



Treasury Inspector General for Tax Administration

TESTIMONY

PROGRESS AND PROBLEMS IN IMPLEMENTING THE INTERNAL
REVENUE SERVICE RESTRUCTURING AND REFORM ACT OF 1998

JOINT HEARING BEFORE COMMITTEES OF THE UNITED STATES
SENATE AND HOUSE OF REPRESENTATIVES

MAY 3, 2000



STATEMENT FOR THE RECORD

THE HONORABLE DAVID C. WILLIAMS

TREASURY INSPECTOR GENERAL FOR TAX ADMINISTRATION

Mr. Chairman and Members of the Committees, I appreciate the opportunity to appear before you today to discuss the progress the Internal Revenue Service (IRS) has made in implementing the Restructuring and Reform Act of 1998 (RRA 98). In July of this year, we will be observing the second anniversary of the RRA 98.

During these past two years, the IRS has undertaken a complex and multifaceted approach to restructuring the way it conducts business. As an example, the IRS has been transforming itself so that it will operate better and serve its customers more efficiently. In this regard, the IRS has changed its mission statement to more clearly address its role in helping taxpayers meet their legal obligations.

Some of the positive results the IRS is achieving can be seen in the outcomes of the recent filing season. By April 23, 2000, the IRS reported that it had processed 83.1 million tax returns, which is 3.2 million more than the same period last year. The IRS also reported that it had certified over 73 million refunds, which is an increase of 2.9 percent over the 1999 filing season. For Fiscal Year 2000, the IRS estimates it will collect more than \$1.9 trillion in revenue, which is an increase of one percent over Fiscal Year 1999. However, there are still some challenges facing the IRS in reversing

some of its declining trends in collection activities. For example, during the first 5 months of Fiscal Year 2000, the IRS had only conducted 28 seizures, compared to 10,000 in Fiscal Year 1997.

While some of the agency's efforts are complete, several major reforms are in the early high-risk stages of implementation. Full implementation of the RRA 98 provisions should result in enhanced taxpayer protection and rights, as well as organizational changes intended to achieve a more efficient and responsive agency. As we monitor the progress that the IRS is making, the Treasury Inspector General for Tax Administration (TIGTA) is focusing on those programs, activities and functions that are subject to the highest risk.

The IRS Restructuring and Reform Act of 1998

The Office of Inspector General was created to replace the IRS Inspection Service. This transition was successfully completed in January 1999. Since that time, TIGTA has been dedicated to ensuring that IRS employees treat taxpayers with the highest degree of integrity and fairness so as to maintain trust in our tax administration system. To better accomplish our mission, we immediately abolished the regional structure of our predecessor organization, which eliminated an unnecessary and remote layer of management. We reorganized the Office of Investigations into direct report field offices, and we have assumed comprehensive responsibility for investigating internal misconduct cases. The Office of Audit also reorganized into specialized issue areas that parallel the new IRS business unit structure. In addition, we created an Office of Investigations'

Strategic Enforcement Division (SED) to meet threats of computer crimes against the IRS, and to ensure that these irregularities are prosecuted to the fullest extent of the criminal and civil law.

In carrying out our new statutory responsibilities, TIGTA has issued 10 reports in response to specific requirements for evaluating the IRS' compliance with key RRA 98 provisions. We evaluated the IRS' compliance with these provisions, starting from their effective dates. We concluded that, although the IRS has made some progress in implementing the RRA 98, the requirements addressing taxpayer protection and rights issues had not been successfully implemented.

At a Senate Finance Committee hearing on February 2, 2000, I reported that:

- The IRS identified approximately 525 violations of the prohibition against using records of tax enforcement results to evaluate employees during its first independent reviews and quarterly certifications. TIGTA identified an additional 96 violations where IRS management used tax enforcement results to evaluate employees, or imposed or suggested employee production quotas or goals (e.g., evaluations contained references to fraud referrals, dollars assessed or collected, or case closures).
- The IRS did not consistently implement federal tax lien provisions. Thirty-three percent of the cases TIGTA reviewed involved potential violations of legislative or procedural requirements. For example, taxpayers were not given the full 30 calendar days to request a hearing, or sufficient documentation was not retained

- to prove that lien notices were sent to taxpayers, or that they were sent timely.
- The IRS did not always follow all legal and internal guidelines when conducting seizures. Thirty-six percent of the 92 taxpayer seizure cases reviewed did not follow all legal and internal guidelines, including business property that was seized without obtaining the required approvals, or taxpayers who were not personally warned before the seizure occurred.
- The IRS had not fully implemented new procedures to notify taxpayers before taking funds for payment. Thirty-two percent of the 284 taxpayer accounts reviewed did not follow legal provisions in that taxpayers were not notified of the IRS' intent to levy or of their appeal rights before levies were issued.

