

GAO

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

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November 2005

# TAX ADMINISTRATION

## IRS Improved Some Filing Season Services, but Long-term Goals Would Help Manage Strategic Trade-offs



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# Highlights

Highlights of [GAO-06-51](#), a report to the Chairman, Subcommittee on Oversight, Committee on Ways and Means, House of Representatives

## Why GAO Did This Study

During the filing season, the Internal Revenue Service (IRS) processes about 130 million individual tax returns, issues refunds, and responds to millions of inquiries. Budget cuts combined with IRS's strategy of shifting resources from taxpayer service to enforcement make providing quality service a challenge. GAO was asked to assess IRS's 2005 filing season performance compared to past years and 2005 goals in the processing of paper and electronic tax returns, telephone service, face-to-face assistance, and Web site service. GAO also examined whether IRS has long-term goals to help assess progress and guide in making decisions. Finally, GAO summarized IRS's response to Hurricanes Katrina and Rita, and their possible effects on IRS's performance.

## What GAO Recommends

GAO recommends that IRS develop better information about the costs of mandatory electronic filing of tax returns for certain categories of tax practitioners and establish a schedule for developing its long-term goals.

In comments, IRS agreed with the recommendations.

[www.gao.gov/cgi-bin/getrpt?GAO-06-51](http://www.gao.gov/cgi-bin/getrpt?GAO-06-51).

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

## TAX ADMINISTRATION

# IRS Improved Some Filing Season Services, but Long-term Goals Would Help Manage Strategic Trade-offs

## What GAO Found

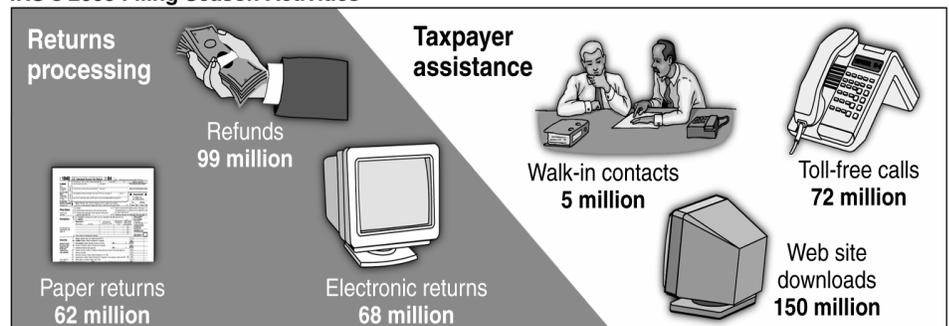
IRS improved some filing season services. According to officials, IRS made a strategic decision to reduce others to accommodate budget cuts. IRS's processing of returns and refunds went smoothly. Accuracy of responses to telephone inquiries about tax law and about taxpayers' accounts significantly improved. And, IRS's Web site performed well. On the other hand, in response to budget cuts, IRS reduced access to telephone assistants, resulting in longer wait-times and more callers hanging up. IRS officials viewed telephone access as a more flexible area for absorbing budget cuts than, for example, processing. The number of taxpayers visiting IRS walk-in sites continued to decline, while the number of tax returns prepared at volunteer sites increased. This is consistent with IRS's strategy of reducing the number of its employees providing expensive face-to-face assistance. IRS continues to lack reliable data on the accuracy of walk-in and volunteer site assistance but has plans in place to improve quality measurement.

For the first time, more than half of individual tax returns were filed electronically, which is important because electronic filing has allowed IRS to reduce resources devoted to processing paper returns. However, despite IRS's actions to promote electronic filing, it is not on track to achieve its long-term goal of having 80 percent of such returns filed electronically by 2007. State mandated electronic filing has proven effective at encouraging electronic filing at the federal level and one IRS advisory group has recommended a federal mandate. However, little is known about the costs and burdens of such mandates.

IRS has been developing long-term goals to help assess agency progress and understand the impact of budget decisions. Because of the difficulty in developing goals, IRS has experienced delays and lacks a schedule for finalizing those goals.

IRS is taking numerous actions to assist taxpayers affected by Hurricanes Katrina and Rita. Most of the impact on IRS, such as more questions from taxpayers, will be felt during the 2006 filing season and beyond.

### IRS's 2005 Filing Season Activities



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

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Abbreviations

CADE	Customer Account Data Engine
CSR	Customer Service Representatives
ETAAC	Electronic Tax Administration Advisory Committee
ETLA	Electronic Tax Law Assistance
FEMA	Federal Emergency Management Agency
FTE	Full-time Equivalent
GAO	Government Accountability Office
GPRA	Government Performance and Results Act of 1993
IRS	Internal Revenue Service
P&R	Probe & Response Guide
PART	Program Assessment Rating Tool
RAL	Refund Anticipation Loan
RRA	IRS Restructuring and Reform Act of 1998
SPEC	Stakeholder Partnership, Education, and Communication
TIGTA	Treasury Inspector General for Tax Administration
W&I	Wage and Investment Division

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United States Government Accountability Office  
Washington, D.C. 20548

November 14, 2005

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

Dear Mr. Chairman,

During the filing season most taxpayers have their only contact with the Internal Revenue Service (IRS) by filing their individual income tax returns, receiving refunds, and, if needed, seeking assistance. Consequently, the agency's performance during this period is a key indicator of how well IRS is serving taxpayers and helping them fulfill their tax responsibilities.<sup>1</sup>

In past reports and testimonies we said that IRS has made significant progress improving taxpayer service since passage of the IRS Restructuring and Reform Act of 1998 (RRA).<sup>2</sup> However, we also described challenges to continued progress. In fiscal year 2005, IRS's budget for taxpayer service was 2.8 percent less than in 2004 and IRS has an ambitious strategy of providing filing season services with fewer resources. This strategy is intended to allow IRS to shift resources to enforcement.

Because of IRS's importance to taxpayers and Congress, you asked us to assess IRS's 2005 filing season performance. With respect to processing paper and electronically filed individual income tax returns, telephone assistance, face-to-face assistance, and the Web site, our objectives were to assess IRS's performance compared to annual goals and past performance and describe any factors or initiatives that significantly affected performance. Additionally, we examined whether IRS has long-term goals to help assess progress and guide in resource and other decision making. In light of Hurricanes Katrina and Rita, we summarized IRS's actions and plans to assist affected taxpayers and the possible implications for the 2005 and 2006 filing seasons. We testified on IRS's interim 2005 performance in a

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

<sup>2</sup>Pub. L. No. 105-206 (1998).

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hearing held by your Subcommittee on Oversight, House Committee on Ways and Means, on April 14, 2005.<sup>3</sup>

Our assessment is based on the reported results and analysis of key IRS performance measures, observations of IRS's operations, interviews with IRS officials, information from representatives of the tax practitioner community, and analyses by the Treasury Inspector General for Tax Administration (TIGTA). For the purpose of this report, we found IRS's data to be sufficiently reliable for assessing IRS's 2005 filing season performance and comparing to prior filing seasons. Further details on our scope and methodology are provided later in this report. We performed our work from January through October 2005 in accordance with generally accepted government auditing standards.

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## Results in Brief

During the 2005 filing season, IRS improved some services, but to accommodate budget cuts, officials made a strategic decision to reduce others. With one notable exception, IRS currently lacks, but is developing, long-term goals that would be useful for managing budgetary trade-offs between improving taxpayer service and enhancing enforcement.

**Processing:** IRS nearly met or exceeded most of its 2005 processing performance goals. For the first time, more than half of all individual income tax returns were filed electronically. Despite numerous actions IRS has taken over the years, it is not on track to meet its one long-term goal of having 80 percent of all returns filed electronically by 2007. Electronic filing mandates in several states for certain categories of tax practitioners have increased electronic filing of federal tax returns. The growing use of mandates by states for electronic filing could lead to more discussion about mandates at the federal level. In fact, one IRS advisory group recommended that IRS should support mandated electronic filing. However, decision makers lack information on the costs that tax practitioners and taxpayers would incur to file electronically.

**Telephone service:** IRS made a strategic decision to reduce access to its telephone service to accommodate a budget reduction, because IRS officials viewed it as flexible area for absorbing budget reductions without significantly affecting taxpayer service. As a result, taxpayers waited longer

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<sup>3</sup>GAO, *Internal Revenue Service: Assessment of Fiscal Year 2006 Budget Request and Interim Results of the 2005 Filing Season*, GAO-05-416T (Washington, D.C.: Apr. 14, 2005).

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to speak with telephone assistors and more taxpayers hung up than last year. In contrast, the accuracy of customer service representatives' (CSR) responses to tax law and account questions significantly improved compared to past performance.

**Walk-in assistance:** Fewer taxpayers used IRS walk-in sites during the 2005 filing season, continuing a trend since 2001. In contrast to walk-in sites, the numbers of taxpayers seeking return preparation assistance at volunteer sites increased since 2001. These trends are consistent with IRS's strategy of reducing face-to-face assistance in favor of less costly options for receiving service, such as IRS's telephone and Internet services, and volunteer sites. Moreover, IRS lacked reliable data on the quality of services provided at both walk-in and volunteer sites, making it impossible to accurately characterize IRS's performance in providing face-to-face assistance. In an effort to obtain reliable data, IRS has initiated quality improvement programs at both sites.

**Internet Web site:** IRS's Web site performed well, was user friendly, and was used extensively this filing season based on the number of visits to the site, pages viewed, and forms and publications downloaded. This is consistent with IRS's strategy to improve taxpayer service by providing options for automated interaction with the IRS, such as "Where's My Refund."

Long-term goals that are focused on results or outcomes are critical for holding agencies accountable and helping agencies and Congress make strategic trade-offs. IRS has been working to establish long-term goals for all aspects of its operations for well over a year. Because of the difficulty in developing goals, IRS has experienced delays and lacks a schedule for finalizing those goals. Although we recognize the difficulty in establishing such goals, until they are developed, taxpayers, Congress, and IRS management will have difficulty assessing long-term progress. In addition, budget decisions that affect the filing season will be made with limited context about the potential impact on long-term performance.

IRS had taken numerous actions to address the aftermath of Hurricanes Katrina and Rita, working closely with, and in support of, other the federal agencies. IRS officials report that any effect on the 2005 filing season performance would be slight, because the hurricanes occurred so late in the filing season. Actions taken to date include finding IRS employees who had been affected by Katrina and Rita, helping answer telephone calls for emergency assistance, reviewing tax provisions, and putting extensive

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information about taxpayer assistance and relief for individuals and businesses on its Web site; other actions are planned. According to IRS officials, IRS is also assessing the longer term implications of the hurricanes for the 2006 filing season, such as the potential impact on the number of telephone inquiries.

We are making recommendations to the Commissioner of Internal Revenue that IRS should

- develop better information about the costs to tax practitioners and taxpayers of mandatory electronic filing of tax returns for certain categories of tax practitioners and
- establish a schedule for developing its long-term goals.

In a letter commenting on a draft of this report (see app. III), the Commissioner of IRS agreed with our recommendations and generally outlined the actions IRS plans to take to address those recommendations.

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## Scope and Methodology

To assess IRS's 2005 filing season performance in the four key filing season activities—processing, telephone assistance, face-to-face assistance, and Web site—compared to goals, past performance, as well as initiatives intended to improve performance, we

- reviewed and analyzed IRS reports, testimonies, budget submissions, and other documents and data, including workload data and data from IRS's current suite of balanced performance measures and annual goals;
- reviewed legislation, policies, and procedures;
- reviewed related TIGTA reports and interviewed TIGTA officials about IRS's performance and initiatives;
- followed up on our recommendations made in prior filing season and related reports;
- tested for statistical differences between yearly changes for various performance measures;
- observed operations at IRS's Atlanta paper processing center, and Atlanta and Pittsburgh call centers, all of which are managed by IRS's

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Wage and Investment operating division (W&I); 3 of IRS's approximately 400 walk-in locations;<sup>4</sup> and 3 of over 14,000 volunteer sites.

- analyzed information posted to IRS's Web site based on our knowledge of the type of information taxpayers look for, and assessed the ease of finding information, as well as the accuracy and currency of the data on the site;
- reviewed information from companies that evaluate Internet performance;
- reviewed staffing data for paper and electronic processing, telephone assistance, and walk-in assistance;
- interviewed IRS officials about current operations, performance relative to 2005 performance goals, and prior filing season performance, trends, and significant factors and initiatives that affected or were intended to improve performance; and
- interviewed representatives of large private and nonprofit organizations that prepare tax returns and trade organizations that represent both individual practitioners and tax preparation companies.

