



*Consolidation of Tax Return Processing Sites
Is Progressing Effectively, but Improved
Project Management Is Needed*

August 31, 2007

Reference Number: 2007-40-165

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.

Phone Number | 202-927-7037

Email Address | Bonnie.Heald@tigta.treas.gov

Web Site | <http://www.tigta.gov>



TREASURY INSPECTOR GENERAL
FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

August 31, 2007

MEMORANDUM FOR COMMISSIONER, WAGE AND INVESTMENT DIVISION

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

SUBJECT: Final Audit Report – Consolidation of Tax Return Processing Sites Is Progressing Effectively, but Improved Project Management Is Needed (Audit # 200640023)

This report presents the results of our review to determine whether the Individual Master File¹ Submission Processing site (hereafter referred to as Processing site or site) consolidation has been adequately planned and monitored and whether anticipated cost savings have been realized. This audit was included in our Fiscal Year 2007 Annual Audit Plan.

Impact on the Taxpayer

Formerly, the IRS used eight Processing sites to process individual income tax returns. Due to the decline in the number of paper returns and corresponding increase in electronic returns, the IRS is consolidating sites and directing taxpayers to file at the remaining sites to reduce costs and increase efficiency. IRS efforts to maintain high productivity and minimize the effect on taxpayers during the transition have generally been successful. However, the IRS has not adequately monitored the consolidation to measure the extent to which it is achieving its primary objective of cost savings.

Synopsis

The IRS initiated a consolidation of its Processing sites after completing a study in December 2000 to evaluate options for site closures. The increase in electronic filing and consequent decrease in paper return filing prompted the IRS study. While implementing its plan, the IRS has closely monitored the level of paper return filing to ultimately transition Processing sites to only three locations: Fresno, California; Kansas City, Missouri; and Austin, Texas.

¹ The IRS database that maintains transactions or records of individual tax accounts.



Consolidation of Tax Return Processing Sites Is Progressing Effectively, but Improved Project Management Is Needed

The IRS effort to transfer Processing site operations to fewer locations has been successful to date. The Brookhaven, New York, and Memphis, Tennessee, Processing Sites have been closed, and the Philadelphia, Pennsylvania, Processing Site is scheduled to close later this year. The IRS has maintained a high level of productivity and successfully processed individual income tax returns while implementing the consolidation. It has also conducted the consolidation effort with limited effect on taxpayers. During the consolidation, the IRS has taken steps to monitor operational aspects of and help employees affected by the consolidation find new positions. The IRS has indicated that it expects to save about \$68 million over 5 years from closing the Brookhaven Processing Site and more than \$39 million by 2010 from closing the Memphis Processing Site.

As the IRS moves forward with the consolidation, improvements are needed in setting financial goals and in updating and monitoring related costs and benefits. The business decision to consolidate sites was based on a qualitative plan that did not include a cost-benefit analysis. The IRS has the tools it needs to do such an analysis and has used these tools to prepare ad hoc reports on specific consolidation issues. Without financial goals related to the consolidation, the IRS has not had an incentive to determine how efficient its decisions have been or if it could be saving more.

As the IRS moves forward with the consolidation, improvements are needed in setting financial goals and in updating and monitoring related costs and benefits.

In addition to not including costs and benefits in an initial consolidation plan, the IRS has not adequately updated or monitored the costs and benefits that accrued as the plan was implemented. The IRS could not provide reliable information on technology costs related to the Brookhaven and Philadelphia Processing Site closures. In addition, it has not adequately monitored and updated financial information on the personnel costs of consolidations. The IRS has also included savings that are not attributable to site consolidation in some of its ad hoc analyses. To its credit, the IRS has developed a preliminary methodology to help address these problems and provide a consistent means of monitoring consolidation costs and benefits. Despite the inadequacies of the existing cost-benefit information, we believe the IRS will benefit in the future from the consolidation.

Recommendations

The Commissioner, Wage and Investment Division, should task the Project Management Office with regularly monitoring the consolidation plan and ensure key analysts receive training in cost-benefit analysis. The Project Management Office should also complete a cost-benefit analysis to determine if the existing plan is still optimal in terms of cost savings and operational effectiveness.



Consolidation of Tax Return Processing Sites Is Progressing Effectively, but Improved Project Management Is Needed

Response

IRS management agreed with our first recommendation and partially agreed with our second recommendation. The Wage and Investment Division Project Management Office will become officially responsible for monitoring and updating activities with regard to consolidation, and key analysts in the Project Management Office are scheduled to attend cost-benefit training.

Management recognized that some of the assumptions used to determine the existing plan may have changed; however, they did not agree to complete a cost-benefit analysis to determine if the existing plan is optimal or if alternatives need to be considered. Management stated the IRS is too far into the process to make changes either to the planned order of consolidation or to the three-site end-state configuration for processing of individual tax returns, and there was no evidence to suggest that the decisions made were incorrect. Management did agree, as an alternative, to conduct a formal cost analysis using its recently developed cost model to calculate the actual savings from the Philadelphia Processing Site consolidation and to calculate the expected savings from the Andover, Massachusetts, Processing Site consolidation. Management stated they would carry forward the lessons learned to maximize the potential savings to be achieved when the Atlanta, Georgia, Processing Site is consolidated, as projected, in 2011. Management believes these actions will significantly enhance the consolidation process and address any prior deficiencies in the area of cost-benefit analysis. Management's complete response to the draft report is included as Appendix V.

Office of Audit Comment

We agree that the IRS' alternative approach to analyze the costs and expected savings of the Philadelphia and Andover Processing Site closures should help improve project management, but we believe additional steps could be taken to improve financial management of the project overall. We recognize that factors other than cost enter into the decision-making process, but we disagree with the IRS' opinion that it should not prepare a mid-project cost-benefit analysis because it is too far into the process to make changes. There are still several years left before project implementation is complete, and we believe a comprehensive cost-benefit analysis would help assure this long-term, multimillion dollar project proceeds in the most efficient manner. The IRS acknowledged improvements were needed in its cost-benefit analysis, including the need to focus on benefits that result primarily from site closures and not from increased electronic filing. In addition, Federal Government guidance documents stress that evaluating costs and benefits should be part of the decision-making and project management processes.

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.