In our Fiscal Year 2000 audits, TIGTA is following up on the IRS' corrective actions for most of the previously reported problem areas. In addition, we are reviewing one new provision, Assessment Statute Extensions, that became effective January 1, 2000. We are conducting, too, an audit related to one of the RRA 98 provisions to determine the effectiveness of the IRS' actions for identifying and reporting potential Fair Debt Collection Practices Act violations.

The IRS has completed some of its corrective actions in response to our recommendations in the prior report. The early analyses of our Fiscal Year 2000 audits indicate that the IRS has significantly improved its compliance with two of the RRA 98 provisions, as follows:

- All 35 seizures conducted by the IRS from May 1 to September 30, 1999 were in accordance with legal seizure provisions and agency guidelines. We identified significant improvement in the way the IRS conducted seizures and disposed of properties compared to our prior review. For example, all of the seizures were reviewed and approved by the Collection Division Chief (third level of management in the district). In addition, the IRS implemented a pre-seizure checklist in April 1999 to assist employees in meeting legal and internal guidelines. All 23 seizures approved after that date had a completed checklist in the file. While the IRS has improved its procedures, the continued reduction in the number of seizures raises questions about potential problems with the sufficiency of the IRS' collection efforts.
- The IRS has significantly improved its compliance with legal and internal guidelines to notify taxpayers of their rights at least 30 days before levies are issued. We believe these improvements are the result of several enhancements to computer systems and the implementation of new procedures to ensure legal requirements are met when issuing levies. For example, a national computer change was made in April 1999 to systemically prevent district office employees from issuing levies before the 30-day period has ended. Another national computer change, made in June 1999, systemically prevents Customer Service computers from automatically generating levies on past due accounts.

We will not be able to determine the IRS' compliance with three of the RRA 98 provisions--Direct Contacts with Taxpayers and their Representatives, Joint Filer Requests, and Taxpayer Complaint Processing--because the IRS does not have management information systems that specifically track these activities. Accordingly, our Fiscal Year 2000 audits of these areas will be limited to the IRS' internal

procedural changes to correct some of the previously identified problems.

In addition to our audit responsibilities, the RRA 98 charges TIGTA with investigating Section 1203 violations. Section 1203 provides that the IRS Commissioner shall terminate the employment of any IRS employee found guilty of misconduct as defined by ten acts or omissions. This firm approach to employee discipline caused some confusion and consternation among IRS employees. There were rumors that thousands of investigations were opened and employees would be terminated for unintentional errors. Because of this, we participated in IRS briefings in Chicago, Illinois and Washington, DC to help ensure that IRS managers have an accurate understanding of the Section 1203 requirements they convey to their staffs. The presentations focused on the following results of our experience to date.

The majority of Section 1203 allegations we received claimed that an IRS employee violated a provision of the Internal Revenue Manual or the Internal Revenue Code in order to retaliate against or harass someone. The second largest type of allegation we received involved civil rights violations, including EEO violations. These are followed by allegations of willful destruction of documents and understatement of federal tax liability.

Since passage of the RRA 98, TIGTA has received 683 allegations involving Section 1203 violations. These allegations resulted in 279 investigations by TIGTA. We have closed or referred 159 investigations to the IRS. The IRS has notified us that 17 employees have been removed or resigned as a result of TIGTA and IRS investigations. Ten investigations by TIGTA resulted in a

lesser discipline. IRS management is emphasizing to its employees that disciplinary action will not be imposed on those employees who make honest mistakes.

Strategic Planning

The IRS developed a Balanced Measurement System as part of its effort to modernize and to reflect the agency's priorities. This approach to measurement is intended to help shift the focus of employees and the agency away from achieving specific production targets or numbers to achieving the overall mission and strategic goals of the IRS. While these changes are in response to the RRA 98, they are also related to the implementation requirements of the Government Performance and Results Act of 1993 (GPRA).

TIGTA previously reported to the Commissioner that the IRS' strategic plan demonstrated progress. However, the plan did not explain how performance measures and strategic goals relate to each other, did not address external factors that impact its mission and goals, and did not describe program and system evaluations. TIGTA recommended, and the agency agreed, to designate an office responsible for oversight and coordination of GPRA implementation activities throughout the IRS.

The IRS' first Annual Program Performance Report was recently submitted with its Fiscal Year 2001 Congressional Justification. A TIGTA audit of the Annual Program Performance Report found that the IRS' processes used to generate the report did not

provide adequate time for management to assemble and analyze the data for the report or to ensure that the report clearly assessed program goals. Additionally, we reported that the IRS needs to develop a process for ensuring that data are verified and validated before being reported. This problem may be resolved when the IRS implements its plan to establish an office with the responsibility to oversee the verification and validation of data included in future Annual Program Performance Reports.

