the additional cost

versus the benefit of being this precise? How much documentation is needed? Because we don't have an accounting system in place that complies with the government standards, and we pull data from the Master File, what is an acceptable number or how material is the difference affecting reliance on the financial statements? Also, because these issues are left to the auditor's judgement, we don't know what to do or how to resolve the problem because there is no standard on which to be judged. This does not mean that we disagree with the auditors, but many of these issues may take years to fix and we would welcome this feedback in their report. However, it should not relieve them of their responsibility for attesting to the fairness of the numbers.

4. Financial Audit vs Program Audit - A financial audit is to determine that the numbers reported on the financial statements are fairly stated. This is different from a program (operational or performance) audit which determines how efficiently, effectively or economically the program is functioning. Could a program be functioning more efficiently, effectively, or economically and the auditors still attest to the fairness of the numbers on the statements? Mr. Musick certainly believes so. Why? Because the controls in place will ensure that the numbers are being correctly posted to the accounts, even if a program audit says you may be able to do it a better or cheaper way. Secondly, some of the program problems we face are Governmentwide and we believe the auditors need to be held accountable for determining what they need to do to assure themselves the numbers are correct until some of these programs can be

changed. The OPAC process for handling interagency payments is one example whereby another federal agency can take their money without prior approval. Another potential problem is the file retention requirements for some of our tax forms.

5. Government Auditors are Risk Averse - In the corporate environment, financial auditors are hired by the organization to render an opinion. The standards place most of the burden on the auditors to ensure themselves that the numbers are fairly stated. In looking at the standards put out by the American Institute of Certified Public Accountants, specifically the Generally Accepted Auditing Standards (GAAS), it is clear that the responsibility for conducting the audit rests with the auditors. It is important that they employ every means possible to satisfy themselves as to the reasonableness of reported amounts. They must employ alternative auditing techniques when warranted. For example, section 350.25 of the GAAS states "...the auditor may not be able to apply the planned audit procedures to selected sample items because, for example, supporting documentation may be missing. The auditor's treatment of unexamined items will depend on their effect on his evaluation of the sample. However, if considering those unexamined items to be misstated would lead to a conclusion that the balance or class contains material misstatement, the auditor should consider alternative procedures that would provide him with sufficient evidence to form a conclusion." In other words, the auditor should be determining what can be done to ensure that they have explored all alternatives

to determine whether the account balance is correctly stated in order to render a fair opinion. We agree that we did not have receipt and acceptance for GPO printing; however, other steps could have been taken by the auditors to ensure the amount we reported as printing expense was reasonable until we improved the current process.

I have separated the financial statement audit into two parts: first, the ability to fairly report the numbers on the financial statements in accordance with generally accepted government accounting standards, and second, the management issues that need to be addressed. Like most corporations that are audited, the management letter to the company on ways to improve is an integral part of the audit; however, it does not hinder the auditors from attesting to the fairness of the numbers on the financial statements.

We welcome from the auditors their report on any of the management issues and their suggestions for better ways of conducting our day-to-day operations. However, the auditors should be required to do enough work, even if it means utilizing alternative auditing approaches as indicated in the AICPA auditing standards, so they can sincerely try to attest to the fairness of the numbers on the statements. This could be moved forward more quickly if the auditors were hired by the agency, as corporations do, and the auditors reported their results to an audit committee or board of directors within the organization where the issues could be discussed and debated between the auditors and this Board or Committee and the CFO.

Accounts Receivable

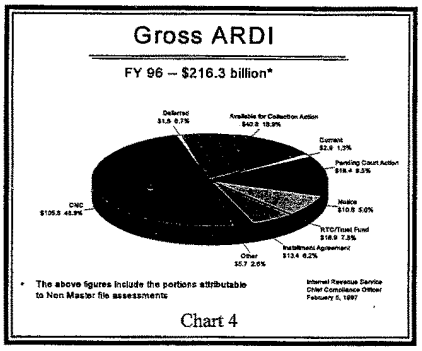


Chart 4

The IRS does know the correct composition of the accounts receivable inventory. It is important to understand what makes up the total amount of our accounts receivable inventory. Our gross accounts receivable inventory includes not only unpaid taxes but also the ever-increasing interest and penalties related to those unpaid taxes. In addition, the law prescribes how long we must keep accounts receivable on the books -- 10 years. Thus, unlike private sector businesses, the IRS' accounts receivable cannot be written off even when we know that they are not collectible.

At the end of FY 1996, IRS' gross accounts receivable inventory equaled $216 billion of which 30 percent reflected accrued interest and penalties. The gross accounts receivable inventory is divided into two major components: Currently Not Collectible and Active Accounts Receivable.

- Currently Not Collectible (CNC) -- are accounts that a collection employee has determined a taxpayer cannot currently pay. Accounts in this category are periodically monitored, and if a taxpayer is able to pay within the statutory 10-year period, the account will be collected. At the end of FY 1996, $105.8 billion

-- nearly half the gross receivable total-- is classified as CNC. Over 76 percent ($80.8 billion) is not collectible because it is owed by defunct corporations; taxpayer adjudicated bankrupt; hardships; or our inability to locate or contact taxpayers.

- Active Accounts Receivable -- are accounts that are potentially collectible and that continue to be pursued through activities ranging from notices and telephone contacts, to installment agreements and offers in compromise, and ultimately, liens, levies, and seizures. At the end of FY 1996, $110.2 billion is classified in the Active Accounts Receivable category. Of this amount:
  - 37% ($40.8 billion), the largest portion of the active accounts has been assigned for enforcement action;
  - 16.7% ($18.4 billion) of the inventory is awaiting adjudication by a court or acceptance of an offer in compromise;
  - 9.8% ($10.8 billion) is currently being collected by sending notices to taxpayers;
  - 12.2% ($13.4 billion) is being collected through installment agreements;
  - 15.3% ($16.9 billion) are trust fund recovery penalty assessments that are potentially duplicative and Resolution Trust Corporation assessments that have not yet moved to currently not collectible;
  - 1.5% ($1.6 billion) is lower value cases that will be substantially collected through systemic monitoring, such as refund offsets and yearly notices to taxpayers;

- 7.8% ($8.6 billion) is other accounts, such as estate taxes which by law have 14 years to pay, etc.

The above data reflects that the IRS does have accurate and reliable information on the taxpayers who are delinquent in paying their taxes and the collection status of each taxpayer's account.

Tax Filing Fraud

The IRS has implemented significant changes in the past three years to detect and prevent fraud. In 1993, the Service detected 77,840 questionable returns versus 24,919 detected returns in 1996. We are pleased that the incidence of detected fraud has declined substantially and believe this decline is the result of our aggressive fraud control efforts.

The IRS has implemented significant changes, including improved validation of information at the "front-end" of the electronic and paper filing systems (especially validation of taxpayer identification numbers); improved detection systems (including revisions to computer scoring of suspicious claims and the Electronic Fraud Detection System); enhanced entry requirements for tax preparers filing electronic returns coupled with a vigorous preparer monitoring program; criminal prosecution of appropriate cases and examination of questionable claims prior to payment of the refund.

The IRS recognizes that it must be continually vigilant in reducing the tax filing system's vulnerabilities to fraud; identifying new fraud control methods, and improving

systemic fraud detection capabilities.

Through the end of September 1996, direct compliance efforts prevented $909 million in erroneous or fraudulent refunds from being issued. (This figure represents $865 million in Examination assessments and $44 million in questionable refunds.) Also, because of recent legislation, the IRS has a more efficient method to handle claims for dependents, the earned income tax credit and the child care credit when there are missing or invalid SSNs involved.

Information Security

GAO's 1997 high-risk report series designated Information Security as another new, government-wide high-risk area that affects the IRS (the other was the year 2000 problem discussed earlier).

The IRS has long understood that protecting taxpayer information is essential to maintaining our country's self-assessment tax system. We also understand that although new technologies will help to streamline IRS operations and improve the delivery of services to taxpayers, these same technologies will also increase the risks to privacy associated with automation unless a strong program is in place to adequately mitigate these risks. Risk mitigation is of greater significance as IRS' reliance on paper decreases and its dependence on new technologies increases. In this regard, we are also aware that our security and privacy programs need to be strengthened, so that the Service has integrated and consistent safeguards in place to adequately ensure (1) the privacy and security of taxpayer account information; (2)

continuity of its operations; and (3) security of the infrastructure for modernized systems.

In January 1997, IRS announced that centralized responsibility for security and privacy issues had been delegated to the Office of Systems Standards and Evaluation (SSE). Recognizing the critical need to enforce federal law and regulations on privacy and non-disclosure of confidential tax information, SSE was created to assume responsibility for establishing and enforcing standards and policies for all major security programs including, but not limited to, physical security, data security, and systems security. In this regard, SSE provides IRS with a proactive, independent security group that is directly responsible for the adequacy and consistency of security over all IRS operations. The Service's aggressive actions to correct security weaknesses and implement GAO recommendations include:

- Preparing a plan for correcting all the weaknesses identified at the five facilities reviewed by GAO and for identifying and correcting security weaknesses at the other IRS facilities;
- Providing the plan to the Chairmen and Ranking Minority Members of the Subcommittees on Treasury, Postal Service, and General Government, Senate and House Committees on Appropriations; Senate Committee on Finance; Senate Committee on Governmental Affairs; House Committee on Ways and Means; and House Committee on Government Reform and Oversight;
- Reporting on IRS' progress against these plans in the fiscal year 1999 budget submission;

- Reevaluating IRS' current approach to computer security along with plans for improvement;
- Reporting the results of the reevaluation of the IRS' current approach by June 1997, to the above cited congressional committees and subcommittees;
- Completely and consistently monitoring, recording, and reporting the full extent of electronic browsing for all systems that can be used to access taxpayer data; and
- Reporting the associated disciplinary actions taken and recommending that these statistics, along with an assessment of the Service's progress in eliminating browsing, be included in IRS' annual budget submission.

One taxpayer security area of particular concern to this Subcommittee and to us is the unauthorized access to taxpayer data by IRS employees -- or "browsing." The IRS does not tolerate browsing. We consistently stress both within and outside the IRS that unauthorized access of taxpayer accounts by IRS employees will not be tolerated. However, recent court cases, especially one in the First Circuit Court of Appeals (United States v. Czubinski, No. 9-1317, 1997 U.S.App. LEXIS 3077 (1st Cir. February 21, 1997), are very troubling to the IRS and make it more difficult for us to appropriately discipline employees who violate our policy against unauthorized access.

In the past several years, the IRS has taken a number of steps to ensure that unauthorized access of taxpayer information by IRS employees does not occur. For example, each time an employee logs onto the taxpayer account data base (the Integrated Data Retrieval System (IDRS), a statement warns of possible prosecution for unauthorized use of the system. All new users receive training on privacy and

security of tax information before they are entitled to access the IDRS. The Service has also installed automated detection programs that monitor employees' actions and accesses to taxpayers' accounts, identify patterns of use, and alert managers to potential misuse.

The Electronic Audit Research Log (EARL) system, which detects potential unauthorized accesses by analyzing the audit trails of each of the transactions on IDRS, is currently the key to detection. Because of the volume of transactions and the extremely small percentage of potential unauthorized accesses, the Service is continuing to refine the EARL software to more efficiently and effectively identify such accesses. The IRS is also contacting "state-of-the-art" private sector organizations with the aim of identifying the feasibility of various security "prevention" systems and their approaches to managing technology risks. This approach will enable the Service to better control access to information through "up front" authorizations and ultimately rely less on after-the-fact detection. In the interim, the feasibility of monitoring potential "browsing" on systems other than IDRS that can be used to access taxpayer data is also being assessed. In this regard, the IRS has initiated efforts to contract for feasibility assessments of all systems that are used to access information (e.g., the Integrated Collection System and the Totally Integrated Examination System) to monitor the full extent of electronic browsing beyond IDRS and develop both prevention and detection measures.

Administratively, the IRS is engaged in a vigorous campaign to let employees know that substantiated unauthorized accesses will result in their removal form the Service.

Recently, the Commissioner issued a memorandum to all executives and employees reiterating the Service's commitment to zero tolerance. The memo states, "Unauthorized access to accounts, absent mitigating circumstances, is serious misconduct and would normally warrant removal. It is also a violation of 18 USC 1030 (fraud and related activity in connection with computers), which can result in criminal prosecution. ... The Internal Revenue Service will enforce a zero tolerance policy in all cases of substantiated unauthorized access." At the same time, I issued a charge to our executives to, at a minimum, support our commitment to taxpayer privacy and the security of tax data by:

1. Assessing personally on a periodic basis the consistency of discipline for browsing within their offices. EARL cases will now be sent directly to Heads of Office, either initially or after investigation by Inspection for appropriate review and action. (Employees are disciplined according to a Guide for Penalty Determinations that includes dismissal. In the recent First Circuit opinion, the court noted that "the IRS rules plainly stated that employees with passwords and access codes were not permitted to access files on IDRS outside the course of their official duties.")
2. Personally ensuring that employees receive the required training and orientation within their offices; and
3. Personally taking every opportunity to communicate the Service's expectations, and to explain IDRS systems monitoring capabilities, to all their employees.

In addition to the internal actions, the IRS has recommended and supported legislative efforts to amend the Internal Revenue Code and Title 18 to clarify the criminal sanctions for unauthorized computer access to taxpayer information. A recent amendment to 18 U.S.C. 1030(a)(2)(B) provides criminal misdemeanor penalties for anyone who intentionally accesses a computer without authorization or who exceeds authorized access and thereby obtains information, including tax information, from any department or agency of the United States. Although the recent amendment to 18 U.S.C. will hopefully serve as a significant deterrent to unauthorized computer access of taxpayer information, this statute only applies to unauthorized access of computer records. It does not apply to unauthorized access or inspection of paper tax returns and related tax information. Legislation such as S.670, introduced in the 104th Congress, would achieve that result. By clarifying the criminal sanctions for unauthorized access or inspection of tax information in section 7213 of the Internal Revenue Code, whether that information is in computer or paper format, the confidentiality of tax information and related enforcement mechanisms would be appropriately found in the Internal Revenue Code.