Consolidation of Tax Return Processing Sites Is Progressing Effectively, but Improved Project Management Is Needed

Table of Contents

Background	Page 1
Results of Review	Page 4
Transfer of the Returns Processing Operations to Fewer Sites Has Been Successful to Date.....	Page 4
The Consolidation Plan Did Not Include a Cost-benefit Analysis of Site Closures.....	Page 9
Consolidation Costs and Savings Are Not Adequately Monitored.....	Page 11
<u>Recommendations 1 and 2:</u>	Page 13
Appendices	
Appendix I – Detailed Objectives, Scope, and Methodology.....	Page 15
Appendix II – Major Contributors to This Report	Page 17
Appendix III – Report Distribution List	Page 18
Appendix IV – Space-Related Savings and Costs for Closing Submission Processing Sites.....	Page 19
Appendix V – Management’s Response to the Draft Report	Page 20



Consolidation of Tax Return Processing Sites Is Progressing Effectively, but Improved Project Management Is Needed

Abbreviations

FTE	Full-Time Equivalent
IRS	Internal Revenue Service

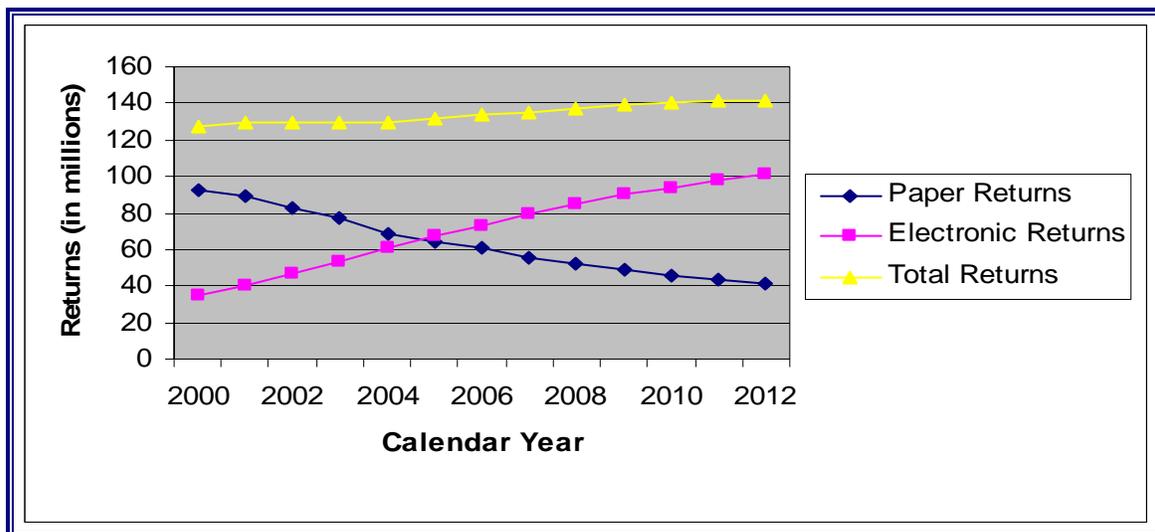


Consolidation of Tax Return Processing Sites Is Progressing Effectively, but Improved Project Management Is Needed

Background

Since the passage of the Internal Revenue Service (IRS) Restructuring and Reform Act of 1998,¹ the IRS has undergone substantial changes, including an extensive reorganization and reduction to the number of Submission Processing Sites (hereafter referred to as Processing site or site) that process paper tax returns. To improve the Electronic Tax Administration program, the IRS Restructuring and Reform Act of 1998 also required the IRS to reach the goal of 80 percent of tax returns filed electronically by 2007. The IRS achieved an electronic filing rate of 54 percent for individual tax returns for 2006.² With increased electronic filing, a substantial decrease in paper returns has occurred nationwide and is projected to continue, as detailed in Figure 1.

Figure 1: Actual and Projected Paper and Electronic Filings for Individuals (in millions)



Numbers for 2007 through 2012 are projected.

Sources: Actual numbers: IRS Statistics of Income Bulletin Table 22, Selected Returns and Forms Filed or To Be Filed by Type During Specified Calendar Years, 1990-2007. Projected numbers: Spring 2006 Update, Calendar Year Projections of Individual Returns (Document 6187).

As electronic filing increases, the IRS has been able to decrease the number of employees needed to process the remaining paper tax returns. The increase in electronic filing and consequent decrease in paper return filing prompted an IRS study on ways to benefit from this trend. To reduce associated overhead and real estate costs, and increase efficiency, the IRS developed a

¹ Pub. L. No. 105-206, 112 Stat. 685 (codified as amended in scattered sections of 2 U.S.C., 5 U.S.C. app., 16 U.S.C., 19 U.S.C., 22 U.S.C., 23 U.S.C., 26 U.S.C., 31 U.S.C., 38 U.S.C., and 49 U.S.C.).

² All dates are calendar years unless otherwise noted.



Consolidation of Tax Return Processing Sites Is Progressing Effectively, but Improved Project Management Is Needed

business plan to gradually reduce the number of Processing sites responsible for handling individual paper tax returns. The plan, completed in December 2000, will take approximately 10 years to fully implement based on the growth rate of electronic filing. The plan is to close an additional site every 2 years, contingent on the continued decline in the number of paper returns filed. Other nonprocessing campus³ operations will continue at the closed Processing sites.

The IRS' initial analysis identified an end state of fewer than four Processing sites as ideal, with Fresno, California; Kansas City, Missouri; and Austin, Texas, deemed to be the best sites for continuing operations. Tax return submissions were to be migrated to the remaining Processing sites until all taxpayers file at one of the three remaining sites. The IRS established a tentative timetable for discontinuing paper return processing at five sites as follows:

1. Brookhaven, New York January 2004
2. Memphis, Tennessee October 2005
3. Philadelphia, Pennsylvania October 2007
4. Andover, Massachusetts October 2009
5. Atlanta, Georgia October 2011

The Brookhaven and Memphis Processing Sites have already closed. The IRS is in the process of closing the Philadelphia Processing Site during 2007. The Andover and Atlanta Processing Sites are still scheduled to close in 2009 and 2011, respectively. The IRS has indicated that, over a 5-year period, it expects about \$68 million in savings from the Brookhaven Processing Site consolidation.⁴ The IRS also estimated that it would recover all costs from closing the Memphis Processing Site by 2006 and save more than \$39 million by 2010.⁵

The IRS began hiring employees with limited terms or temporary employees instead of permanent employees in Processing sites slated to close so the costs of having to lay off employees would be reduced. The IRS also expects to reduce the related equipment and real estate costs. As part of a continuing process to manage its space, the IRS worked with the General Services Administration to develop a comprehensive real estate master program to deal more efficiently with the 10 million square feet of space it occupied. The plan shows a possible 16 percent reduction in space over 15 years.

