



*Taxpayer Service Savings Estimates for  
Fiscal Years 2006 and 2007 Could Not Be  
Validated*

**August 13, 2007**

**Reference Number: 2007-40-125**

This report has cleared the Treasury Inspector General for Tax Administration disclosure review process and information determined to be restricted from public release has been redacted from this document.

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TREASURY INSPECTOR GENERAL  
FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY  
WASHINGTON, D.C. 20220

August 13, 2007

**MEMORANDUM FOR** COMMISSIONER, WAGE AND INVESTMENT DIVISION

**FROM:**

*Michael R. Phillips*  
Michael R. Phillips  
Deputy Inspector General for Audit

**SUBJECT:**

Final Audit Report – Taxpayer Service Savings Estimates for Fiscal Years 2006 and 2007 Could Not Be Validated (Audit # 200640034)

This report presents the results of our review to determine whether the Internal Revenue Service (IRS) Wage and Investment (W&I) Division accurately accounted for its estimated Taxpayer Service cost savings and program efficiency initiatives for Fiscal Years 2006 and 2007 and achievements for Fiscal Year 2006. This audit was included in our Fiscal Year 2007 Annual Audit Plan.

*Impact on the Taxpayer*

The IRS estimated it would achieve more than \$160 million in Taxpayer Service savings from various reengineering and improvement projects and program efficiency initiatives to support the decrease in funding for Taxpayer Service in Fiscal Years 2006 and 2007. Neither the estimates nor the achievements could be validated. When budget savings are estimated without an adequate analysis of the effect on the level of taxpayer service, the resulting budgets may not provide the resources needed to provide sufficient service. This can also affect other IRS operations because funds must be later shifted between programs to meet operational requirements.

*Synopsis*

The W&I Division is responsible for serving individual taxpayers whose main sources of income are wages and investment income reported by third parties. Approximately 87 percent of the IRS' Taxpayer Service budget is allocated to this Division.



## *Taxpayer Service Savings Estimates for Fiscal Years 2006 and 2007 Could Not Be Validated*

To support decreases in funding for Fiscal Years 2006 and 2007, the W&I Division estimated it would achieve approximately \$122 million and \$47 million in Taxpayer Service savings,

**Figure 1: Results of Validating the Taxpayer Service Savings**

Fiscal Year and Initiative	Estimated Savings	Estimated Savings Validated
<b>Fiscal Year 2006</b>		
Electronic Filing	\$7,700,000	\$7,437,837
Taxpayer Service Reengineering	114,103,000	22,437,929
<b>Total for Fiscal Year 2006</b>	<b>\$121,803,000</b>	<b>\$29,875,766</b>
<b>Percentage Validated</b>		25%
<b>Fiscal Year 2007</b>		
Electronic Filing	\$6,760,000	\$6,490,634
Improvement Projects	8,215,000	9,417,218
Taxpayer Service Program Efficiencies	32,200,000	3,246,367
<b>Total for Fiscal Year 2007</b>	<b>\$47,175,000</b>	<b>\$19,154,219</b>
<b>Percentage Validated</b>		41%

*Source: IRS Fiscal Year 2006 and 2007 Congressional Justifications and Treasury Inspector General for Tax Administration analyses.*

respectively. Figure 1 shows details of those estimates. For the most part, the methodologies for calculating the Taxpayer Service savings estimates for the approximately \$14 million Electronic Filing Initiatives and the \$8 million Improvement Projects were documented. These savings were based on business cases, and the IRS had maintained the records used to build the business cases and estimates. However, the savings estimates for the approximately \$114 million Taxpayer Service Reengineering<sup>1</sup> and \$32 million Taxpayer Service Program Efficiencies Initiatives were generally not supported and could not be validated.

For the savings that could not be validated, the W&I Division had not adequately documented the methodologies used to calculate the savings. Source documentation had not been created or maintained, or not all data provided were accurate or the most current available, and some of the data were based on estimates and projections instead of actual data currently available. In addition, the W&I Division Strategy and Finance Office relied on other division offices and functions to provide the documentation.

The lack of validation happened for many reasons, including the length and complexity of the budget process itself and not having a cost accounting system that can adequately capture costs at the activity or program level. In addition, the various components of the savings were calculated by different W&I Division offices and functions using different methods and rates. Finally, the data were not subjected to a quality review process.

Most of the \$122 million Taxpayer Service savings estimated for Fiscal Year 2006 were not achieved or could not be validated. The W&I Division financial records system showed adjustments for the almost \$110 million savings estimated and allocated to the various W&I Division financial plans. Eventually, most of the funds were internally reallocated because legislation prohibited the IRS from taking certain actions, projects were cancelled or delayed,

<sup>1</sup> The Taxpayer Service Reengineering savings amount includes an allocation of \$20 million for the Taxpayer Education and Communication Realignment and the Small Business/Self-Employed Division. This amount was not included in our review.



## *Taxpayer Service Savings Estimates for Fiscal Years 2006 and 2007 Could Not Be Validated*

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and savings did not materialize. The lack of sufficient management information and financial systems that capture activity costs hinders the W&I Division's ability to determine whether it is meeting its performance goals.

### *Recommendations*

We recommended the Commissioner, W&I Division, (1) develop a thorough process for compiling the data used for the IRS' budget requests to help ensure the accuracy of the estimates and to facilitate a better understanding of the impact of budget reductions on operations and (2) evaluate the extent to which estimated savings are achieved as well as the impact on IRS operations of savings that are not achieved, to assist in formulating future budget submissions and allocations.

### *Response*

IRS management agreed with both of our recommendations. They agreed many facets of the budget estimating process can be improved and will incorporate our suggestions for standardization and quality control into the W&I Division Strategy and Finance Office process. Management's complete response to the draft report is included as Appendix V.

Please contact me at (202) 622-6510 if you have questions or Michael E. McKenney, Assistant Inspector General for Audit (Wage and Investment Income Programs), at (202) 622-5916.