Conclusion

We appreciate the opportunity to discuss the IRS management challenges which have been identified through the "high-risk" process. It is critically important that any enterprise manage and prudently mitigate its systems, financial and managerial risks. Without minimizing the work that needs to be completed in the designated areas, I

hope we have succeeded in placing those continuing needs in the fuller context of the full tax administration process. Despite the substantial complexity of the underlying code and the almost continuous amendments which are made to it, the IRS has been and is today committed to continuously enhancing the service provided to customers and the basic fairness with which all citizens are dealt.

Mr. Chairman, this concludes my statement. I would be happy to respond to any questions.

IRS Operations Statistics for

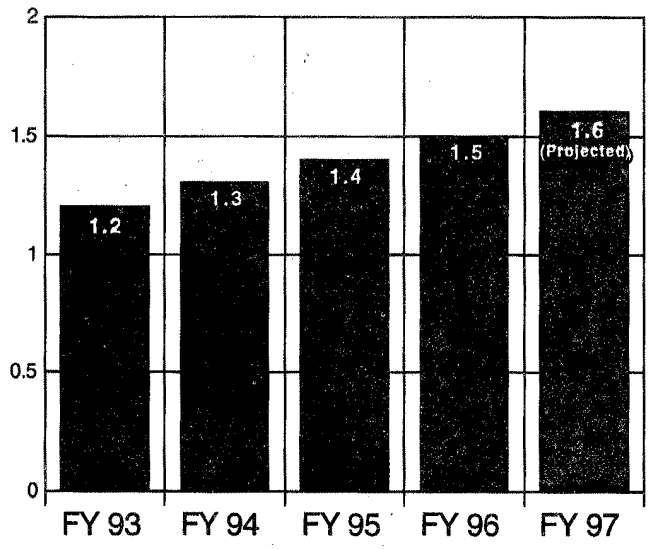
Government Reform and Oversight Subcommittee on Government Management, Information and Technology

April 14, 1997

Department of the Treasury - **Internal Revenue Service**

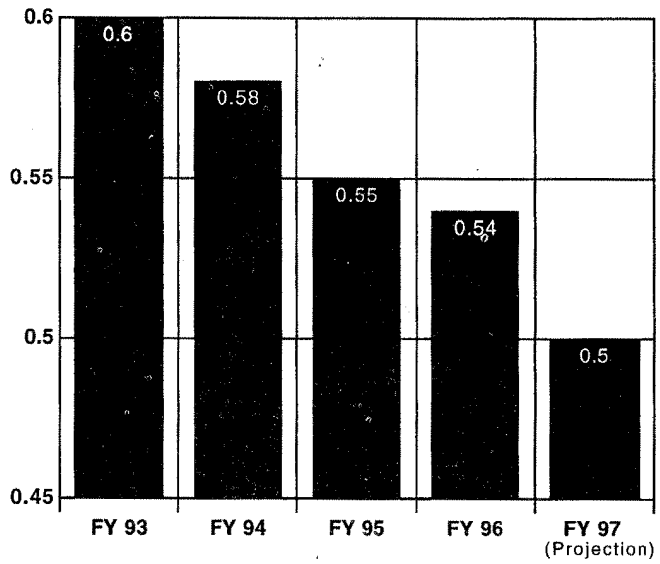
Gross Revenue

Dollars in Trillions

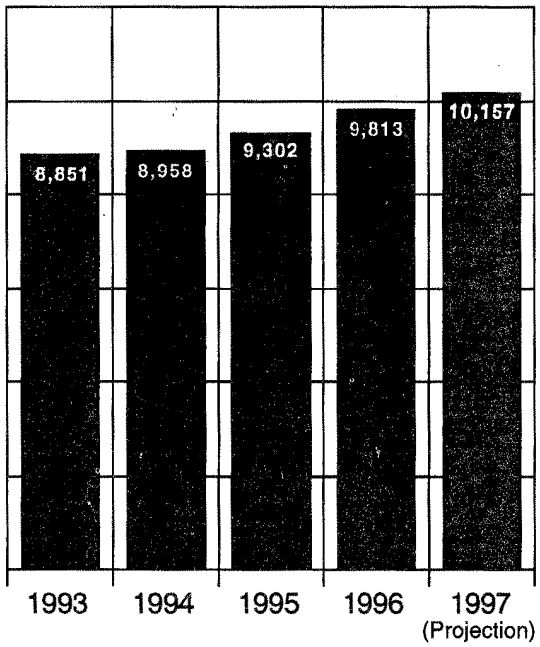


IRS

Budget cost to Collect $100



Primary Returns per FTE



Electronic Filing

Individual Income Tax Returns

	FY93	FY 94	Change	FY 95	Change	FY 96	Change	FY 97 (Projection)	Change
All 1040 ELF (includes Telefile)	12.5M	14M	+12%	11.8M	-16% *1	15M	+27%	19M	+26%
Telefile Form 1040EZ	149,000	519,000	+248%	680,000	+31%	2.8M	+318% *2	4.5M	+60%

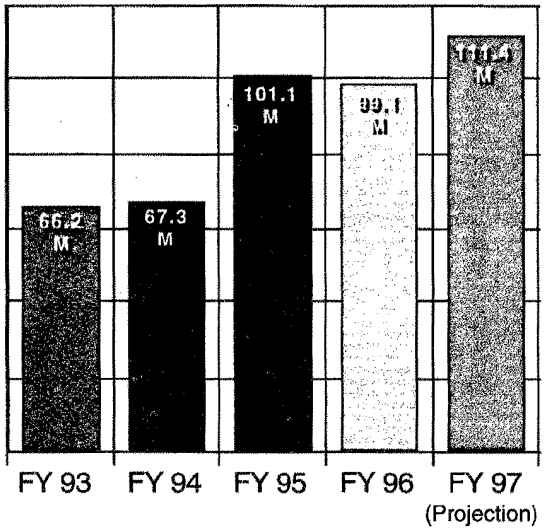
*1. Revenue Protection Strategy Initiated
*2. Nationwide Program Initiated

Tax Payments

	FY 93	FY 94	FY 95	FY 96	FY 97 (Projection)
Electronic	$0.8B	$6.3B	$232.3B	$383B	$490B
Lockbox	$102B	$107B	$125.1B	$170B	$187B

Customer Service Calls Answered

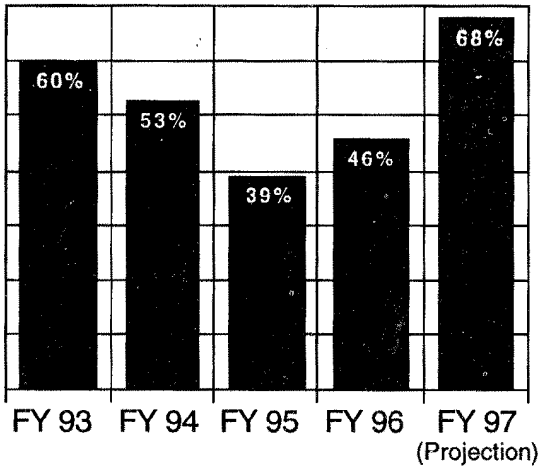
In Millions



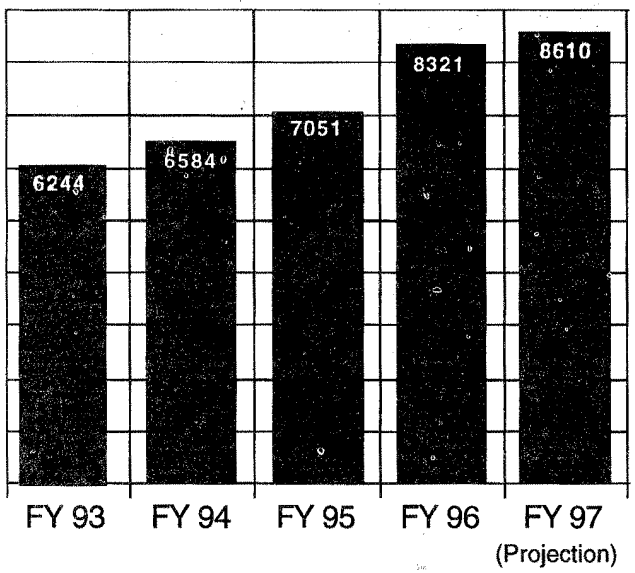
Total Calls: Includes toll-free, non -toll-free, Tele-Tax, & after hours calls (routed to Tele-Tax)

Customer Service Calls

Level of Access

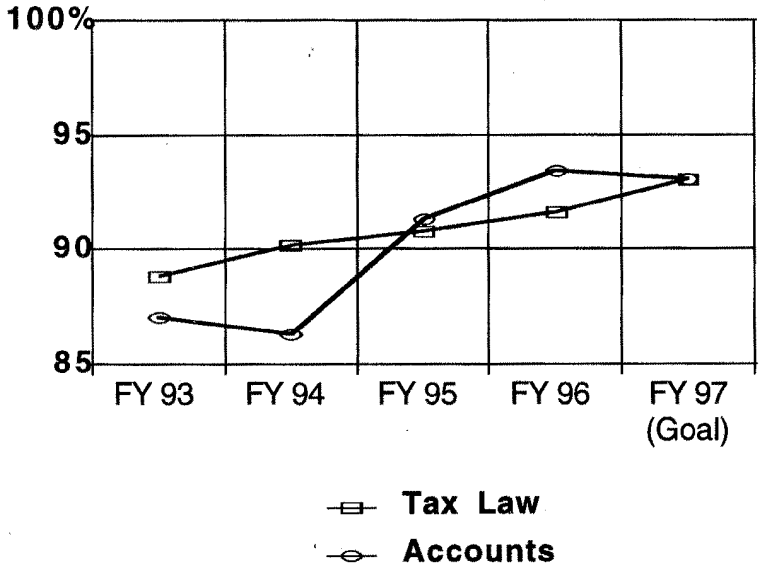


Customer Service Calls Per FTE



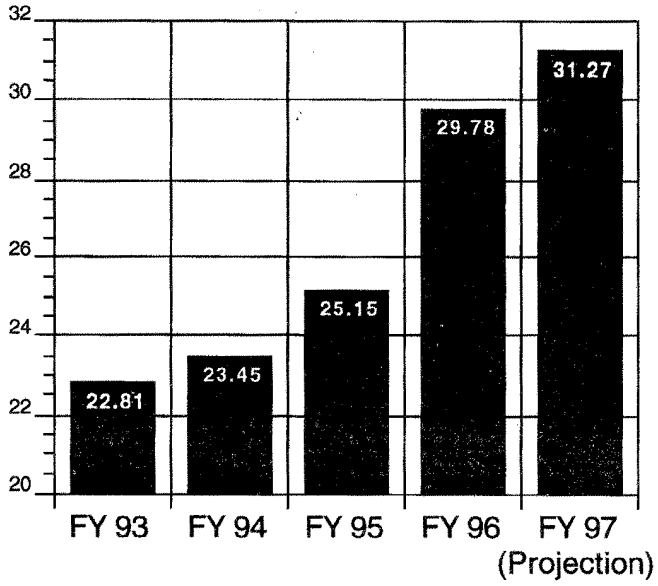
Customer Service

Tax Law and Accounts Accuracy



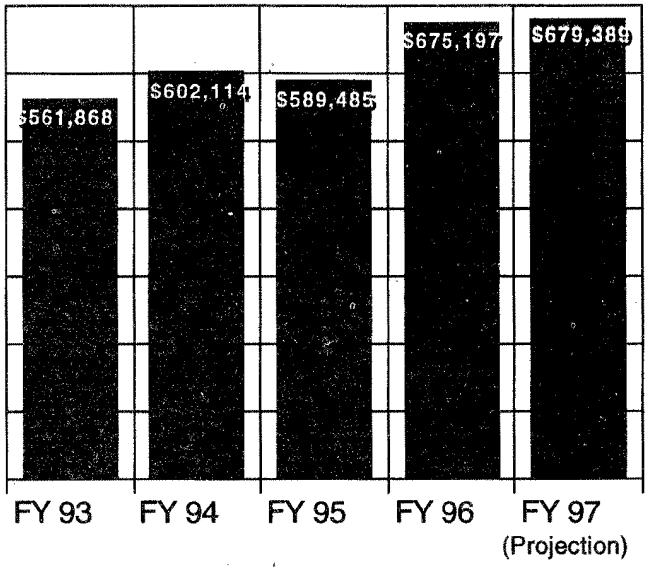
Collection

Amounts in Billions



Collection

Telephone and Field Functions
Dollars Collected per FTE



Examination

Program Accomplishments

	FY 93	FY 94	FY 95	FY 96	FY 97 (Projection)
Examinations Closed	1,300,230	1,426,573	2,100,144	2,136,819	1,516,988
Audit Coverage	0.96%	0.93%	1.62%	1.63%	1.15%
Examination Production	$778,926	$866,901	$979,931	$1,013,094	$948,343

Mr. HORN. Well, since I am half Irish, I can sympathize with you. I enjoyed what you had to say.

Let me pursue a few of the points you made, and then we will go down the line on another area.

One of the things that really concerns people is the browsing, snooping issue, if you will. I was assured by the Commissioner a year or so ago that IRS had taken action to reduce browsing, and there were several people under indictment for violating the statute. I am just curious, what happened to them? Were any people ever indicted? Were they fired? What?

Mr. DOLAN. The answer is yes to all of the above. If you permit me to roll it back maybe just a frame or two before that, when the Commissioner was before you, as she has before others, she said unequivocally that browsing was not acceptable and not to be condoned. And what she and the rest of the senior management team have tried to do is drive that down in the organization in all of the ways you would expect in a large organization.

We have taken and adjusted the tables of penalties that apply to disciplinary action. We have instructed those who are responsible for taking discipline that abuses or unauthorized accesses were to be treated very seriously in the discipline process. We have created basically a system we call the electronic access research log, which gives us an opportunity to take, in a much more creative way, these audit trails and determine where there are potential abuses.

We have developed case processing procedures and the personnel and inspection and line management process to ensure that not only detection of abuses takes place, but that discipline be appropriate and be consistent.

We have taken a variety of steps. We have actually prosecuted a number of cases, some of which we have found bouncing back on us, because while we had a standard that we thought was clear, the courts have in some instances distinguished between those instances where somebody uses information for some purpose and in other instances where they do what they have dubbed "self-disclosure," so if that person has accessed information and made no further use of it, some of our prosecution and disciplines have failed because people have looked at that and said the standard of conduct is not explicit enough to have put the employee on notice—that is unacceptable.

