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INTERNAL REVENUE SERVICE

Business Operations Need Continued Improvement

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The Honorable Ted Stevens
Chairman
The Honorable John Glenn
Ranking Minority Member
Committee on Governmental Affairs
United States Senate

As you requested, this report offers an overall perspective on opportunities to improve the Internal Revenue Service's (IRS) business operations and is based on our recent reports and related testimonies on this topic.[1] These testimonies and related reports extensively describe the substantial problems IRS has experienced in fulfilling its business vision, overcoming management and technical weaknesses in its tax systems modernization (TSM) efforts, and improving the reliability of its financial management systems used to account for hundreds of billions of dollars in taxpayer monies and to measure IRS' performance.

We are not making any new recommendations in this report. As detailed in our recent studies, IRS has initiated actions that begin to implement the dozens of recommendations we have previously made in these areas. But to date, IRS has not fully implemented our recommendations, which offer a framework for correcting its management and technical problems.

Results in Brief

This report identifies pivotal actions that IRS should take to fully implement our recommendations and improve its business practices. These steps include:

- limiting funding for TSM to critical priorities;
- developing an effective implementation strategy for achieving IRS' business vision that includes an agreed upon set of performance measures, which is imperative to changing the way IRS operates and serves customers;
- developing the capacity to make sound investments in information technology, which will be heavily relied upon to achieve IRS' business strategy and measure performance;

[1]Tax Systems Modernization: Management and Technical Weaknesses Must Be Overcome To Achieve Success (GAO/T-AIMD-96-75, March 26, 1996); Tax Systems Modernization: Progress in Achieving IRS' Business Vision (GAO/T-GGD-96-123, May 9, 1996); Financial Audit: Actions Needed to Improve IRS Financial Management (GAO/T-AIMD-96-96, June 6, 1996); and Tax Systems Modernization: Actions Underway But IRS Has Not Yet Corrected Management and Technical Weaknesses (GAO/AIMD-96-106, June 7, 1996).

- building the necessary technical foundation for TSM information systems projects, which will provide the overall blueprints for developing systems, and the disciplined processes needed for completing information systems projects timely and economically, and ensuring that information systems concepts are transformed into practical tools that perform as intended; and
- addressing serious and persistent financial management problems, which affect the credibility of financial information, such as over $1 trillion in monies collected from American taxpayers and billions of dollars in delinquent taxes owed to the government.

The success of these critical efforts hinges on IRS, the Department of the Treasury, the Office of Management and Budget (OMB), and congressional initiatives to ensure that recommendations in these areas are promptly and fully implemented. Historically, IRS has not been highly responsive in fixing business operation problems and implementing our recommendations. Treasury, in particular, has become more active in oversight and, while that is a positive development, the department's continued focus on monitoring IRS' corrective actions will be a key factor in ensuring progress. OMB needs to emphasize its leadership and oversight roles in resolving these matters as well.

The Congress has legislatively established management tools it can use to closely monitor IRS' progress and hold IRS accountable for improving its business operations. These laws include (1) the Chief Financial Officers Act of 1990, (2) the Government Performance and Results Act of 1993, (3) Title V of the Federal Acquisition Streamlining Act of 1994, (4) the Paperwork Reduction Act of 1995, as amended, and (5) the Information Technology Management Reform Act of 1996.

Through this legislation, the Congress has provided an excellent framework for (1) overseeing IRS' efforts to improve financial management operations and modernize tax processing with more effective technology and (2) measuring IRS' performance in meeting its business vision. In addition, the new National Commission on Restructuring IRS, legislated by the Congress, will have a principal role over the next year in conducting a broad-based evaluation of IRS' operations and recommending changes to IRS' organizational structure, management practices, and operating procedures.

Objective, Scope, and Methodology

To provide the requested overview of what we see as opportunities to improve IRS business operations, we synthesized several of our most recently issued products. These reports and testimony evaluate IRS'

- performance in achieving major mission objectives to process returns more efficiently, improve service to taxpayers, and increase taxpayer compliance;
- accountability for revenues designated for the general fund and a wide spectrum of trust funds as well as its appropriations for salaries and expenses; and
- initiatives to modernize by modifying business processes and incorporating information technology to enhance mission and financial accountability and productivity.