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*Taxpayer Service Savings Estimates for  
Fiscal Years 2006 and 2007 Could Not Be Validated*

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*Table of Contents*

**Background** .....Page 1

**Results of Review** .....Page 4

    Most Estimates for Fiscal Years 2006 and 2007  
    Taxpayer Service Savings and Program Efficiency  
    Initiatives Could Not Be Validated.....Page 4

Recommendation 1: .....Page 13

    Estimated Fiscal Year 2006 Taxpayer Service Savings  
    Were Not Achieved or Could Not Be Validated .....Page 13

Recommendation 2:.....Page 15

**Appendices**

    Appendix I – Detailed Objective, Scope, and Methodology .....Page 16

    Appendix II – Major Contributors to This Report .....Page 18

    Appendix III – Report Distribution List .....Page 19

    Appendix IV – Outcome Measure .....Page 20

    Appendix V – Management’s Response to the Draft Report .....Page 21



*Taxpayer Service Savings Estimates for  
Fiscal Years 2006 and 2007 Could Not Be Validated*

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*Abbreviations*

<i>e-file</i>	Electronic File
FTE	Full-Time Equivalent
IRS	Internal Revenue Service
W&I Division; Division	Wage and Investment Division



*Taxpayer Service Savings Estimates for  
Fiscal Years 2006 and 2007 Could Not Be Validated*

## *Background*

In February each year, the Internal Revenue Service (IRS) submits its budget request to Congress to support its 5-year strategic plan. The current strategic plan guides the IRS' operations from October 1, 2004, through September 30, 2009, and underscores its commitment to provide quality service to taxpayers and enforce America's tax laws in a balanced manner. The first theme of the strategic plan is to Improve Taxpayer Service. Figure 1 shows the IRS budget requests for Fiscal Years 2006 and 2007 and what funds and savings were directed or attributed to Taxpayer Service.

**Figure 1: Taxpayer Service Budget Requests**

<b>Fiscal Year 2006</b>	<b>Fiscal Year 2007</b>
<p><b><u>Overall Budget:</u></b> The IRS requested \$10.679 billion; the enacted budget was \$10.573 billion.</p>	<p><b><u>Overall Budget:</u></b> The IRS requested \$10.591 billion; the enacted budget was \$10.539 billion.</p>
<p><b><u>Taxpayer Service Budget:</u></b> The IRS directed \$3.567 billion to Taxpayer Service (a 1.1 percent decrease from its Fiscal Year 2005 enacted budget).</p>	<p><b><u>Taxpayer Service Budget:</u></b> The IRS directed \$3.583 billion to Taxpayer Service (a 0.4 percent increase from its Fiscal Year 2006 enacted budget).</p>
<p><b><u>Estimated Savings:</u></b> Estimated Taxpayer Service savings included the following:</p> <ul style="list-style-type: none"><li>• Taxpayer Service Reengineering – \$134,103,000.<sup>1</sup></li><li>• Increased Individual Master File<sup>2</sup> Electronic Filing – \$7,700,000.</li></ul>	<p><b><u>Estimated Savings:</u></b> Estimated Taxpayer Service savings included the following:</p> <ul style="list-style-type: none"><li>• Increased Individual Master File Electronic Filing – \$6,760,000.</li><li>• Improvement Projects Savings – \$7,553,000.</li><li>• Program Efficiencies – \$32,200,000.</li></ul>

*Source: Fiscal Year 2006 Internal Revenue Service Congressional Justification, dated February 7, 2005; Internal Revenue Service Fiscal Year 2007 Congressional Budget Submission, dated February 6, 2006; and the Corporate Performance Budgeting office.*

<sup>1</sup> The \$134,103,000 in Taxpayer Service Reengineering savings includes an allocation of \$20 million for the Taxpayer Education and Communication Realignment and the Small Business/Self-Employed Division. This amount was not included in our review.

<sup>2</sup> The IRS database that maintains transactions or records of individual tax accounts.



*Taxpayer Service Savings Estimates for  
Fiscal Years 2006 and 2007 Could Not Be Validated*

IRS business units and divisions are each responsible for creating and submitting their annual organizational budget requests to the IRS Chief Financial Officer. The Wage and Investment Division (hereafter referred to as the W&I Division or Division) is responsible for serving individual taxpayers whose main sources of income are wages and investment income reported by third parties. Approximately 87 percent of the IRS' Taxpayer Service budget is allocated to this Division.

During the budget cycle, which spans 2 years, budget requests move from initiation at the operating units and divisions to the IRS Chief Financial Officer, the Department of the Treasury, and the Office of Management and Budget before submission to Congress. During this time, negotiations take place in which budget amounts are revised because of differing priorities and funding levels. Figure 2 presents a simplified list of steps taken during the Fiscal Year 2006 budget cycle.

**Figure 2: Fiscal Year 2006 Budget Cycle**

<b>Date</b>	<b>Action</b>
November 2003	The W&I Division began its research and planning for the Fiscal Year 2006 budget.
February 2004	The business operating divisions submitted budget initiatives to the Chief Financial Officer.
June 2004	The Commissioner submitted the IRS' Fiscal Year 2006 budget to the Department of the Treasury.
July 2004	The Department of the Treasury reviewed the IRS' budget submission and provided feedback and recommendations.
September 2004	The Department of the Treasury finalized its overall budget request and submitted it to the President and the Office of Management and Budget.
December 2004	The Office of Management and Budget reviewed the IRS' budget submission with the Department of the Treasury and the IRS. The Office of Management and Budget advised the IRS of adjustments to its budget request.
February 2005	The IRS submitted its revised formal budget request to Congress.
November 2005	The budget was enacted. The IRS adjusted its budget for any differences in what was submitted and enacted.

*Source: IRS, Department of the Treasury, and Office of Management and Budget documents.*

From this process, the IRS determines its final operating budgets and makes adjustments to the related bookkeeping accounts for any differences in what was requested and enacted.

Based upon budget guidance from the Office of Management and Budget during the Fiscal Year 2006 budget negotiation process, the IRS reduced its request for Taxpayer Service funding



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*Taxpayer Service Savings Estimates for  
Fiscal Years 2006 and 2007 Could Not Be Validated*

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by approximately \$134 million. To help reach the \$134 million savings in Taxpayer Service, the IRS decided on a number of cost-reduction strategies, including the closure of some Taxpayer Assistance Centers<sup>3</sup> and the reduction of toll-free telephone operating hours.