A couple of things have happened in the meantime. We have made it administratively explicit that it doesn't make any difference whether you use the information or not. If it is an unauthorized access, it is offensive and actionable with respect to a disciplinary action.

On the automated access side, as I think you know, the changes last year in title 18 have now substantially improved the ability to take the criminal prosecution where the access is one that occurs through automation. Both Chairman Archer and Senator Glenn have bills working in the House and Senate that take that same provision and overlay it on paper accesses.

So we are hopeful that those additional attributes will help us continue to try to make this less and less the type of risk that an individual employee takes and more and more the kind of protec-

tion we can sit here in front of you and say we have greater confidence that it is not going to go on.

Mr. HORN. Well, I don't want to create 106,000 pieces of paper in the agency, but it seems to me you could get employees to sign a statement that I am aware of this policy, and I will not violate it. Do we have something like that?

Mr. MADER. Mr. Chairman, we do have a policy when employees first come into the Internal Revenue Service. As part of our orientation program we talk about the rules of conduct. As Mr. Dolan mentioned, safeguarding taxpayer information is in those rules of conduct. When employees are trained and profiled to access our computer systems, they sign the very kind of form that you mentioned, advising that they have been told what the rules and regulations are and what the ramifications are for violating them.

Every time an IRS employee accesses one of our main systems, a warning screen comes on and reminds them another time about unauthorized access.

Mr. HORN. Approximately how many thousand employees have access to this information?

Mr. DOLAN. I think Bill told me the exact number, but somewhere in the neighborhood of 55,000 people would have responsibilities that would take them into what is our principal, one of our principal on-line systems, our integrated on-line retrieval system.

Mr. HORN. So over half the agency personnel have access?

Mr. DOLAN. In having the access, they all have different kinds of access, depending upon the nature of the job. I may have access that allows me research, or I may have access that allows me to adjust. I may have some combination. Specific authorities comes with the passwords and the specific accreditations that are akin to my job.

About 1.5 billion transactions take place in that one integrated data retrieval system in the course of a year by these 55,000-some people. We are talking about an incredibly fractional number of instances in which there is any unauthorized access. One is too many, but in the context of the 50,000-some people being asked to do the key responsibilities across the data point, it is only a fractional number.

Mr. HORN. At what point have we found a weakness in the system in the sense that they could make the claim that, gee, this employee didn't really know it was a problem? Has that come at the internal IRS, or Treasury level, where discipline was administered, that claim was made and they haven't been able to make it stick? Where has it happened? Or is it happening in court?

Mr. DOLAN. We talked a little bit about the court, and the administrative action, it goes something like this: the EARL system will produce a lead. The lead will go to some combination, typically of a line person, personnel person, maybe an inspection person. They will develop the lead, go back into the person's assignments. They will make some judgment as to whether it appears that this is a good lead, a good lead meaning a lead that looks like it——

Mr. HORN. Is this lead a tip?

Mr. DOLAN. It is a tip, but it comes as a result of massaging these thousands of audit trails. Without getting into a lot of explicit detail here, it takes characteristics. There have been a series of sce-

narios developed that are high likelihoods of abuse scenarios. Not every one of them reflects abuse, but they will narrow a set of leads. Those leads will then subsequently have to go back to the individual employee's precise work assignments, precise fact patterns, and determine, yes, this lead turns out to be an instance of abuse.

When it is, that instance of abuse, that allegation of abuse, will go to the head of an office. The head of that office will end up having their personnel people develop an adverse action or disciplinary action. It will be taken. It may or may not be appealed.

One of the things we found upon appeal is, again, we are operating within a system that the Federal disciplinary system assumes a couple of things. It assumes for the most part discipline is progressive. What that means in a code word is, typically a person is disciplined for a first offense and given some opportunity to remediate their performance or to improve on the job.

Mr. HORN. In other words, nothing happens if they don't do it again?

Mr. DOLAN. No.

Mr. HORN. You could get one crack at a rock star, celebrity, or politician?

Mr. DOLAN. I knew I was going down the wrong road giving you that explanation. That is not the rule.

Mr. HORN. I am trying to get the process.

Mr. DOLAN. There are no one cracks. You do it once, it is wrong. I was trying to explain in the context of the precedents built up in the Merit Systems Protection Board, the courts and everywhere else. There are some rules about how you do discipline in the Government. I can sit here and say it is wrong one time, it ought to be a firing and nobody ought to have any recompense on that. That is not the real world.

The real world we have taken the disciplines into, is a world surrounded by the practice of precedents of the general disciplinary system. What we tried to do, as I mentioned at the outset, is tried to make our penalty provisions be explicit about ranges. We tried to say to our directors—propose on the high end and make it very difficult to mitigate from the high end, meaning removal. So principally our reaction is going to be removal when it is a willful access.

When it is some trainee in the first week who bounces up there and comes back and says, wait a minute, I did it and didn't mean to, that person is not going to be removed probably. But the willful access is something we would be pursuing removal as a first resort.

Mr. HORN. Willful is very hard to prove; is it not?

Mr. DOLAN. It is. Our systems today, Mr. Chairman, lock you out of your own account. Everybody knows they lock you out of your own account. Notwithstanding that, we will have on the audit trail evidence that somebody tried to go to their own account. When you go to that person, you get one of two answers. You can find somebody who was brand new, didn't understand or whatever, went up and bounced, and that will come up as a transgression. Or you can find some of your best employees who will tell you—when they have been on the system all day long, bringing up Social Security numbers to resolve them, they will on occasion bring up their own

Social Security number. You will have that pop. They will not get into their own account because they are frozen, but it will show up. When you go back to that person, if indeed there is no history of anything else, you can say, OK, I take that explanation of what it was for and it is not some attempt to gain the system.

Mr. HORN. Well, how many people have you had any effective discipline with, and what penalties have you given and how many are involved? How many were brought up to the disciplinary system and what happened as a result of that disciplinary system?

Mr. MADER. I would like to submit for the record, Mr. Chairman, a summary of those actions from fiscal year 1994 through the year-to-date. But let me, if I could, just talk about 1996.

There were a total of, and this goes back to what Mr. Dolan said, of 1,374 instances where the computer system kicked out there may be something here, you need to investigate it further. Of that 1,374, 797 of them were confirmed as an unauthorized access. Of those cases, 93 employees were separated, either involuntarily or they resigned before we could separate them. There were 476 cases where upon further investigation there was no unauthorized access.

What I would like to do is submit this for the record. I know there have been a lot of numbers in the press in the last week and I think it is important.

Mr. HORN. It will be in the record, without objection.

[The information referred to follows:]

Browsing Cases Statistics
Requested By
House Government Reform and Oversight Committee
10/01/94 - 03/31/97

IRS District	Cases Accepted For Prosecution	Guilty	Pretrial Diversion	Plad Guilty To Lesser Offense	Deferred Prosecution	Not Guilty	Total Judicial Results*	Cases Declined For Prosecution**	Cases Pending Prosecutive Determination	Total Cases Per District
Arkansas-Oklahoma							0	1	1	2
California-Central							0	6	3	9
California-Los Angeles	1	1					1	6	5	12
California-Northern	6		1				1	25	5	36
California-Southern	1	1					1	4		5
Connecticut-Rhode Island	1			1			1	1	3	5
Delaware-Maryland	2	1	1				2	10	3	15
Florida-North							0	4	1	5
Florida-South							0	6	3	9
Georgia	1	1					1	4	1	6
Gulf Coast							0	3		3
Illinois							0	4		4
Indiana	1	1					1	5	1	7
Kentucky-Tennessee	1	1					1	6	1	8
Michigan	1		1				1	1		2
Midwest							0	1		1
New England	2	2					2	5	1	8
New York-Brooklyn							0	3	1	4
New York-Manhattan							0	1		1
New York-Upstate							0	4	2	6
No-So Carolina							0		1	1
North Central							0	1		1
Ohio	2	2					2	5	3	10
Other Location							0	1		1
Pacific Northwest	2						0	4	3	9
Pennsylvania							0	6	2	8
Rocky Mountain							0	4		4
SC-Andover							0	2	1	3
SC-Atlanta	1			1			1	5		6
SC-Austin							0	2		2
SC-Brookhaven	2				1		1	6	2	10
SC-Cincinnati							0	2		2
SC-Fresno	1				1		1	3	3	7
SC-Kansas City							0	1		1
SC-Memphis	1					1	1	1	1	3
SC-Ogden	1						0	3		4
SC-Philadelphia	1	1					1			1
Southwest							0		1	1
Texas-Houston							0	8	4	12
Texas-North	1			1			1	7	4	12
Texas-South							0	3		3
Virginia-West Virginia							0	1	1	2
Totals	29	11	3	3	2	1	20	165	57	251

* Some cases are pending judicial action, therefore, the number of Total Judicial Results does not equal the number of cases accepted for prosecution

**Reason for declination not documented in Management Information System and is not otherwise available

Mr. HORN. Could you just give me the summary again of how many cases, how many didn't result in cases once it was explored, how many went into the disciplinary system beyond the first or second stages, and what happened and what were the penalties?

Mr. MADER. Of the total 1,374 cases, 411 of them were not cases in which there was abuse.

Mr. HORN. What were they? What is the typical one, the 411 were?

Mr. MADER. As Mr. Dolan mentioned, when we actually pulled the work of the employee, we determined that the kind of access they had to a particular account was justified. As Mr. Dolan said, we have several scenarios built on the front end of this system that pull together certain transactions.

Mr. DOLAN. The system looks for multiple accesses to the same account. On the face of it that might look like somebody has got either an interest in browsing or it might, in fact, be someone who has had repeated conversations or repeated telephone calls from the same taxpayer, and gone into the account several times to either look at a refund or look at some other transaction.

Mr. HORN. Of the 963 left, what happened?

Mr. MADER. Of the remaining cases, there were 797 cases in which we confirmed there was an unauthorized access. Twenty of those resulted in a caution letter to the employee.

Mr. HORN. I am sorry, 20 what?

Mr. MADER. Twenty resulted in a caution letter to the employee.

Mr. HORN. Don't do it again?

Mr. MADER. Don't do it again; 326 resulted in oral or written counseling, which is more severe in our disciplinary system than just a caution letter.

Again, Mr. Dolan had mentioned——

Mr. HORN. Excuse me, the caution order doesn't go into their personnel file?

Mr. MADER. No, it does not, sir.

Mr. HORN. How do you have any trail that this person keeps doing these things if you don't put something in the personnel file?

Mr. MADER. They are given a letter. The next instance would result in more severe discipline, and that would go in their personnel file.

Mr. HORN. You have 326 you tell me you did put in out of the 963 that was made after you got rid of 411 by not really being abusive?

Mr. MADER. Right.

Mr. HORN. But was justified. So I am just trying to find out how the system works. So we get down to 326 where you have got oral and written. Now, is it both?

Mr. MADER. It is either/or.

Mr. HORN. So how many actually had something put in their personnel files?

Mr. MADER. Counseling is a step above the caution. The counseling is formal discipline, and a notation would be made in their personnel file. Sixty-two employees received an admonishment.

Mr. HORN. What does that do? Does that get into the personnel file?

Mr. MADER. Yes, it does, sir.

Mr. HORN. Is that the first level that goes into the personnel file?

Mr. MADER. Yes, sir.

Mr. HORN. And 62 admonishments.

Mr. MADER. Eighty-seven reprimands, which are more severe than admonishments.

Mr. HORN. Eighty-seven reprimands.

Mr. MADER. One hundred forty-seven suspensions of 14 days or less.

Mr. HORN. And that is without pay?

Mr. MADER. That is without pay, sir. Thirty-eight suspensions greater than 14 days without pay, one reduction in pay, and 93 separations from the service.

Mr. HORN. Ninety-three separations as a result of this incident or did they have other reasons?

Mr. MADER. As a result of this incident.

Mr. HORN. OK. So 93 were asked to leave and did.

Now, did you lose any of those on appeal?

Mr. MADER. I don't know, sir. I would have to check the record.

Mr. HORN. Would you mind? Check it, because where did the union stand in all this? Did they back you on a no browsing, no tolerance, as the Commissioner told me, policy?

Mr. DOLAN. I think for the most part, yes. Bob Tobias is a co-signatory on a series of memorandums that have been put out on this. I think they would clearly have an interest in making sure that whatever disciplinary process works, gives people an opportunity to explain themselves and defend themselves, but they have not condoned it, either.

Mr. HORN. Any other data relevant to this?

Mr. DOLAN. Dave has all 4 years there, actually 4 years, and we will provide all 4 to you, Mr. Chairman.

[The information referred to follows:]

We are providing a status report on the number of cases of unauthorized access, or browsing, that were appealed by employees either to arbitration or to the Merit Systems Protection Board (MSPB). These figures are from October 1993 to the present. There were six cases appealed to arbitration: five were sustained and one was mitigated to a suspension in excess of one year. There were seven cases referred to the MSPB: six were sustained and the seventh is the Czubinski case, which was recently overturned by the courts.

Mr. HORN. Does it show a trend line in any way? Is there more browsing now than there was 4 years ago?

Mr. MADER. No, it shows, Mr. Chairman, as Mr. Dolan testified, that 1995 and 1996 are about the same. So far, the trend in 1997 is upwards a little bit.

Mr. DOLAN. That is a classic dilemma. Is the trend a function of better detection or a function of more instances? As I sit here, I can't tell you, but I can tell you we improved our detection, but I can't tell you in absolute terms what it reflects.

Mr. HORN. What we are talking about here is in 1/13th of the cases that start there is an actual separation and a notice put in their personnel file, a note on a separation? Is it simply a separation or does it state why the separation occurred?

Mr. DOLAN. Within the personnel parlance, it would be a permanent record that would be reflected upon anybody, any other Federal employer pulling their Federal jacket. It would be reflected in there.

Mr. HORN. In other words, when they go to another agency the next day and they phone back, presumably they are told this person was separated for cause.

Mr. DOLAN. Don't let me mislead you. There will be some instances in that 93, whereupon realizing that we were going to fire them, the person might have left. When you leave before the actual discipline is accomplished, then your record would not reflect that.

Mr. HORN. In other words, you can't fire me, I quit?

Mr. DOLAN. Correct.

Mr. HORN. OK. Do you think that is sufficient action or should there have been any criminal action?

Mr. DOLAN. I don't think any action——

Mr. HORN. What was the biggest number of voyeur cases you had in terms of one person accessing 200 files, 500 files?