Each of these products is grounded in large bodies of work performed over several years in accordance with generally accepted government auditing standards.

We requested comments on a draft of this report from the Department of the Treasury, the Internal Revenue Service, and the Office of Management and Budget. IRS provided us with written comments on August 16, 1996. Treasury officials concurred with IRS' comments. A representative from the Office of Management and Budget provided us with oral comments on August 19, 1996. Comments are discussed in the Agency Comments and Our Evaluation section.

Limiting Funding for TSM to Critical Areas

In its May 6, 1996, report on the status of TSM to the Senate and House Appropriations Committees, the Department of the Treasury candidly assessed TSM progress and future redirection. It described ongoing and planned actions intended to respond to our July 1995 recommendations to correct management and technical weaknesses.[2] It concluded that despite some qualified success, IRS had not made progress on TSM as planned because systems development efforts had taken longer than expected, cost more than originally estimated, and delivered less functionality than originally envisioned. It further stated that significant changes were needed in IRS' management approach and that IRS did not currently have the capability to develop and integrate TSM without expanded use of external expertise.

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

Treasury's report delineates, and we verified, that IRS has initiated a number of actions and is making some progress in addressing our recommendations. For example, IRS (1) is preparing a comprehensive strategy to maximize electronic filing, (2) has created an investment review board to select, control, and evaluate its information technology investments, (3) has updated its systems engineering process, is updating its systems life cycle methodology, and is working across various IRS organizations to define disciplined processes for software requirements management, quality assurance, configuration management, and project planning and tracking, and (4) has completed a descriptive overview of an integrated, three-tier, distributed systems architecture.

However, as we reported in June 1996, many of these actions are still incomplete and do not respond fully to any of our recommendations.[3] Examples include the following:

- The comprehensive business strategy for electronic filing is not scheduled for completion until early fall 1996. Completing this strategy is central to maximizing electronic filings and achieving IRS' business vision of significantly reducing the volume of paper returns.
- IRS does not yet have a complete and repeatable process for selecting, controlling, and evaluating its technology investments. Implementing such a process is necessary to make sound investment decisions on planned and ongoing systems.
- The procedures for requirements management, quality assurance, configuration management, and project planning and tracking are being developed, but are still incomplete. Overcoming these weaknesses is critical to successful systems modernization.
- IRS has not completed its integrated systems architecture or its security and data architectures, and has no schedule for doing so. Completing these architectures is fundamental to designing and building TSM systems.

As a result, IRS has not made adequate progress in correcting its management and technical weaknesses, and none of our recommendations have been fully implemented. IRS expects to improve the accountability for and probability of TSM success by increasing its reliance on contractors. However, IRS has not addressed the risk inherent in shifting hundreds of millions of dollars to additional contractual efforts before it has the disciplined processes in place to manage all of its current contractual efforts effectively.

[3]GAO/AIMD-96-106, June 7, 1996.

As we reported, until IRS' weaknesses are corrected and our recommendations are fully implemented, we believe the Congress should consider limiting TSM spending to only cost-effective modernization efforts that

- support ongoing operations and maintenance;
- correct IRS' pervasive management and technical weaknesses;
- are small, represent low technical risk, and can be delivered in a relatively short time frame; and
- involve deploying already developed systems that have been fully tested, are not premature given the lack of a completed architecture, and produce a proven, verifiable business value.

As the Congress gains confidence in IRS' ability to successfully develop these smaller, cheaper, quicker projects, it could consider approving larger, more complex, more expensive projects in future years.

Imperative Need for an Effective Business Vision Implementation Strategy

In 1986, IRS initiated TSM primarily to replace the computers that it was using to process and store the information on tax returns. IRS planned to introduce the new technology without changing its existing organizational and operating structure, which included 10 service centers that processed tax returns, over 70 telephone call sites that provided various types of service to taxpayers, and 63 district offices that were responsible for many of IRS' compliance activities.