This review was performed at the Fresno, Kansas City, and Philadelphia Processing Sites and the Memphis Accounts Management Site during the period September 2006 through March 2007. The audit was conducted in accordance with *Government Auditing Standards*. Detailed

³ A campus is the data processing arm of the IRS. The campuses process paper and electronic submissions, correct errors, and forward data to the Computing Centers for analysis and posting to taxpayer accounts. A Processing site is a component of a campus.

⁴ March 2004 IRS internal report, *Submission Processing Brookhaven Consolidation Cost Savings*.

⁵ Congress had requested certain cost information related to the Processing site consolidation, and this estimate was in a document provided to Congress in 2004.



Consolidation of Tax Return Processing Sites Is Progressing Effectively, but Improved Project Management Is Needed

information on our audit objectives, scope, and methodology is presented in Appendix I. Major contributors to the report are listed in Appendix II.



Consolidation of Tax Return Processing Sites Is Progressing Effectively, but Improved Project Management Is Needed

Results of Review

Transfer of the Returns Processing Operations to Fewer Sites Has Been Successful to Date

Consolidation of Processing sites has proceeded according to the IRS plan. The reduction in the number of Processing sites has not adversely affected the processing of individual tax returns, and the IRS has continued to have successful filing seasons⁶ during the consolidation process. IRS efforts to maintain high productivity and minimize the effect on taxpayers during the transition have generally been successful. Most productivity measures such as error rates, processing timeliness, and some efficiency measures have improved since the consolidation began. Figure 2 shows the improvements in productivity since 2002.

Figure 2: Submission Processing Productivity Measures for Individual Tax Returns by Calendar Year

Productivity Measure	2002	2003	2004	2005	2006	Percentage Change 2002 - 2006
Productivity (weighted returns per staff year)	28,389	30,179	30,405	31,444	33,237	+17%
Deposit Error Rate (percentage of misapplied payments)	4.8%	4.2%	3.5%	2.2%	1.6%	-67%
Deposit Timeliness (interest forfeited due to untimely deposit of checks per \$1 million)	\$578	\$529	\$407	\$390	\$354	n/a*
Letter Error Rate (percentage of incorrect letters issued to taxpayers)	7.4%	7.1%	6.6%	3.1%	3.6%	-51%
Refund Error Rate (percentage of refunds with errors caused by the IRS)	8.0%	5.3%	4.9%	5.0%	4.5%	-44%
Refund Timeliness (percentage of refunds issued within 40 days)	98.2%	98.8%	98.3%	99.2%	99.3%	+1%

* = Calculation method for this measure changed from 2003 to 2004, causing data to be not comparable.
 Source: Data obtained from the IRS Business Results Measures Intranet site.

Long-term planning was needed to ensure timely changes to the instructions advising taxpayers where to file their tax returns. To determine how many returns can be moved to remaining sites,

⁶ The period from January through mid-April when most individual income tax returns are filed.



Consolidation of Tax Return Processing Sites Is Progressing Effectively, but Improved Project Management Is Needed

the IRS monitors the level of paper filing from each State and projects the number of paper returns for the following years. Then it gradually redirects taxpayers who had previously filed at a closing site to file at the remaining Processing sites. Staffing needs and processing capacity at both the losing and gaining sites are considerations in the decision to redirect returns. Figure 3 shows the redistribution of returns processing to the remaining sites as sites have closed.

Figure 3: Paper Return Processing Volume by Campus and Calendar Year Individual Tax Returns (in thousands)

Campus Location	2002	2003	2004	2005	2006	Percentage Change 2002 - 2006
Processing Sites Closed or to Be Closed						
Ogden and Cincinnati sites*	6,764	0	0	0	0	-100%
Brookhaven (closed 2003)	7,480	4,240	0	0	0	-100%
Memphis (closed 2005)	8,051	8,302	5,227	3,024	0	-100%
Philadelphia (to be closed 2007)	10,666	10,114	9,545	8,333	6,848	-36%
Andover (to be closed 2009)	7,531	8,066	8,712	7,797	7,940	+5%
Atlanta (to be closed 2011)	9,959	9,975	10,414	9,755	10,406	+4%
Remaining Processing sites						
Austin	9,679	9,932	10,429	9,768	9,559	-1%
Fresno	12,618	15,306	13,349	13,683	13,713	+9%
Kansas City	10,758	11,329	11,474	11,453	12,476	+16%
Totals	83,505	77,265	69,149	63,812	60,942	-27%

Column totals may be off due to rounding.

* Some individual returns were processed at the Ogden and Cincinnati Processing Sites in 2002. Since 2003, these Sites have processed only business and exempt organization returns.

Source: Document 6186: Calendar Year Return Projections for the United States and IRS Centers (2003 Update, Fall 2004 Update, 2005 Update, and 2006 Update).

During this consolidation process, the IRS has taken steps to minimize the effect on taxpayers. It took steps to inform taxpayers about changes in filing locations by:

- Updating information available on the IRS web site.
- Updating *Your Federal Income Tax For Individuals* (Publication 17).
- Including updated information in the tax packages sent to taxpayers.
- Disseminating information on changes in filing locations at annual tax practitioner forums.



Consolidation of Tax Return Processing Sites Is Progressing Effectively, but Improved Project Management Is Needed

A small percentage of taxpayers sent returns to the old locations after the sites were closed. About 524,000 individual returns, approximately 12 percent of the previous year's returns, were sent to the Brookhaven Processing Site in error in 2004. By 2006, this was down to less than 3 percent. The Memphis Processing Site received about 128,000 individual returns sent in error, or 4 percent of the previous year's returns, the year after it closed.

The IRS considers returns that are timely postmarked to be timely filed; consequently, any additional time required for processing due to longer shipping distances or misdirected mail would not cause a return to be considered late filed. The Processing sites do not directly mail out refunds; consequently, the time to mail refunds has not been significantly affected by the consolidation.

Increased paper return volume is starting to cause some unanticipated issues for at least one of the remaining Processing sites visited during our review. Although the returns were considered timely filed, increased mail volume at the Fresno Post Office caused some delay in quickly processing taxpayers' returns. There are also indications that the Fresno Processing Site could experience staffing shortages or increased costs to fully staff it in the future. These issues are discussed more fully later in the report.