Modernization of the Agency

Commissioner Rossotti first introduced the concept of modernizing the IRS in January 1998. A cornerstone of his initiative was to organize the IRS into four operating divisions. Each operating division will have end-to-end responsibility for a defined group of taxpayers with similar characteristics. The four operating divisions are:

- Tax Exempt and Government Entities Operating Division
- Large and Mid-Size Business Operating Division
- Wage and Investment Operating Division
- Small Business and Self-Employed Operating Division

The Tax Exempt and Government Entities Operating Division is the first and only Division to stand up¹. This Division has been standing up since December 5, 1999, and is currently in the adjustment phase of its modernization efforts. During the adjustment phase, the Division will be formulating plans to meet and discuss issues concerning changes in conditions of employment with the National Treasury Employees Union (NTEU).

The Large and Mid-Size Business Operating Division is now scheduled to stand up in June 2000. The Division is currently in the establishment phase, and the NTEU will be provided with an advanced copy of a placement notice. IRS employees will also be given the opportunity to request a review of the placement notice. The Division will be in the establishment phase for at least 90 days.

The remaining two Divisions are scheduled to stand up in October 2000. The Commissioner is expected to approve the Divisions' design packages in May 2000. After approval by the Commissioner, the Divisions will begin the establishment phase of their modernization efforts.

Additionally, the following nine functional divisions will provide support to the four operating divisions:

- Taxpayer Advocate
- Customer Service/Submissions Processing
- Information Systems

- Appeals
- Communications and Liaison
- Agency Wide Shared Services
- Criminal Investigation
- Chief Counsel
- National Office Headquarters

Only three of the nine functional divisions--Taxpayer Advocate, Information Systems and Customer Service/Submissions Processing--have stood up and are in the adjustment phase. Two divisions--Communications and Liaison and Agency Wide Shared Services--are in the establishment phase and should stand up in either the early summer or fall of 2000. The remaining four divisions are in the design phase.

Computer Systems Modernization

Key IRS goals, such as receiving 80 percent of tax returns electronically by the Year 2007 and significantly improving service levels in answering taxpayers' questions, are contingent on the development of new technology. For more than a decade, the IRS has been attempting to modernize its outdated, paper-intensive tax processing systems. During that period, the IRS spent over

\$3 billion with minimal improvement, despite intense scrutiny from the Congress. The IRS is now in the early stages of a new effort to modernize its systems and is employing contractors to assist in this effort at an estimated cost of over \$5 billion.

Previous General Accounting Office audits of computer systems modernization initiatives identified serious management and technical weaknesses. A recent TIGTA audit indicated that the IRS has made progress in correcting the organizational weaknesses of past systems modernization efforts by ensuring that top level IRS executives, including the Commissioner, are heavily involved in the modernization initiative. These executives have recognized the need to build systems modernization program management disciplines, risk management processes and quality assurance policies and procedures.

While the involvement of top management is noteworthy and is essential to the success of systems modernization, the IRS stumbled out of the starting blocks in executing the early phases of the effort. A recent IRS review of key systems modernization initiatives found that as many as 68 percent of the work products required during the planning phases of these projects had not been completed. One of the primary reasons these problems were not identified earlier is the lack of a stable program management organization to oversee the modernization initiative. For example:

- Key processes for managing the risks in the modernization effort and monitoring

- the performance of the contractor need to be improved.
- Roles and responsibilities inside the program management organization and between the IRS and the contractor are not clearly defined.
- Program management staffing needs have not been determined.

These growing pains were a primary cause of the IRS' decision to scale back or delay delivery of several modernization initiatives originally slated to provide improved service to taxpayers by the 2001 tax filing season. These first projects were intended to improve communications with taxpayers by centralizing IRS' nationwide call screening/routing for selected toll-free numbers, providing telephone and Internet automated self-service applications, and providing upgraded electronic filing and research technology. However, the IRS still believes it is on track to deliver some of the scaled-back systems enhancements in 2001 that will improve responsiveness to taxpayers, such as increasing the capacity for handling and routing incoming telephone calls. Examples of initiatives that have been delayed include:

- A telephone application that would allow taxpayers to determine whether their tax returns have been received.
- An Internet application that would allow taxpayers to determine the status of their refunds.
- An application that would provide taxpayers electronic access to their tax account information.

These problems could have been identified much sooner and corrective actions taken without the delays the projects are now facing if an effective performance monitoring process had been in place. If the IRS does not address these issues soon, there is a risk that the planned systems enhancements for 2001 may not be delivered on time.

Some of the actions the IRS has underway to address these problems include:

- A proposed organizational structure to oversee systems modernization with associated roles and responsibilities.
- A redefined relationship between the IRS and the contractor to build in more accountability.
- A draft listing of reporting requirements for modernization projects.
- A request that the contractor develop a "get well" plan to deliver needed performance monitoring information.
- A plan to implement systems modernization program-wide and project level risk management policies and procedures.
- An identification and evaluation of the top risks to systems modernization.