In 1992, in response to recommendations by GAO and others, IRS began to analyze how it might use new technology to change its business operations. As a result, IRS developed a vision for 2001 that called for organizational, technological, and operational changes affecting the way it processes tax returns, provides customer service, and ensures compliance.

Specifically, IRS' vision calls for

- moving from a paper-laden, labor-intensive tax return processing environment to a modern electronic environment;
- providing better service to taxpayers through wider use of the telephone, better access to data, and new information systems; and
- improving compliance through access to accurate, up-to-date data, earlier identification of noncompliant taxpayers, and increased efficiencies in its field enforcement functions.

Since 1992, IRS has made some progress in modernizing its operations, but the differences between IRS' current operations and those proposed in its vision are great. Part of the reason IRS has not been more successful in significantly changing its business operations is that it does not have a well-defined business strategy for achieving its vision. As discussed in the following sections, IRS is, for example, revisiting its electronic filing strategy and looking for alternative ways for improving customer service.

The Government Performance and Results Act (GPRA) provides an excellent vehicle for IRS to reach agreement with the Congress on a business strategy and for the Congress to assess IRS' performance in implementing an agreed upon strategy. Under GPRA, each agency is to develop strategic plans for its program activities, laying out the organization's fundamental mission and long-term goals and objectives for accomplishing that mission. GPRA requires that these plans be submitted to OMB and the Congress by September 30, 1997. Recognizing the value of such plans, OMB has accelerated the legislative schedule and is currently working with agencies in developing key elements of their strategic plans.

IRS Does Not Yet Have a Comprehensive Strategy to Significantly Reduce the Volume of Paper Returns

One of the biggest problems facing IRS is its inefficient system for processing most tax returns. IRS has made little progress either in reducing the number of paper returns it processes or in delivering the new systems needed to better process paper.

IRS' strategy for receiving and capturing data from tax returns was and still is a critical component of IRS' business vision. Initially, IRS' strategy focused on replacing computers in its 10 service centers with more efficient ones. However, in 1992, IRS began examining other processing options. As a part of that analysis, IRS concluded that it had to make various organizational and business changes.

One of the most important business changes was IRS' decision to significantly increase, by the year 2001, the number of tax returns received electronically. Compared with IRS' current procedures for processing paper returns, electronic filing has several benefits for IRS. These benefits include reduced processing, storage, and retrieval costs; and faster, more accurate processing of returns and refunds.

Although IRS has implemented some initiatives that have increased the number of electronic returns since 1993, IRS does not have a comprehensive business strategy to reach or exceed its electronic filing goal, which was 80 million electronic filings by 2001. IRS' estimates and projections for individual and business returns suggested that, by 2001, as few as 39 million returns may be submitted electronically, less than half of IRS' goal and only about 17 percent of all returns expected to be filed.

We have reported that IRS' business strategy would not maximize electronic filings because it primarily targeted taxpayers who use a third party to prepare and/or transmit simple returns, are willing to pay a fee to file their returns electronically, and are expecting refunds. Focusing on this limited taxpaying population overlooked most taxpayers, including those who prepare their own tax returns using personal computers, have more complicated returns, owe tax balances, and/or are unwilling to pay a fee to a third party to file a return electronically.

To date, most of the returns filed electronically are ones that, if filed on paper, could be filed on forms (like the 1040EZ) that are among the least costly paper returns to process. With that in mind, we recommended, in October 1995, that IRS identify those groups of taxpayers that offer the greatest opportunity to reduce IRS' paper processing workload and operating costs if they filed electronically and develop strategies that focus on eliminating or alleviating impediments that inhibit those groups from participating in the program.[4]

Some of IRS' 21 electronic filing initiatives have realized some positive results. For example, certain taxpayers who are eligible to file a Form 1040EZ are now allowed to file electronically using a toll-free number on touch-tone phones. This year, about 2.8 million taxpayers used that filing method, known as TeleFile.