Due to concerns raised by the National Treasury Employees Union and the National Taxpayer Advocate over the proposed closing of several Taxpayer Assistance Centers nationwide, Congress enacted legislation on November 30, 2005,<sup>4</sup> restricting the IRS from reducing taxpayer services until the Treasury Inspector General for Tax Administration had completed a study of the proposed changes. Congress further defined a reduction of taxpayer services to include limiting available hours of telephone taxpayer assistance on a daily, weekly, and monthly basis to those levels in existence during October 2005.<sup>5</sup>

After reviewing the plans and supporting data, we reported that not all data used were accurate or the most current available and some of the data were based on estimates and projections instead of actual data currently available.<sup>6</sup> We have also previously reported concerns that the IRS does not have effective management information systems to calculate costs and measure program achievements.<sup>7</sup>

This review was performed at the W&I Division Strategy and Finance office in Atlanta, Georgia, and the Corporate Performance Budgeting office of the Chief Financial Officer in Washington, D.C., during the period July 2006 through April 2007. Certain information needed to validate the data was not available. These matters are discussed in further detail in the Results of Review section. The audit was conducted in accordance with *Government Auditing Standards*. Detailed information on our audit objective, scope, and methodology is presented in Appendix I. Major contributors to the report are listed in Appendix II.

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<sup>3</sup> Taxpayer Assistance Centers are local IRS offices where taxpayers can obtain face-to-face assistance with tax matters.

<sup>4</sup> The Transportation, Treasury, Housing and Urban Development, the Judiciary, the District of Columbia, and Independent Agencies Appropriations Act, Pub. L. No. 109-115, 119 Stat. 2396 (2005).

<sup>5</sup> Department of Defense Appropriations Act, Pub. L. No. 109-148, 119 Stat. 2680 (2005).

<sup>6</sup> *The Taxpayer Assistance Center Closure Plan Was Based on Inaccurate Data* (Reference Number 2006-40-061, dated March 2006) and *The Savings Used to Recommend Reducing Toll-Free Telephone Hours of Operation Are Not As Significant As Projected* (Reference Number 2006-40-169, dated September 21, 2006).

<sup>7</sup> *The Effectiveness of the Taxpayer Assistance Center Program Cannot Be Measured* (Reference Number 2005-40-110, dated July 2005).



*Taxpayer Service Savings Estimates for  
Fiscal Years 2006 and 2007 Could Not Be Validated*

*Results of Review*

**Most Estimates for Fiscal Years 2006 and 2007 Taxpayer Service Savings and Program Efficiency Initiatives Could Not Be Validated**

The IRS was, for the most part, able to document its methodologies for the Taxpayer Service savings estimates for the approximately \$14 million Electronic Filing Initiative and the \$8 million Improvement Projects. These savings were based on business cases, and the IRS had maintained the records used to build the business cases and estimates. However, the savings estimates for the approximately \$114 million Taxpayer Service Reengineering and \$32 million Taxpayer Service Program Efficiencies were generally not supported and could not be validated. Figure 3 provides the results of our validation of the estimated Taxpayer Service savings for Fiscal Years 2006 and 2007.

**Figure 3: Results of Validating the Taxpayer Service Savings**

Fiscal Year and Initiative	Estimated Savings	Estimated Savings Validated
<b>Fiscal Year 2006</b>		
Electronic Filing	\$7,700,000	\$7,437,837
Taxpayer Service Reengineering	114,103,000	22,437,929
<b>Total for Fiscal Year 2006</b>	<b>\$121,803,000</b>	<b>\$29,875,766</b>
<b>Percentage Validated</b>		<b>25%</b>
<b>Fiscal Year 2007</b>		
Electronic Filing	\$6,760,000	\$6,490,634
Improvement Projects <sup>8</sup>	8,215,000	9,417,218
Taxpayer Service Program Efficiencies	32,200,000	3,246,367
<b>Total for Fiscal Year 2007</b>	<b>\$47,175,000</b>	<b>\$19,154,219</b>
<b>Percentage Validated</b>		<b>41%</b>

*Source: IRS Fiscal Year 2006 and 2007 Congressional Justifications and Treasury Inspector General for Tax Administration analyses.*

<sup>8</sup> The Improvement Projects savings amount includes an allocation of \$662,000 for the Contact Recording Project related to Enforcement. Because it was part of the business case, we included it in our results.



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*Taxpayer Service Savings Estimates for  
Fiscal Years 2006 and 2007 Could Not Be Validated*

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The four main components (Initiatives) of the Taxpayer Service savings validated are:

1. Electronic Filing for Fiscal Years 2006 and 2007 – These savings result from increased electronic filing and a reduction in the number of individual taxpayers' paper returns. Estimated electronic file (*e-file*) savings are based on the projected reduction in the number of paper returns processed each year, offset by the cost of processing *e-file* returns.
2. Taxpayer Service Reengineering for Fiscal Year 2006 – These savings were to be achieved through a variety of reforms including closing a number of Taxpayer Assistance Centers, reducing the toll-free telephone hours of operation, and increasing reliance on more efficient telephone and Internet service options.
3. Improvement Projects for Fiscal Year 2007 – These savings are to be from operational improvements generated by the Contact Recording, Queuing Management System, Correspondence Imaging System, and End-to-End Publishing improvement projects already in progress. Contact Recording enables managers at toll-free telephone sites and Taxpayer Assistance Centers to improve the quality of taxpayer assistance on incoming and outgoing telephone calls/interviews. Queuing Management is an online system available at Taxpayer Assistance Centers to facilitate workload and resource distribution for improved workflow and timeliness of service. The Correspondence Imaging System will allow customer service representatives to work from a stored image to streamline case resolution. End-to-End Publishing will provide technology solutions to streamline business processes associated with publishing and distribution.
4. Taxpayer Service Program Efficiencies for Fiscal Year 2007 – Taxpayer Service operations will be improved through a variety of efforts, including the judicious distribution of workload and the automation of certain taxpayer assistance functions such as the centralized monitoring of case inventories.