Implementation teams monitor the operational aspects of the consolidation

Implementation teams have monitored the operational aspects of the consolidation. IRS efforts to ensure a smooth transition during the consolidation include monitoring the need to reroute taxpayer returns as paper volumes decline, preparing action plans, having frequent management meetings, providing informational web site resources, and documenting lessons learned at closed sites.

The Project Management Office staff develop a model at least annually detailing State mapping options (i.e., determining which geographic area each IRS campus will handle). The staff work closely with the Director, Submission Processing, to determine when taxpayers from affected States should be directed to file at the remaining sites. The decision regarding which States should have filing locations moved is made about 7 months before the end of the calendar year. Several months are needed to make all the necessary changes to the IRS web site and publications.

At the closed sites and at the next location to close (the Philadelphia Processing Site), the IRS has used action plans to detail needed tasks and issues encountered during the consolidation process. The plans contained specific action items, dates, and responsible parties to help ensure accountability. IRS executives and managers participated in multiple meetings during the consolidation process, at which the action plans and progress were discussed. The IRS also provided web site resources for the implementation teams and to help employees understand how the consolidation process would affect them.



Consolidation of Tax Return Processing Sites Is Progressing Effectively, but Improved Project Management Is Needed

The Director, Submission Processing, is responsible for making final decisions regarding transferring workload to the remaining sites. The Project Management Office provides technical support and offers alternatives for workload movement. Workload transfer is accomplished over a period of years (except in the Brookhaven Processing Site due to the shorter time period for closure) by gradually reducing the number of returns arriving at a site for processing. For example, Figure 4 shows how the number of States filing at the Memphis Processing Site was gradually decreased.

Figure 4: States Sending Individual Returns to the Memphis Processing Site

2002	2003	2004	2005	2006
Alabama	Alabama	Ohio	Ohio	None
Arkansas	Arkansas	Virginia		
Kentucky	Ohio			
Louisiana	Tennessee			
Mississippi	Virginia			
Tennessee				
Virginia				

The Memphis Processing Site ceased processing returns at the end of June 2005.

Source: Mapping plans provided by the Project Management Office.

Steps were taken to assist employees affected by site closures

The IRS has made significant efforts to address employee needs in implementing its Processing site consolidations. Site-level executives and managers used several methods to engage employees and to help them understand the process and obtain new employment. Executives and managers stressed that frequent communication was the best tool to help employees find new jobs and keep morale and productivity high during the transition.

The methods the IRS used to inform employees included:

- Working with the employee union.
- Providing terminals to search for jobs online.
- Holding seminars on job search issues.
- Holding large and small group meetings, as well as individual meetings, to inform employees about the transition and their options.
- Holding job fairs.
- Coordinating with other IRS functions to publicize job openings.
- Soliciting and obtaining some new types of work for the site, such as Office of Appeals and compliance work, in line with preexisting business needs.



Consolidation of Tax Return Processing Sites Is Progressing Effectively, but Improved Project Management Is Needed

- Facilitating “job swaps” in which employees who may lose their jobs can, under certain circumstances, exchange jobs with employees in unaffected positions (for example, an employee who wants to stay employed with the IRS could swap jobs with someone who is interested in early retirement).

By the time the sites closed, 3,105 (73 percent) of 4,280 Processing site employees were released or chose to leave the IRS. Most of these employees were seasonal workers (working mostly during peak processing). Fewer than 40 full-time permanent employees were terminated using a reduction in force⁷ action at the Brookhaven and Memphis Processing Sites (see Figure 5). The IRS estimates it paid severance costs of \$10.6 million from 2003 to 2006 related to Processing site closures.

Figure 5: Employees Affected by Processing Site Closures

	Total Baseline Positions ^(a)	Employees Who Took VERA/ VSIP ^(b)	Employees Reassigned to Positions Within the IRS	Employees Who Left the IRS	Employees Separated Through a RIF ^(c)
Brookhaven					
Permanent	567	131	255	162	19
Seasonal	2,135	110	506	874	645
Totals	2,702	241	761	1,036	664
Memphis					
Permanent	342	136	178	9	19
Seasonal	1,236	53	236	415	532
Totals	1,578	189	414	424	551

^a The baseline dates were June 15, 2002, for Brookhaven and October 1, 2004, for Memphis.

^b VERA - Voluntary Early Retirement Authority. VSIP - Voluntary Separation Incentive Payments.

^c RIF - Reduction in Force.

Source: Data were provided by the Project Management Office.

The Brookhaven Processing Site, as the first site to close, faced some additional challenges. These included a shorter time period before closure, difficulties in developing procedures for the necessary human resources actions, and a steeper learning curve due to being the first site to close. IRS officials stated the Memphis and Philadelphia Processing Sites have benefited from the early lessons learned.

⁷ A reduction in force is equivalent to being laid off for operational reasons in the private sector. Employees who are subject to a reduction in force may be eligible for certain benefits, including severance pay, as a result of the adverse action.



Consolidation of Tax Return Processing Sites Is Progressing Effectively, but Improved Project Management Is Needed

The Consolidation Plan Did Not Include a Cost-benefit Analysis of Site Closures

The Office of Management and Budget has issued guidelines to assist agencies in making decisions that promote efficient resource use.⁸ The guidelines describe how to assess a large program or project with costs or benefits that extend 3 or more years into the future. Cost-benefit elements that agencies should include in their analysis are policy rationale, explicitly stated assumptions, alternative means of achieving objectives, and verification of costs and benefits through retrospective studies. Information should be suitable for promoting good decision making by IRS management and Congress.⁹

According to IRS officials and the supporting documentation they provided to us, the IRS made a business decision to reduce the number of paper tax return Processing sites without a cost-benefit analysis supporting its decision, even though the primary objective was to achieve cost savings as well as a more efficient organization. The consolidation plan was a broad vision of how to proceed with closing individual tax return Processing sites. The plan did not incorporate goals related to labor, facilities, or support savings to be achieved. A contractor assisted in the consolidation planning effort and helped develop a model used to prioritize sites in order of consolidation. The qualitative analysis used to prioritize the sites included factors such as regional unemployment rates, median average incomes, commercial real estate costs (from industry sources), and size (number of employees). However, the IRS consolidation plan did not include:

- **Cost-benefit analysis** – The plan did not attempt to project the cost savings it would realize or how long it would take to achieve savings.
- **Alternatives analysis** – The IRS did not assess the baseline state of its processing operations by determining the cost of continuing operations in the existing eight locations and consolidating space locally. The alternatives that the IRS considered were only how to close the five sites chosen for consolidation (faster, slower, all at once, etc.).
- **Actual or projected internal IRS data** – The plan relied on publicly available statistical and industry data. For example, the plan included a comparison of regional income,¹⁰ unemployment,¹¹ and commercial real estate costs¹² but not an analysis of IRS labor costs, recruitment results, and actual or projected real estate costs.