Also, IRS has not yet successfully addressed one of the major impediments to the expansion of electronic filing—its cost to taxpayers. We concluded that, without a strategy that also targets these taxpayers, IRS would not meet its electronic filing goals. In addition, if, in the future, taxpayers file more paper returns than IRS expects, added stress will be placed on IRS' paper-based systems. Accordingly, we recommended that IRS refocus its electronic filing business strategy to target, through aggressive marketing and education, those sectors of the taxpaying population that can file electronically most cost-beneficially.

[4]Tax Administration: Electronic Filing Falling Short of Expectations (GAO/GGD-96-12, October 31, 1995).

To respond to our recommendation, to date, IRS has performed an electronic filing marketing analysis at local levels; developed a marketing plan to promote electronic filing; consolidated its 21 electronic filing initiatives into its Electronic Filing Strategies portfolio; and initiated a reengineering project with a goal to reduce paper tax return filings to 20 percent or less of the total volume by the year 2000. It plans to complete its electronic filing strategy in early fall 1996. These initiatives could result in future progress toward increasing electronic filings.

However, these initiatives are not far enough along to determine whether they will culminate in a comprehensive strategy that identifies how IRS plans to target those sectors of the taxpaying population that can file electronically most cost-beneficially. It also is not clear how the reengineering project will affect the strategy, or how these initiatives will affect TSM systems that are being developed.

IRS has also experienced problems in delivering the systems to process paper returns in the future. IRS' business vision for 2001 included consolidating the processing of all paper documents (tax returns, correspondence, and information returns) into 5 of its 10 service centers. IRS identified which five centers will specialize in paper processing and consolidated the processing of paper information returns and Federal Tax Deposit coupons in those centers with the roll out of an interim scanning and imaging technology known as the Service Center Recognition Image Processing System (SCRIPS). Besides information returns and tax deposit coupons, SCRIPS was originally expected to process all forms 1040EZ, 1040PC, and 941 (employment tax returns). Instead, for 1996, SCRIPS is processing about 50 percent of the 1040EZs and none of the 1040PCs and 941s.

Also, in 1988 IRS began designing a Document Processing System (DPS) in an effort to use imaging and optical character recognition technologies to process paper tax returns and capture 100 percent of the data on those returns. In April 1992, we said that IRS had not adequately assessed the cost-benefit trade-offs associated with its strategy for receiving and capturing tax return data using DPS.[5] We recommended that IRS develop a comprehensive analysis to determine the cost and benefits of alterative strategies for receiving and capturing tax return information.

[5]Tax Systems Modernization: Input Processing Strategy is Risky and Lacks a Sound Analytical Basis (GAO/T-IMTEC-92-15, April 29, 1992).

IRS proceeded with the development of DPS without this analysis and estimates that it spent about $270 million on DPS through fiscal year 1995. According to IRS officials, IRS is now uncertain whether the benefits of DPS outweigh the costs and IRS is currently reevaluating its needs. With the problems encountered with both the SCRIPS and DPS systems, IRS is left without a proven system for more efficiently processing paper returns in the future.

IRS Faces Several Challenges in Implementing Its Customer Service Vision

The second part of IRS' business vision is to improve service to taxpayers. A key IRS goal is to resolve 95 percent of taxpayer issues after one contact. For service to improve, taxpayers must be able to reach IRS by telephone when they have questions or problems, and IRS employees must have easy access to the information needed to help taxpayers.

Taxpayers have long had a problem reaching IRS by telephone. The percentage of taxpayer calls that IRS assistors answered decreased from 58 percent for the 1989 filing season to 8 percent for the 1995 filing season. Although the accessibility rate improved during the 1996 filing season, assistors were still only able to answer 20 percent of taxpayers' telephone calls.[6]

Also, even when a taxpayer reaches IRS, assistors do not always have easy access to the information needed to resolve taxpayers' problems. As a result, the assistor may have to either (1) refer the taxpayer to another office, (2) research the problem and call the taxpayer back, or (3) tell the taxpayer to call back later.