The various W&I Division functions and offices provided the specific savings and efficiencies to the Division Strategic Planning and Finance offices. However, not all the functions and offices could provide support for their respective portions of the allocated Taxpayer Service savings.

For the savings that could not be validated, the W&I Division had not adequately documented the methodologies used to calculate the savings. Source documentation had not been created or maintained, or not all data provided were accurate or the most current available, and some of the data were based on estimates and projections instead of actual data currently available. In addition, the Division Strategy and Finance Office did not maintain the supporting data but relied on the Division's other offices and functions to provide it.

The lack of validation happened for many reasons, including the length and complexity of the budget process itself and not having a cost accounting system that can adequately capture costs at the activity or program level. In addition, the various components of the savings were



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*Taxpayer Service Savings Estimates for  
Fiscal Years 2006 and 2007 Could Not Be Validated*

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calculated by different W&I Division functions and offices using different methods and rates. Finally, the data were not subjected to a quality review process.

To run and control its operations, an agency must have relevant, reliable, and timely data and communications relating to internal as well as external events. *Standards for Internal Control in the Federal Government*<sup>9</sup> require information to be recorded and communicated to management and others within the entity who need it and in a form and within a time period that enables them to carry out their internal control responsibilities. In addition, the risk increases that the IRS is using inaccurate data to support its budget request and cannot provide sound business cases for the budget decisions that are made.

**The Federal Government budget process is lengthy and complex**

When the budget process begins, the budget is prepared based on the IRS' 5-year strategic plan and the current priorities of the IRS, the Department of the Treasury, and the President. A year later, when the budget is submitted to the Office of Management and Budget, priorities and expected funding levels may change. Therefore, budget submissions have to be revised based on those changing priorities and funding levels.

IRS officials stated that much of the savings identified in the Fiscal Years 2006 and 2007 Congressional Justifications were created from the Office of Management and Budget guidance when the IRS and the W&I Division did not receive anticipated funding. In some cases, specific projects and initiatives were identified that were expected to produce savings during the 2 fiscal years. When these were not sufficient to produce the necessary savings, the IRS had to identify additional areas where it could reduce spending.

For example, the IRS reduced its request for Taxpayer Service funding by \$134 million based upon budget guidance from the Office of Management and Budget during the Fiscal Year 2006 budget negotiation process. The IRS allocated this amount among various Taxpayer Service activities, which occur primarily in the W&I Division.

The \$134 million is represented in the Congressional Justification with the following:

*IRS is working aggressively to improve productivity and achieve cost savings. Efforts such as expanded use of pay-for-performance incentives, legislative proposals to accelerate e-file growth, competitive sourcing, and reducing dependence on walk-in taxpayer service will save \$134,103 K [thousand] in taxpayer service programs in 2006.*

To reach the \$134 million, the W&I Division allocated the savings to its offices and functions and asked each to provide the information as to how it would produce the savings. Subsequently, the offices and functions provided the methods they would use to produce the savings.

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<sup>9</sup> GAO/AIMD-00-21.3.1, dated November 1999.



*Taxpayer Service Savings Estimates for  
Fiscal Years 2006 and 2007 Could Not Be Validated*

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The functions and offices had little time to determine how they would save money and operate with reduced funding. The IRS generally could document the methodologies it used to produce the saving estimates for established projects and initiatives. On the other hand, when there were no established projects or initiatives, the IRS was unable to provide sufficient support to validate the savings estimates, even though the savings appeared to be targeted and/or specific.

W&I Division officials explained that little effort is made to document and support budget reductions. They believe it is not an efficient use of financial program resources and from a program perspective it is better to focus on effective budget execution. Notwithstanding, we believe the IRS' current process is not efficient. An organized method of compiling accurate data is needed, given the significance of its operations and the amount of resources needed to prepare and execute its budget. Documenting and supporting its savings estimates during the budget formulation process would help the IRS make adjustments to its budget requests because the methodologies and estimated figures would be readily available.

**Documents could not be located or had not been maintained**

The IRS was able to demonstrate how the Taxpayer Service savings were calculated and what specific amounts made up each of the four components. However, it could provide sufficient documentation for us to validate over \$22 million of the \$114 million of Fiscal Year 2006 Taxpayer Service Reengineering savings and over \$3 million of the \$32 million of Fiscal Year 2007 Taxpayer Service Program Efficiencies savings. Figure 4 provides a breakdown of the amounts that made up each of the four components: Electronic Filing, Taxpayer Service Reengineering, Improvement Projects, and Taxpayer Service Program Efficiencies.



*Taxpayer Service Savings Estimates for  
Fiscal Years 2006 and 2007 Could Not Be Validated*

**Figure 4: Components of the Taxpayer Service Savings**

Fiscal Year 2006	Estimated Savings	Estimated Savings Validated	Fiscal Year 2007	Estimated Savings	Estimated Savings Validated
<b>Electronic Filing</b>	\$7,700,000	\$7,437,837	<b>Electronic Filing</b>	\$6,760,000	\$6,490,634
<b>Taxpayer Service Reengineering</b>			<b>Improvement Projects</b>		
Accounts Management Paper Inventory Reduction	16,000,000	0	Contact Recording	\$4,716,000	\$6,341,657
Discontinue the TeleFile Program	5,000,000	0	Correspondence Imaging System	526,000	689,929
Internet Employee Identification Number	5,103,000	4,487,157	End-to-End Publishing Contracts	158,000	0
Media and Publications Printing and Postage	12,000,000	0	Queuing Management System	2,815,000	2,385,632
Service Center Recognition/Image Processing System	6,000,000	4,856,682	<b>Total Projects</b>	\$8,215,000	\$9,417,218
SPEC Publications	1,000,000	1,094,090	<b>Taxpayer Service Program Efficiencies</b>		
Submission Processing Productivity Gains	12,000,000	12,000,000	Individual Taxpayer Identification Number	\$3,100,000	\$3,246,367
Taxpayer Assistance Center Closures	44,000,000	0	Span of Control	13,700,000	0
Toll-Free Telephone Hours Reduction	13,000,000	0	Taxpayer Service Share of Telecom/Notice Issuance	15,400,000	0
<b>Total Reengineering</b>	\$114,103,000	\$22,437,929	<b>Total Efficiencies</b>	\$32,200,000	\$3,246,367
<b>Total Amounts for Fiscal Year 2006</b>	<b>\$121,803,000</b>	<b>\$29,875,766</b>	<b>Total Amounts for Fiscal Year 2007</b>	<b>\$47,175,000</b>	<b>\$19,154,219</b>
<b>Percentage for Fiscal Year 2006</b>		<b>25%</b>	<b>Percentage for Fiscal Year 2007</b>		<b>41%</b>

Source: IRS Fiscal Year 2006 and 2007 Congressional Justifications and Treasury Inspector General for Tax Administration analyses. SPEC=Stakeholder Partnerships, Education, and Communication.