Mr. DOLAN. I don't have those specifics in front of me. I would tell you that if you ask is it sufficient—to the extent it exists at all, it has not been sufficient. So I think we have still got a task ahead of us to eradicate it.

Mr. HORN. Now, did any of these cases, were they ever taken to the U.S. attorney, asked for an indictment?

Mr. DOLAN. Some have. We could get you more detail.

Mr. HORN. What did the U.S. attorney say? Didn't want to deal with it?

Mr. DOLAN. On several occasions, U.S. attorneys have taken the cases. We talk in our testimony about a couple that have not been successful, but there are others that have been successful. The U.S. attorneys are not reluctant to help us pursue the prosecution, and particularly in the grievance cases.

Mr. HORN. Are they primarily here in Washington or out in the field?

Mr. DOLAN. Principally in the field.

Mr. HORN. Principally in the field. In terms of the U.S. attorney's actions, could you give us a statement for the record of how many times you went to a U.S. attorney, wherever, separate field and Washington, and the times they took it and times they rejected it, and, if so, what was the reason for rejection. Just they are overworked and have more serious things like murders or whatever, and I understand that, but I am not happy about it. And what went on to a court and what did those courts rule on this. Did they give you any further instructions from the court as to clarity of policy or what?

Mr. DOLAN. In response to your invitation, why don't you let us give you the whole spectrum.

Mr. HORN. The whole works. I want to know why this policy isn't working and it keeps occurring.

[The information referred to follows:]

We are providing a chart which provides a breakdown on the U.S. Attorney's actions concerning unauthorized access (browsing) cases from October 1, 1994, through March 31, 1997.

[Note.—The chart can be found on p. 202.]

Mr. DOLAN. The other thing, that I think will be implicit in anything we give you about this part of it, is one place that I suspect you would be at anyway. This is something today you are not going to prosecute out of existence. Because with the most cooperative

U.S. attorneys in the world, what you want to do is you want to eradicate this on the front end. You don't want to depend on prosecution. You want the deterrence of people knowing that not only will you prosecute but upon prosecution, it will be a successful prosecution. But at the end of the day our objective has been to eradicate this sort of prosecution by the training, by the systems, by the front end proactive stuff to the maximum extent possible.

Mr. HORN. In the early 1970's, the Nixon White House, one Presidential assistant went to Federal prison for looking at one FBI file. We now have cases in the White House, we still don't know their reason for looking at 600 to 1,100 FBI filings, and nothing has happened.

Is this just we change our sense of morality in three or four decades or are we just incompetent in terms of our processes for dealing with discipline or what?

Mr. DOLAN. Well, I don't believe——

Mr. HORN. What would you do to change this process and make it very clear that this is serious business?

Mr. DOLAN. A couple of things. One is at the front end, I would like to be able to prevent more of it so I don't have to explain it in any context of it being unacceptable. But it is plain flat out impossible to occur.

Mr. Chairman, you have been involved in big organizations, and I believe you know it is repetition, repetition, repetition. It is finding every possible way, every medium available to you, training, information, communication, to continue to reinforce up and down the line with everybody to the point of people being tired of hearing you reinforce it.

Mr. HORN. That is why I want them to sign a piece of paper and get it in the file.

Mr. DOLAN. They need to sign it and need to sign it and sign it. Because, again, the repetition, one time doesn't do it on that score, either.

Mr. HORN. Maybe they shouldn't be working for your agency if they are that dumb.

Mr. DOLAN. I don't think people who are making unauthorized access should be working for the agency.

Mr. HORN. Let me move to the results bit. We talked earlier in some of the testimony about the Government Performance and Results Act. In testimony to the appropriations subcommittee on the IRS fiscal year 1988 budget, the Commissioner stated that the IRS has outcome-oriented performance indicators. I assume that is in the 1998 budget, right? Yes, 1998 budget. Here it says 1988. Thank you. It is 1998, as I thought.

The appendix to the fiscal year 1998 included several measures. Now, I found them rather interesting, and I would like to put it in the record, without objection.

[The information referred to follows:]

APPENDIX

FY 1998 Performance Measures and Targets

Budget Level Measures	FY 98 Targets
Mission Level	
Mission Effectiveness Indicator: Total Net Revenue - (Budget +Burden) / Total True Tax Liability	79.9%
Objective - Increase Compliance (IC)	
Total Collection Percentage	87.3%
Total Net Revenue Collected (in trillions)	$1.57
Servicewide Enforcement Revenue Collected (in billions)	$35.2
Servicewide Enforcement Revenue Protected (in billions)	$7.5
Servicewide Audit Coverage	1.17%
Objective - Improve Customer Service (ICS)	
Taxpayer Burden Cost (in dollars) for IRS to Collect $100	$8.06
Initial Contact Resolution Rate	TBD
Objective - Increase Productivity (IP)	
Budget Cost to Collect $100	$0.47
Percent of Returns Filed Electronically	14.0%
Percent of Dollars Received Electronically	48.4%
Percent of Dollars Received Via Third Party Processors (Lockbox)	66.3%
Operations and Maintenance Appropriation	
Budget Activity Code (BAC) Measures	
Submission Processing BAC:	
Number of Primary Returns Processed (in thousands)	199,964
Total Number of Individual Refunds Issued (in millions)	85.5
Processing Accuracy Rate - Paper	95%
Processing Accuracy Rate - Electronic Filing	99%
Refund Timeliness--Paper (in days)	40
Refund Timeliness--ELF (in days)	21
Telephone and Correspondence BAC:	
Number of Calls Answered (in millions)	111.4
Taxpayer Service Level of Access	60.2%
Taxpayer Service Tax Law Accuracy Rate	92%
ACS Dollars Collected per FTE (in millions)	$1.4
Service Center (Examination) Dollars Recommended per FTE	$480,000
Problem Resolution Program Average Processing Time To Close Cases (District Office)	43.4
Problem Resolution Program Average Processing Time To Close Cases (Service Center)	32.3
Problem Resolution Program Quality Customer Service Rate - Districts	83.1%
Document Matching BAC:	
Document Matching Dollars Assessed (in billions)	$1.2

Mr. HORN. This is the chart where it says fiscal year 1998 Performance Measures and Targets. It starts in with the mission effectiveness indicator, total net revenue of budget minus burden, divided by total true tax liability, is roughly 80 percent, 79.9, and goes down with a series of indicators on collection, where we are on compliance, improved customer service. You mentioned some of that, increase in productivity, and then various budget activity code measures such as processing accuracy, processing accuracy rate, and so forth.

I guess I would ask why is refund timeliness used? Does it serve the American people well if you send out refunds in a timely manner, but they are for the wrong amount to the wrong people, and how do we get at that problem?

Mr. DOLAN. Well, in the first instance, in the very largest percentage, in almost every instance, the right refund is going out to the right person in what we have identified within our customer service standard, which is 40 days.

In point of fact, if you are using both electronic input and taking your refund to the bank, you are going to get it out considerably quicker than that. We do believe, Mr. Chairman, if I am following your question correctly, that this is a measure our customers have told us is important to them. It doesn't have to be overnight, but it has to be predictable, and it has to be consistent.

Mr. HORN. Are we looking at the wrong refunds and working that in?

Mr. DOLAN. Maybe your point is to refund fraud. Is that your point?

Mr. HORN. Let me just read you a little bit, a paragraph from the IRS Management Report, High Risk Series, U.S. General Accounting Office, February 1997.

"When we first identified filing fraud as a high-risk area in February 1995, the amount of filing fraud being detected by IRS was on an upward spiral. From 1991 to 1994, the number of fraudulent returns that IRS detected rose from 11,168 to 77,781, and the total amount of fraudulent refunds detected rose from $42.9 million to $160.5 million. In 1995, after being urged to take immediate action by us, Congress and the Treasury task force, IRS introduced new controls and expanded existing controls in an attempt to reduce its exposure to filing fraud. Those controls were directed toward either, one, deterring the filing of fraudulent returns; or, two, identifying questionable returns after they had been filed."

Then it notes that "To deter the filing of fraudulent returns, IRS took several steps that were focused on electronic filers. As a result of these steps, IRS, one, expanded the number of upfront filters in the electronic filing system designed to screen electronic submissions for problems, such as the missing, or incorrect Social Security numbers, to prevent returns with these problems being filed electronically, and strengthened the process for checking the suitability of persons applying to participate in the electronic filing program as return preparers or transmitters by requiring fingerprint and credit checks," all of which are good moves.

"To better identify fraudulent returns once they have been filed, IRS placed an increased emphasis in 1995 on validating the Social Security numbers on filed paper returns and delayed any related

refunds to allow time to do these validations and to check for possible fraud. IRS also improved its Questionable Refund Program by, one, revising the computerized formulas used to score all tax returns as to their fraud potential, and, two, upgrading the electronic Fraud Detection System to give staff better research capabilities."

I will put the rest in the record. I will not bore you with reading it. You are probably well familiar with it.

[The information referred to follows:]

Correcting the problems and improving collections will require long-term and continuous efforts. To ensure that these efforts are on the right track, IRS needs a comprehensive strategy that involves all aspects of IRS' operations. As part of this strategy, IRS needs to set priorities; modernize outdated equipment and processes; and establish goals, timetables, and a system to measure progress.

Filing Fraud

When we first identified filing fraud as a high-risk area in February 1995, the amount of filing fraud being detected by IRS was on an upward spiral. From 1991 to 1994, the number of fraudulent returns that IRS detected rose from 11,168 to 77,781, and the total amount of fraudulent refunds detected rose from $42.9 million to $160.5 million. In 1995, after being urged to take immediate action by us, Congress, and a Treasury task force, IRS introduced new controls and expanded existing controls in an attempt to reduce its exposure to filing fraud. Those controls were directed toward either (1) deterring the filing of fraudulent returns or (2) identifying questionable returns after they have been filed.

To deter the filing of fraudulent returns, IRS took several steps that were focused on electronic filers. As a result of these steps, IRS (1) expanded the number of upfront filters in the electronic filing system designed to screen electronic submissions for problems, such as missing or incorrect Social Security Numbers (SSN), to prevent returns with those problems from being filed electronically and (2) strengthened the process for checking the suitability of persons applying to participate in the electronic filing program as return preparers or transmitters by requiring fingerprint and credit checks.

To better identify fraudulent returns once they have been filed, IRS placed an increased emphasis in 1995 on validating SSNs on filed paper returns and delayed any related refunds to allow time to do those validations and to check for possible fraud. IRS also improved its Questionable Refund Program by (1) revising the computerized formulas used to score all tax returns as to their fraud potential and (2) upgrading the Electronic Fraud Detection System (EFDS) to give staff better research capabilities.

IRS' efforts produced some positive results. For example, the number of SSN problems

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identified by the electronic filing filters increased from about 1 million in 1994 to about 4.1 million in 1995. In addition, about 350 persons who applied to participate in the electronic filing program for 1995 were rejected because they failed the new fingerprint and credit checks. IRS' efforts to validate SSNs on paper returns produced over $800 million in reduced refunds or additional taxes. Unfortunately, IRS identified many more SSN problems than it was able to deal with and released about 2 million refunds without resolving the problems.

Despite the generally positive results, there is insufficient information available to determine which of IRS' actions have had a significant impact on either detecting or deterring filing fraud. IRS conducted some studies in 1995 and 1996 that may shed some light on the effects of its changes and upgrades, but IRS has not released the results of these studies.

The number of fraudulent returns identified by IRS has declined recently, from 77,781 fraudulent returns involving refunds of $160.5 million in 1994 to 62,309 fraudulent returns with refunds of $131.7 million in 1995. That downward trend continued in 1996, at an even more significant pace.

During the first 9 months of 1996, IRS reported detecting 20,521 fraudulent returns involving refunds of $55.4 million, compared with 59,241 returns totaling $124.8 million in the first 9 months of 1995. There is insufficient information available to determine whether the decline was the result of staff reductions, changes in the program's operating and reporting procedures, or a general decline in the incidence of fraud.

IRS' efforts to control filing fraud are also constrained by the relatively short time available, after a return is filed and before any refund is issued, in which to identify a questionable return. Therefore, it is critically important for IRS to (1) optimize the controls, such as upfront filters, that are intended to prevent the filing of fraudulent returns and (2) maximize the effectiveness of available staff. Modernization is the key to achieving these objectives, and electronic filing is the cornerstone of that modernization.

As discussed previously, one of the benefits of electronic filing is the ability to build controls into the system, in the form of filters, that prevent returns with certain problems (such as incorrect SSNs) from being filed electronically. IRS cannot identify those kinds of problems on paper returns until

after the returns are filed and, as happened in 1995, is limited in the number of cases it can pursue by the number of staff available. One solution to this dilemma is to increase the percentage of returns filed electronically. IRS' business vision calls for increasing the number of electronic returns to 80 million by 2001. However, our analysis of recent filing trends indicated that only about 33 million returns are expected to be filed electronically by 2001. To achieve its goal, IRS must first identify those groups of taxpayers who offer the greatest opportunity to reduce IRS' paper-processing workload and operating costs if they were to file electronically. IRS must then develop strategies that focus its resources on eliminating or lessening impediments that inhibit those groups from participating in the program. As of early January 1997, IRS was finalizing its electronic filing strategy.

The EFDS enables IRS to use its staff more effectively by automating a process that had been labor and paper intensive and by enhancing the staff's research and query capabilities. To date, EFDS has been used primarily on electronic returns, which accounted for only about 13 percent of all individual income tax returns filed in 1996. IRS had planned to expand EFDS to all paper

returns, but it is unclear how those plans will be affected by IRS' recent decisions to terminate its major paper processing modernization project (the Document Processing System) and to consider other options for processing paper returns.

Mr. HORN. But, again, are we treating the electronic forms on refunds differently and permitting more errors to get through simply because they haven't filed in paper? Filing in paper, programs you have more time to deal with that. So where are we between those two filings?

Mr. DOLAN. It is a great question because it is actually just the reverse. Part of what gets lost in the GAO narrative is, there is a little bit of apples and oranges between the kinds of returns that are being detected because not when the GAO first discovered this, but when we discovered it and the GAO then began writing reports on it, part of what we understood about both the paper and the electronic side were there were insufficient filters.