This report discusses numerous filing season performance measures and data that cover the quality, accessibility, and timeliness of IRS's services, which we have used to evaluate IRS's performance in key areas for years. Although some measures could be further refined, the majority of IRS's filing season measures have the attributes of successful measures, including objectivity and reliability. We reviewed IRS documentation, interviewed IRS officials about computer systems and data limitations, and compared those results to GAO standards of data reliability.<sup>5</sup> As a result, we determined that the IRS data we are reporting are sufficiently reliable for assessing IRS's filing season performance. Data limitations are discussed where appropriate.

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<sup>4</sup>Our review focuses on IRS's W&I Division, which serves taxpayers whose income is from wages and investments, processes individual income tax returns, and provides assistance to taxpayers who call on the telephone or walk into an IRS office.

<sup>5</sup>GAO, *Assessing the Reliability of Computer-Processed Data*, GAO-02-15G (Washington, D.C.: Sept. 1, 2002).

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We conducted our work at IRS headquarters in Washington, D.C.; the Small Business/Self-Employed Division headquarters in New Carrollton, Maryland; the W&I Division headquarters, the Joint Operations Center (which manages telephone service), and a telephone call site in Atlanta, Georgia; a telephone call site in Pittsburgh, Pennsylvania; and walk-in and volunteer locations in Georgia and Maryland. We selected these offices for a variety of reasons, including the location of key IRS managers, such as those responsible for telephone, walk-in, and volunteer services. Hurricanes Katrina and Rita struck just as we were completing our 2005 filing season review.<sup>6</sup> Because Katrina and Rita occurred when we were finishing our work, we did not assess the effectiveness of IRS's actions. We performed our work from January through October 2005 in accordance with generally accepted government auditing standards.

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## Background

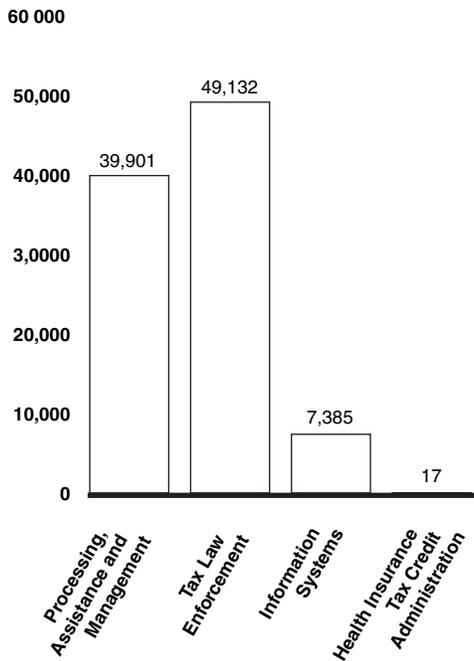
IRS received over \$10 billion in fiscal year 2005 to fund over 96,000 full-time equivalents (FTE).<sup>7</sup> Of the total, processing and taxpayer services account for 41 percent, almost 40,000 FTEs, as shown in figure 1. Of the roughly 40,000 FTEs, almost 16,000, just less than 40 percent, were budgeted just for processing, most of which occurs during the filing season.

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<sup>6</sup>Hurricane Katrina struck Alabama, Florida, Louisiana, and Mississippi, between August 25 and 29, 2005, and Hurricane Rita struck Louisiana and Texas on September 24, 2005, causing widespread displacement of over a million people.

<sup>7</sup>According to IRS, an FTE is the equivalent of one person working full-time for 1 year without overtime.

**Figure 1: Full-time Equivalents Budgeted for IRS Activities, Fiscal Year 2005**  
FTEs



Source: GAO analysis of IRS data.

IRS provides a variety of taxpayer services. Tens of millions of taxpayers receive telephone assistance. Taxpayers call IRS to inquire about their refunds, the tax laws, or their accounts. The calls are answered by CSRs or automated services.

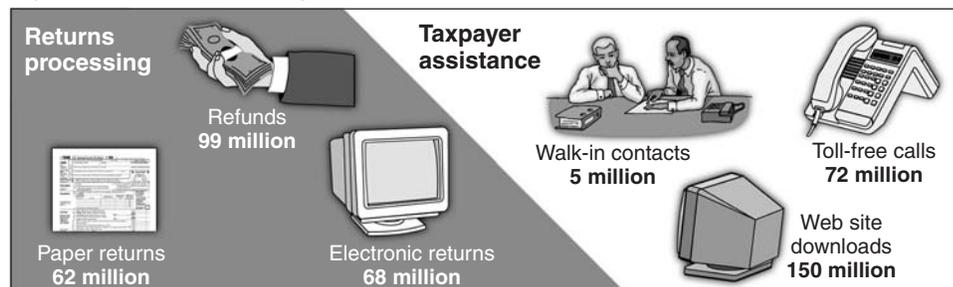
For face-to-face assistance, IRS has approximately 400 walk-in sites where taxpayers ask basic tax law questions, get account information, receive assistance with their accounts, and have returns prepared (if annual gross income is \$36,000 or less).<sup>8</sup> Also, low-income and elderly taxpayers get returns prepared at over 14,000 volunteer sites run by community-based coalitions that partner with IRS. IRS's Stakeholder Partnership, Education, and Communication (SPEC) organization fosters relationships between

<sup>8</sup>According to IRS officials, need-based return preparation at IRS walk-in sites is limited to taxpayers meeting certain requirements. These requirements provide return preparation assistance to taxpayers with a total income limit of \$36,000 or less, because they approximate the amount set in the tax code for claiming the Earned Income Tax Credit.

IRS and the nonprofit community to provide an alternative means for taxpayers to receive volunteer return preparation assistance. According to IRS, SPEC officials identify and select partners, such as the American Association of Retired Persons, that meet taxpayer needs, such as tax assistance for the elderly, and help train, provide resource materials, and oversee operations at these partners' facilities. In some cases, IRS awards grants, trains and certifies volunteers, and provides reference materials, computer software, and computers to these volunteers.

IRS now provides many Internet services that did not exist a few years ago. For example, the "Where's My Refund" feature has the benefit of reducing phone calls and enables taxpayers to use the IRS Web site to find out if IRS received their tax returns and whether their refunds were processed. IRS's filing season activities and associated workload volumes are depicted in figure 2.

**Figure 2: IRS's 2005 Filing Season Activities**



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

Notes: The number of paper and electronic returns and refunds are estimated for the time period January 1, 2005, to September 16, 2005; toll-free calls for the time period January 1, 2005, to July 16, 2005; walk-in contacts, which includes returns prepared at volunteer sites, for the time period December 26, 2004, to April 23, 2005; and Internet downloads for the time period October 1, 2004, to August 31, 2005. We used different dates for the various areas because those dates best reflect IRS's filing season workload in that area.

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## IRS's Processing Performance Continued to Improve, and, for the First Time, More Returns Were Filed Electronically Than by Paper

IRS's performance measures show that IRS has improved its performance processing individual income tax returns and nearly met or exceeded most of its 2005 goals. The continued growth in the number of tax returns filed electronically resulted in more than half of all individual income tax returns being filed electronically for the first time. Despite the continued growth, IRS is not on track to meet its 80 percent long-term electronic filing goal. Electronic filing mandates imposed by several states on tax practitioners who meet certain criteria have increased electronic filing of federal individual income tax returns. However, stakeholders have noted information is lacking on the costs and burdens of mandating electronic filing.

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## Most Measures Showed that IRS Continued to Improve Its Processing Performance

As of September 16, 2005, IRS processed about 130 million individual tax returns, including 68 million returns electronically, with no significant disruptions and issued 99 million refunds in a timely manner.<sup>9</sup>

According to IRS data, IRS equaled or exceeded its 2004 performance and nearly met or exceeded its 2005 goals for the following seven measures (see app. 1 for further details).<sup>10</sup>

- Deposit error rate: the percentage of payments applied in error.
- Deposit timeliness, paper: the amount of interest forgone by not depositing payments the business day after receipt.
- Letter error rate: the percentage of letters issued to taxpayers with errors.

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<sup>9</sup>The time period covered for paper returns and refunds was January 1 through September 16, 2005.

<sup>10</sup>Two of IRS's nine performance measures cannot be compared to years before 2004. Deposit timeliness is not comparable to years prior to 2004, since IRS changed the formula to not include weekends in calculating timeliness in 2004. The measure for Individual Master File efficiency cannot be compared to other years because this is the first year for this performance measure. The only performance measure that did not meet or exceed its performance since last year was refund interest paid, which increased \$20.55 in 2004 to \$27.54 in 2005. According to IRS officials, performance did not improve relative to this measure because IRS did not anticipate the significant increase in the interest rates that has taken place this year.

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- Notice error rate: the percentage of incorrect notices issued to taxpayers.
  - Refund error rate, individual: the percentage of refunds with IRS-caused errors in the entity information (e.g., incorrect name or Social Security number).
  - Refund timeliness, paper: the percentage of refunds issued within 40 days or less for individual tax returns filed on paper.
  - Productivity: the weighted volume of work processed per staff year.

For one measure IRS's performance declined and the 2005 goal was not met.

- Refund interest paid rate: the interest paid per \$1 million of refunds issued late.

One measure was new for 2005, and IRS met the goal.

- Individual Master File efficiency: the number of tax returns processed per staff year.

Although IRS's performance measures indicate smooth processing and improved performance, we have previously recommended that IRS adopt others. Specifically, we recommended that IRS adopt a refund timeliness performance measure for individual tax returns filed electronically to promote growth in electronic filing.<sup>11</sup> This measure could help IRS better monitor and evaluate electronic filing performance and determine the impact of initiatives intended to increase electronic filing. However, IRS does not plan to implement such a measure, stating it would not enhance performance and, in fact, might be counterproductive if disappointed taxpayers who had to wait longer than expected to receive their refunds were to call or seek face-to-face assistance. Although not publicly reported, IRS data shows that refunds associated with returns filed electronically are received in about half the time as those filed on paper. IRS publications also inform taxpayers that they can receive their tax refund in 10 days if they file electronically if they use direct deposit.

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<sup>11</sup>GAO, *Tax Administration: IRS Needs to Further Refine Its Tax Filing Season Performance Measures*, GAO-03-143 (Washington, D.C.: Nov. 22, 2002).

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The number and costs of refund anticipation loans (RAL) are evidence that taxpayers might benefit from having more information about the time it takes to get refunds. RALs are very short-term loans issued while taxpayers wait for their refunds. In a previous testimony, we found examples of interest rates on RALs of well over 100 percent.<sup>12</sup> The measure could be designed to minimize the problem of disappointed taxpayers calling IRS by, for example, reporting the number of days within which 90 percent of refunds are issued.

For the first time, IRS used the Customer Account Data Engine (CADE)<sup>13</sup> to process the simplest taxpayer returns, that is, 1040EZs. CADE is important because it is the foundation of IRS's modernization effort and will ultimately replace the Individual Master File, which currently houses taxpayer data for individual filers, with new technology, applications, and relational databases. As of August 2005, CADE processed over 1.4 million returns with no significant problems, handled \$424 million in refunds, and shortened the average turnaround for refunds from 7 days to 3.5 days. A recent TIGTA report noted that information from tax returns was accurate and posted on time to CADE accounts.<sup>14</sup> IRS released the next update to CADE in mid-September 2005; another release is scheduled for January 2006 and is on schedule, according to an IRS division chief.<sup>15</sup>

IRS officials attribute this year's smooth processing to adequate planning and relatively few tax law changes. Tax practitioners, who last year prepared approximately 60 percent of all individual income tax returns, agreed that the processing of individual tax returns has gone smoothly during the 2005 filing season. Representatives from the National Association of Enrolled Agents, National Society of Certified Public

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<sup>12</sup>GAO, *Paid Tax Preparers: Most Taxpayers Believe They Benefit, but Some Are Poorly Served*, GAO-03-610T (Washington, D.C.: Apr. 1, 2003).

<sup>13</sup>CADE is intended to replace IRS's antiquated system that contains the agency's repository of taxpayer information. In July 2004 and January 2005, IRS implemented the initial releases of CADE, which were used to process 2004 and 2005 1040EZ returns, respectively, for single taxpayers with refund or even-balance returns.

<sup>14</sup>Treasury Inspector General for Tax Administration, *Individual Income Tax Return Information Was Accurately and Timely Posted to the Customer Account Data Engine* 2005-40-109, July 18, 2005.

<sup>15</sup>The September release added the ability to process tax returns with address changes. The January 2006 release will add two new features, forms 1040/1040A with no schedules attached, and tax law changes for tax year 2005.

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Accountants, and other tax-related organizations had positive comments about IRS's processing of individual tax returns. Similarly, TIGTA officials told us that IRS generally processed individual tax returns smoothly in 2005.