The IRS is beginning to make progress toward implementing an effective systems

modernization management approach. However, significant risks need to be addressed to ensure that the IRS overcomes the management and technical weaknesses that plagued its prior efforts for more than a decade.

Another significant initiative involves the system used for receiving electronic tax returns. The RRA 98 requires that the IRS receive 80 percent of all tax returns electronically by the Year 2007. As of April 23, 2000, the IRS reported receiving

approximately 35 million electronic income tax returns, which represents 30 percent of all individual federal tax returns filed. The electronic filing system had sufficient telecommunications capacity to receive and store the expected tax return volumes this year. However, a TIGTA audit of the system showed that the IRS needs a performance and capacity management plan to determine whether the system is capable of handling 80 percent of all transactions electronically. The IRS completed stress tests in late 1999 that indicated the system might not have the capacity needed for these higher volumes.

Computer Security

Progress has been made in bolstering computer security at the IRS, but further improvements are needed. The IRS has conducted comprehensive security reviews of its major facilities and has significantly reduced the number of security weaknesses previously identified by the General Accounting Office. These efforts should help reduce the risk of unauthorized access to sensitive taxpayer information and/or destruction of major IRS systems and data.

However, recent TIGTA audits and investigations have identified additional weaknesses in security controls over the IRS' computer facilities, networks and systems, including:

- Most IRS systems containing sensitive taxpayer information were not certified as having adequate security controls. This has been an issue for years that has not been resolved.
- The IRS does not effectively use audit trails to detect unauthorized access or abuse of taxpayer data, except for the Integrated Data Retrieval System.
- The IRS needs to improve its program for computer virus prevention and detection.

- The IRS needs to develop plans and increase the resources available to more effectively recover from disasters or failures at its facilities. This issue has been reported to the IRS before, but adequate actions have not been taken.

- Approximately 35 million electronically filed individual federal income tax returns are grouped and transmitted in batches from third parties over public telephone and data communications lines without being encrypted.

- The IRS has not developed overall policies and guidance for securing its local area networks and related telecommunications processes.

- The IRS needs to do more to protect its critical infrastructure by defining which of

its systems are critical to its operation, and taking actions to reduce vulnerabilities to disruptions in service.

Striking an appropriate balance between maintaining systems' security and conducting day-to-day operations is not simple. In some cases, adding security controls may slow systems down and result in less timely service to taxpayers. However, until these weaknesses are resolved, IRS systems and taxpayer data are vulnerable to tampering, loss or unauthorized disclosure. We believe the IRS should strengthen security in its existing computer systems, networks and facilities and ensure that adequate controls are built into new systems before they are rolled out.

To address computer issues, TIGTA has developed a computer security program to investigate improper internal and external access to IRS computers. TIGTA's SED is responsible for developing an aggressive program to investigate any attempts to interfere with the operation and security of the IRS' computer systems. In the six months ending March 31, 2000, our SED opened 120 investigations regarding possible violations of the Taxpayer Browsing Protection Act of 1997.

The SED's operation is a collaborative effort between the IRS and TIGTA involving the use of computer technology and computer matching to identify criminal violations, secure evidence, and detect and prevent improper accesses. This group focuses on the threat posed by IRS employee misconduct as it relates to misuse of taxpayer information. The group is also responsible for identifying and investigating internal and external unauthorized electronic accesses to federal taxpayer records.

The SED also maintains computer research and reference equipment and assesses technical threats to the integrity of the IRS computer network. The Division conducts proactive security testing to ensure that adequate safeguards are in place to defend against newly identified network vulnerabilities, as well as newly disseminated hacker tools found throughout the Internet. Our work transcends tax administration as we disseminate threat advisories beyond the IRS to the Department of the Treasury and to a number of other federal agencies.

Conclusion

Improvements emanating from the IRS' current reform efforts will not be immediately apparent. The full impact of the reforms may only be recognizable once the RRA 98 has been completely implemented and managers and employees have embraced cultural changes. However, I do believe that the

current approach, while daunting, is the right one. Past efforts at reform have been ineffective and focused on symptoms and surface issues, rather than on the ailments that have plagued this agency.

Instances of faltering speed and misdirection for the RRA 98 reforms dictate that the IRS and its stakeholders need to closely monitor the outcomes. All participants in these reforms need to maintain a determination that this time they are committed to making long-term improvements in the IRS. It will be a while before the American public can readily identify the benefits of these reforms, but the initiative is vital if we are to provide the quality service that taxpayers should expect and are entitled to from

their government.

¹ Standing Up: The establishment of a new organization with at least the minimum requirements of operating, including a finance office, separate budget, key management positions filled, temporary solutions to problems, personnel actions for realignment completed, and necessary business authorities in place.