⁸ OMB Circular A-94, *Guidelines and Discount Rates for Benefit-Cost Analysis of Federal Programs*.

⁹ Statement of Federal Financial Accounting Standards No. 4: *Managerial Cost Accounting Standards and Concepts*.

¹⁰ The source was the Bureau of Economic Analysis.

¹¹ The source was the Bureau of Labor Statistics.

¹² The sources were Oncor North America Office Market Report and Colliers Commerce CRG, Real State Weekly, AustinOfficecs.com, and Facilities Design & Management.



Consolidation of Tax Return Processing Sites Is Progressing Effectively, but Improved Project Management Is Needed

Not only do these deficiencies in the IRS analysis make it difficult to evaluate the effectiveness of the plan, they also make it difficult to evaluate the costs and benefits of the implementation. Consequently, the IRS does not have estimates of when benefits will occur, how much the benefits will be, or whether other options would have provided additional benefits. To date, the IRS' objective has primarily been to close sites with as little disruption to tax return processing as possible, rather than trying to achieve any specific savings. As the IRS moves forward with its consolidation, improvements are needed in setting financial goals and in updating and monitoring costs and benefits accruing from consolidation.

Developing such cost-benefit information would enhance the IRS' ability to prepare more accurate budget estimates with respect to the remaining consolidations and better manage its resources. Such an analysis would provide decision makers with quantified and realistic objectives as the consolidation progresses. Without financial goals related to the consolidation, the IRS has not had an incentive to determine how efficient its decisions have been or if it could be saving more.

A good cost-benefit analysis would take into consideration circumstances that have changed over the years since the initial consolidation plan was developed. These changes could affect the cost-benefit analysis. Two examples of previously unanticipated developments at the Fresno Processing Site are (1) delays in processing returns due to post office capacity problems and (2) a possible staffing shortfall (or increased costs to hire sufficient numbers of employees).

The IRS capacity planning document concluded that working with local post offices would be sufficient to address any capacity issues due to increased return volume. However, the Fresno Processing Site has coordinated with the local post office and has been unable to resolve the delays in processing mailed returns caused by the large volume of mail at the peak filing time. Continuing to increase return volume at the Fresno Processing Site without resolving this issue could affect the timeliness of return processing. When checks are included with delayed returns, the Federal Government loses interest it would otherwise collect if the checks had been timely processed and deposited.

The cost to fully staff large remaining sites with seasonal workers is another area that might warrant additional assessment. The IRS had previously estimated its ability to hire qualified workers based partly on the unemployment rate. At the time, Fresno had an unemployment rate of about 14 percent, but recently the unemployment rate in Fresno has fallen below 8 percent. Using the more recent unemployment rate, the IRS' own methodology indicates it will be unable to hire enough staff if it reaches its projected workload in Fresno.

The IRS has the basic tools to assist in cost-benefit analyses, and it has used these tools in the past to develop ad hoc reports dealing with specific consolidation issues. For example, it has used its Program Optimization Model to assist in determining how and when to remap States from the closing sites to one of the remaining sites. The Program Optimization Model projects labor-related costs over several years and incorporates relative productivity as part of the



Consolidation of Tax Return Processing Sites Is Progressing Effectively, but Improved Project Management Is Needed

analysis. The IRS has also performed some analysis to include real estate and severance costs along with the Program Optimization Model data to develop more realistic cost information. This analysis was used to evaluate timing and order of closure for the Memphis, Philadelphia, and Andover (but not Atlanta) Processing Sites in January 2003. In June 2004, it was used to evaluate which of the Andover, Atlanta, and Austin Processing Sites would be best as a third remaining site.

Consolidation Costs and Savings Are Not Adequately Monitored

While the IRS has realized savings associated with the reduced staff needed to process returns, it is likely that the increase in electronic filing rather than the consolidation is a more important factor in the decline in the IRS' labor costs. The IRS has downsized its workforce by approximately the same percentage as the decrease in the number of paper returns. From 2002 to 2006, the number of individual taxpayer paper returns filed declined by approximately 26 percent and IRS field processing staff declined by approximately 25 percent. The associated cost savings were at a lower rate, 12 percent, due to inflation. We estimate the IRS realized about \$56 million in labor-related cost savings in 2006 compared to 2002.

Figure 6: Return Volume Compared to Full-Time Equivalent (FTE)¹³

	2002	2003	2004	2005	2006	Decrease 2002 - 2006	Percentage Decrease
Calendar year individual paper tax returns (millions)	83.5	77.3	69.1	63.8	61.7	21.8	26%
Fiscal year FTEs at Processing sites	11,219	10,370	9,329	8,998	8,389	2,830	25%
Fiscal year processing field labor and contract costs (millions)	\$455	\$447	\$432	\$420	\$399	\$56	12%

Sources: Individual paper tax returns: IRS Statistics of Income Bulletin Table 22, Selected Returns and Forms Filed or To Be Filed by Type During Specified Calendar Years, 1990-2007. FTEs and labor costs were provided by the Wage and Investment Division Customer Account Services Finance Office.

The IRS has compiled estimated space costs and savings from site closures based on the current schedule for Processing site closures and included the actual costs for the two locations already closed (the Brookhaven and Memphis Processing Sites). Figure 7 presents a summary of the IRS' plan.

¹³ An FTE is a measure of labor hours in which 1 FTE is equal to 8 hours multiplied by the number of compensable days in a particular fiscal year. For Fiscal Years 2006 and 2007, 1 FTE was equal to 2,080 staff hours.



Consolidation of Tax Return Processing Sites Is Progressing Effectively, but Improved Project Management Is Needed

Figure 7: Space-Related Savings and Costs for Closing Processing Sites

Submission Processing Site	Annualized Rent/ Related Savings	Exit/Release Costs for Space
Brookhaven	\$9,640,500	\$4,128,040
Andover	\$5,981,244	\$1,123,128
Atlanta	\$1,735,212	To Be Determined
Memphis	\$3,563,769	\$2,261,051
Philadelphia	\$1,779,046	To Be Determined

The Annualized Rent Savings are applicable to the first full fiscal year after closing the Processing site. For more complete information, see Appendix IV.