Of the \$22 million Fiscal Year 2006 Taxpayer Service Reengineering savings estimates that were validated:

- The IRS provided business cases to support the savings estimates for the \$5 million Internet Employee Identification Number and the \$6 million Service Center Recognition/Image Processing System.
- The W&I Division provided support to show savings identified in the production product lines, program travel, and contracts for the \$1 million estimated Stakeholder Partnerships, Education, and Communication Publications savings.



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*Taxpayer Service Savings Estimates for  
Fiscal Years 2006 and 2007 Could Not Be Validated*

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- W&I Division officials stated \$12 million of the Taxpayer Service savings was allocated to the Submission Processing function when the Director, Submission Processing, stated the savings would be accomplished through productivity gains. No specific information was provided on how these efficiencies would achieve the \$12 million savings. However, a journal entry showed the function's reduced funding and documents were provided to show most of the savings were achieved.

The remaining Fiscal Year 2006 Taxpayer Service Reengineering savings estimates, for the most part, could not be validated.

- Accounts Management Paper Inventory Reduction – \$16 million estimated, \$0 validated. IRS officials stated documentation did not exist.
- Discontinue the TeleFile Program<sup>10</sup> – \$5 million estimated, \$0 validated.<sup>11</sup> The IRS could not provide documentation to show how it arrived at the estimated \$5 million in annual cost savings it hoped to realize as a result of eliminating the TeleFile Program. Without this documentation, we cannot be certain that all applicable factors were properly considered when computing the estimate. For example, the IRS stated it had considered the cost it would incur to mail paper income tax packages once the TeleFile Program ended. However, the IRS could not provide the cost figure nor the method used to compute that figure.
- Media and Publications Printing and Postage – \$12 million estimated, \$0 validated.<sup>12</sup> Specific print products were identified for reduction, along with the resulting decrease in postage costs. No documentation was provided to support these estimates.

The IRS was able to provide support for more than \$9 million in estimated savings for Fiscal Year 2007 Improvement Projects but could not provide information or support for most of the \$32 million of Fiscal Year 2007 Taxpayer Service Program Efficiencies. A business case was provided that supported about \$3 million in estimated savings for the Individual Taxpayer Identification Number improvement project. The remainder consisted of the following:

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<sup>10</sup> The TeleFile Program allowed taxpayers meeting certain criteria to file their tax returns using the keypads on their telephones.

<sup>11</sup> *Eliminating TeleFile Increased the Cost and Burden of Filing a Tax Return for Many Taxpayers* (Reference Number 2007-40-116, dated July 20, 2007).

<sup>12</sup> While documents supporting the Congressional Justification stated \$12 million would be saved in this function, IRS officials stated the amount was initially calculated at \$12.5 million based on \$11 million for printing and postage costs and \$1.5 million related to savings resulting from the National Distribution Center contract.



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*Taxpayer Service Savings Estimates for  
Fiscal Years 2006 and 2007 Could Not Be Validated*

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- Span of Control – Almost \$14 million in planned savings estimates was to be achieved through reducing management span of control across several operating divisions and support functions on a percentage basis.
- Taxpayer Service Share of Telecommunications Costs and Notice Issuance – More than \$15 million related to savings was to be shared across the W&I Division.

The Corporate Performance Budgeting office provided no documentation supporting the calculation for the span of control or telecommunications costs. Corporate Performance Budgeting office officials stated the savings of \$32 million were generally budget adjustments allocated to the various W&I Division functions. They stated they were involved in preparing the Fiscal Year 2008 budget submission and did not have the resources to respond to requests for documents and assistance in validating historical budget figures.

**Data used were not always accurate, consistent, or current**

While we generally validated the estimated savings related to the improvement projects by accepting many of the IRS assumptions used to calculate the estimated savings, the W&I Division does not have a consistent methodology for calculating project savings. For example, calculations for Full-Time Equivalents (FTE)<sup>13</sup> to dollars and number of FTEs saved were used inconsistently.

Project savings were generally calculated by identifying the number of FTEs to be saved and used to calculate the dollar savings. However, the methods used to calculate the FTE dollars were inconsistent. For example, dollar amounts were calculated based on (1) the General Schedule average pay grade, (2) an average labor cost per hour per processing function, or (3) use of a unit cost rate macro provided by the Office of the Chief Financial Officer.

***The methods used to calculate  
the FTE dollars were  
inconsistent.***

Labor rates were also calculated differently by the various program offices. One project used a flat \$45,000 salary rate based on the project manager's knowledge of the "typical" employee working on the project. Another project calculated the percentage of indirect hours to direct hours and applied the percentage to the total direct hours used to calculate the volume of FTEs saved.

Other inconsistencies involved the estimates of the number of FTEs that could be saved. The business cases cited one estimate, the estimates were reduced for the budget, and then the actual amount saved was a different amount.

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<sup>13</sup> An FTE is a measure of labor hours. One FTE is equal to 8 hours multiplied by the number of compensable days in a particular fiscal year.



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*Taxpayer Service Savings Estimates for  
Fiscal Years 2006 and 2007 Could Not Be Validated*

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- The savings calculations for 1 project identified 227 FTEs could be saved after the project was implemented, but the business case and budget savings only included 111 FTEs saved.
- Another project's business case calculations identified 39 FTEs could be saved but reported only 35 FTEs saved based on an accounting error in the Fiscal Year 2003 budget.