What was happening on the electronic side was you had, my term, some "bozo criminals" out there putting together various scheme and trying to game the electronic system. What we have done over the past several years, particularly with the filters, is make it far less possible—it is impossible, I never want to say impossible—highly unlikely today that a bogus Social Security number is going to get through the electronic processes because of the way the electronic screens are able to look at all that data and basically pull any of the mismatches out. So what happens today, what used to show up as a casework further downstream, is those cases which are rejected up front.

Now, in the instance where it is not anybody with fraudulent intent, but somebody who transposed their daughter's Social Security number or forgot their spouse's or didn't make an adjustment of maiden to married name, those things reject, but don't ever get in the system. They reject, but are able to be corrected and, when corrected, they process through. In the early years we were relying almost exclusively on catching those on the back end, particularly on the electronic side. We are able to detect much, if not all, of that on the front end.

Mr. HORN. Let me move to another indicator here and that is the number of calls that are taken. I think, wouldn't you agree, that it isn't the fact that you talk to the people over the telephone, but isn't the real measure a measure of the outcome—such as the call is correctly answered. I know from time to time we have all seen stories where they have checked the same question at different regional offices and gotten different answers. I have forgotten if you have an internal review like that. So could you tell me a little about it? Why don't we have as one of the results indicators the accuracy of the response rather than simply the fact that, yes, I talked to a taxpayer.

Mr. DOLAN. We do, Mr. Chairman. We actually have two other metrics that I think make your point. One is the actual accuracy rate. You are quite correct that in years past it was quite a celebrated cause, what the quality rate of the IRS was, and a lot of pundits had a lot of fun with that. For the last several years, the GAO and IRS have actually had their acts pretty well together. We have had a protocol for doing test calls and evaluating quality. It is posted weekly. It is tracked very carefully. At least on the appendix I have, which if it is the same one you are looking at, toward the bottom, maybe a third of the way to the bottom of that, it is

something called "Taxpayer Service Tax Law Accuracy Rate," 92 percent, that would be one of the metrics we would use.

The other one, up toward the top of that page, under something called "Objective—Improve Customer Service," you see something called "Initial Contact Resolution Rate." That is another metric that we think is very important, because we want the person to call, ask their question, and we want a person capable of resolving that issue then, not having to write us, or call us back.

So those three things would work in concert as a function of how well we are doing our customer service.

Mr. HORN. How is that 92 percent arrived at? Is that simply a random sample check of your people or do you know what they have said on each call? How can you, unless you tune in and tap them, how do you know?

Mr. DOLAN. It is actually a very precise formula, agreed upon by the GAO before the start of the filing season, where you take a specific category of calls, numbers, and you place a specific set of test calls that will give you statistical reliability of the result. You take that at the front of the season, you agree with GAO, and you have test calls made throughout the season. We report site-by-site so that every site is able to track week-to-week not only their gross quality rate, but know where they are falling below on a particular set of answers. So it is a fairly elaborate process designed to give us that kind of feedback.

Mr. HORN. What else do you think needs to be done in that area to improve accuracy?

Mr. DOLAN. Well, we have got a significant number of automated systems that I think at the end of the day will take what I would call some of the more easy traffic off of the system, so that somebody who really has a relatively routine question, and is comfortable with the automated systems, that you can move that traffic off into those systems, thereby giving not only greater access, but knowing that the human beings that you have working on the phones are ones that you could continue to specialize. So at least arguably you wouldn't have to spend as much time answering, where is my refund or can I claim this dependent, and maybe somebody becomes more skilled in some of the more technical areas. So being able to provide depth of training to a greater range of our employees, I think that is the next best thing we can do.

Mr. HORN. What do you think of the rest of the appendix, what do you think the best outcome measure is? If you as a manager had to look at one thing, what would be the one that meant the most to you as to how the agency is doing?

Mr. DOLAN. As a manager, the first thing I would want to do is make sure that I knew where my board of directors was going to come with that answer; because I would probably tell you at any given time, I am trying to balance a success in both access and accuracy of my customer service; as well as my ability to collect my accounts receivable; and as well as my ability to place the rest of my compliance resource across those parts of the tax gap that are most significant.

So I think we are always in a balancing exercise. And then overlaid on that, I would say I would hope I am seeing productivity out

of all corners. That is kind of the horse race we find ourselves in, not always with a board of directors that sees it the same way.

Mr. HORN. You might want to file this for the record, if you are not prepared to deal with it now, but the last point I have on that appendix is which of those indicators do you regard as outcome oriented? Do they meet the definition of an outcome indicator envisaged in the Government Performance and Results Act? I don't know if you had a chance to review all these.

Mr. DOLAN. I will be happy to take your invitation of giving you something for the record.

Mr. HORN. Just file it in the record then and we will take a look at it.

[The information referred to follows:]

The IRS considers the following measures to be outcome oriented:

- Mission Effectiveness;
- Total Collection Percentage;
- Total Net Revenue Collected;
- Servicewide Enforcement Revenue Collected;
- Servicewide Enforcement Revenue Protected;
- Taxpayer Burden Cost for IRS to Collect $100;
- Initial Contact Resolution Rate;
- Budget Cost to Collect $100;
- Percent of Returns Filed Electronically;
- Field Examination Dollars Recommended; and
- Field Collection Dollars Collected.

The General Accounting Office recently completed a review of the results orientation of selected federal regulatory agencies and generally agreed that the IRS Objective Level Measures were outcome oriented. In addition, most of the measures in the President's Budget Submission for IRS were intended to fulfill the GPRA Annual Performance Plan requirements.

Mr. HORN. Let me ask you now on the lien problem, that has come up before, and we have some horror stories of course that often occur.

All of us have district offices, as you know, where we have a staff that operates, as the Swedes would call it, in an ombudsman role, where if they have problems with any Federal agency, we try to be helpful with them.

I must say your congressional relations people at Laguna Niguel have been outstanding. When we needed help, they have done a very fine job and have been very receptive.

I noticed this article in the Washington Post, Albert B. Crenshaw wrote called "A Struggling IRS Collects Its Fair Share of Problems." They have this one case, and I am sure you are knowledgeable of it: Betty and Gerald Wesley of Annapolis. The difficulties for the Wesley's began after they missed a payment in November, when Gerald Wesley became sick. The Internal Revenue Service sent a notice that unless the couple caught up in 30 days, the installment agreement would be canceled and the full amount would be due. So the Wesleys quickly arranged a personal loan and paid up 4 days later. They made their next payment as scheduled and were confident the issue was behind them.

On February 7th, however, the IRS seized the checking account, leaving them with 23 cents in cash. The matter was straightened out. The lien on their account was lifted the following Tuesday. The Wesleys, meanwhile, were left shocked and mystified at their experience. "Nobody at the IRS can explain why this happened. They honestly do not know," Betty Wesley said.

The reason that case interests me, I had a case exactly like that about a year ago where one part of the IRS was moving with a lien, the other part of the IRS was settling with the individual. When the individual got back, he found all his accounts tied up, and the fact was that he couldn't pay his workers and he couldn't pay his tax bill.

So how many of these do we have floating around where the right and left hand don't know what each other is doing?

Mr. DOLAN. If you will permit me, what I would like to do is ask John Dalrymple to talk a little bit about the core issue you identified in the lien issue. That will shed some general light. John?

Mr. DALRYMPLE. The issue around filing Federal tax liens that you mentioned earlier—those are generally filed by our field personnel. And once that lien would have been filed on the taxpayer, when we went to execute on it, the taxpayer sent a payment in, in a particular case the Wesleys, it is possible that the payment showed up after the lien or levy had been effectuated at the bank.

The process is that the bank is to generally hold the funds, notify the taxpayer they are going to be held for a period of time, and then the taxpayer has an opportunity to deal with the service before those funds are actually taken and given back to the taxpayer.

I can't really talk about this case specifically, but that is what generally is supposed to happen.

Mr. HORN. Well, if you could, since it has appeared in the papers, let's get a little analysis of the case, put it at this point in the record as to what happened and what went wrong. Is it communication and have we got some management process by which that can be checked? Because, let's face it, that is a real shock when you go home and you can't get anything because the lien is placed on your property, on your bank account, and all the rest.

How are you going to even make the payment if you haven't got the money?

[The information referred to follows:]

Section 6103 of the Internal Revenue Code prohibits the disclosure of any taxpayer's tax return or return information. This prohibition includes providing an analysis of the Wesley's case.

Mr. DALRYMPLE. I should make an explanation between lien and levy, because they are two different things. I think what is described in the newspaper article is a levy, which generally arises out of a lien. A lien, of course, attaches to property. But until you actually effectuate some action, such as a levy, then it just has the effect of notifying other creditors that the IRS, in fact, is a creditor itself, protecting the Government's interest.

Mr. HORN. Let me pursue the year 2000 problem for a little while. This subcommittee started that discussion back in April 1996 with the executive branch, and just perhaps, Mr. Gross, I read a lot about you in Time Magazine here. I want to put the Time's story in the record. It says Arthur Gross, the Assistant IRS Commissioner who is "the agency's first world-class information systems officer," so I am looking for a lot out of you with the endorsement of Time.

[The information referred to follows:]

TIME (April 7, 1997), pp 56-62

BUSINESS

AN OVERTAXED IRS

Its klutzy computer system costs the Federal Government $150 billion a year in uncollected taxes and makes the agency an easy mark for cheats

By RICHARD STENGEL WASHINGTON

THE SMALL BRONZE LETTERS ON THE OUTSIDE OF THE SEVEN-STORY NEOCLASSICAL building on Constitution Avenue spell out the following:

ERNAL REVEN E SE VICE

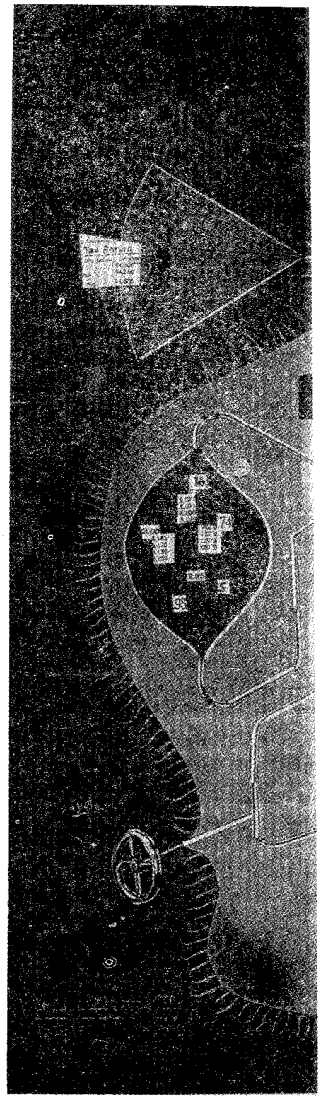
Despite the missing characters, the second two words are teased out easily enough: REVENUE SERVICE. But the first word is puzzling. ETERNAL REVENUE SERVICE? PATERNAL REVENUE SERVICE? INFERNAL REVENUE SERVICE? Perhaps all of the above?

Inside, purposeful people stride down endless hallways, past frosted-glass doors with signs denoting COLLECTION, AUDITING, INFORMATION—and one that reads OFFICE OF ACCURACY AND PERFECTION, ROOM 7513. But within the empire of the largest and most successful tax and enforcement agency in history, there is nothing resembling perfection. Like the old Soviet Union, grand and powerful on the outside but an antiquated shambles within, the IRS has profound problems with outdated technology and outmoded thinking that have undermined its self-described mission: "To collect the proper amount of tax revenue at the least cost."

The agency better known for turning the thumbscrews on tax miscreants is collecting something like $150 billion a year less than the proper amount, and misspending billions doing it. The IRS's mammoth nationwide collection and processing machine is a great, clanking Rube Goldberg contraption, a computer system that has long been disastrously and inexplicably inept—so much so that the agency allowed some 5 million suspect returns to go unexamined in 1995.

Despite being tethered to hardware that was state-of-the-art when color television was a novelty, the agency harvested about $1.5 trillion from more than

Illustrations by David Plunkert



200 million individual and corporate taxpayers in 1996. Over the past decade it has spent nearly $4 billion in an attempt to bring its computers up to date. But Arthur Gross, the assistant IRS commissioner who is the agency's first world-class information-systems officer, concedes that the IRS's computers "do not work in the real world."

The Creaky System Invites Scams

GROSS DESCRIBES THE IRS'S INFORMATION network as a "stovepipe" system—vertically aligned computers that do not communicate with one another. Tracking down the records of a single taxpayer means getting access to as many as nine different computer systems. The once vaunted IRS computer system has trouble accomplishing what would seem to be the most basic of functions: reconciling Social Security numbers, W-2 forms and even the number of children in a household. Notes Gross: "Resolving taxpayer account issues often requires considerable research on multiple systems and a series of complex, time-consuming tasks to update the various databases." In English: You can't get there from here. "Dysfunctional as some of these systems may be today," Gross says, "the IRS is wholly dependent on them."

Like it or not, the IRS is the indispensable agency. With its 106,000 employees, $7 billion annual budget and 10 regional service centers, each the size of a small city, the IRS is the second largest federal agency, after the Pentagon. It handles in excess of 200 million returns a year and sorts 1.2 billion pieces of information from 1,200 financial institutions. It reviews 60,000 employee-compensation plans and checks 90,000 tax-exempt organizations.

Americans, perhaps because they have a guilty conscience, think of the IRS as being omniscient. In fact, the IRS is often not paying attention at all. Your chances of being prosecuted for a tax crime are about the same as for being murdered on the street, 17 in a million. Fewer than 4 of every 10,000 nonfilers ever get caught. Not filing is known as noncompliance, small beer to the IRS. "We eat $200 billion a year in unpaid taxes," says Representative Bill Archer, chairman of the House Ways and Means Committee, which oversees the IRS. "All of that is fraud." The IRS's computer problems, he says, "open the door to more and more fraud."

Open the floodgates, he should say. While you've been fussing over itemization, less solid citizens have been pillaging the IRS, having discovered that the agency can't catch them. The foundation of fraud detection is what professionals call "information matching"—reconciling all the information supplied by the taxpayer (including Social Security numbers) with the information on W-2s and 1099 (miscellaneous income) forms, not to mention investment income and bank transactions. The antiquated IRS computer system is apparently unable to do this in a timely way, or sometimes to do it at all. Fraud happens between those stovepipes. "The IRS does not have a modern customer-service capability," says Jeff Trinca, staff director of the National Commission on Restructuring the IRS, "the sort of thing Visa and American Express do every day."