Source: Information provided by the IRS Agency-Wide Shared Services office.

However, for other aspects of the consolidation, the IRS does not have reliable estimates and is unable to monitor actual versus planned costs and savings. For example, the IRS could not provide accurate information technology costs for the Brookhaven Processing Site closure. It did track information technology costs for the Memphis Processing Site closure and estimated these to be \$2.46 million. However, the IRS was unable to provide the information technology costs for the Philadelphia Processing Site even though it is closing in this fiscal year.

In addition, the IRS has not adequately monitored and updated financial information on the personnel costs of consolidations. It could not provide a postclosing assessment of the costs and benefits attributable to the Memphis Processing Site consolidation. Further, the IRS has not estimated the personnel savings from closing the Philadelphia Processing Site (or any other future site) separately from savings that will accrue from other consolidations. In some ad hoc estimates, the IRS has included savings resulting from electronic filing (i.e., a decreased paper workload) in the savings it has attributed to consolidation. For example, the IRS combined electronic filing and consolidation personnel savings in its Brookhaven Processing Site cost study to arrive at a total savings estimate.

The Wage and Investment Division Project Management Office was given responsibility to prepare requested ad hoc reports related to the consolidation but not to monitor the costs and project savings or to check the supporting data and assumptions in the original plan against the actual results. Therefore, it is not in a position to monitor or update results or to recommend changes to the plan. Further, the IRS stated that Project Management Office employees have not been given training in cost-benefit analysis.

The IRS should have an estimate of the costs for each location to be closed in the future, to prepare budgets that reflect its expected results. Comparing the expected results with the existing baseline costs will help determine the extent to which the remaining consolidation steps should be taken and when costs incurred in consolidation efforts will be recovered and savings begin to accrue. Benefits should be limited to the consolidation-related benefits (primarily



Consolidation of Tax Return Processing Sites Is Progressing Effectively, but Improved Project Management Is Needed

savings from eliminating management overhead and space-related costs) and not combined with electronic filing benefits. For example, our analysis of the Memphis Processing Site, which includes estimated costs and benefits for labor, facilities, and support services related to the consolidation effort, shows that benefits will not begin to exceed costs until 2008, approximately 3 years after the site was closed. Our analysis includes labor savings from overhead and management positions eliminated at the sites but does not include any savings that are primarily attributed to increased electronic filing. Despite the inadequacies of the existing cost-benefit information, we believe the IRS will benefit in the future from the consolidation.

Management Action: Subsequent to our discussions during the audit, the Project Management Office developed a preliminary methodology to help it assess the costs and benefits attributable to consolidation efforts. The preliminary methodology also separates consolidation efforts from the effects of reduced paper workload due to electronic filing. The IRS expects to have the methodology completed and results for closed Processing sites compiled by July 2007.

Recommendations

To update the consolidation plan and improve monitoring of costs and savings, the Commissioner, Wage and Investment Division, should:

Recommendation 1: Designate the Wage and Investment Division Project Management Office as the office responsible for monitoring and updating consolidation information and financial results, and provide key analysts with cost-benefit analysis training to fulfill this responsibility.

Management's Response: IRS management agreed with this recommendation. They stated that the Wage and Investment Division Project Management Office has in the past been responsible for most monitoring and updating activities with regard to consolidation and officially will be responsible for those activities in the future. The key analysts are scheduled to attend cost-benefit training.

Recommendation 2: Designate the Wage and Investment Division Project Management Office to complete a cost-benefit analysis to determine if the existing plan is still optimal in terms of cost savings and operational effectiveness or if alternatives to the plan need to be considered. Experience with two closures should assist in identifying the costs and benefits that can be expected. The analysis should include:

- Baseline costs related to running the existing sites.
- Productivity data when comparing sites if possible.
- Actual savings from site closures and expected savings from future site closures.
- Use of lessons learned from prior site closures to maximize savings and minimize costs.
- Validation of assumptions made in the original plan by monitoring, identifying, addressing, and reporting variations in the projected savings and costs.



Consolidation of Tax Return Processing Sites Is Progressing Effectively, but Improved Project Management Is Needed

Management's Response: IRS management partially agreed with this recommendation. Management recognized that some of the assumptions used to determine the existing plan may have changed; however, they did not agree to complete a cost-benefit analysis to determine if the existing plan is optimal or if alternatives need to be considered. Management stated the IRS is too far into the process to make changes either to the planned order of consolidation or to the three-site end-state configuration for processing of individual tax returns, and there was no evidence to suggest that the decisions made were incorrect. Management did agree, as an alternative, to conduct a formal cost analysis using its recently developed cost model to calculate the actual savings from the Philadelphia Processing Site consolidation and to calculate the expected savings from the Andover Processing Site consolidation. Management stated they would carry forward the lessons learned to maximize the potential savings to be achieved when the Atlanta Processing Site is consolidated, as projected, in 2011. Management believes these actions will significantly enhance the consolidation process and address any prior deficiencies in the area of cost-benefit analysis.

Office of Audit Comment: We agree that the IRS' alternative approach to analyze the costs of and expected savings from the Philadelphia and Andover Processing Site closures should help improve project management, but we believe additional steps could be taken to improve financial management of the project overall. We recognize that factors other than cost enter into the decision-making process, but we disagree with the IRS' opinion that it should not prepare a mid-project cost-benefit analysis because it is too far into the process to make changes. There are still several years left before project implementation is complete, and we believe a comprehensive cost-benefit analysis would help assure this long-term, multimillion dollar project proceeds in the most efficient manner. The IRS acknowledged improvements were needed in its cost-benefit analysis, including the need to focus on benefits that result primarily from site closures and not from increased electronic filing. In addition, Federal Government guidance documents stress that evaluating costs and benefits should be part of the decision-making and project management processes.