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### For the First Time, More Than Half of All Individual Tax Returns Were Filed Electronically

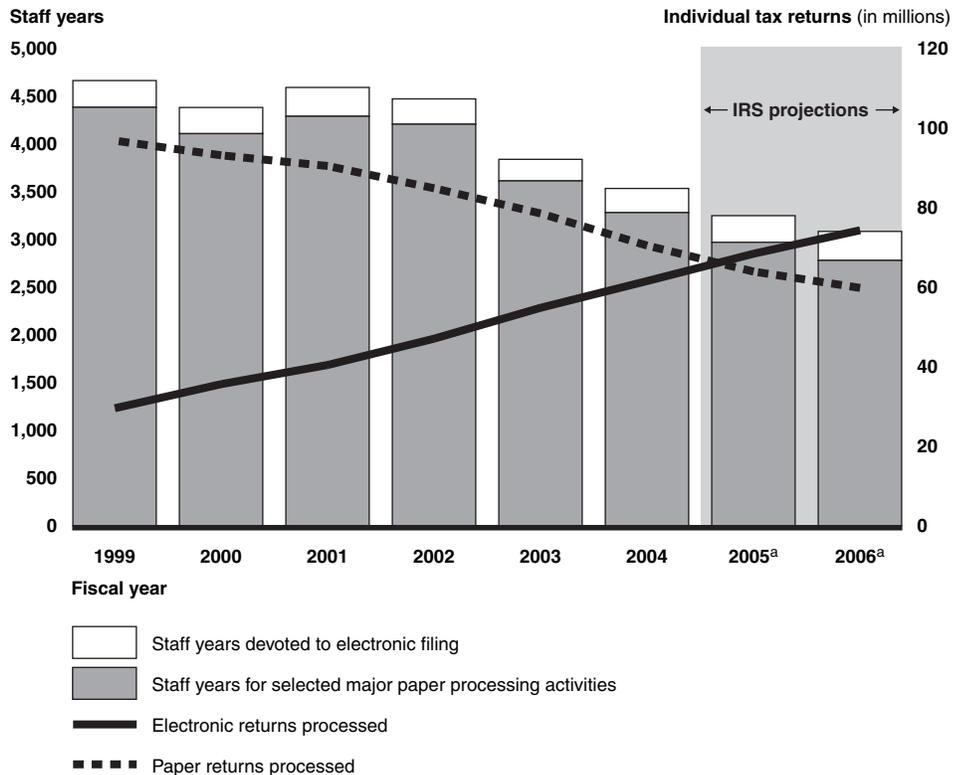
Electronic filing remains important to IRS because electronic returns cost less to process than paper returns. While obtaining accurate cost estimates may be problematic given inadequacies in IRS's financial accounting system,<sup>16</sup> IRS estimates it saves \$2.15 on every individual tax return that is processed electronically. According to IRS data, electronic filing has allowed IRS to use about 300 fewer staff years to process paper returns in 2005 than in 2004, which is reflected in budget savings for processing. This is in addition to about 1,000 staff years saved between 2002 and 2003. IRS anticipates additional staff-year savings when paper processing is eliminated in the Submission Processing Center in Memphis, Tennessee, after the 2005 filing season.

This is the first year that more than half of the 130 million returns filed were filed electronically. The number of individual tax returns filed electronically increased by about 11 percent, to an estimated 67.9 million electronic individual tax returns as of September 16, 2005. IRS is forecasting about a 9 percent increase in the number of individual income tax returns filed electronically in 2006.

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<sup>16</sup>GAO, *Financial Audit: IRS's Fiscal Years 2005 and 2004 Financial Statements*, GAO-06-137 (Washington, D.C.:Nov. 10, 2005).

**Figure 3: Number of Individual Returns and IRS Staff Years for Individual Paper and Electronic Processing, Fiscal Years 1999 through 2006**



Source: GAO analysis of IRS data.

<sup>a</sup>Fiscal years 2005 and 2006 are IRS projections and, given the current lower electronic filing growth rates, the estimates may be optimistic.

Note: Staff years and FTEs are units of measurement that are often used interchangeably. According to IRS, an FTE is the equivalent of one person working full-time for 1 year with no overtime. A staff year includes overtime. Therefore, the cost of 1 staff year is equal to the cost of 1 FTE plus overtime. As noted in the figure, staff years for paper filing are for selected major activities only.

## IRS Has Taken Actions to Encourage Electronic Filing but Will Not Meet Long-term Goal

Over the years, IRS has taken numerous actions to encourage electronic filing by taxpayers and tax practitioners, including

- 
- making electronic filing free to most taxpayers via the Free File Alliance program<sup>17</sup> on the IRS Web site;
  - making the process totally paperless if a taxpayer uses a personal identification number to sign their tax return;
  - making over 99 percent of all individual tax forms suitable for electronic filing;
  - allowing electronic payment of balance due payments; and
  - surveying taxpayers and tax practitioners in response to a recommendation in our 2001 filing season report<sup>18</sup> to determine why 40 million tax returns were prepared on a computer but filed on paper.

For the 2005 filing season, IRS took the following actions to encourage taxpayers and tax practitioners to file electronically. IRS

- contacted about 4,600 tax practitioners who prepared tax returns on computers but then filed paper tax returns and encouraged them to file tax returns electronically. IRS estimates that these types of practitioners file over 15 million paper tax returns annually;
- accepted e-filed returns from married taxpayers filing separately who reside in community property states; and
- made four more forms available for electronic filing.

Despite these actions, IRS is not on track to achieve its long-term goal of having 80 percent of all individual income tax returns filed electronically by 2007. IRS officials do not want to abandon the goal because it serves as a symbol of IRS's determination to increase electronic filing. As we have previously reported, IRS's progress toward the goal has required enhancement of its technology, development of software to support

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<sup>17</sup>In 2003, IRS entered into a 3-year agreement with the Free File Alliance, a consortium of tax preparation companies that provide free electronic filing to taxpayers who access any of the companies via a link on IRS's Web site. Twenty companies offered free filing via IRS's Web site this filing season.

<sup>18</sup>GAO, *Tax Administration: Assessment of IRS' 2001 Tax Filing Season*, GAO-02-144 (Washington, D.C.: Dec. 21, 2001).

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electronic filing, education of taxpayers and practitioners, and other steps that could not be completed in a short time frame.<sup>19</sup>

To achieve its long-term goal, however, IRS would have to average about a 26 percent growth rate over the next 2 years. Assuming a continuation of the current growth rates of 11.08 percent for individual tax returns filed electronically and 1.18 percent for the total number of individual tax returns filed, IRS would receive an estimated 63 percent of all individual income tax returns filed electronically in 2007. This would leave IRS about 23 million short of the approximately 107 million individual income tax returns that would need to be filed electronically to meet the goal. We estimate that if IRS could close this gap, it could save about \$49 million in processing costs.<sup>20</sup>

IRS, the Electronic Tax Administration Advisory Committee (ETAAC),<sup>21</sup> and GAO<sup>22</sup> do not expect IRS to maintain this year's rate of growth. IRS is predicting declining growth rates in 2006 and 2007, and in 2003, ETAAC concurred with IRS's prediction. IRS officials stated that, to achieve its electronic filing goal, tax practitioners and taxpayers who prepare about 40 million tax returns on computers but file paper returns would have to convert to filing electronically; however, IRS's efforts have not resulted in converting a large portion of these filers from paper to electronic filing.

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<sup>19</sup>GAO, *IRS Modernization: Continued Progress Requires Addressing Resource Management Challenges*, GAO-05-707T (Washington, D.C.: May 19, 2005).

<sup>20</sup>Our estimated savings is based on the IRS figure of \$2.15 per tax return processed electronically multiplied by the approximately 23 million additional tax returns that would have to be filed electronically if the 80 percent goal were met in 2007. This estimate may be potentially low, because IRS officials have stated that as electronic filing increases, greater savings are achieved because shared fixed costs are distributed to the total number of tax returns processed electronically.

<sup>21</sup>ETAAC, *Annual Report to Congress* (Washington D.C., June 30, 2003 and June 30, 2004). The IRS Restructuring and Reform Act of 1998 mandated that the Secretary of the Treasury convene an electronic commerce advisory group to ensure that the Secretary receives input from the private sector on IRS's plan to increase electronic filing. ETAAC reports annually on IRS's progress towards meeting electronic filing goals.

<sup>22</sup>GAO-05-416T.

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## State Mandates Have Encouraged Electronic Filing of Federal Tax Returns

Electronic filing mandates imposed by several states on tax practitioners who meet certain criteria, such as filing 100 state tax returns or more, have increased electronic filing of federal individual income tax returns. According to IRS, the growth rate in 2004 of federal tax returns filed electronically was greater than expected, because five states, including California, mandated electronic filing of state tax returns prepared by qualified tax practitioners who filed a certain number of state returns. In 2005, three more states mandated electronic filing of state tax returns prepared by qualified tax practitioners. These state mandates have contributed to an increase in electronic filing of not only state tax returns, but of federal individual tax returns as well. According to IRS officials, these mandates led to significantly more electronic filing of federal tax returns in these states because tax practitioners converted their entire practices to electronic filing. In total, the eight states with electronic filing mandates added an estimated 5.6 million additional electronically-filed federal income tax returns over the 2 years. For 2006, several additional states, including New York, are mandating electronic filing for state returns for some tax practitioners.

In its 2004 report to Congress, ETAAC stated that federal electronic filing growth may now be entirely dependent on what states are doing, rather than actions taken by IRS. IRS cannot require states to mandate electronic filing. However, IRS continually informs states of the benefits of electronic filing in hopes that more states will institute mandates.

The growing use of mandates by the states could lead to more discussion of mandates at the federal level. In the past, ETAAC has recommended that Congress should support mandated electronic filing by tax practitioners because in ETAAC's view, electronic filing mandates are key to IRS achieving its 80 percent goal.

IRS knows more about the benefits of mandated electronic filing than it knows about the costs. The benefits are reduced processing costs to IRS, and faster issuance of refunds to taxpayers. As already discussed, IRS has an estimate of how much it saves on each electronic return. However, in 2005, ETAAC noted that decision makers lack information on the costs and burdens of electronic filing. The costs are borne largely by tax practitioners and taxpayers. In the past, tax practitioners have complained about the costs and burdens associated with converting their businesses to electronic filing, although benefits have also been reported, once the businesses converted. Knowing more about the nature and magnitude of these costs could provide fact-based information that could help inform any future

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debate about making electronic filing mandatory for certain categories of tax practitioners or taxpayers. ETAAC believes that IRS is well positioned to gather such information.

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### **IRS Reduced Access to Telephone Assistors, but Accuracy of Tax Law and Account Responses Significantly Improved**

IRS made a strategic decision to reduce access to its telephone service to accommodate a budget reduction because IRS officials viewed it as flexible area for absorbing such reductions without significantly affecting taxpayer service. As a result, the average time taxpayers waited for CSRs increased and more taxpayers hung up without receiving service than last year. In contrast, the accuracy of CSR answers to millions of tax law and account questions significantly improved compared to past performance.

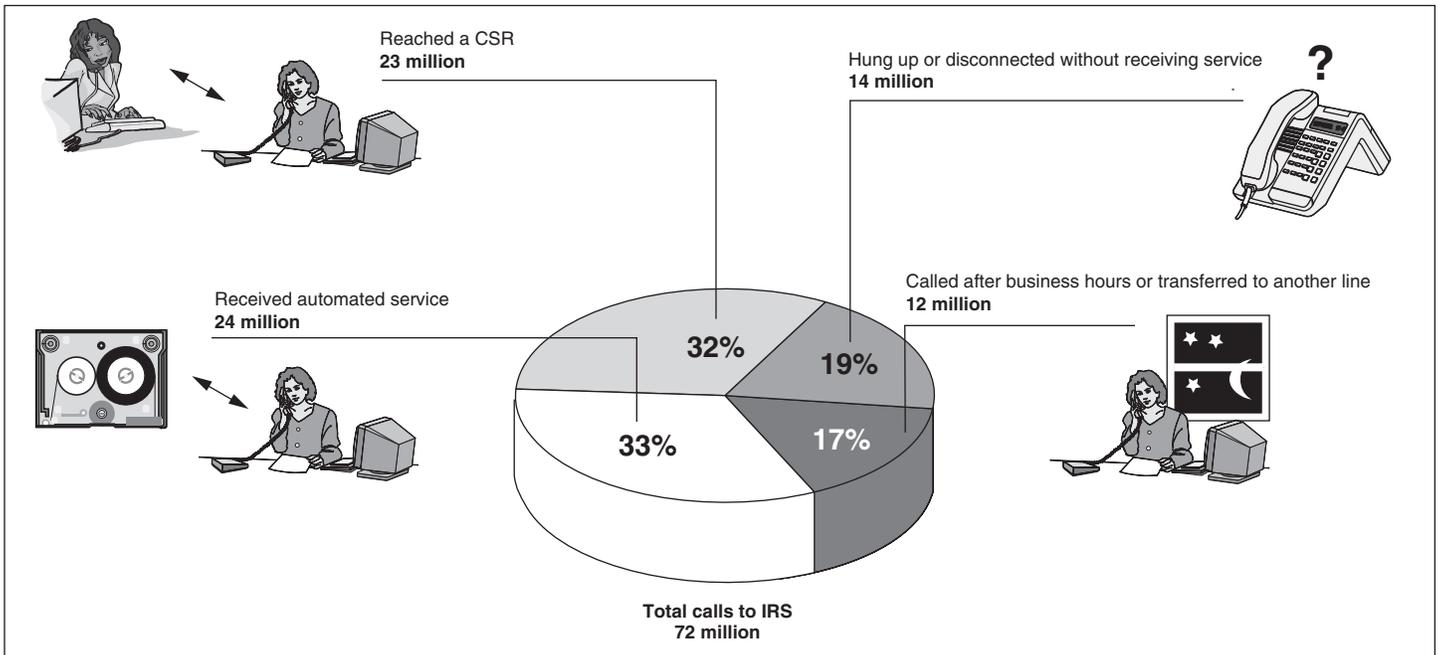
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### **IRS Reduced Access to Telephone Assistors**

IRS received 72 million calls on its toll-free telephone lines through mid-July 2005. Over a third of those calls—31 million—were from callers trying to obtain information on the status of their tax refunds. Another 16 and 20 million calls were about tax law or taxpayer account questions respectively. The rest were miscellaneous calls.