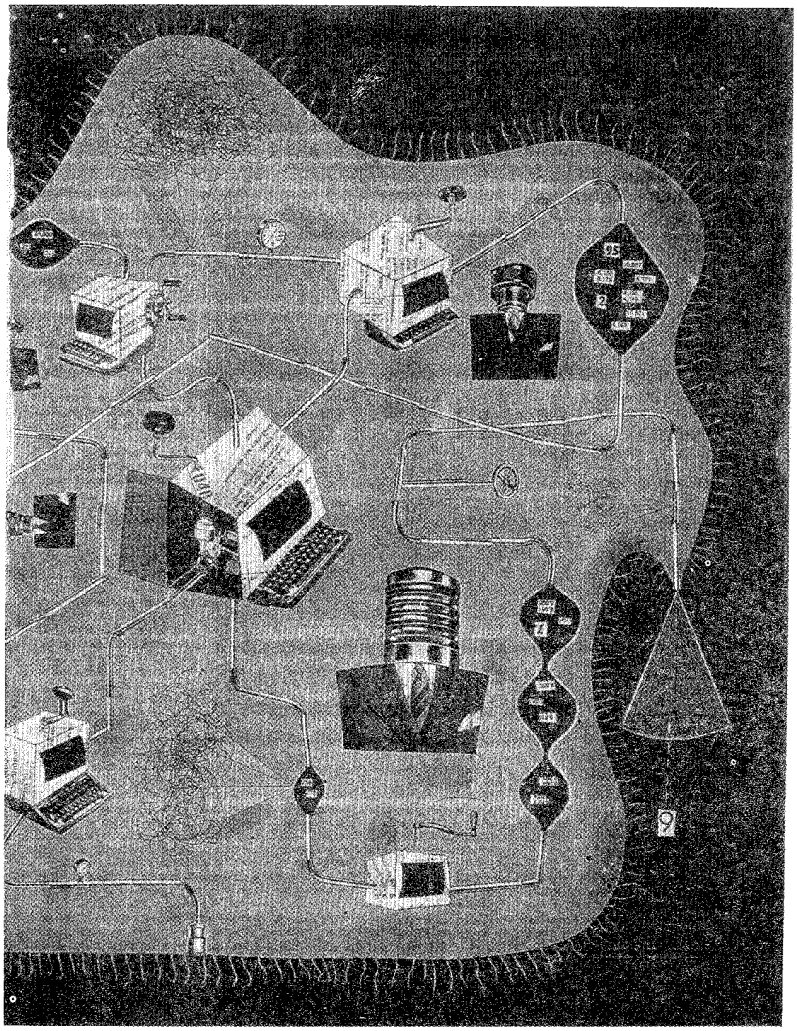
The once vaunted IRS computer system has trouble accomplishing what would seem to be the most basic functions

Frazier Todd Jr., a flimflam man from Atlanta, sussed out the IRS's inability to detect fraud. Todd obtained Social Security numbers from dozens of Atlanta women who lived in public housing projects. He then secured employer IDs from the IRS (making him look as if he were hiring them) and transcribed both numbers onto W-2 forms that he used to prepare electronic returns. Todd filled in an income for these women and a figure for taxes withheld that was high enough to kick back a generous refund. Todd then took the returns to banks to obtain "refund anticipation" loans, which came through within 48 hours. Todd's take was an estimated $511,000 over two years (tax free, of course) before an informant tipped off the IRS. He was sentenced to 30 months in jail.

Richard M. Hersch of Florida and Pennsylvania owned a tax-preparation company called Quik Tax Dollars that he turned into Quik cash. In 1991 he filed 145 false returns, using W-2 forms, fictitious names and phony Social Security numbers to get refunds for the phantom taxpayers. He too received refund anticipation loans. When the IRS began to improve its control on Social Security numbers, Hersch started using real numbers to perpetrate the same scam. All told, he filed 431 false electronic returns claiming refunds of $1,131,241. He was nabbed after the IRS raided his office in 1993, and is serving five years in a federal prison. No one knows how many folks pulled off this ruse, but it is safe to say that most were never caught.

Another sublimely uncomplicated scam involved the earned-income tax credit (EITC), which gives a tax credit to low-income families for each of their children. No complex accounting rigmarole here. Thousands simply gave birth to paper children on their tax forms and immediately got their "credit" in checks from the IRS. The cost: "a couple of billion," according to former IRS Commissioner Larry Gibbs. But that is almost certainly a lowball figure. According to the restructuring commission, at least a quarter of the more than $25 billion in refunds went to people who were simply ineligible, and an additional 35% to 40% went to folks who were enti-

RESCREEN & SQUARE HALFTONES 2-4



RESCREEN & SQUARE HALFTONES 3-4

tled to less credit, if any. That amounts to more than $5 billion annually, and as they say in Washington, pretty soon you're talking about real money.

The IRS has hustled to catch up with these scams. It ended its arrangement with banks in the refund-loan program in early 1995. At the same time, it made an emergency installation of computer filters to screen electronic returns. "It amounted to the sort of front-end screen the credit-card industry does at the point of sale," says assistant IRS commissioner Ted Brown. With new filters, the IRS discovered 4.1 million "problems" with Social Security numbers—an increase of more than 3 million from the year before. In 1995, 1.8 million dependents suddenly disappeared from the system, and there were 2 million fewer EITC claims than the year before. According to the Government Accounting Office, even the IRS's cursory effort to validate Social Security numbers on paper returns resulted in more than $800 million in reduced refunds or additional taxes.

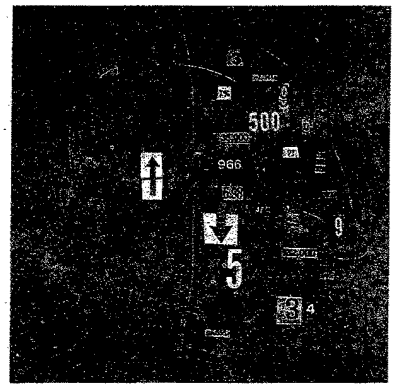
Near Meltdowns

THAT SAME YEAR, THE IRS held up 6 million returns that seemed fishy. "The problem for the IRS," says a staff member on the restructuring commission, "was that they did not have the ability to go after 6 million people, so the agency arbitrarily took 800,000 to a million cases and tried to deal with them." According to the GAO, the IRS released 2 million questionable refund checks that year, even though its computers had detected irregularities.

IRS managers went to Congress to beg, plead and cajole for money to rectify the problem. But their entreaties fell on deaf ears. Congress just isn't very sympathetic to the IRS's real and imagined plaints. But both sides saw eye to eye on one thing: the extent and nature of the swindles had to be secret. No one wanted to give Americans a primer on how to cheat on their taxes.

This year the IRS asserts that it has a more comprehensive fraud-detection system up and running for electronic filing. The agency will not say exactly what the new system does, though it is thought to be able to provide sophisticated "matching" across various computer networks.

Alas, the fraud detection works only with electronic returns, a mere 13% of those filed. There is evidence that some unscrupulous filers have shifted back to old-fashioned paper, which bypasses the sophisticated screening. The IRS recently reviewed some rejected electronic returns only to discover that the same taxpayers subsequently refiled on paper, using the same phony Social Security numbers, and duly got their refunds.



The odds of being prosecuted for tax crimes are about the same as for being murdered on the street: 17 in a million

Back in the 1960s, at the same time that the Beatles were wailing about the *Taxman* ("If you drive a car, I'll tax the street/ If you try to sit, I'll tax your seat"), the men at the IRS, in their IBM white shirts and skinny ties, were at the cutting edge of computer technology. The IRS had automated its processing system, eventually gathering everything into 10 service centers, with a computer nucleus in West Virginia. For the first time, taxpayers were required to write their Social Security number on their return. Computers, it seemed, could keep track of everything.

But by the early 1970s, in the mutating world of computerization, the IRS had fallen behind. Instead of making incremental changes, the IRS spent six years formulating an overarching plan called the Tax Administration System that would cost $649 million and be in operation by the early '80s. The IRS presented the plan to Congress shortly after the final agonies of Watergate (which featured a paranoid President who used the IRS to harass his enemies). Congress was spooked by the idea of a more centralized, all-knowing, all-seeing IRS, and said no thanks. The IRS was told simply to replace worn-out machines: nothing new and nothing fancy.

The IRS burrowed away on a new plan, known innocuously enough as the Service Center Replacement System, whose deadline for start-up was 1985. Instead 1985 was the year the great meltdown almost occurred. Because of computer bugs, a backlog of unprocessed returns (in Philadelphia more than 100 unopened envelopes containing returns were found in garbage cans) almost brought the entire system to a halt. "We came as close as you can to going out of business," says Gibbs, who took over as IRS Commissioner in 1986.

Members of Congress got nervous. The lifeblood of democracy—and of their fancy offices—had almost been cut off. So Congress promptly funded IRS computer modernization. Before, the IRS had had a plan and no money; now it had money and no plan. No matter. It initiated a flood of programs (a state-of-the-art computer was necessary just to keep track of all the acronyms—ACI, AES, ALSS, AUR, FAISR, ICS, IMS). But each system was designed independently to meet specific needs within the empire. All systems would be go by the year 2001, the agency blandly assured Congress. With all the requests and funding, the final price tag for what ultimately became known as the Tax Systems Modernization plan was around $8 billion.

Modernization turned out to be a digital Tower of Babel. Treasury Deputy Secretary Lawrence Summers, charged with looking after the IRS, says, "I think modernization has gone way off track. They tried to build the Taj Mahal." Senator Bob

Kerrey, co-chairman of the restructuring commission, describes tax modernization as a failure. Says Kerrey: "While the world has moved into the wireless age with home banking, ATMs on every corner and stock investing over the Internet, IRS technology has remained stagnant."

This year when your conventional returns go to a regional service center, tens of thousands of people, many seasonal hires at $7 an hour, will process them in much the same way as when the first *Star Wars* movie came out. The workers will handle the 200 million taxpayer envelopes, opening and sorting the returns into categories, coding and editing them and then laboriously tapping much of the data into an out-of-date keypunch system.

Techno Dreams

THE ALPHABET-SOUP modernization programs make up a scrap heap of failed technology. Herewith the IRS's roll of glitches:

▶ SCRIPS. The Service Center Recognition/Image Processing System was meant to enable the IRS to "read" tax forms. The original cost was pegged at $133 million, later rising to $288 million. The IRS initially predicted it would save $17 billion in labor costs, but by last year the agency said SCRIPS would in fact eat more money than it saved. Cost to taxpayers to date: $209 million.

▶ DPS. Like SCRIPS, the Document Processing System was meant to create "optical images" from paper returns, converting them to a readable format for the agency's computers. A number of states have such a system, yet the GAO's Rona Stillman declared DPS "a complete fiasco." The $1.3 billion project was scrapped. Cost to taxpayers: $284 million.

▶ CAPS. The Corporate Accounts Processing System was meant to create a single integrated database of taxpayer account information. The idea was to resolve corporate issues immediately via access to the CAPS database. The system was axed. Cost to taxpayers: $179 million.

▶ ICP. The Integrated Case Processing system was supposed to permit customer-service representatives to access in one step all the data needed to answer taxpayer questions or resolve problems. It failed. Cost to taxpayers: $44.8 million.

▶ Cyberfile. This program was meant to allow taxpayers to file returns through their home computers. It fizzled. Cost to taxpayers: $17 million.

In all, according to Gross, 12 major IRS modernization programs have been either canceled or put on hold. Not all the money was wasted. A billion dollars went to upgrade aging systems and improve customer service. But the GAO is not sure about the rest. The problem, it says, is that the IRS keeps such lousy books the agency can't actually account for it. "They can't come anywhere near demonstrating how they spent this money," says Stillman. The GAO claims that if the IRS were a business, its accountants would not be able to sign off on its financial statements.

The IRS has a monster future problem to deal with: the double goose-egg, better known as the millennium dilemma. IRS computers, like those of most businesses, use only two digits to denote the year, so when the clock strikes midnight on Dec. 31, 1999, the computers will assume it's 1900. Without a fix, thousands of Americans could get bills dunning them for decades of delinquency—or undeserved refunds of considerable proportions. Because of the threat of a great crash at the turn of the century, says IRS Commissioner Margaret Richardson, the agency is deferring "all but critical and legislatively mandated legacy systems changes during fiscal year 1997." More delay.

The situation is not altogether bleak. That the IRS acknowledges problems is a sign that it is on the road to remedying them

The situation on Constitution Avenue is not altogether bleak. That the IRS is publicly acknowledging problems is a sign that it is on the road to remedying them. The agency is not entirely in the digital Dark Ages. It has a nifty Website (*www.irs.ustreas.gov*), which is taking a million queries daily. Although it is still hit-and-miss to get through to a real live person on the phone, taxpayers who do speak to an IRS employee now have a 94% chance of getting the right answer, compared with 63% in 1989, according to the GAO. Last year the agency's Teletax recorded information line took 45 million toll-free calls.

The 1997 filing season, according to the IRS and independent observers, is going swimmingly. The agency says it has "seen significant increases ... in electronic filing and telephone accessibility." By March 21 this year, 15.9 million electronic returns had been filed, 3 million more than at the same time last year. Testifying in late March at a Ways and Means Committee hearing, Beanna Whitlock, representing the National Association of Enrolled Agents, said, "This is not the old IRS. In many respects, it's now doing a good job."

So is it necessary to destroy the IRS in order to save it? Not quite. Remember, the IRS already collects what it estimates is 86% of the tax pie; to get to 90% should not be impossible and would mean an extra $65 billion or so. Gross's game plan—making incremental reforms and remedying the stovepipe problem while improving customer service and electronic filing—is a sensible start. The IRS should also consider the following:

▶ Get Thee a Manager. The agency has had four commissioners in the past four years, all of them green-eyeshade tax specialists. The job requires continuity and independence. The IRS ought to have an *über*-manager with the stature of the head of the Federal Reserve.

▶ Oh, for Multiyear Funding. The IRS needs at least a two-year budgeting cycle. "Congress is mischievous when it appropriates funds and then cuts them," says Mitchell Adams, Massachusetts revenue commissioner. "You can't budget and plan that way."

▶ Outsource What You Can. Although the IRS has long resisted this on privacy grounds, there are tasks (like hassling people for money) that are not confidential and might be done better by commercial agencies. The IRS has realized this as well. According to Treasury's Summers, the agency is already contracting out 64% of modernization work in 1997, compared with 40% in 1995.