IRS' strategy for improving customer service includes consolidating work units, changing work processes, and increasing the use of or implementing new information systems. For instance:

- IRS' customer service vision calls for consolidating the work of different functional areas that do not have face-to-face interaction with taxpayers. IRS is making some progress in consolidating the work of 70 such organizational units in 44 locations that traditionally have non face-to-face interaction with taxpayers into 23 customer service centers. This consolidation effort will continue through 2002. The consolidated centers would, for example, absorb the functions of toll-free taxpayer assistance

[6]As discussed in appendix I, IRS measures the level of access based on the number of taxpayers assisted divided by the estimated number of taxpayers that called. Through June 1996, IRS statistics show it provided a 46-percent level of access compared to 38 percent the prior year.

sites, which answer calls about tax law and procedures, taxpayer accounts, and notices that taxpayers receive from IRS.

- IRS' customer service vision emphasizes use of the telephone to interact with taxpayers. To fulfill this vision, IRS must complete actions directed at converting to telephone much of the work now being done by correspondence and at making it easier for taxpayers to reach IRS and resolve their problems by telephone. IRS is making some progress in (1) extending its hours of operation, (2) improving its ability to route calls nationwide, (3) increasing the use of interactive systems, and (4) reducing demand for assistance.

IRS' strategy offers promise as it is designed to improve taxpayers' ability to get assistance from IRS and to provide IRS employees easy access to information. However, IRS must address several important managerial, technical, and human resource challenges to fully achieve that vision. Specifically, IRS has to manage the transition to the customer service vision while continuing to answer taxpayer inquiries, manage taxpayer accounts, and collect unpaid taxes. IRS also has to determine the scope of responsibilities for those staff employed at customer service centers and provide the requisite training for that staff. IRS also has to develop the information systems necessary to support the accomplishment of its vision, including an interactive telephone system that is easy for taxpayers to use.

Achieving Customer Service and Compliance Goals Depends on Better Access to Critical Data

Achieving IRS' customer service and compliance goals depends in large measure on increasing the use of and implementing new information systems. However, IRS has not fully defined its business requirements for those systems and lacks a cost-effective strategy for accessing taxpayer data that may be needed for customer service and compliance.

Also, IRS' primary taxpayer account database that is used for assisting taxpayers—the Integrated Data Retrieval System (IDRS)— was designed in the 1960s. Until 1995, account information in IDRS was spread among 10 service centers, and employees in each center had access to information on only a small percentage of IDRS accounts. When an employee did not have access to the account information needed to respond to a taxpayer's question, the employee typically wrote down the question and mailed it to the location that had access to the information. Then, that office would respond to the taxpayer's question.

Early in 1995, IRS implemented a networking capability among the 10 service centers so that employees could have access to IDRS data nationwide. This networking capability is referred to as Universal IDRS. Although Universal IDRS gives IRS employees access to taxpayer account information nationwide, IDRS does not always contain complete information on a taxpayer's account. Other information needed to help the taxpayer may reside in different systems that are not linked to IDRS.

Making it easier for taxpayers to reach IRS by telephone is of limited value if IRS employees on the other end of the line do not have access to the data needed to help the taxpayers, which has been a long-standing problem in IRS. IRS eventually intends to provide its employees with access to greater amounts of on-line taxpayer data in shorter time frames than current systems can provide.

Another major goal of IRS' vision is to increase compliance. Achieving this goal hinges on the ability of enforcement staff to readily access good data. For example, as we discussed in recent testimony on IRS' debt collection practices, existing IRS computer systems do not provide ready access to needed information and, consequently, do not adequately support modern work processes.[7] Access to current and accurate information on tax debts is essential if IRS is to enhance the effectiveness of its collection tools and programs to prevent taxpayers from becoming delinquent in the first place.

Although technology plays a key role in helping an organization collect good data and make it readily accessible to employees, it is critical that the organization first determine what data it needs. IRS has not yet identified all of the data that enforcement staff need to do their job.

IRS currently captures about 40 percent of the data provided by taxpayers on their individual income tax returns. IRS' intent, as part of modernization, was to capture either through electronic submission or imaging, 100 percent of the data. However, as part of the TSM reassessment effort, IRS has decided that it will continue capturing about 40 percent of the individual income tax return data for at least the next 5 years, with the intent of moving to 100 percent later. If IRS is going to continue capturing 40 percent of the tax return data, it is critical that it capture the right 40 percent. IRS does not now know if it is capturing the right data.