Figure 4 shows how IRS handled those calls. Toll-free telephone calls from taxpayers typically are routed through IRS's telephone system based on taxpayers' response to prompts and are then answered by CSRs or by automated recordings. IRS's automated service handled 24 million calls and CSRs handled 23 million. The remaining 26 million calls came in after business hours, were transferred, were disconnected, or the caller hung up before receiving service.

**Figure 4: How IRS Handled Calls for Telephone Assistance during the 2005 Filing Season**



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

Note: Data cover the period January 1, 2005, through July 16, 2005. Numbers do not add to the total and percentages do not add to 100 due to rounding.

IRS devotes significant resources to providing access to CSRs. Since 2001, IRS has devoted at least 8,300 staff years per year to telephone service. IRS estimates that it will use 8,561 staff years to answer telephone calls in 2005, primarily during the filing season.

According to IRS officials, IRS made a strategic decision to reduce its CSR level of service goal from 85 to 82 percent to accommodate a budget reduction of about \$5 million. (see app. II). In response, IRS reduced the number of FTEs devoted to phone service by less than 1 percent, resulting in taxpayers having less access to CSRs. Also, due to a lower call volume than last year, as of July 16, IRS had used 7 percent fewer FTEs than planned for to answer telephones.

IRS officials chose to reduce telephone access because they viewed it as a more flexible area to absorb budget reductions than, for example, processing. IRS officials said that telephone access had improved in recent years to a more acceptable level, giving IRS flexibility to adjust CSR level of

service. As a result of IRS reducing access to its telephone assistors, the average time taxpayers waited for CSRs (average speed of answer) increased, and more taxpayers hung up (abandoned rate) as shown in table 1.

**Table 1: IRS Telephone Assistors Accessibility Performance, 2001-2005 Filing Seasons**

Accessibility measures <sup>a</sup>	2001 Actual	2002 Actual	2003 Actual	2004 Actual	2005 Actual	Fiscal year 2005 goals
CSR level of service <sup>b</sup>	66%	69%	87%	86%	82%	82%
Average speed of answer (in minutes) <sup>c</sup>	5.7	4.5	2.8	2.8	4.4	2.8
Abandoned rate	16.1%	14.3%	8.3%	8.4%	12.2%	n/a

Source: GAO analysis of IRS data.

<sup>a</sup>Based on actual counts from January through mid-July for 2001, 2002, 2003, 2004, and 2005.

<sup>b</sup>The percentage of callers who want to speak to a CSR who get through and receive service.

<sup>c</sup>Average number of minutes a taxpayer waits in queue for a CSR. Beginning in 2004, IRS expanded the services included in this measure. However, the calculation of the measure remained the same. Recomputed figures are shown here and, as a result, are different than what we reported in the past (see GAO-04-84).

IRS officials told us that these declines are acceptable and IRS is effectively managing its resources while still providing a high level of service. According to the IRS Oversight Board's *2004 Taxpayer Attitude Survey*, most taxpayers are willing to wait an average of 11 minutes to speak to a CSR. On the other hand, table 1 shows that taxpayers abandoned more calls in 2005 when the average speed of answer increased. According to IRS officials, there are no government or industry standard definitions for telephone measures, such as for average speed of answer. IRS is part of a new government wide group organized to baseline, research, benchmark, standardize, and implement a minimum set of expectations for agencies with telephone operations so that agencies can be measured and compared against an objective standard to demonstrate success and improvement.

Some taxpayers who hang up may not be receiving poor service. Preliminary results from IRS analyses of callers who hung up show some taxpayers hang up after hearing the prompt to visit IRS's Web site. Rather than wait for a CSR, these taxpayers may have switched to IRS's Web site to get the information they needed. Midway through the 2005 filing season,

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IRS began collecting detailed data on why taxpayers hang up. According to IRS officials, they will continue to collect and analyze the hang-up data to further determine when and why taxpayers are hanging up.

This year represents the first time since 1998 that IRS reduced its annual level of service goal. However, it is difficult to assess what this year's decline means in the longer term because IRS does not have long-term goals for taxpayer service. A long-term CSR level of service goal may help Congress and other stakeholders understand whether this year's reversal of telephone access is the beginning of a trend. As will be discussed in a later section, we recognize that setting a long-term goal for telephone service would depend on assumptions about available resources, but that is part of the value of long-term goals. They help clarify the trade-off between service and other priorities.

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### Accuracy of Responses to Telephone Inquiries Improved

As table 2 shows, compared to goals and past performance, the accuracy of CSR responses to tax law and account questions significantly improved. First, IRS officials attributed the improved tax law accuracy rate primarily to changes in the *Probe & Response (P&R) Guide*, a publication that CSRs use to help answer tax law questions. In the last 2 years, IRS blamed problems with the P&R Guide for declines in accuracy. Unlike previous years, IRS tested this year's changes before disseminating the guide to CSRs.

Second, with respect to the accuracy of accounts inquiries, IRS officials stated that IRS improved the rate and exceeded the goal because of an improved quality review process, which, in their view, gives employees a heightened sense of their contribution to the agency's mission. Part of that review process is Contact Recording, a system for recording all contacts between taxpayers and CSRs including, for some calls, the computer screen displays used by CSRs. Managers can then review the contacts in their entirety. IRS officials told us that Contact Recording has resulted in employees receiving more constructive feedback and more efficient and consistent scoring of performance and quality by managers, which likely has improved both tax law and accounts accuracy. One IRS manager we spoke with stated that she liked the system because it allows managers to listen to the prerecorded contact at their convenience, and therefore provide more complete feedback to employees. Furthermore, she said that Contact Recording is more efficient than the method used before, wherein managers listened to selected calls in "real time" and provided CSRs feedback based on what the managers heard during the call.

As noted in our 2004 filing season report, IRS decided to implement Contact Recording at all call sites by the end of the 2005 filing season. IRS was slightly behind schedule on implementing this system by the end of this year's filing season.

**Table 2: IRS Telephone Assistors Accuracy Performance, 2001-2005 Filing Seasons**

Accuracy measures <sup>a</sup>	2001 Actual	2002 Actual	2003 Actual	2004 Actual	2005 Actual	Fiscal year 2005 goals
Tax law accuracy rate <sup>b</sup>	79.1% +/- 0.6	84.9% +/- 0.5%	81.3% +/- 0.7%	79.5% +/- 0.8%	89.5% +/- 0.6%	82.0%
Accounts accuracy rate <sup>b</sup>	88.1% +/- 0.6	90.5% +/- 0.4%	88.6% +/- 0.4%	89.0% +/- 0.5%	91.3% +/- 0.4%	89.8%

Source: GAO analysis of IRS data.

<sup>a</sup>Based on representative samples from January through June for 2001, 2002, 2003, 2004, and 2005.

<sup>b</sup>The percentage of calls in which CSRs provided accurate answers for the call type and took the appropriate follow-up resolution action, with a 90 percent confidence interval.

## IRS Has Efforts Intended to Improve Its Telephone Services

IRS had two efforts intended to improve telephone services for the 2005 filing season. First, IRS continued to implement Contact Recording, as previously discussed. Second, in an effort to streamline the process for managing its telephone workforce, and in turn save FTEs, IRS began to implement the Centralized Contact Center Forecasting and Scheduling project in 2005. The project is designed to assess IRS's current telephone workforce management efforts and determine the most appropriate and efficient solution for managing that workforce. IRS has held initial meetings to solicit team members and define high-level requirements for the project. IRS has a project plan in place and is on schedule to meet its deadlines for this project.

## Fewer Taxpayers Used IRS Walk-in Sites and More Used Volunteer Sites, but IRS Lacks Reliable Quality and Other Data

Past trends have continued as fewer taxpayers used IRS's walk-in services and more used volunteer tax return preparation services. These trends are consistent with IRS's strategy to direct taxpayers away from face-to-face assistance provided by its employees to less costly alternatives. However, IRS lacks reliable data on quality that could be used to compare the two services and understand the impact of IRS's strategy on taxpayers. IRS initiated quality improvement programs for both services intended to

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improve data reliability, but these programs have yet to produce sufficiently reliable data.

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**Fewer Taxpayers Used IRS Walk-in Sites for Return Preparation and Other Types of Assistance, but Quality Data Are Not Reliable**

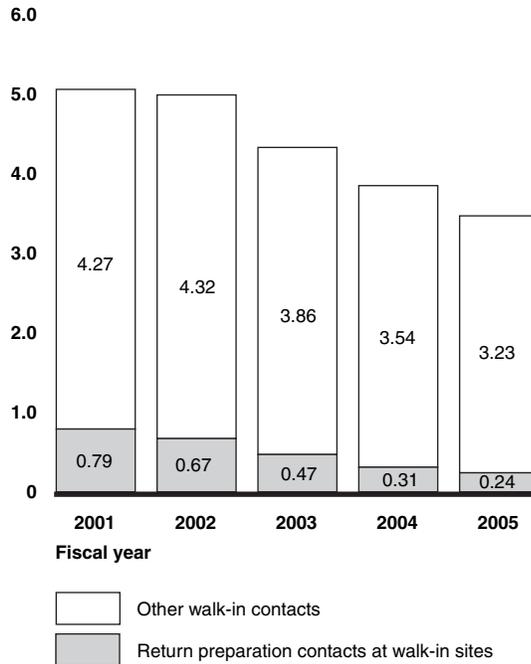
Fewer taxpayers used IRS's approximately 400 walk-in sites during the 2005 filing season, continuing a trend since 2001. At these sites, IRS employees provide taxpayers with information about their tax accounts, answer a limited scope of tax law questions,<sup>23</sup> and prepare returns if the taxpayer's annual gross income is \$36,000 or less. As reflected in figure 5, the total number of walk-in taxpayer contacts during the 2005 filing season declined by nearly 385,000 (10 percent) from last year.<sup>24</sup> Contacts for return preparation declined by almost 68,000 (22 percent) during the same period.

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<sup>23</sup>Walk-in site employees are trained and authorized to only answer tax law questions on specific tax topics such as those related to income, filing status, exemptions, deductions, and related credits.

<sup>24</sup>Total walk-in contacts represent the total number of in-person contacts concerning notices, tax law inquiries, return preparation, forms, and other in-person contacts.

**Figure 5: Assistance Provided by IRS Walk-in Sites, 2001-2005 Filing Seasons**  
Walk-in contacts (in millions)



Source: GAO analysis of IRS data.

Note: "Other walk-in contacts" includes assistance for account notices, tax law inquiries, forms, and compliance work, but not return preparation. The time periods covered are December 31, 2000, through April 28, 2001; December 30, 2001, through April 27, 2002; December 29, 2002, through April 26, 2003; December 28, 2003, through April 24, 2004; and December 26, 2004, through April 23, 2005.