▶ Be at the Table. Congress proposes, the IRS disposes. Tax legislation is drafted without reference to the consequences for the IRS. Let the exigencies of tax collection guide the framing of tax legislation.

▶ Weed Out the Bureaucracy. Top managers have overseen the failure of modernization. They've had their chance. The quality of agents is declining. Morale is low. Broaden the merit pay system: the fact that managers have it but not those in the field creates an unhealthy rivalry.

This is a nation founded on a tax revolt. No one wants a meddlesome Big Brother tax system that can find your odd sock for you, but it ought to be as capable as American Express or Citicorp. Chiseled above the entrance of the IRS building in Washington is an Oliver Wendell Holmes axiom: "Taxes are what we pay for civilized society." Americans also pay for the agency that collects those taxes, and they have a right to expect not perfection but efficiency. —***Reported by Bruce van Voorst/Washington, Sam Allis/Boston and S.C. Gwynne/Austin***

Mr. HORN. I remember the words of the late George Murphy who, when he was in the Senate, when one day I questioned some article he was going to read as a Senate staff person, he put his arm around me and said, Steve, it is in print, it has got to be true.

I assume, Mr. Gross, it is all true and you are going to solve the problem. So how are you solving it?

Mr. GROSS. The century date problem for the IRS is a world-class problem. We have more than, potentially more than 100 million lines of computer code that are embedded in our core business systems and a variety of our field systems. Since April, we have made a very aggressive, as GAO reported, a very aggressive effort to gain command and control of the core business systems, the systems that process the 200 million tax returns, and the hundreds of millions of payment records that account for $1.4 trillion in tax payments each year.

I would say at this point we have reasonable command and control of the century date conversion for those core business systems, and it is far more complex than simply the application systems. There are major infrastructure problems. What I mean by that is that we have more than 50 mainframe computers that have to interact with each other that support these core business systems across our 10 service centers and 2 computing centers. The century date conversion plan that we have developed and are in the midst of executing provides, therefore, not just for the application code analysis and conversion, but also the upgrade, where applicable, of the infrastructure, the mainframe platforms, the telecommunications, that support those systems.

The second part of the century date challenge for the IRS are our field systems. While those systems do not provide for the core business support processing tax returns, issuing refunds, processing tax payments, they are, nevertheless, important to the business of the Internal Revenue Service. And for those systems we are in the midst of an inventory of both the application code and the infrastructure upon which that application code functions.

We do not know what we do not know. What I mean by that is until we complete that inventory of those field systems, we are not going to be in a position to assess the extent of the problem or to execute a plan. Our projection is we should have most of that inventory completed by June 1997, this June, and once that inventory is completed we will be able to provide a much more detailed decomposition of both the problem, the resources to correct it, and the plan for executing.

Mr. HORN. I should say for the record that what we are talking about here is back in the 1960's, when you got your present computer system, we didn't have very much capacity in computers in those days, and somebody had the bright idea, why use a 4-digit year, let's just put in "66" instead of "1966." They knew it would be a problem, but they figured technology would take care of it somehow.

I take it, then, your computers from the 1960's have essentially used the 2-digit year; is that correct? Or was there a point where you have changed to the 4-digit year?

Mr. GROSS. Your first statement is correct. Not only our computer systems of the 1960's, but like many corporations and other

Government agencies, even computer systems developed in the 1970's, 1980's, and even early 1990's, typically have the 2-digit date field. That means that the application code analysis and conversion covers more than simply the legacy systems built in the 1960's. It also covers a variety of applications built in the 1980's and 1990's, and, interestingly enough, the commercial products that are purchased even as late as the mid 1990's are not necessarily century date compliant. What that means is that we need to also evaluate each and every one of our commercial off-the-shelf products to assess compliance.

We have initiated procurement and acquisition guidance to our procurement office so that since December 1996, we are not acquiring any commercial products until and unless they are validated and certified as century date compliant.

Mr. HORN. In brief, what happens when you get to the year 2000 with a "66" in there and it becomes suddenly "00" for the year 2000, the computer doesn't know what to do, and you get some misinformation. Someone mentioned the other day, I don't know if it is true, that various delinquencies were issued, it was primarily in the Pentagon, I didn't know if that had happened at IRS, but I think they got a 1997 year delinquency, because something flipped over into the year 2000 and just sent the notice out. So that it had to be corrected.

Have you had any problems at this point?

Mr. GROSS. Mr. Chairman, we have identified those application systems that do project out in the current year, and we have already converted more than 200 systems that have future year 2000 or beyond implications. So, to date, we have been able to avoid that kind of a problem in the IRS.

Mr. HORN. Now, presumably the figure that the Gartner Group gave us way back in April was that it would be a $30 billion Federal problem, a $600 billion worldwide problem on private and public computers, and the U.S. share would be half that, because we have half the computers in the world.

The administration when it sent up its budget for fiscal year 1998 said it is a $2.3 billion problem. When we listened to Assistant Secretary Paige in the Pentagon, who is in charge of that area, said we have just started trying to figure out what we are facing in the year 2000. And we had submitted $1 billion of that $2.2 or $2.3 billion, I guess I would ask, how are you analyzing the code? Can you put a price on it in terms of the human resource help or technical help that you have to get to solve the problem? What are some of the problems that you are dealing with?

Mr. GROSS. Of the 100 million lines of codes that we are estimating, 62 million lines of code are in our core business systems for which we have identified a plan of conversion. Our projections are that we will be spending approximately $2.50 per line of code for that conversion. That is based on an estimated 1,780 work years of effort from the date that conversion began to the date it is projected to be completed. We have not yet identified the total all in costs for the infrastructure upgrades necessary to support the core business systems, nor have we estimated the cost of the conversation for the field applications, and we will not be able to do so until we complete that inventory.

Mr. HORN. That is very helpful.

Well, gentlemen, I know we have kept you a long time. We have some other questions. If you don't mind following our usual procedure, we will submit them to IRS. If you would give us a reply, we will put it in at this point in the record.

[Folowup questions and responses follow:]

FOLLOW-UP QUESTIONS FOR MIKE DOLAN, IRS

1. **You are deferring all but critical and legislatively mandated legacy system changes during FY 1997. Does that include making changes required to comply with the Government Performance and Results Act in regard to setting up performance measurement systems, and making changes to improve revenue accounting financial management? How is this going to impact Treasury's agency-wide audit due this year and the government-wide audit due next year?**

   In order to improve the financial data reported on our custodial financial statements, IRS has identified all necessary enhancements/modifications to existing legacy systems as critical for revenue accounting. This will ensure that revenue information necessary for the Department's and the government-wide audits is proper and substantiated.

   With respect to performance measurement systems, there is a contractor currently in-house who is working with the IRS to develop a performance measures strategy.

2. **The IRS is in the process of competitively acquiring a Systems Engineering and Technical Assistance (SETA) contractor to provide technical, program, and project management guidance to the modernization effort. The Treasury Modernization Management Board is preparing the RFP to implement the program. How are you going to ensure that the project does not end up a flop like the CyberFile project?**

   Departing from past practice, the Internal Revenue Service (IRS) is issuing a Request for Comments (RFC) to initiate the process for competitively acquiring a Prime Systems Services Contractor, hereinafter known as the "PRIME," that would assume primary responsibility for systems development and integration

   Additionally, to augment the IS organization's capacities and capabilities, the IRS is competitively acquiring a Federally Funded Research and Development Center (FFRDC) to provide Systems Engineering and Technical Assistance (SETA) contractual services including strategic planning, program management, independent verification and validation services, procurement advice and a variety of engineering services.

   Thus, it is essential for the IRS and the private sector to form a strategic partnership in which the IRS contributes its knowledge of tax administration and the operational systems and infrastructures while the private sector provides project management, reengineering, systems engineering, design and development and integration expertise.

3. In testimony, the IRS has said that it plans to "augment the revenue accounting information to meet the requirements of the CFO Act." How specifically will this be accomplished?

Beginning with the FY1995 statements, we implemented a strategy of developing financial statements from the detail Master File (taxpayer accounts) that would provide an audit trail back to the detail transactions by tax type (individual, social security, etc.). For the FY1995 and FY1996 audits, in cooperation with the GAO, we began extensive analysis and documentation of all revenue transaction flows and source documentation. Detailed flowcharts were prepared to document revenue flows between RACS and supporting feeder systems. Site visits were made with the GAO to all service centers to validate these flowcharts and further document detailed transaction flows that were unique to a service center. This was done to refine our process to generate detail transaction data from the Master File.

As a result of GAO's recommendations and the Service's intent to have audited revenue information, we have initiated methods of obtaining financial information which can be substantiated from our current systems. Also, to ensure that management and staff are aware of required actions and due dates, the CFO organization has put into place a written action plan for preparation of our financial statements which addresses all key milestones. A status report on this action plan was delivered to the Subcommittee in March of this year.

Mr. HORN. I thank you all for coming, and I wish you well, because you have a tough job. But the key part I think, before you get computer systems or anything else, is to think through what you are doing from a management standpoint and try to get some integration of those numerous computer systems you have got right now, which I guess you are trying to figure out, Mr. Gross, how to get them to talk to each other effectively. And hopefully you field the equipment off the shelf without sitting around doing what FAA and your predecessors did, getting the last ultimate system. You are never going to get it. You just need to take it off the shelf, I would think. Is there anything on the shelf that makes sense for use with IRS? Or does everything have to be redesigned from ground zero?

Mr. GROSS. There are systems in the commercial market, for example, financial reporting systems that have applicability to our environment. Part of our modernization plan for the future is to identify the application of commercial products in lieu of custom development, to the extent possible.

Mr. HORN. Good. I think that is a sensible way to go. Thank you all for coming.

We have one more panel, one witness, Mr. Trinca, the Chief of Staff of the National Commission on Restructuring the Internal Revenue Service. Please come up. If you would stand and raise your right hand.

[Witness sworn.]

Mr. HORN. Let the clerk note Mr. Trinca has affirmed that oath.

Jeffery S. Trinca has been Chief of Staff of the National Commission on Restructuring the Internal Revenue Service for how many months now?

Mr. TRINCA. Ten months, sir.

Mr. HORN. About a year. And the Commission reports when?

Mr. TRINCA. The end of June.

Mr. HORN. The end of June. Could you tell us a little bit about the interim thinking of the Commission in terms of the IRS?

Mr. TRINCA. Yes, sir.

STATEMENT OF JEFFERY S. TRINCA, CHIEF OF STAFF, NATIONAL COMMISSION ON RESTRUCTURING THE INTERNAL REVENUE SERVICE

Mr. TRINCA. Thank you, Mr. Chairman. Thank you for allowing me on behalf of Congressman Portman to provide an update on the work of the National Commission on Restructuring the IRS.

Mr. Portman, who I believe is the newest member of this subcommittee——

Mr. HORN. That is correct.

Mr. TRINCA [continuing]. Sends his regrets and apologizes that he could not make it here this morning.

Let me begin by telling you a bit about the Commission's work to date. The Commission has 17 members; 4 from Congress, 2 from the administration, and 11 from the private sector or State government.

Our congressional members are Senators Bob Kerrey and Charles Grassley, Congressmen Rob Portman and Bill Coyne. So this Commission is both bipartisan and bicameral.

The staff is made up of professionals with backgrounds in law, accounting, business management, and computer systems development.

The Commission has a 1-year life, and the final report will be completed in June, as I said. Over the last 10 months, our members and the staff have been digging through a mountain of reports, studies, and data from the IRS. We are also conducting a number of our own studies, including interviews of over 275 front line IRS employees, most of the top IRS executives here in Washington, discussions with business groups, tax preparers, and many other stakeholders.

Additionally, we have been very active in soliciting input from the most important experts on the IRS, ordinary American taxpayers. We have communicated with many folks on our home page and through town meetings. We also intend to conduct a survey of taxpayers later this month.

We have learned a great deal about the IRS and the challenges it faces. Let me briefly describe what we have found to date. Many of the problems of the IRS can be traced to three main areas: management and governance at the top of the tax administration system; inability to deliver quality customer service to taxpayers; and the complexity of the tax code.

First, in the area of management and governance, the Commission has found an agency that is unable to set long-term strategies and priorities and stick with them. I would like to stress that this phenomenon is historical in nature and not a product of a particular administration.

The current IRS management and governance structure, which includes Congress, the Department of Treasury, and senior IRS management, does not ensure, one, that a shared vision for the agency can be developed and maintained over time; two, that priorities and strategic direction can be set and maintained; three, that accountability is imposed on senior management and a knowledgeable governing body; four, that appropriate measures of success can be developed and used; five, that budget and technology can be aligned with these priorities and strategic direction; and, finally, that continuity and coordination of oversight is achieved so problems can be caught at an early stage.

Of these, the most crucial elements necessary for a turn around at the agency are continuity, knowledge and expertise at the top, and accountability. In the Commission's view, the major technology and cultural changes that the IRS needs will require a governing structure that is capable of setting, implementing, and achieving long-term goals. Many of our Commissioners have discussed publicly the possibility of creating a private sector style board of directors of the agency, with outside expertise that is accountable to the President and Congress and has the authority to hold top level managers at the IRS equally accountable. A majority of our Commissioners strongly believe that any structure put in place at the IRS must fulfill the six criteria cited above if it is to have any likelihood of success.

Let me briefly address another area on which the Commission's findings have focused to date, customer service. The Commission has found an IRS that has not successfully made high-quality cus-

tomer service a top organizational priority. While the private sector has rewritten customer service standards over the last 25 years, IRS taxpayer service has remained essentially static or actually declined. Billing notices are confusing. Taxpayers have a hard time getting through on the phone. Taxpayers must contact the agency too many times to resolve even the simplest problems. IRS computer systems are not readily accessible for personnel to solve these problems once they do get through. Indeed, an IRS employee may have to access as many as nine different computer systems to resolve a taxpayer's problem.

Taxpayers have become accustomed to increasingly high performance standards from their banks, credit card companies, airlines, and other service organizations. They have come to expect timely, accurate, and respectful service from both private companies and public agencies. The IRS must move aggressively to close this customer service gap. Among other things, this involves improved technology, better training, and enhanced coordination between all elements of IRS customer service.