Without fully costing out the labor associated with an FTE on a project or artificially reducing the FTEs reported, the project's costs and savings are inaccurate.

In addition, we reported in January 2007 that IRS business cases used to manage and fund specific information technology investments were inaccurate and unreliable.<sup>14</sup> IRS business case inaccuracies distort the true life cycle costs of information technology investments and present a false depiction of the IRS' information technology portfolio, resulting in potential waste and mismanagement of taxpayer dollars. Senior IRS executives and officials from the Department of the Treasury and Office of Management and Budget still cannot rely on the data in IRS business cases to manage and fund IRS projects.

Separate audits were conducted to validate the Toll-Free Telephone Hours Reduction and Taxpayer Assistance Center Closures:

- Toll-Free Telephone Hours Reduction<sup>15</sup> – The IRS used the most current data available at the time the original analysis was performed and estimated savings of approximately \$18 million for Fiscal Year 2004. Using Fiscal Year 2005 data, the most current complete data available at the time of the review, the savings potential would be considerably less, approximately \$914,000 or 20 FTEs. In addition, there were minor errors in the Fiscal Year 2004 calculations, and the estimated savings were not recalculated when Fiscal Year 2005 data became available. The IRS could not provide adequate documentation to support its decision to reduce hours. Therefore, we could not duplicate or validate many of the assumptions used. In addition, some of the documentation provided contained minor errors.
- Taxpayer Assistance Center Closures<sup>16</sup> – Testing identified that not all data used were accurate or the most current available, and some of the data were based on estimates and projections instead of actual data currently available. Estimates of facilities costs and employee costs were used rather than actual data. The estimates caused the final

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<sup>14</sup> *Business Cases for Information Technology Projects Remain Inaccurate* (Reference Number 2007-20-024, dated January 25, 2007).

<sup>15</sup> *The Savings Used to Recommend Reducing Toll-Free Telephone Hours of Operation Are Not As Significant As Projected* (Reference Number 2006-40-169, dated September 21, 2006).

<sup>16</sup> *The Taxpayer Assistance Center Closure Plan Was Based on Inaccurate Data* (Reference Number 2006-40-061, dated March 22, 2006).



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*Taxpayer Service Savings Estimates for  
Fiscal Years 2006 and 2007 Could Not Be Validated*

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projected savings to be inaccurate. Data discrepancies ultimately affected the ranking and overall selection of Taxpayer Assistance Centers for closure. When we reran the Model for the 60 selected Taxpayer Assistance Centers, the overall scores for each of the 60 Taxpayer Assistance Centers changed.

In addition, source documents allowed us to recalculate and validate the *e-file* savings estimated at \$7.7 million for Fiscal Year 2006 and \$6.76 million for Fiscal Year 2007. While we generally were able to validate the estimated savings by tracing the amounts used to source documentation, eliminating the TeleFile Program reduced the actual savings achieved by *e-file* because almost one-half of the taxpayers who could no longer use TeleFile to submit their tax returns reverted to filing their tax returns on paper. This reduced the *e-file* volumes and increased the printing and postage required for preparing tax return forms as well as increased the amount of FTEs required to process the additional paper tax returns that were filed. Even though the IRS was aware that a percentage of taxpayers who had previously participated in the TeleFile Program would revert to filing their tax returns on paper, these costs were not offset against the estimated savings used for budgetary purposes.

The W&I Division Strategy and Finance Office has recognized the difference in cost estimation methods applied by the various functions. It is developing procedures for all improvement project business cases to ensure consistency.

**Data are not subjected to a quality review before they are used to support the budget**

Data are not reviewed or validated as the budget estimates are passed up from the various W&I Division functions and offices to the Strategy and Finance Office. IRS officials stated these numbers are just projections and estimates; therefore, validation is not required or necessary. They also stated it is not an efficient use of financial program resources to document estimated savings when money is not received.

Nevertheless, without review or validation, there is no assurance the IRS is using accurate data to support its annual budget request. The inability to document or explain how amounts are derived as a part of the budget process makes it difficult for the IRS to identify how these savings affect specific areas of Taxpayer Service. It also makes it more difficult for the IRS to provide a business case to oversight bodies to demonstrate why adjustments can or cannot be made. Finally, if budget estimates are not consistently and appropriately solicited, received, reviewed, and reported, the resulting budgets may not provide the resources needed to achieve organizational goals. As a result, shortages and overages can occur, causing the need to shift funds between programs to meet operational requirements.



*Taxpayer Service Savings Estimates for  
Fiscal Years 2006 and 2007 Could Not Be Validated*

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***Recommendation***

***Recommendation 1:*** The Commissioner, W&I Division, should develop a thorough process for compiling the data used for the IRS' budget requests to help ensure the accuracy of the estimates and to facilitate a better understanding of the impact of budget reductions on operations.

***Management's Response:*** IRS management agreed with this recommendation and will standardize the process for estimating and documenting budgetary savings estimates to include the implementation of a quality review component. A team consisting of representatives from W&I Division Headquarters Program and Finance staffs will be established to review budget estimates to assess accuracy, assure consistently applied estimate methodologies, and provide information on the impact of budget reductions on operations.

***Estimated Fiscal Year 2006 Taxpayer Service Savings Were Not Achieved or Could Not Be Validated***

Most of the approximately \$122 million Taxpayer Service savings estimated for Fiscal Year 2006 were not achieved or could not be validated. Figure 5 shows the results of validating Fiscal Year 2006 achieved savings.