The declines in walk-in usage were consistent with IRS's strategy of reducing costly face-to-face assistance in favor of other service options such as the telephone and Web site.<sup>25</sup> While some of the decline in return assistance is likely due to taxpayers taking advantage of other increasingly available and attractive alternatives, like the improved Web site, some of it

<sup>25</sup>In a similar effort to reduce face-to-face assistance, in February 2005, California's Franchise Tax Board closed 11 of its 16 field offices due to budget constraints. These offices provided limited public access that allowed taxpayers to walk in, address particular tax-related issues, and obtain information and assistance about other programs administered by the state's tax board. The board estimated that these sites were the most expensive way by far to deliver general taxpayer assistance, with an average \$11.15 for a field office contact, versus \$6.07 per call center response, and \$5.21 for a written response.

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is attributable to IRS's attempt to direct taxpayers away from face-to-face assistance. For example, since 2003, IRS has required appointments for most taxpayers seeking return preparation service at its sites.<sup>26</sup>

As we have previously reported,<sup>27</sup> this decline and the shift of taxpayers from walk-in sites to other service options is important because it has allowed IRS to transfer time-consuming services, such as return preparation, from IRS to other less costly alternatives that can be more convenient for taxpayers. As a result, IRS devoted fewer resources—as represented by direct FTEs<sup>28</sup>—to providing return preparation and other services during the 2005 filing season. As reflected in figure 6, IRS reduced the number of direct FTEs devoted to walk-in sites during the filing season by over 4 percent overall and by 22 percent for return assistance from the same period last year.

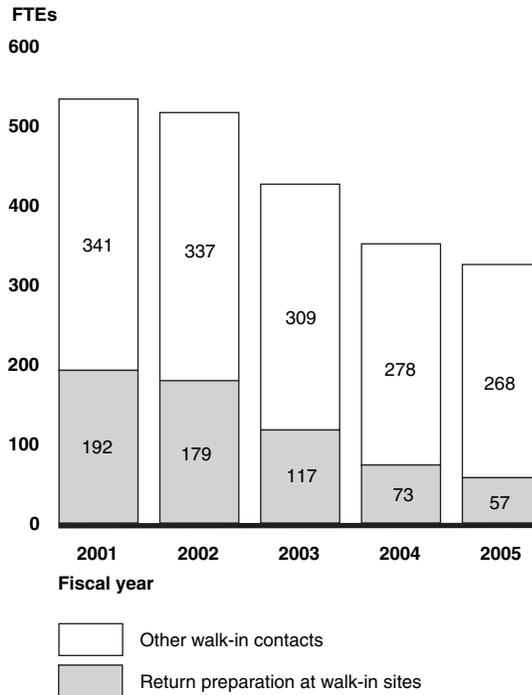
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<sup>26</sup>Because of legislative concerns about the impact of reduced services at walk-in sites, IRS does not plan to further reduce the number of taxpayers receiving tax return assistance in the 2006 filing season. Instead, IRS will attempt to maintain this level of assistance with available resources.

<sup>27</sup>GAO, *Tax Administration: IRS Improved Performance in the 2004 Filing Season, but Better Data on the Quality of Some Services Are Needed*, GAO-05-67 (Washington, D.C.: Nov. 15, 2004).

<sup>28</sup>An FTE is the equivalent of one person working full-time for a year with no overtime. A *direct* FTE does not include overhead.

**Figure 6: Direct FTEs Used for Assistance Provided by IRS Walk-in Sites, 2001-2005 Filing Seasons**



Source: GAO analysis of IRS data.

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

In previous years, IRS transferred enforcement staff to walk-in sites to help staff handle the workload that occurs during the filing season. IRS has nearly eliminated this practice, which pulled the staff away from performing enforcement work, and instead hired more full-time staff to cover the workload during the filing season.

To prevent the newly expanded walk-in staff from experiencing downtime after the filing season, when the workload drops off, since fiscal year 2004, IRS began having walk-in staff perform some collections work after the

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filing season.<sup>29</sup> For example, between October and July 2005, IRS used 53 of its 602 total direct FTEs (9 percent) to handle this collections work. According to IRS officials, this has provided sufficient work to keep walk-in staff productive all year and greatly reduced dependence on enforcement staff. Besides regulating the filing season workload, IRS officials stated that handling these individual taxpayer collection cases at walk-in sites could help them address overdue collections that, in their view, may be overlooked by the normal collections process.

Some IRS officials question moving collections work out of the normal collection process because IRS lacks information about the effectiveness of conducting such work using walk-in site staff. According to IRS officials, IRS will have a reporting system in January 2006 that will allow it to analyze the results of that work and compare it to normal collection results to determine the most effective place to do the work. IRS is on schedule for implementing this system, according to IRS officials. Furthermore, IRS is reevaluating the services provided at walk-in sites, including collections work.

IRS lacks reliable and comprehensive data on the quality of the services provided at walk-in sites. In 2004, IRS began implementing a program to collect data on the quality of services provided to taxpayers at walk-in sites, and we noted concerns with the reliability of the data due to the collection method.<sup>30</sup> Under this program, managers directly observe a sample of employee interactions with taxpayers. We were concerned that employees' performance could be influenced by the knowledge that they are being observed by managers, biasing the sample results. Also, IRS found that managers were not consistently coding employee performance. As a result, we<sup>31</sup> and TIGTA<sup>32</sup> have stated that the quality review program used to monitor walk-in sites does not provide reliable data and made recommendations intended to improve quality measurement.

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<sup>29</sup>IRS officials stated that IRS uses these staff to contact individual taxpayers, notify them of their delinquent tax accounts and, perhaps, enable them to make arrangements, such as face-to-face appointments at local sites, to discuss their account.

<sup>30</sup>GAO-05-67.

<sup>31</sup>GAO-05-67.

<sup>32</sup>Treasury Inspector General for Tax Administration, *Customer Service at the Taxpayer Assistance Centers Is Improving but Is Still Not Meeting Expectations*, Reference No. 2005-40-021 (Washington, D.C.: December 2004).

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To obtain reliable and comprehensive data on the quality of services provided, IRS is implementing Contact Recording at walk-in sites, which is similar to the method used for IRS's telephone service, whereby IRS employee and taxpayer interactions will be recorded and reviewed later by managers.<sup>33</sup> IRS piloted Contact Recording at a small number of walk-in sites, ending in July 2005, and decided to continue implementation.

The results of the Contact Recording pilot and the current direct observation method are quite different. According to IRS officials, Contact Recording results showed quality to be significantly worse than the results from the direct observation method.<sup>34</sup> However, IRS is not scheduled to fully implement Contact Recording at walk-in sites until December 2007. Until that occurs, IRS will lack reliable and comprehensive data. While IRS appears to be on schedule based on its implementation plan for Contact Recording, it has previously experienced delays implementing other parts of its quality review program. In fact, in a previous report we made a recommendation to help ensure that IRS addresses the causes of past delays in implementing its quality program at walk-in sites.<sup>35</sup>

For 2006, IRS asked TIGTA to assess the accuracy of tax law assistance, one service offered at walk-in sites. The results of TIGTA's requested assessment of tax law assistance would be unreliable because sites they covered would be selected judgmentally and the results could not be projected to all sites. Also, IRS will continue to lack data on the other services it provides, namely account assistance and return preparation.

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<sup>33</sup>As with IRS's telephone service, Contact Recording is intended to enable supervisors to provide walk-in site staff with more complete feedback on their performance and better assess the quality of services provided at walk-in sites. The system records all interactions, including the computer screen activity of the walk-in-site employee as they work with the taxpayer, into a database. A sample is selected for review, where managers play back and monitor the interaction and score it for quality. Staff can review the interaction when receiving feedback.

<sup>34</sup>IRS officials believe results obtained from Contact Recording to be more reliable compared to results from direct observations because, for example, far more interactions are captured than are used for potential review and staff are not aware of which of their recorded interactions with taxpayers will be selected for review.

<sup>35</sup>GAO-05-67.

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In addition to the lack of reliable data on quality, IRS lacks complete data on what kind of services these sites should offer. As TIGTA<sup>36</sup> and the National Taxpayer Advocate<sup>37</sup> have noted, IRS lacks accurate and complete management information on walk-in sites. For example, TIGTA reported that (1) IRS has limited information on the exact numbers and types of services provided at IRS's walk-in sites as well as information on what kind of face-to-face service taxpayers need or want and (2) the lack of information hinders IRS's ability to make appropriate decisions about the locations and services it provides taxpayers. Consequently, TIGTA made recommendations to IRS to enhance the validity and reliability of information on taxpayer needs and ensure that the services provided effectively and efficiently address these needs.

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**More Taxpayers Sought  
Return Preparation  
Assistance from Volunteer  
Sites, but Quality Data Are  
Not Reliable**

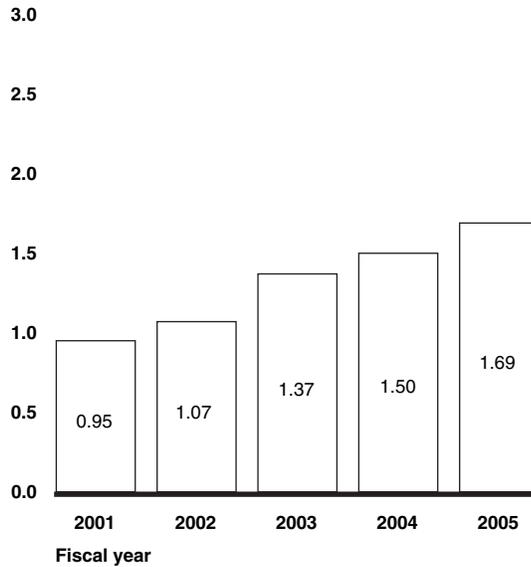
In contrast to IRS's walk-in sites, the numbers of taxpayers seeking return preparation assistance at about 14,000 volunteer sites increased by nearly 13 percent from last year (see fig. 7). Again, this increase is consistent with IRS's strategy to direct taxpayers away from face-to-face IRS assistance to volunteer sites.

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<sup>36</sup>Treasury Inspector General for Tax Administration, *The Effectiveness of the Taxpayer Assistance Center Program Cannot be Measured*, Reference No. 2005-40-110 (Washington, D.C.: July 2005).

<sup>37</sup>National Taxpayer Advocate, *2004 Annual Report to Congress* (Washington, D.C.: Dec. 31, 2004).

**Figure 7: Assistance Provided by Volunteer Sites, 2001-2005 Filing Seasons**  
Millions of returns prepared at volunteer sites



Source: GAO analysis of IRS data.

Note: The time periods covered are January 1, 2001, through April 21, 2001; December 30, 2001, through April 27, 2002; December 29, 2002, through April 26, 2003; December 28, 2003, through April 24, 2004; and December 26, 2004, through April 23, 2005. IRS does not collect data on the number of contacts at volunteer sites.

As with its walk-in sites, IRS lacks reliable data on the quality of services provided at volunteer sites. Ensuring quality service at volunteer sites is important because not only does IRS provide assistance to volunteer sites, but IRS actively promotes volunteer sites as an alternative for face-to-face services at its walk-in sites. Furthermore, we<sup>38</sup> and TIGTA<sup>39</sup> have reported concerns about the quality of return preparation assistance provided at volunteer sites and have made recommendations to remedy the concerns, some of which date back to 2000.<sup>40</sup> More recently, a TIGTA official told us

<sup>38</sup>GAO-05-67.

<sup>39</sup>Treasury Inspector General for Tax Administration, *Improvements Are Needed to Ensure Tax Returns Are Prepared Correctly at Internal Revenue Service Volunteer Income Tax Assistance Sites*, Reference No. 2004-40-154 (Washington, D.C.: August 2004).

<sup>40</sup>GAO, *Tax Administration: Assessment of IRS' 2000 Tax Filing Season*, GAO-01-158 (Washington, D.C., Dec. 22, 2000).

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that that while improvements have been made at volunteer sites, continued effort is needed to ensure the accuracy of services provided.

IRS recognized the data quality problems and proposed a strategy to address them, but there is still insufficient data to determine the quality of services provided. As part of IRS's strategy for improving quality at volunteer sites, it developed three methods to monitor quality during the 2005 filing season--observation reviews, site reviews, and mystery shopping.<sup>41</sup> However, IRS halted its use of observation reviews immediately after starting due to concerns raised by the National Taxpayer Advocate and some partner organizations that observation reviews violate taxpayer privacy and unfairly target low-income taxpayers. IRS maintained its two other methods, but according to IRS officials, neither of these methods are as comprehensive as the observation method in following the process volunteers used to prepare returns, such as appropriate probing techniques to acquire dependency information from taxpayers. Furthermore, IRS conducted only 14 of the proposed 100 mystery shopping visits, which did not provide sufficient results. As a result, the methods used to collect data on quality at volunteer sites were inadequate for monitoring and evaluating quality at volunteer sites in 2005.