Finally, the Commission has increasingly focused between the length of and the complexity of the tax code and the shortcomings of the IRS. Mr. Chairman, I realize that the tax code is a matter for another committee, but I would like to point out that the complexity of the code has a direct impact on the problems for tax administration. Even the best run IRS would have a great difficulty administrating the complex and ever-changing tax laws presently forced upon it.

Congress and the administration often act well-intentioned but impose overly complex tax laws without understanding the downstream problems they impose on the IRS and the average taxpayer. One reason is that the IRS does not have an independent voice in the tax writing process to make Congress and the administration aware of the necessary administrative changes and tax form revisions required to implement new tax laws.

Another reason is there is no incentive in place to encourage simplicity in the legislative process, and, of course, there are some tax provisions that create such tax administration and compliance nightmares they need to be repealed. The Commission will address each of these issues.

Mr. Chairman, let me conclude by saying that the Commission study to date has given us a good sense of where the IRS stands today. More importantly, though, it has helped the Commission create a vision of where the agency needs to be 5, 10, and 15 years from now.

The Commission's vision of the IRS for the next century is a service-oriented organization that will collect the proper amount of revenue by relying more on modern customer service practices and less on enforcement mechanisms. Its highly trained customer service representatives will be able to resolve taxpayer problems on the first phone call. It is an IRS that operates under a simplified tax code, and not on reducing inadvertent noncompliance. This summer the Commission will challenge the President and Congress to create an agency that responds to the needs of taxpayers by fulfilling this vision.

The Commission report will be comprehensive, outlining changes needed in Congressional oversight, Treasury governance, IRS management, IRS operations and culture, computer systems, taxpayer rights and measures to simplify the tax code. This will be the first opportunity since 1952 for Congress to create such sweeping changes at the IRS. We look forward to working with the subcommittee.

[The prepared statement of Mr. Trinca follows:]

TESTIMONY OF JEFFERY TRINCA
Chief of Staff, National Commission on Restructuring the IRS
April 14, 1997

Mr. Chairman and distinguished Members of the Subcommittee, thank you for allowing me on behalf of Congressman Rob Portman to provide an update on the work of the National Commission on Restructuring the IRS. Mr. Portman sends his regrets and apologizes that he cannot make it here this morning.

Let me begin by telling you a bit about the Commission and its work to date. The Commission has 17 members – four from Congress, two from the Administration, and 11 from the private sector or state government. Our Congressional members are Senators Bob Kerrey and Charles Grassley and Congressmen Portman and Bill Coyne. So, this Commission is both bipartisan and bi-cameral. The staff is made up of professionals with backgrounds in law, accounting, business management, and computer systems development.

The Commission has a one year life, and the final report will be completed by the end of June. Over the last ten months, our members and the staff have been digging through a mountain of reports, studies, and data from the IRS. We are also conducting a number of our own studies, including interviews of over 275 front line IRS employees, most of the top IRS executives in Washington, discussions with business groups, tax preparers and many other stakeholders.

Additionally, we have been very active in soliciting input from the most important experts on the IRS – ordinary American taxpayers. We have communicated with many folks on our home page and through town meetings. We also intend to conduct a survey of taxpayers later on this month.

We have learned a great deal about the IRS and the challenges it faces. Let me briefly describe what we have found to date. We have found that many of the problems at the IRS can be the traced to three main areas: (1) management and governance at the top of the tax administration system; (2) inability to deliver quality customer service to taxpayers; and (3) the complexity of the tax code.

I. MANAGEMENT AND GOVERNANCE

First, on its management and governance, the Commission has found an agency that is unable to set long-term strategy and priorities and stick with them. I would like to stress that this phenomena is historical in nature and not a product of a particular

Administration. The current IRS management and governance structure, including Congress, the Department of Treasury and senior IRS management – does not ensure:

(1) that a shared vision for the agency can be developed and maintained over time;
(2) that priorities and strategic direction can be set and maintained over time;
(3) that accountability is imposed on senior management and a knowledgeable governing body;
(4) that appropriate measures of success can be developed and used;
(5) that budget and technology can be aligned with priorities and strategic direction; and
(6) that continuity and coordination of oversight is achieved so that problems can be caught at an early stage.

Of these, the most crucial elements necessary for a turn around at the agency are **continuity, knowledge and expertise at the top, and accountability**. In the Commission's view, the major technology and cultural changes that the IRS needs will require a governance structure that is capable of setting, implementing and achieving long-term goals. Many of our Commissioners have discussed publicly the possibility of creating a private sector-style board of directors at the agency with outside expertise that is accountable to the President and Congress, and has the authority to hold top level managers at the IRS equally accountable. A majority of our Commissioners strongly believe that any structure put in place at the IRS must fulfill the six criteria cited above if it is to have any likelihood of success.

II. CUSTOMER SERVICE

Let me briefly address another area on which the Commission findings have focused to date – customer service and complexity of the tax code. The Commission has found an IRS that has not successfully made high quality customer service a top organizational priority. While the private sector has rewritten customer service standards over the last 25 years, IRS taxpayer service has remained essentially static or has actually declined. Billing notices are confusing. Taxpayers have a hard time getting through on the phone. Taxpayers must contact the agency too many times to resolve even the simplest problems. IRS computer systems are not readily accessible for personnel to solve these problems once they do get through – indeed an IRS employee may have to access as many as 9 different computer systems to resolve a taxpayer's problem.

Taxpayers have become accustomed to increasingly high performance standards from their banks, credit card companies, airlines and other service organizations. They have come to expect timely, accurate and respectful service from both private companies and public agencies. The IRS must move aggressively to close this customer service gap. Among other things, this involves improved technology, better training and enhanced coordination between all elements of IRS customer service.

III. COMPLEXITY OF THE TAX CODE

Finally, the Commission is increasingly focused on the link between the complexity of the tax code – and the shortcomings of the IRS. Mr. Chairman, I realize that the tax code is a matter for another Committee, but I would like to point out that the complexity of the code has a direct impact on the problems for tax administration. Even the best run IRS would have great difficulty administering the complex and ever-changing tax laws Congress foists upon the agency.

Congress and the Administration often enact well-intentioned but overly complex tax laws without understanding the downstream problems they impose on the IRS and the average taxpayer. One reason is that the IRS does not have a voice in the tax writing process independent of the Treasury Department's policy objectives to make Congress and the Administration aware of the necessary administrative changes and tax form revisions required to implement new tax laws. Another reason is that there is no incentive in place to encourage simplicity in the legislative process. And, of course, there are some tax code provisions that create such administration and compliance nightmares that they need to be changed or repealed. The Commission's recommendations will address each of these issues.

IV. CONCLUSION

Mr. Chairman, let me conclude by saying that the Commission's study to date has given us a good sense of where the IRS stands today. More importantly, though, it has helped us create a vision of where the agency needs to be in 5, 10, and 15 years from now.

The Commission's vision of the IRS for the next century is a service-oriented organization that will collect the proper amount of revenue by relying more on modern customer service practices and less on enforcement mechanisms. Its highly trained customer service representatives would be able to resolve taxpayer problems on the first phone call. It is an IRS that operates under a simplified tax code, reducing inadvertent noncompliance. This summer, the Commission will challenge the President and Congress to create an agency that responds to the needs of taxpayers by fulfilling this vision.

The Commission report will be comprehensive, outlining changes needed in Congressional oversight, Treasury governance, IRS management, IRS operations and culture, computer systems, taxpayer rights, and measures to simplify the tax code. This will be the first opportunity since 1954 for Congress to make such sweeping changes at the IRS. We look forward to working with the Subcommittee. Thank you.

Mr. HORN. We thank you for testifying, Mr. Trinca. In your review of IRS operations and activities and their goals and their role within our Government, has the Commission come to any conclusion as to the attributes a new Commissioner ought to have to be an effective executive in charge of that organization?

Mr. TRINCA. Well, we are just now reaching our recommendation stage of process, so it is difficult to predict totally. But I think going back to the points about continuity, knowledge and expertise, and accountability, those can be directed at the Commissioner as well as the——

Mr. HORN. Well, to what does knowledge apply? Is it simply knowledge of the tax laws and the code, or is it knowledge of how to run an organization?

Mr. TRINCA. It's knowledge of how to run an organization, how to reengineer processes, how to bring very large, very complex computer systems and integrate them into those new processes and the tax laws.

Mr. HORN. I'd like to ask the gentleman from Vermont, Mr. Sanders, who has rejoined us, if he has some questions.

Mr. SANDERS. Thank you, Mr. Chairman. I really want to congratulate you on conducting a very important hearing.

Mr. Trinca, you are familiar, perhaps, with the recent reorganization plans of the IRS?

Mr. TRINCA. Yes, sir.

Mr. SANDERS. I can't tell you what impact they are having around the country, but I know that there are a lot of concerns about them in New England and the State of Vermont. In Burlington, VT, which is our largest city, we were one of the district offices that was centralized. As you know, Vermont, Maine, New Hampshire, and Massachusetts now form one district.

Mr. TRINCA. Yes, sir.

Mr. SANDERS. And my impression is that is not working in terms of improving the IRS's relationship to consumers. We have seen a layoff of workers in Burlington, many of whom have been frontline people, people able to respond to the day-to-day needs of Vermont taxpayers. Third, we have seen the very successful volunteer income tax assistance and tax counseling of the elderly programs now being coordinated out of the Boston office rather than out of Vermont, which has not been a good thing. And fourth, we are seeing that IRS has instructed its taxpayer services personnel to route most telephonic inquiries by Vermont taxpayers to toll-free numbers in Boston, and from what we are hearing, people are not making the connection, not all of those people are getting in, they are getting kept on hold for a long point, being shifted around and so on and so forth. It seems to me from what I have been hearing, we have talked to many tax preparation people who are also concerned about the lower quality of service. What's your judgment on the recent reorganization?

Mr. TRINCA. Recently, we held two town meetings; we're going to hold two more, one in Ohio, one in Nebraska. And I have to say, the disturbing information received in those town meetings was not necessarily from the unions or from the IRS employees on the reorganization, but from practitioners, enrolled agents, very much concerned that there seems to be a sense of rolling back customer

service in rural areas into more urban areas. One practitioner pointed out that this potentially could be analogous to the State, the Federal parks closing the Washington Monument to point out what happens when you cut their budgets.

The Commission is still chewing on this issue right now, but there were a lot of concerns raised, and it seemed to be pretty uniform across; lawyers, accountants, enrolled agents, everyone.

Mr. SANDERS. So this is not just a New England or Vermont concern?

Mr. TRINCA. No, that's right.

Mr. SANDERS. It seems to me that if you cut back on employees who service people in a given region in a rural area, if you have a 1–800 number that is not particularly effective, in is enormously frustrating. Here are taxpayers up against a wall. They have an April 15th deadline. They are put on hold, shifted all over the place. That does not do anybody any good, and I think it just engenders more antagonism toward the IRS.

So what you are saying is even in the Midwest this reorganization is not working particularly well?

Mr. TRINCA. Yes, sir.

Mr. SANDERS. Do you have any thoughts on how those of us in Congress might want to respond to that?

Mr. TRINCA. I think it's best to wait for our report from our perspective than me to get out in front of our Commissioners.

Mr. SANDERS. Thank you very much.

Mr. HORN. I thank the gentleman. Let me just ask one concluding question. Has the Commission and the Commission staff had an opportunity to review the Treasury plan with regard to any reorganization of the Internal Revenue Service?

Mr. TRINCA. Yes, sir, we have.

Mr. HORN. Is there a reaction the Commission has at this point?

Mr. TRINCA. I think there's some concern among some of the Commissioners that it deals with just pieces of the big picture. We hope to deal with the big picture. I think we go back to those three tests again on accountability, expertise and continuity.

Mr. HORN. I take it your report then will have a critique of the Treasury's proposal?

Mr. TRINCA. Not specifically. I think it will—I think that basically the critique that's done overall will probably stand, even with the Treasury.

Mr. HORN. Well, in other words, you are going to make your own report, but there won't be a closure as to detail of where the Commission feels the Treasury ought to either expand its proposals or think again about integration of the various functions? I mean, how are you going to approach that?

Mr. TRINCA. Well, I think our report in a sense will stand on its own. The Treasury report in some sense will take steps toward some of those directions they might head in, but I believe that the Commissioners are interested in making much more comprehensive and dramatic steps than were taken by the Treasury Department.

Mr. HORN. As you know, in the legislative body the clash of ideas is what counts, and if the clash isn't clear, a lot of people are going to go hunting, fishing, misinterpreting, so forth, and I would think when we have a group of experts such as you have on the staff in

the Commission on both parties, it would be helpful to us in Congress if the Treasury's plan was reviewed and very pertinent points were made. You could reference other sections of your Commission report. But there's got to be closure here for what did you think, what did they think, ultimately that we will use to make some decisions.

Mr. TRINCA. We have experienced quite a bit of clash on this, and I believe there will be a sharp contrast, sir.

Mr. HORN. That's the problem with too much business around here. We compromise it down, and then we gripe when the executive branch issues regulations under it, when, frankly, we haven't given them specific direction so they know what they are doing. And they say, what are those people saying; what do they mean?

So I'd like to see something that has a real sharpness to it, and I think it would be helpful in the Ways and Means Committee, the Appropriations Subcommittee, and to the Committee on Government Reform and Oversight, and this subcommittee in particular.

Mr. TRINCA. Yes, sir. Thank you.

Mr. HORN. We thank you for coming. I want to thank the staff that developed this hearing, J. Russell George, the staff director of the Government Management, Information, and Technology Subcommittee; and Anna Miller, who is on my immediate left, professional staff member that prepared the hearing; John Hynes, professional staff member who has been a lot of help in letting the world know this hearing has existed; Andrea Miller, our clerk, faithful, helpful; and David McMillian, professional staff member for the minority; Mark Stephenson, professional staff member for the minority; Jean Gosa, the clerk for the minority. And we thank our court reporters for whom we have put a little test this morning, Bob Cochran and Tracy Petty and Katrina Wright. Thank you all.

With that, this hearing is adjourned——

Mr. SANDERS. Could I introduce this into the record, please?

Mr. HORN. Yes. This is the statement of Mr. Sanders. We will also introduce the statement of Mrs. Maloney, and they will be put after the opening statements made by myself and others.

Mr. SANDERS. Thank you very much.

Mr. HORN. Thank you very much. Without objection, we're adjourned.

[Whereupon, at 2:07 p.m., the subcommittee was adjourned.]

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