*Taxpayer Service Savings Estimates for  
Fiscal Years 2006 and 2007 Could Not Be Validated*

**Figure 5: Results of Validating IRS Achieved Savings**

<b>Fiscal Year 2006</b>	<b>Estimated Savings</b>	<b>Achieved Savings Validated</b>
<b>Electronic Filing</b>	\$7,700,000	\$4,612,301
<b>Taxpayer Service Reengineering</b>		
Accounts Management Paper Inventory Reduction	\$16,000,000	\$0
Discontinue the TeleFile Program	5,000,000	0
Internet Employee Identification Number	5,103,000	5,215,328
Media and Publications Printing and Postage	12,000,000	6,857,714
Service Center Recognition/Image Processing System	6,000,000	0
Stakeholder Partnerships, Education, and Communication Publications	1,000,000	242,045
Submission Processing Productivity Gains	12,000,000	0
Taxpayer Assistance Center Closures	44,000,000	0
Toll-Free Telephone Hours Reduction	13,000,000	0
Total Reengineering	\$114,103,000	\$12,315,087
<b>Total Amounts for Fiscal Year 2006</b>	<b>\$121,803,000</b>	<b>\$16,927,388</b>

*Source: IRS Fiscal Year 2006 Congressional Justifications and Treasury Inspector General for Tax Administration analyses.*

The W&I Division financial records system showed adjustments for the almost \$110 million savings estimated and allocated to the various W&I Division financial plans. Eventually, most of the funds were internally reallocated because legislation prohibited the IRS from taking certain actions, projects were cancelled or delayed, and savings did not materialize.

By the time the budget is enacted 3 years after the first steps in the budget cycle are taken, adjustments, funding levels, and late legislation affect the final budget and budget execution. Expected or estimated expenses may not have occurred while unexpected expenses may have occurred. The estimated savings may or may not occur because improvement projects may have encountered delays or initiatives may have been postponed. In addition, budgeted dollars for a particular function or for a particular improvement project may be directed elsewhere to fund higher priority shortfalls.

For example, the IRS estimated it would save \$44 million by closing a number of Taxpayer Assistance Centers and \$13 million by reducing toll-free telephone hours of operation. Legislation prevented both of these actions. When we asked how the W&I Division dealt with this significant portion of unrealized savings, officials stated the funds were internally



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*Taxpayer Service Savings Estimates for  
Fiscal Years 2006 and 2007 Could Not Be Validated*

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reallocated to W&I Division budget accounts. However, IRS officials could not explain which programs or services in the Division or other business operating units absorbed the losses.

The IRS does not have a financial system designed to capture activity costs at the functional level. In addition, we have reported the IRS does not have effective management information systems and have identified inaccuracies used to estimate cost savings.<sup>17</sup> The Government Performance and Results Act of 1993 directs Federal Government agencies to focus on their missions and goals, how to achieve them, and how to improve their structural organizations and business processes.<sup>18</sup> Nonetheless, without an effective process for determining how its organizational structures or business processes can be improved to produce the estimated savings, the IRS risks having an adverse impact on operations, especially if funds must be later reprogrammed to offset unexpected shortfalls because the estimated savings were not achieved.

### ***Recommendation***

**Recommendation 2:** To assist in formulating future budget submissions and allocations, the Commissioner, W&I Division, should evaluate the extent to which estimated savings are achieved as well as the impact on IRS operations of savings that are not achieved.

**Management's Response:** IRS management agreed with this recommendation. The Chief Financial Officer is developing an IRS-wide process to document the achievement of savings identified in the Congressional Justification.

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<sup>17</sup>*The Effectiveness of the Taxpayer Assistance Center Program Cannot Be Measured* (Reference Number 2005-40-110, dated July 2005); *The Taxpayer Assistance Center Closure Plan Was Based on Inaccurate Data* (Reference Number 2006-40-061, dated March 2006); and *The Savings Used to Recommend Reducing Toll-Free Telephone Hours of Operation Are Not As Significant As Projected* (Reference Number 2006-40-169, dated September 21, 2006).

<sup>18</sup> Pub. L. No. 103-62, 107 Stat. 285 (codified as amended in sections of 5 U.S.C., 31 U.S.C., and 39 U.S.C.).



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*Taxpayer Service Savings Estimates for  
Fiscal Years 2006 and 2007 Could Not Be Validated*

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## **Appendix I**

### *Detailed Objective, Scope, and Methodology*

Our overall objective was to determine whether the IRS W&I Division accurately accounted for its estimated Taxpayer Service cost savings and program efficiency initiatives for Fiscal Years 2006 and 2007 and achievements for Fiscal Year 2006. Specifically, we validated the methodologies and calculations used to develop the savings and initiatives. To accomplish our objective, we:

- I. Determined the budget submission process used by the Associate Chief Financial Officer for Corporate Performance Budgeting to identify and calculate the cost savings and program efficiency initiatives.
  - A. Interviewed management in the Associate Chief Financial Officer for Corporate Performance Budgeting office to determine their roles and responsibilities in the process of identifying and developing the cost savings and program efficiency initiatives.
  - B. Obtained available documentation and data related to the development of the cost savings and program efficiency initiatives for Fiscal Years 2006 and 2007.
  - C. Determined how budget formulation adjustments are addressed based on the Department of the Treasury, Office of Management and Budget, and Congressional funding level changes.
- II. Determined the process used by the W&I Division Strategy and Finance Office to identify and calculate the Taxpayer Service cost savings and program efficiency initiatives.
  - A. Interviewed Division Strategy and Finance Office management to determine their roles and responsibilities in the process of identifying and developing the cost savings and program efficiency initiatives.
  - B. Interviewed Division operating unit analysts to determine the methodologies and calculations used to estimate cost savings and program efficiency initiatives.
  - C. Obtained all available documentation and data related to the development of the cost savings and program efficiency initiatives for Fiscal Years 2006 and 2007.
  - D. Determined whether cost savings calculations were verified or validated by a third party to ensure accuracy.



*Taxpayer Service Savings Estimates for  
Fiscal Years 2006 and 2007 Could Not Be Validated*

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- E. Evaluated methodologies and assumptions made to calculate the cost savings and program efficiency initiatives.
- III. Determined whether the W&I Division achieved planned Fiscal Year 2006 Taxpayer Service cost savings and program efficiency initiatives.
- A. Interviewed Division management to determine whether cost savings had been achieved and, if not, why.
  - B. Determined the process used by the Division to calculate Fiscal Year 2006 cost savings and program efficiency initiatives achieved.
  - C. Obtained documentation used to calculate achieved cost savings and program efficiency initiatives and to verify the accuracy of the calculations.
  - D. Determined the impact of Division estimated savings that were not achieved and where the savings were actually made.