IRS has proposed conducting return reviews instead of observational reviews for the 2006 filing season.<sup>42</sup> During each site review, IRS officials plan to select three tax returns to examine by comparing a taxpayer's return against their supporting tax-related documents, as well as other information obtained by the volunteers, to determine the accuracy of the return. According to IRS officials, IRS has consulted with several partner groups participating in the volunteer program about the return reviews.

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<sup>41</sup>Observation reviews were to be used to assess tax return preparation accuracy through first-hand observations of site operations as well as watching volunteers prepare taxpayers' returns. IRS staff conducted site reviews through mandatory and routine visits to volunteer sites nationwide to gauge adherence to minimum site requirements, such as use of IRS resources. Mystery shopping was done by representatives from the American Institute of Certified Public Accountants who posed as taxpayers needing assistance.

<sup>42</sup>IRS officials stated that they would use results of return reviews to obtain information about the accuracy of return preparation. IRS would review a sample of taxpayers' returns before the taxpayer leaves, and compare information on the return to supporting documents and any additional information prepared by the site. Accuracy would be determined on such factors as filing status, dependencies, exemptions, Earned Income Tax Credit applications, and income. According to IRS officials, unlike observation reviews, neither site representatives nor taxpayers can opt out from participating in return reviews.

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The partners did not express the same concerns with return reviews as those they had with observation reviews.

IRS intends to use return reviews, along with site and mystery shopping reviews, in an implementation plan for the 2006 filing season as part of its strategy to monitor and evaluate quality of return preparation at volunteer sites. According to IRS officials, the plan is on schedule for critical events, such as developing publications and training. For example, IRS officials told us that they were working to avoid the logistical problems of last year that resulted in fewer than the anticipated number of mystery shopping reviews.

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## Web Site Performed Well, Was Highly Rated, and Used Extensively

IRS's Web site is important because it provides taxpayers and tax practitioners with assistance without having to contact IRS employees and results in IRS saving resources. Our review and external Web site ratings of IRS's Web site and various other data indicates that it performed well, was user friendly, and was used extensively. This is consistent with IRS's strategy to improve taxpayer service by providing options for automated interaction with the IRS, such as "Where's My Refund."

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## Web Site Performed Well and Was User Friendly

IRS's Web site was user friendly, based on our testing for the types of information taxpayers look for when accessing the Web site. Specifically, our testing found it (1) was accessible and easy to navigate, (2) had no broken links, (3) did not have outdated or inconsistent data, (4) had facts and information logically arranged and easy to obtain, (5) had a search function that worked well, and (6) had a quick response time.

Two independent assessments done by Keynote and Brown University's Center for Public Policy confirm our observations of IRS's Web site.

- Keynote, an independent Web site rater of Internet performance that does a weekly study during the filing season, reported that IRS's Web site performed very well. For example, it was ranked in the top 4 out of 40 government Web sites and users were able to access the IRS Web site in less than 1 second during the entire filing season. The same independent weekly assessment reported that IRS ranked first or second in response time for downloading data.

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- Brown University's Taubman Center for Public Policy rated IRS's Web site among the upper half of 61 federal government Web sites in providing service to citizens.

Taxpayers can ask IRS tax law questions via the agency's Electronic Tax Law Assistance (ETLA) program on its Web site. The substantial increase in IRS's performance for the ETLA program this year is due to the fact that IRS received significantly fewer questions than last year, which allowed it to improve its timeliness and accuracy in responding to those questions. IRS received fewer questions because it kept the ETLA function at the same, less prominent location on the Web site that it was moved to last year. As we reported last year, IRS moved the ETLA function on its Web site to a less prominent location in the middle of the filing season last year.<sup>43</sup> According to IRS officials, this significant increase in performance is because the number of questions being submitted declined from about 64,200 last filing season to 18,700 this filing season. As a result, the average time to respond to questions is down from 3 days last filing season to 1.2 days in the 2005 filing season and the accuracy rate in responding to questions has improved from 64 percent last year to 86 percent this filing season.

IRS intended to discontinue this program for the 2006 filing season for taxpayers residing in the United States because questions can be answered more efficiently if handled via the telephone. However, due to congressional concerns, IRS now plans to keep the program.

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## Web Site Was Used Extensively

IRS's Web site experienced extensive use this filing season based on the number of visits to the Web site, pages viewed, and forms and publications downloaded. As of August 31, 2005, the Web site had been visited about 169 million times and users viewed about 1.2 billion pages. This year is the first year that IRS is publicly reporting these figures. Further, as of August 31, 2005, about 150 million forms and publications had been downloaded via the IRS Web site.

IRS's Web site continues to provide two very important tax service features that were used extensively by taxpayers: (1) "Where's My Refund" enables taxpayers to check on the status of their refund and for the first time this

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<sup>43</sup>GAO-05-67.

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year allows a taxpayer whose refund was returned as undeliverable mail to change their address and (2) Free File provides taxpayers the ability to file their tax return electronically for free. As of August 31, 2005, 28.5 million taxpayers had accessed the “Where’s My Refund” feature, about a 24 percent increase over the same time period last year. As of September 16, 2005, over 5 million tax returns had been filed via Free File, which represents a 46.2 percent increase over the same time period last year. For the first time this year, all individual taxpayers were eligible to file for free via IRS’s Web site. The performance of IRS’s Web site is consistent with IRS’s strategy to improve taxpayer service by providing options for automated interaction with IRS.

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## IRS Is Developing Long-term Goals for Taxpayer Service, but Completion Date Is Unknown

IRS currently lacks, but is developing, long-term goals for taxpayer services, tax enforcement, and modernization. We have reported on lack of such goals in past reports in each of these three areas.<sup>44</sup> Similarly, a 2004 Program Assessment Rating Tool (PART)<sup>45</sup> review conducted by the Office of Management and Budget found that IRS lacks long-term goals, not just for filing season activities, but for all aspects of its operations. PART asks, for example, whether a program’s long-term goals are specific, ambitious, and focused on outcomes, and found that IRS did not meet the criteria.

IRS has been working to establish long-term goals as part of its strategic planning efforts for all aspects of its operations for well over a year. However, at this time IRS does not have a schedule for finalizing its long-term goals.

According to federal law and good management practices, as part of its strategic planning, a executive agency should not only have annual performance goals for each program, but these annual goals should be linked to long-term goals that set longer term and broader expectations for

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<sup>44</sup>GAO-05-416T, GAO-05-707T, GAO, *Tax Compliance: Better Compliance Data and Long-term Goals Would Support a More Strategic IRS Approach to Reducing the Tax Gap*, GAO-05-753 (Washington, D.C.: July 18, 2005), and *IRS Telephone Assistance: Opportunities to Improve Human Capital Management*, GAO-01-144 (Washington, D.C.: Jan. 30, 2001).

<sup>45</sup>The PART is a diagnostic tool meant to provide a consistent approach to assessing federal programs. The PART includes general questions in each of four broad topics to which all programs are subjected: (1) program purpose and design, (2) strategic planning, (3) program management, and (4) program results (i.e., whether a program is meeting its long-term and annual goals).

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how an agency should be accomplishing its mission. While these long-term goals do not necessarily need to be quantifiable, they should be sufficiently focused on results or outcomes to provide the agency's management and Congress with information not only prospectively—i.e., how well the agency expects to perform, but retrospectively as well—i.e., how close actual performance is to expectations. This information holds agencies accountable and helps agencies and Congress make strategic trade-offs. Long-term goals can help

- an agency meet its goals by setting targets and providing incentives to meet them;
- determine whether annual goals contribute to long-term progress;
- identify gaps in performance or misaligned priorities;
- consider new strategies to improve service in the future, especially since these strategies could take several years to implement; and
- provide a framework for assessing budgetary trade-offs—for example, for IRS, between taxpayer service and enforcement on an annual basis and over the longer term.

Long-term goals are a component of the statutory strategic planning and management framework that Congress adopted in the Government Performance and Results Act of 1993<sup>46</sup> (GPRA). GPRA requires executive agencies to develop a strategic plan with long-term, results- or outcome-oriented goals and objectives for all major functions and operations. Furthermore, each long-term goal must be linked to annual performance goals, which should be quantifiable, i.e., should indicate whether or not incremental progress is being made toward the long-term goal.

IRS has taken some steps toward meeting GPRA's criteria for strategic planning. IRS has established a strategic plan and associated strategic and annual performance goals. The strategic goals, which are qualitative and descriptive, are long-term goals in the sense that they represent IRS's vision for the next 5 years. IRS's Strategic Plan for fiscal years 2005-2009 describes IRS's three strategic goals for 5 years hence: (1) improve taxpayer service, (2) enhance enforcement of tax laws, and (3) modernize

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<sup>46</sup>Pub. L. No. 103-62 (1993).

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IRS through its people, processes, and technology. The plan includes strategies and means for achieving the strategic goals, such as reducing face-to-face assistance and increasing less expensive ways of interacting, i.e., electronic interactions such as IRS's Web site.

IRS's strategic goals, however, lack specific targets against which progress can be measured. More specifically, IRS's strategic goals do not spell out where IRS wants to be in the future with respect to levels of taxpayer service or enforcement. In contrast, IRS has one long-term goal—for electronic filing—which is quantitative. Because it is specific, it is useful for identifying gaps between actual and intended performance and measuring progress toward the goal.

We recognize that developing long-term goals that meet the above criteria is difficult. Not all goals may be as easily quantified as the goal for electronic filing. Because of the difficulty, IRS has experienced delays in finalizing its proposed goals. In our April 2005 testimony,<sup>47</sup> we stated IRS reported that the goals would be finalized and publicized before May 2005. However, as of October 2005, IRS lacked a schedule for the public release of long-term goals.

If long-term goals are not in place in a timely manner in 2006, Congress and IRS management will be less informed about budgetary trade-offs between improving taxpayer service and enhancing enforcement. Such trade-offs, as we have noted before, involve risk. One risk is surrendering some of the gains that have been made in taxpayer service.

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<sup>47</sup>GAO-05-416T.

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## IRS Has Taken Numerous Actions to Deal with the Aftermath of Hurricanes Katrina and Rita, but Implications for the 2006 Filing Season Are Not Yet Known

IRS has taken numerous actions to address the aftermath of Hurricanes Katrina and Rita, including assessing employee and infrastructure needs, providing tax relief, and providing assistance to federal partners. IRS officials report that any effect on this year's filing season performance was slight because the hurricanes occurred so late in the filing season. IRS is also assessing the longer term implications of the hurricanes for the 2006 filing season and beyond.

According to IRS officials, IRS followed mandated procedures, which focus on the impact to employees, critical business processes, and computer systems. IRS established an Emergency Command Center in Nashville, Tennessee, to deal with immediate issues in the field related to employee safety and assistance, damage to facilities and equipment, and security of taxpayer data and other IRS records. The center maintained ongoing communications with the highest levels of IRS management, including the two deputy commissioners, providing daily reports on the impact of the disaster and recovery process. IRS planned to close the center by mid-September 2005. IRS located and contacted all 517 employees in the affected areas. Many have returned to work at sites that have been reopened or alternative locations.

A vital part of IRS's response to any disaster is its support of other federal agencies and stakeholders. IRS worked with the Federal Emergency Management Agency (FEMA) and the General Services Administration to inspect the buildings, determine if and when those facilities would be operational, and obtain replacement space for the offices closed indefinitely. IRS reopened offices in all but two locations (Gulfport, Mississippi, and New Orleans, Louisiana) in September and plans to reestablish workload inventories at those offices. IRS plans to reopen offices in Gulfport and New Orleans after November 4, 2005. Finally, IRS had four offices closed as a result of Hurricane Rita, all of which were reopened by the end of October 2005.

In response to Hurricane Katrina, IRS has assigned employees to work in approximately 30 disaster recovery centers including in Alabama, Mississippi, and Texas; assigned nearly 5,000 employees to augment federal telephone call sites; and called back 4,000 seasonal employees to minimize the disruption to ongoing IRS work.

IRS gave priority over its regular telephone service to help disaster victims with the FEMA registration process whereby people call in and provide IRS

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employees with basic information such as their name, address, and property damage. IRS officials estimated that IRS staff may handle up to 50 percent of these FEMA calls. As of September 18, 2005, IRS had answered over 384,000 telephone calls for FEMA, which was about 65 percent of all calls at the time. In a letter commenting on a draft of this report, the Commissioner noted that as of the end of October, IRS answered over 786,000 disaster-related calls. Besides FEMA, IRS was the only other federal agency using its own facilities and employees to answer these calls.

IRS's actions to safeguard taxpayer data include working with external groups such as the Federal Protection Service and General Services Administration to secure facilities and assess operational capability. According to IRS officials, they are implementing the best practices learned from Hurricane Andrew and the September 11<sup>th</sup> attack, retrieved archived documents, and used many of the managers and employees who were involved in these prior events to support the current efforts.