Consolidation of Tax Return Processing Sites Is Progressing Effectively, but Improved Project Management Is Needed

Appendix I

Detailed Objectives, Scope, and Methodology

The overall objectives of this review were to determine whether the Individual Master File¹ Submission Processing site (Processing site) consolidation has been adequately planned and monitored and whether anticipated cost savings have been realized. To accomplish our objectives, we:

- I. Determined the reliability of the Processing site consolidation model.
 - A. Interviewed IRS officials to determine:
 1. Whether the model has been a benefit for planning and oversight.
 2. Whether IRS executives were involved in monitoring and approving the model.
 3. Causes for variance between projected cost savings and actual cost savings.
 - B. Reviewed assumptions and parameters of the model using authoritative guidance including Office of Management and Budget Circular A-94, *Guidelines and Discount Rates for Benefit-Cost Analysis of Federal Programs*, and Financial Accounting Standards Advisory Board Standard 4, *Managerial Cost Accounting Standards and Concepts*. We also reviewed results of the model for accuracy, reasonableness, and variances between projected and actual cost savings.
 - C. Reviewed updates to the model over time.
- II. Determined whether the IRS has realized FTE² cost savings.
 - A. Interviewed IRS officials on cost savings related to personnel.
 - B. Obtained and reviewed IRS cost savings data on personnel cost and FTEs, including expenses related to labor costs needed to coordinate consolidation, severance pay or buyouts, and consideration of transferred functions.
 - C. Obtained detailed business plans provided to Congress and verified the reported information on costs and savings.
 - D. Reviewed recent management reports detailing processing FTE savings (by location).

¹ The IRS database that maintains transactions or records of individual tax accounts.

² An FTE is a measure of labor hours in which 1 FTE is equal to 8 hours multiplied by the number of compensable days in a particular fiscal year. For Fiscal Years 2006 and 2007, 1 FTE was equal to 2,080 staff hours.



Consolidation of Tax Return Processing Sites Is Progressing Effectively, but Improved Project Management Is Needed

- E. Compared the IRS' use of resources over the period it was consolidating Processing sites to demonstrate how resource use changed (increases and decreases in the processing function vs. other functions).
- III. Determined whether the IRS has realized real estate cost savings.
- A. Interviewed IRS officials on cost savings related to real estate.
 - B. Obtained and reviewed IRS cost savings data on real estate, including exit costs such as those related to relocation costs, facility reconfiguration costs, information technology modifications, guard services and other contracted services related to buildings, and lease buyouts.
 - C. Reviewed budgets to verify whether real estate costs reflect anticipated decreases.
 - D. Reviewed recent management reports detailing processing function real estate savings (by location).



Consolidation of Tax Return Processing Sites Is Progressing Effectively, but Improved Project Management Is Needed

Appendix II

Major Contributors to This Report

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

Scott A. Macfarlane, Director

Richard J. Calderon, Audit Manager

Mary Jankowski, Lead Auditor

Glory Jampetero, Senior Auditor

John Mansfield, Senior Auditor

Elizabeth A. Miller, Senior Auditor



Consolidation of Tax Return Processing Sites Is Progressing Effectively, but Improved Project Management Is Needed

Appendix III

Report Distribution List

Acting Commissioner C

Office of the Commissioner – Attn: Acting Chief of Staff C

Deputy Commissioner for Services and Enforcement SE

Deputy Commissioner, Wage and Investment Division SE:W

Director, Customer Account Services, Wage and Investment Division SE:W:CAS

Director, Submission Processing, Wage and Investment Division SE:W:CAS:SP

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:

Chief, GAO/TIGTA/Legislative Implementation Branch SE:S:CLD:PSP:GTL

Senior Operations Advisor, Wage and Investment Division SE:W:S



Consolidation of Tax Return Processing Sites Is Progressing Effectively, but Improved Project Management Is Needed

Appendix IV

Space-Related Savings and Costs for Closing Submission Processing Sites

This table presents the IRS' plans related to space release at Processing sites that have been or will be consolidated and closed. The IRS did not have complete information on exit/release costs for two locations, which is indicated by TBD.

Processing Site Space-Related Savings and Costs

Location	Release Date	Rentable Square Feet	Rent/Related Savings	Exit/Release Costs
BROOKHAVEN Total		273,200	\$9,640,500	\$4,128,040
Brookhaven: Waverly & Yaphank	2004	144,600		
Brookhaven: 5000 Corporate Drive	2005	128,600		
ANDOVER Total		321,712	\$5,981,244	\$1,123,128
Andover: Fitchburg	2009	30,197		
Andover: Methuen	2011	155,250		
Andover: Cross Point 3	2011	80,053		
Andover: Cross Point 1	2012	56,212		
ATLANTA				
Atlanta: 4800 Buford Highway	2011	325,284	\$1,735,212	TBD
MEMPHIS Total		239,775	\$3,563,769	\$2,261,051
Memphis: Lamar	2006	79,290		
Memphis: Lamar	2007	58,960		
Memphis: Mendenhall	2007	101,525		
PHILADELPHIA Total		227,838	\$1,779,046	TBD
Philadelphia: Allentown	2008	10,510		
Philadelphia: Southeast	2008	55,200		
Philadelphia: South	2011	8,280		
Philadelphia: North	2012	153,848		

Note: Annualized Rent/Related Savings are applicable to the first full fiscal year after closing the Processing site.
 Source: Information provided by the IRS Agency-Wide Shared Services office.



Consolidation of Tax Return Processing Sites Is Progressing Effectively, but Improved Project Management Is Needed

Appendix V

Management's Response to the Draft Report



DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
ATLANTA, GA 30308

RECEIVED
AUG - 7 2007

AUG 07 2007

MEMORANDUM FOR MICHAEL R. PHILLIPS
DEPUTY INSPECTOR GENERAL FOR AUDIT

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

SUBJECT: Draft Audit Report – Consolidation of Tax Return Processing Sites is Progressing Effectively, but Improved Project Management Is Needed to Better Demonstrate the Costs and Benefits (Audit # 200640023)

I reviewed the draft report and appreciate your acknowledgement that the consolidation of returns processing operations to fewer sites has been successful. As you know, planning and implementation of our consolidation strategy has been a monumental task spanning several years. Consolidation has significantly impacted areas within and outside of our agency. Overall, we believe given the scope and extended timeline of the task, our consolidation activity has been one of our greatest successes.

I acknowledge our plan for submission processing site consolidation has not included a formal cost-benefit analysis under the purview of Office of Management and Budget Circular A-94. However in 2000, we developed an extensive business case analysis for consolidation. In subsequent years, we conducted multiple analyses, some involving comparative costs, as an ongoing validation of our consolidation strategy. All of these analyses have been an integral part of planning, monitoring, and implementing our consolidation strategy.