*Taxpayer Service Savings Estimates for  
Fiscal Years 2006 and 2007 Could Not Be Validated*

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**Appendix II**

*Major Contributors to This Report*

Michael E. McKenney, Assistant Inspector General for Audit (Wage and Investment Income Programs)

Augusta R. Cook, Director

Paula W. Johnson, Audit Manager

Lynn Faulkner, Lead Auditor

Jack Forbus, Senior Auditor

Tracy Harper, Senior Auditor

Jean Bell, Auditor

Nelva Usher, Auditor



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*Taxpayer Service Savings Estimates for  
Fiscal Years 2006 and 2007 Could Not Be Validated*

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**Appendix III**

*Report Distribution List*

Acting Commissioner C  
Office of the Commissioner – Attn: Acting Chief of Staff C  
Deputy Commissioner for Operations Support OS  
Deputy Commissioner for Services and Enforcement SE  
Chief Financial Officer OS:CFO  
Deputy Commissioner, Wage and Investment Division SE:W  
Associate Chief Financial Officer for Corporate Performance Budgeting OS:CFO:CPB  
Director, Customer Account Services, Wage and Investment Division SE:W:CAS  
Director, Customer Assistance, Relationships, and Education, Wage and Investment Division  
SE:W:CAR  
Director, Strategy and Finance, Wage and Investment Division SE:W:S  
Chief, Performance Improvement, Wage and Investment Division SE:W:S:PI  
Chief Counsel CC  
National Taxpayer Advocate TA  
Director, Office of Legislative Affairs CL:LA  
Director, Office of Program Evaluation and Risk Analysis RAS:O  
Office of Internal Control OS:CFO:CPIC:IC  
Audit Liaisons:  
    Associate Chief Financial Officer for Corporate Performance Budgeting OS:CFO:CPB  
    Senior Operations Advisor, Wage and Investment Division SE:W:S



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*Taxpayer Service Savings Estimates for  
Fiscal Years 2006 and 2007 Could Not Be Validated*

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## **Appendix IV**

### *Outcome Measure*

This appendix presents detailed information on the measurable impact that our recommended corrective actions will have on tax administration. This benefit will be incorporated into our Semiannual Report to Congress.

#### **Type and Value of Outcome Measure:**

- Reliability of Information – Potential; \$91.9 million in Fiscal Year 2006 and \$28 million in Fiscal Year 2007 (see page 4).

#### **Methodology Used to Measure the Reported Benefit:**

The IRS submitted to Congress a Taxpayer Service savings of \$121.8 million for Fiscal Year 2006 and \$47.2 million for Fiscal Year 2007. Most of the actual savings were not achieved or could not be validated. Of the Fiscal Year 2006 \$121.8 million savings, \$29.9 million could be validated resulting in \$91.9 million in unachieved or unverifiable savings. Of the Fiscal Year 2007 \$47.2 million savings, \$19.2 million could be validated resulting in \$28 million in unverifiable savings.



*Taxpayer Service Savings Estimates for  
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**Appendix V**

*Management's Response to the Draft Report*



COMMISSIONER  
WAGE AND INVESTMENT DIVISION

DEPARTMENT OF THE TREASURY  
INTERNAL REVENUE SERVICE  
ATLANTA, GA 30308

July 6, 2007

RECEIVED  
JUL 11 2007

MEMORANDUM FOR MICHAEL R. PHILLIPS  
DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: Richard J. Morgante *Richard J. Morgante*  
Commissioner, Wage and Investment Division

SUBJECT: Draft Audit Report – Taxpayer Service Savings Estimates for  
Fiscal Years 2006 and 2007 Could Not Be Validated  
(Audit # 200640034)

I reviewed the draft report on fiscal year 2006 and 2007 taxpayer service savings and appreciate your observations regarding our planning for future year budgetary reductions. I also appreciate your acknowledgement of the complexity of the federal budget process and your recognition that the Wage and Investment (W&I) Division Strategy and Finance Office has also recognized some of the issues you raise in this report and have begun to address those concerns.

I agree that many facets of the budget estimating process can be improved. We will incorporate your suggestions for standardization and quality control into the portions of the process that are executed by W&I Division Strategy and Finance.

We agree with the Outcome Measures as stated in Appendix IV of your report. Our specific comments to the recommendations are attached. If you have any questions, please contact me at (404) 338-7060, or members of your staff may contact Julie Rushin, Director, Strategy and Finance, at (404) 338-8800.

Attachment



*Taxpayer Service Savings Estimates for  
Fiscal Years 2006 and 2007 Could Not Be Validated*

Attachment

**RECOMMENDATION 1**

The Commissioner, W&I Division, should develop a thorough process for compiling the data used for the IRS' budget requests to help ensure the accuracy of the estimates and to facilitate a better understanding of the impact of budget reductions on operations.

**CORRECTIVE ACTION**

We agree with this recommendation and will standardize the process for estimating and documenting budgetary savings estimates to include the implementation of a quality review component. A team consisting of representatives from W&I headquarters program and finance staffs will be established to review budget estimates to assess accuracy, assure consistently applied estimate methodologies, and provide information on the impact of budget reductions on operations.

**IMPLEMENTATION DATE**

October 15, 2007

**RESPONSIBLE OFFICIAL**

Director, Strategy and Finance, Wage and Investment Division

**CORRECTIVE ACTION MONITORING PLAN**

We will monitor this corrective action as part of our internal management control system.

**RECOMMENDATION 2**

To assist in formulating future budget submissions and allocations, the Commissioner, W&I Division, should evaluate the extent that estimated savings are achieved as well as the impact on IRS operations of savings that are not achieved.

**CORRECTIVE ACTION**

We agree with this recommendation. The Chief Financial Officer is developing an IRS-wide process to document the achievement of savings identified in the Congressional Justification.

**IMPLEMENTATION DATE**

October 15, 2007

**RESPONSIBLE OFFICIAL**

Director, Strategy and Finance, Wage and Investment Division

**CORRECTIVE ACTION MONITORING PLAN**

We will monitor this corrective action as part of our internal management control system.