IRS took numerous actions to provide broad relief to affected taxpayers including postponing deadlines for filing and payment, providing relief from interest and penalties, waiving some low-income housing tax credit rules, waiving the usual fees and expedite requests for copies of previously filed tax returns for affected taxpayers who need them to apply for benefits or to file amended returns claiming casualty losses, and encouraging widespread use of leave donation programs for disaster victims.

IRS communicated this and other information via a series of news releases and notices. In addition, IRS established a special toll-free disaster number to handle taxpayer inquiries and launched a special section on its Web site to provide information on tax relief and related issues.

IRS also coordinated with the Department of Labor to expedite filing verifications and with the U.S. Postal Service to locate and redirect mail to the affected area. IRS temporarily suspended correspondence and compliance activities in the affected areas; additional guidance was pending at the time we concluded our work. Also, IRS has partnered with the Associated American Institute of Certified Public Accountants to provide outreach to affected taxpayer disaster recovery centers, and has coordinated with the Federation of Tax Administrators to provide assistance to impacted states.

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IRS also is assessing the longer term implications of Hurricanes Katrina and Rita for the 2006 filing season and beyond, which was complicated by the number of taxpayers involved, dispersion of those taxpayers across the country, and unanticipated computer programming and other business changes that need to be made in response to legislation under relatively tight time frames. Regarding the 2006 filing season, according to IRS officials, IRS's actions, including using seasonal employees to answer IRS calls, should help minimize disruption to telephone service in particular while other employees assist FEMA in answering emergency calls.

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## Conclusions

In recent years, IRS has significantly improved its filing season services to taxpayers. The trend continued this year in several areas, such as telephone accuracy. However, because of overall budget constraints and its strategy of shifting resources from service to enforcement, IRS will be challenged to continue improving service.

In principle, IRS could shift resources from service to enforcement while maintaining or improving the quality of service to taxpayers if it can provide service more efficiently. But there is risk that this strategy could result in surrendering some of the past gains in taxpayer services.

In practice, however, IRS has been able to shift resources and realize noticeable efficiency gains. IRS's efficiency gains can be linked, in part, to management's focus on results, performance measurement, and in the case of electronic filing, progress towards its long-term goal.

We identified two areas where additional information might lead to better informed decision making about how to continue improving IRS's performance. The first area is electronic filing. Despite numerous IRS initiatives that have increased electronic filing, there remains considerable room for further growth. Some states and federal tax experts have recognized that mandatory electronic filing for certain categories of tax practitioners is the one remaining option with the potential for significant impact. However, mandatory electronic filing would likely impose some costs and burdens on tax practitioners. Better information about the nature and magnitude of these costs and burdens would provide more facts about the pros and cons of mandatory electronic filing.

The second area is long-term goals. Without agency wide long-term goals that are concrete and as quantifiable as possible, it is difficult to assess IRS's progress and budget requests.

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## Recommendations for Executive Action

To address the problems with meeting its long-term electronic filing goal and needing time frames for developing and publicizing long-term goals, we recommend that the Commissioner of Internal Revenue direct the appropriate officials to

- develop better information about the costs to tax practitioners and taxpayers of mandatory electronic filing of tax returns for certain categories of tax practitioners and
- establish a schedule for developing its long-term goals.

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## Agency Comments and Our Evaluation

The Commissioner of Internal Revenue provided written comments in a November 4, 2005, letter outlining IRS's view of its 2005 filing season performance in return processing, telephone service, walk-in service, volunteer return preparation, and Internet services, which is reprinted in appendix III. The Commissioner wrote that he appreciated our recognition of IRS's successes for the 2005 filing season, which he characterized as one of the most successful ever for IRS. He stated that IRS was able to balance its resources to focus on both service and enforcement and provide customer service through detailed planning, improved efficiencies, and the dedication of IRS staff. However, he also recognized room for improvement.

The Commissioner agreed with both of the report's recommendations. In responding to our first recommendation to develop better information about the costs of mandatory electronic filing of returns for certain categories of tax practitioners, the Commissioner stated that IRS would initiate a study to analyze the relationship of state-mandated electronic filing requirements to the federal electronic filing rate. Regarding the second recommendation for IRS to establish a schedule for developing its long-term goals, the Commissioner stated that IRS had initiated efforts to develop long-term, outcome-oriented goals and would establish a schedule for developing these goals by the end of the calendar year 2005.

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As agreed with your office, unless you publicly announce the contents of this report earlier, we will not distribute it until 30 days from the date of the report. At that time, we will send copies of this report to the Chairmen and Ranking Minority Members of the Senate Committee on Finance, the House Committee on Ways and Means, and the Ranking Minority Member,

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Subcommittee on Oversight, House Committee on Ways and Means. We are also sending copies to the Secretary of the Treasury; the Commissioner of Internal Revenue; the Director, Office of Management and Budget; and other interested parties. We will also make copies available to others on request. In addition, the report will be available at no charge on the GAO Web site at <http://www.gao.gov>.

If you have any questions regarding this report, please contact me at (202) 512-9110 or at [whitej@gao.gov](mailto:whitej@gao.gov). Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. Key contributors to this report include Emily Byrne, Evan Gilman, John Lesser, Alan Patterson, Cheryl Peterson, Neil Pinney, Amy Rosewarne, Joanna Stamatiades, and Daniel Zeno.

Sincerely yours,

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

James R. White,  
Director, Tax Issues  
Strategic Issues

# Data on Processing Performance Relative to Fiscal Years 2001 through 2004 Performance and Fiscal Year 2005 Goals

As table 3 shows, the Internal Revenue Service (IRS) nearly met or exceeded eight of the nine processing performance goals for 2005. For five measures (refund timeliness, deposit error rate, letter error rate, productivity, and efficiency), IRS exceeded its goal. For three of the remaining measures (refund error rate, deposit timeliness, and notice error rate), IRS nearly met or met its goal. For one measure, refund interest paid, IRS did not meet the goal, according to IRS officials, because of an unanticipated but substantial increase in the interest rate.

Comparing actual 2005 performance to 2004 performance shows that IRS's performance improved or remained about the same for seven of the eight measures, again with the exception of refund interest paid. Table 4 also shows that IRS processing performance in 2005 has improved compared to 2002 performance for all but one of the measures that could be compared.

**Table 3: IRS's Processing Performance, Fiscal Years 2001 through 2005**

Measure name	Definition	Fiscal year 2001 actual <sup>a</sup>	Fiscal year 2002 actual	Fiscal year 2003 actual	Fiscal year 2004 actual	Fiscal year 2005 actual (through July) <sup>a</sup>	Fiscal year 2005 goal
Deposit error rate	Percentage of payments applied in error by, for example, reimbursing a taxpayer who overpaid when the taxpayer wanted any overpayment credited to next year's tax bill.	5.0%	4.8% +/- .3% <sup>d</sup>	4.2% +/- .3% <sup>d</sup>	3.5% +/- .31% <sup>d</sup>	2.3% +/- .23% <sup>d</sup>	3.4%
Deposit timeliness—paper	Interest foregone by not depositing monies the business day after receipt, per \$1 million in deposits. Measure assumes an 8 percent interest rate.	Not comparable because of revisions to the measure.	Not comparable because of revisions to the measure.	Not comparable because of revisions to the measure.	\$407 <sup>e</sup>	\$401 <sup>e</sup>	\$400
Letter error rate	Percentage of letters issued to taxpayers with errors (includes systemic errors). <sup>a</sup>	Not comparable because of revisions to the measure.	7.4% +/- .6% <sup>c</sup>	7.1% +/- .5% <sup>c</sup>	6.6% +/- .38% <sup>c</sup>	3.1% +/- .30 <sup>c</sup>	5.9%
Notice error rate	Percentage of incorrect notices issued to taxpayers (includes systemic errors). <sup>b</sup>	Not comparable because of revisions to the measure.	18.7% +/- 2.4% <sup>c</sup>	9.4% +/- 1.2% <sup>c</sup>	9.5% +/- 1.31% <sup>c</sup>	8.8% +/- 1.07% <sup>c</sup>	8.6%

**Appendix I  
Data on Processing Performance Relative to  
Fiscal Years 2001 through 2004 Performance  
and Fiscal Year 2005 Goals**

(Continued From Previous Page)

Measure name	Definition	Fiscal year 2001 actual <sup>a</sup>	Fiscal year 2002 actual	Fiscal year 2003 actual	Fiscal year 2004 actual	Fiscal year 2005 actual (through July) <sup>a</sup>	Fiscal year 2005 goal
Refund error rate – individual (paper)	The percentage of refunds with IRS-caused errors in the entity information (e.g., incorrect name, Social Security number, or refund amount); includes systemic errors. <sup>c</sup>	9.8%	8.0% +/- .46% <sup>c</sup>	5.3% +/- .41% <sup>c</sup>	4.9% +/- .44% <sup>c</sup>	5.1% +/- .53% <sup>c</sup>	4.8%
Refund interest paid	Amount of refund interest IRS paid per \$1 million of refunds issued.	Not comparable because of revisions to the measure.	Not comparable because of revisions to the measure.	\$36.29	\$20.55	\$27.54	\$19.00
Refund timeliness– individual (paper)	Percentage of refunds issued within 40 days or less.	95.2%	98.2% +/- .32% <sup>d</sup>	98.8% +/- .26% <sup>d</sup>	98.3% +/- .17% <sup>d</sup>	99.2% +/- .18% <sup>d</sup>	98.4%
Productivity	Weighted volume of documents processed per staff year expended at the processing centers.	30,133	28,389	30,179	30,405	31,286	30,179
Individual Master File Efficiency	Measure of individual Master File returns processed per staff year expended.	Measure not in existence.	Measure not in existence.	Measure not in existence.	Measure not in existence.	16,172	14,878.

Note: GAO analysis of IRS data.

<sup>a</sup>According to IRS officials, they did not compute a margin of error for these measures in 2001.

<sup>b</sup>The measures for fiscal year 2005 are through July 31, which were the latest data available at the time we ended our audit work. According to IRS officials, the 2004 results through July 31 are reflective of IRS's performance during the filing season. In addition, IRS officials told us that the results for the measures should not change significantly through September 30.<sup>c</sup>Systemic errors are computer-generated errors over which a particular processing center would have no control.

<sup>d</sup>IRS estimates these measures to have a 90 percent confidence interval.

<sup>e</sup>IRS's measure for deposit timeliness for 2004 and 2005 was not comparable to previous years because IRS changed the formula to not include weekends.

# Budget Reduction Had Some Impact on Service to Taxpayers

IRS's fiscal year 2005 budget was approximately \$10.2 billion which funded approximately 96,400 full-time equivalents (FTE). The taxpayer services accounted for about \$3.6 billion (35 percent) of the entire IRS budget. The remaining budget was used to fund various operations such as examination, collection, investigations, and business systems modernization.

From fiscal year 2004 through fiscal year 2005, IRS received a slight budget reduction in taxpayer service of about \$103 million (2.8 percent) as shown in table 4.<sup>1</sup> Although IRS officials stated that the reduction would have had minimal impact on taxpayer service during the 2005 filing season, our analysis of IRS's performance measures showed some impact on service, most notably in the area of telephone access. IRS also absorbed budget reductions for its volunteer and Web site operations, with minimal impact on taxpayer service, according to IRS officials. In both these areas, however, officials stated that future budget reductions could have a negative impact on taxpayer service. As discussed in the report section on long-term goals, long-term goals could help IRS decision makers decide how to best allocate resources during times of budget reductions.

**Table 4: Overall Taxpayer Service Budget Reduction, Fiscal Years 2004 and 2005**

(Dollars in thousands)

	Fiscal Year 2004	Fiscal Year 2005	Change	
			Dollars	Percentage
Assistance	\$1,828,373	\$1,829,189	\$817	0.0%
Outreach	544,146	500,329	-43,817	-8.1
Processing	1,337,128	1,276,459	-60,669	-4.5
<b>Total</b>	<b>\$3,709,647</b>	<b>\$3,605,977</b>	<b>-\$103,670</b>	<b>-2.8%</b>

Source: GAO analysis of IRS data.

<sup>1</sup>IRS presented its fiscal year 2006 taxpayer service budget in the proposed format of Assistance, Outreach, and Processing. However, it is unlikely that Congress will approve this new budget structure. We were unable to obtain information within the old structure in the time available for this audit, so the information is presented in the new proposed format. However, the impact of the budget reduction on taxpayer service remains unchanged.

*Direct Costs.* About \$18 million of the \$103 million budget reduction shown in table 4 was a reduction in direct costs and these reductions did have some impact on taxpayer service, primarily telephone service.