As you know, we conduct a yearly state mapping exercise to realign workload at our processing sites based on a complete analysis of projected return volumes and operational capacities at the processing sites, computing centers, and lockbox banks. On two occasions, we validated our planned order of site consolidations based on comparative costs using our latest productivity, real estate, and strategic human resource data. An analysis based on costs and risk factors was conducted to consider whether we should accelerate the consolidations of the Andover and/or Atlanta processing sites. Another comprehensive study resulted in our adding Austin as a third end-state processing site and further demonstrates our commitment to ensuring our strategy is flexible enough to react to shifting demands and priorities.



Consolidation of Tax Return Processing Sites Is Progressing Effectively, but Improved Project Management Is Needed

2

In addition, we consistently addressed other IRS processes that are impacted by consolidation. For example, we conducted a very extensive analysis of e-filing growth, systems, and capacity, and developed a long-term strategy for processing e-filed returns that would fit with how we planned to consolidate our paper processing sites. In conjunction with our consolidation of the Philadelphia processing site, a substantive analysis was done to determine how, when, and where to move the International and Individual Taxpayer Identification Number (ITIN) processing programs.

We believe we have demonstrated substantial cost savings from increased electronically filed returns, decreased paper returns, and consolidation of processing sites. We recently developed a comprehensive methodology that will support our efforts to more accurately determine our total cost savings, and will differentiate the savings realized through e-file growth from the savings achieved by consolidating sites that are no longer needed to manually process paper returns. I want to acknowledge discussions with your auditors were very helpful in developing our new model for determining cost savings.

In the report you refer to delays in processing of mailed returns at the Fresno Post Office. To eliminate issues experienced with the United States Postal Service (USPS) during the previous filing seasons, correspondence was sent to the Assistant Postmaster General and subsequent meetings were held with key members of the national USPS staff. Our experience with the USPS this year was a positive one with only two isolated, one day instances of mail delayed during the two week peak processing period.

I appreciate the constructive feedback and positive tone of your report in acknowledging that our consolidation of processing sites is progressing effectively. Attached are our specific comments to your recommendations. If you have any questions, please contact me at (404) 338-7060, or members of your staff may contact Peter Stipek, Director, Customer Account Services, at (404) 338-8910.

Attachment



Consolidation of Tax Return Processing Sites Is Progressing Effectively, but Improved Project Management Is Needed

Attachment

Recommendation 1

To update the consolidation plan and improve monitoring of costs and savings, the Commissioner, Wage and Investment Division should designate the Wage and Investment Project Management Office as the office responsible for monitoring and updating consolidation information and financial results, and provide key analysts with cost-benefit analysis training to fulfill this responsibility.

Corrective Action

We agree with both actions in this recommendation.

1. The Wage and Investment (W&I) Project Management Office has in the past been responsible for most monitoring and updating activities with regard to consolidation. We are officially designating that office to be responsible for those activities in the future.
2. Key analysts in the Project Management Office are scheduled to attend cost-benefit training.

Implementation Date

- 1) August 15, 2007
- 2) September 15, 2007

Responsible Official

Director, W&I, Customer Account Services

Corrective Action Monitoring Plan

We will monitor these corrective actions as part of our internal management control system.

Recommendation 2

To update the consolidation plan and improve monitoring of costs and savings, the Commissioner, Wage and Investment Division should designate the Wage and Investment Project Management Office to complete a cost-benefit analysis to determine if the existing plan is still optimal in terms of cost savings and operational effectiveness, or whether alternatives to the plan need to be considered. Experience with two closures should assist in identifying the costs and benefits that can be expected. The analysis should include:

- Baseline costs related to running the existing sites;
- Productivity data when comparing sites if possible;
- Actual savings from site closures and expected savings from future site closures;
- Use of lessons learned from prior site closures to maximize savings and minimize costs,



Consolidation of Tax Return Processing Sites Is Progressing Effectively, but Improved Project Management Is Needed

2

- Validation of assumptions made in the original plan by monitoring, identifying, addressing, and reporting variations in the projected savings and costs.

Corrective Action

We partially agree with this recommendation. We will not complete a cost-benefit analysis to determine if the existing plan is still optimal, or whether alternatives to the plan need to be considered. While we recognize that some assumptions on which our earlier decisions were based may have changed, we are too far into the process to make changes either to our planned order of consolidations or to our three site end-state site configuration for processing of individual tax returns, and there is no evidence to suggest that the decisions we made are incorrect.

There are a number of considerations. First, we have demonstrated substantial cost savings from prior site consolidations and anticipate similar savings from consolidating the Andover processing site in 2009 and the Atlanta processing site in 2011. Secondly, our consolidation plan is long-term. Making changes could adversely affect employees, who have planned based on our stated consolidation strategy. Term employees were hired in those sites we intend to consolidate in the future, and we are hiring and training new employees in our end-state sites. In addition to employee impact, there could be a significant, negative cost impact from changing our existing consolidation strategy. For example, over the past several years substantial costs were incurred which related to updating and resizing the planned end-state sites, moving equipment, transferring programs such as ITIN and International processing, reprogramming systems, and restacking space at closing campuses to accommodate other IRS functions.

Furthermore, there have been no significant variances to our original assumptions that lead us to believe our current strategy is unworkable. For example, while earlier assumptions regarding unemployment rates and available workforce in a site like Fresno might have changed, as your report noted, the current anticipated volumes for future paper returns indicate we will not have to grow Fresno to the level initially projected. We are confident the prospect of processing more than one million fewer paper returns, combined with continued productivity improvements, positions Fresno very well to fulfill its end-state responsibilities.

As an alternative to doing a complete cost-benefit analysis to determine if the existing plan is still optimal as described in your recommendation, we intend to take the following actions:

- The IRS will conduct a formal cost analysis using its recently developed cost model to calculate the actual savings from the Philadelphia processing site consolidation, and to calculate the expected savings from the Andover processing site consolidation scheduled for September 2009. A comparison of Andover's projected and actual savings will include lessons learned that can be carried forward to



Consolidation of Tax Return Processing Sites Is Progressing Effectively, but Improved Project Management Is Needed

3

maximize the potential savings to be achieved when the Atlanta processing site is consolidated, as projected, in 2011.

We believe the above actions will significantly enhance our consolidation process and address any prior deficiencies in the area of cost-benefit analysis. The actions we will take are consistent with the third and fourth bullets in your recommendation above.

Implementation Date

February 15, 2008

Responsible Official

Director, W&I, Customer Account Services

Corrective Action Monitoring Plan

We will monitor these corrective actions as part of our internal management control system.