*Support Costs.* Most of the \$103 million reduction, about \$85 million, was in support costs. Support costs are composed of both indirect costs and overhead costs such as rent, management, information services, legal services, and security. According to IRS officials, while large, this reduction did not impact taxpayer service because the services are not directly related to the funding of IRS programs.

We examined those budget adjustments that we believed could have significantly affected the filing season activities we review annually. We found the following:

- *Tax return processing.* Processing received a slight overall budget reduction of direct funds of \$7.6 million, about 1 percent, in fiscal year 2005. In particular, Submission Processing received a direct reduction of \$11 million. IRS absorbed this reduction by allowing some management contracts to expire because they were no longer needed due to the consolidation of paper processing operations. Additionally, the Electronic Tax Administration, which is responsible for advertising electronic filing, received a marketing budget reduction of approximately \$7.6 million (40 percent) for the 2005 filing season. In spite of the budget reduction, the number of tax returns filed electronically increased 11 percent from 2004. However, IRS officials are becoming increasingly concerned about the potential impact of future reduction on their ability to increase electronic filing.
- *Telephone services.* Perhaps the most significant impact of the budget reduction was in the area of telephone services. According to IRS officials, IRS's telephone services received a direct budget reduction of \$5 million. As a result, taxpayers' ability to talk to a customer service representative (CSR) was more limited than the year before, their wait time increased, and more taxpayers hung up before speaking with a CSR.
- *Walk-in & volunteer sites.* IRS's budget for walk-in sites remained stable, and due to congressional concerns, plans to close some walk-in sites in 2006 are on hold. For its volunteer sites, IRS shifted resources from taxpayer service to enforcement, resulting in an overall reduction in the Stakeholder Partnership, Education, and Communication (SPEC)

budget of about \$3 million. SPEC absorbed approximately \$2 million of the budget reduction by implementing a voluntary reassignment program that allowed 28 SPEC staff, including 10 front-line managers, to transfer to enforcement work. Although SPEC had planned to reorganize its field management structure for the 2006 filing season as a result of changes made in 2005, as with the walk-in sites, it no longer plans to do so. Also, IRS officials stated that future budget reductions could impede sustainable growth and negatively impact taxpayer service in the future because their model of leveraging resources relies on partnerships and networking opportunities.

- *Web site.* Web Services, which oversees IRS's Web site, received an overall budget reduction of approximately \$4 million (10 percent) in 2005. As a result, Web Services reduced some contract services. Officials believe that because Web site use has increased annually, its budget should grow to keep pace with the increase. However, they expressed concern that future reductions could negatively impact the Web site's performance.

# Comments from the Internal Revenue Service



COMMISSIONER

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

November 4, 2005

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

Dear Mr. White:

I have reviewed your draft report entitled "TAX ADMINISTRATION: IRS Improved Some Filing Season Services, but Long-Term Goals Would Help Manage Strategic Trade Offs," and I appreciate your recognition of our success this year; the 2005 filing season was one of our most successful ever. We were able to balance our resources to better focus on both service and enforcement, and we were able to provide solid customer assistance through detailed planning, improved operational efficiency, and the dedication of our managers and employees. We recognize there is always room for improvement and thus will continue to dedicate our efforts to providing more accurate, timely, and professional customer service.

Following are our additional comments concerning specific aspects of the filing season:

#### Telephone Service

Our 2005 efforts focused on improving efficiency to save resources with as little impact to levels of service (LOS) as possible. For example, in our efforts to ensure a LOS of 82 percent, we increased staffing schedule accuracy, allowing sites to staff, by half hour, to meet anticipated demand. Having the right skills in the right place at the right time has minimized our wait time and optimized available resources. More accurate staffing schedules have also kept Customer Service Representatives (CSRs) working at optimal capacity. Through mid-July 2005, assistor availability (the percentage of a CSR's time spent waiting for calls) was 5.9 percent, compared to 10.4 percent for the same period in Fiscal Year (FY) 2004. The lower availability is indicative of our more efficient use of available resources. Moreover, notwithstanding the slightly lower LOS in this filing season, we were pleased to maintain our high level of customer satisfaction scores on our telephone service.

This year we also improved the accuracy of our tax law and account answers on the IRS Toll-Free telephone lines. Recognizing that the Probe & Response Guide (P&RG) is a major driver behind improving tax law accuracy, we significantly revised the guide for 2005. We solicited extensive front-line employee input and conducted field validations, which resulted in a more user-friendly and interactive P&RG. We ensured

consistent implementation of the revised P&RG by delivering topic-specific training to all employees and their managers responsible for responding to tax law inquiries.

As a result of these efforts, through August 2005, we achieved a Toll-Free Tax Law accuracy rate of 88.9 percent, marking the highest tax law accuracy the Service has ever achieved and surpassing our goal of 82 percent by 6.9 percentage points. Our accuracy on taxpayer accounts inquiries also improved. Through August 2005, the Toll-Free Accounts accuracy rate was 91.5 percent, which is 1.7 percentage points greater than our FY 2005 goal, and 2.2 percentage points above what we achieved in 2004. Accuracy gains can also be attributed to our improved quality review process, which employs Contact Recording to allow managers to listen to and/or review recorded customer contacts, and provide more complete feedback to employees.

#### Tax Return Processing

We continued to meet or exceed performance goals for returns processing activities, as we have done each year since 2001. Through September 30, we processed over 130 million income tax returns and issued over \$210 billion in refunds to our customers. At the same time, we successfully implemented several significant tax law changes resulting from the Medicare Prescription Drug Improvement and Modernization Act of 2003, the Working Families Tax Relief Act of 2004, and the American Jobs Creation Act of 2004.

Finally, the IRS achieved a major modernization milestone with the initial roll-out of the Customer Account Data Engine (CADE) in 2005. CADE successfully processed over 1.4 million returns and shortened the time for issuing refunds by approximately 50 percent. The successful implementation of this new technology has paved the way for expanding CADE's scope to include more complex returns as we move forward with our modernization effort.

#### Electronic Filing and Internet Services

We are pleased your report recognizes our key accomplishments in electronic filing. The following are highlights of our 2005 accomplishments:

- As of October 5, 2005, over 68 million taxpayers filed electronically, surpassing the 61 million who did so last year and resulting in more accurate returns and faster processing. For the first time, individuals who filed their returns on paper were in the minority. More than 47.6 million of the returns filed in 2005 were filed by electronic return originators.
- Home computer e-filing continued to increase as taxpayers filed more than 17 million returns from their home computers, a 17 percent increase over last year. Over 5.1 million taxpayers used free online filing services offered by the Free File Alliance, a 46 percent increase over last year.

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- Over 51.5 million taxpayers signed their returns electronically using one of our three Personalized Identification Number options.
- The IRS website, IRS.gov, is consistently one of the most heavily visited government sites. So far in 2005, there have been more than 174 million total visits resulting in more than 1.2 billion page views. The number of page views is a 34 percent increase from 2004 and the total visits in 2005 is 15 percent higher than 2004.

More than 125 million forms, publications, instructions, and other documents were downloaded from IRS.gov in 2005.

As stated in your report, we agree that state electronic filing mandates have significantly contributed to an overall increase in the electronic filing of Federal returns. To that end, we will continue to inform states of the benefits of electronic filing and we will encourage them to implement policies that promote electronic filing.

#### Taxpayer Assistance Centers (Walk-In Service)

Your report states the IRS lacks reliable data on the quality of the services we provide at walk-in sites due to the manner in which we collect this data, which relies upon managers' observations of employee interactions with taxpayers. You raise concerns that employees' performance could be influenced by the knowledge they are being observed by managers, biasing the sample results. We agree this method of data collection has limitations and we will not base critical measures on managers' direct observations.

We requested that the Treasury Inspector General for Tax Administration (TIGTA) continue anonymous shopping at our Taxpayer Assistance Centers (TAC) until Field Assistance's (FA) Embedded Quality Business Integration (EQBI) system is refined. We are optimistic that full implementation of EQBI, along with Contact Recording, will provide FA managers the means to consistently evaluate employees' performance.

You also stated we lack complete data on the kind of services walk-in sites should offer. Your report cites TIGTA findings that indicate the IRS has limited information on the exact numbers and types of services provided at our walk-in sites, as well as the kind of face-to-face service taxpayers need or want. We use various methods to ensure services offered in TACs are those most needed by our customers. For example, we use results from our customer satisfaction survey, and we solicit feedback from

stakeholders, practitioners, Congressional liaisons, and others to ensure the TACs continue to provide timely, accurate, and professional services.

Volunteer Return Preparation

Another driver behind our successful filing season is our community-based coalitions and partners. Through September 3, 2005, over 2.1 million returns were filed through Volunteer Income Tax Assistance (VITA) and Tax Counseling for the Elderly (TCE) sites, a 9.1 percent increase over 2004. Other achievements include:

- Over 299 million outreach contacts, including more than 214 million through media channels (television, radio, newspaper, etc.), and 84 million through non-media channels (seminars, etc.).
- Increased outreach to underserved segments of the population (low-income, elderly, disabled, and Limited English Proficient) by expanding community-based coalitions from 265 in 2004 to over 290 in FY 2005.
- Increased electronic filing (of the 2.1 million volunteer-prepared returns filed in FY 2005, 77.7 percent e-filed).

In 2005 SPEC established and implemented a number of initiatives and processes that resulted in significant improvements to the VITA Program. We believe these improvements are commensurate with SPEC's increased ability to oversee and monitor the VITA Program, as well as SPEC's increased focus on quality. This includes requiring all VITA volunteers, regardless of their professional background and experience, to pass a tax law examination and sign a Standards of Conduct Volunteer Return Preparation Program (Form 13615). Additional improvements include providing enhanced training and tax reference materials, developing a multi-year quality business plan, and upgrading SPEC's management information system.

In August 2005, the IRS was recognized for its community-based partnerships that link low-income taxpayers with organizations that prepare tax returns for free, ensure they properly receive tax credits, and assist them in ways to build financial savings. SPEC received the Connect America Partner of the Year Award that is presented each year by the Points of Light Foundation & Volunteer Center National Network. The IRS is the first Federal agency to receive the award.

Finally, as cited in your report, observation reviews were discontinued during the 2005 filing season due to concerns over potential adverse taxpayer reaction to the presence of IRS employees during the return preparation process. As a result of these concerns, we will not include observation reviews for SPEC quality assurance in 2006. However, SPEC will continue to work with its partners to achieve and sustain quality service and accuracy.

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However, until our quality processes are refined, we have requested TIGTA continue anonymous shopping at our volunteer sites.

Hurricanes Katrina and Rita

We appreciate your recognition of our numerous and continuing efforts in response to the Hurricane Katrina disaster. The IRS has played a significant role in supporting relief efforts by converting four IRS call sites (Atlanta, Buffalo, Dallas, and Philadelphia) to Federal Emergency Management Agency (FEMA) call sites. Since we began assisting FEMA on September 2nd, we have answered over 786,000 disaster-related calls.

As noted in your report, IRS has taken steps to minimize any disruption of service due to Hurricanes Katrina and Rita during the 2006 filing season; and we are in the process of assessing the overall impact to taxpayers.

Long-Term Goals

The IRS has initiated efforts to develop long-term, outcome-oriented goals to directly support the IRS mission. All of the Operating Divisions have provided substantive input, feedback, and support to these efforts. While the IRS has not yet finalized the Service-wide long-term goals, we anticipate their approval in the future.

Responses to your specific recommendations are enclosed. I appreciate your observations on the successful filing season for 2005 and if you have any questions, please contact me or Floyd Williams, Director, Legislative Affairs, at (202) 622-3720.

Sincerely,



Mark W. Everson

Enclosure

Enclosure

Recommendation for the Commissioner

Develop better information about the costs to tax practitioners and taxpayers of mandatory electronic filing of tax returns for certain categories of tax practitioners.

Response

The IRS will initiate a study to analyze the relationship of state-mandated electronic filing requirements to the federal electronic filing rate. We will also collect information on the cost and burdens of electronic filing for the practitioner community and taxpayers. Understanding the impact of state-mandated electronic filing and the cost incurred by practitioners and taxpayers of electronic filing will better prepare the IRS to meet its long-term electronic filing goals.

Recommendation for the Commissioner

Establish a schedule for developing its long-term goals.

Response

The IRS has initiated efforts to develop long-term, outcome-oriented goals that are consistent with the IRS' Strategic Plan and directly support the IRS mission. All of the Operating Divisions, including Wage and Investment, have provided substantive input, feedback, and support to these efforts. The IRS is currently identifying the key components for the set of enterprise long term goals, and by the end of calendar year 2005 we will establish a schedule for the development of these goals.

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