[7]Tax Administration: IRS Tax Debt Collection Practices (GAO/T-GGD-96-112, April 25, 1996).

It is also important that any data IRS captures, whether 40 percent or 100 percent of the universe, be easily accessed by staff who need it. In that regard, IRS officials told us that enforcement staff are not able to readily access the data that IRS is now capturing.

TSM Projects and Reengineering Efforts Must Be Integrated

One of the managerial weaknesses discussed in our July 1995 report on TSM that has significant programmatic implications was a lack of integration of IRS' reengineering efforts and TSM projects. Specifically, we said that IRS' business reengineering efforts were not tied to its TSM projects and that IRS lacked a comprehensive plan and schedule defining how and when to integrate these business reengineering efforts with ongoing TSM projects.

We continue to question IRS' ability to make sound investment decisions on TSM until the reengineering of important processes is sufficiently complete. Reengineering could result in new business requirements that are not addressed by planned TSM projects or that make those projects obsolete.

For example, IRS' strategy for returns processing needs to be based on a clear definition of its downstream business requirements for customer service and compliance, and on an analysis of the cost and benefits of meeting those requirements. These requirements may evolve from the different scenarios that IRS is currently considering as a part of its reengineering efforts. Until such an alternatives analysis of the business requirements is completed, IRS has no assurance that its technology investments for submission processing are sound.

Developing the Capacity to Make Sound Technology Investments

Successfully achieving IRS' business goals—reducing the volume of paper returns, better serving customers, and improving compliance—will depend heavily on investing in information technology. Consequently, IRS needs to effectively manage information technology investments by using the best practices of leading organizations and the provisions of the Information Technology Management Reform Act of 1996 and the Paperwork Reduction Act of 1995, as amended.

Despite the billions of dollars at stake, IRS information systems are not yet managed as investments, and strategic information management practices are not fully in place. To overcome this, and provide the Congress with insight needed to assess IRS' priorities and rationalization for TSM projects, we recommended that the IRS Commissioner take immediate action to implement a complete process for selecting, prioritizing, controlling, and evaluating the progress and performance of all major information systems investments, both new and ongoing, including explicit decision criteria, and using these criteria, to review all planned and ongoing systems investments by June 30, 1995.

IRS has taken positive steps that indicate a willingness to address the strategic information management problems we have raised. IRS has, for example, created the executive-level Investment Review Board for selecting, controlling, and evaluating all of IRS' information technology investments; developed the Business Case Handbook that includes decision criteria on costs, benefits, and risks; and developed the Investment Evaluation Review Handbook designed to assess projected costs and benefits against actual results.

But, as noted in Treasury's report on TSM, the investment process is not yet complete. According to Treasury, it was missing (1) specific operating procedures, (2) defined reporting relationships between different management boards and committees, and (3) updated business cases for major TSM technology investments. Our own analysis shows serious weaknesses, such as inadequate data, an incomplete portfolio, and the lack of an effective investment evaluation review process.

These concerns coincide with two central criticisms we have repeatedly made about TSM. Because of the sheer size, scope, and complexity of TSM, it is imperative that IRS institutionalize a repeatable process for selecting, controlling, and evaluating its technology investments, and that it make informed investment decisions based on reliable qualitative and quantitative assessments of costs, benefits, and risks. Although IRS is planning and is in the initial stages of implementing parts of such a process, a complete, fully-integrated process does not yet exist. Specifically, IRS has not provided us evidence to justify its claims that its decisions were supported by acceptable data on project costs, benefits, and risks.

To help ensure that agencies such as IRS have the capacity to manage information technology as an investment, the Information Technology Management Reform Act of 1996 establishes a framework for improving the capital planning and control of investments in information technology. Under the act, agencies are to design and implement a process for maximizing the value and assessing and managing the risks of information technology acquisitions and use the process to select, control, and evaluate agency information technology investments. Much more effort will be required by IRS in order to fully meet this standard.

Building a Technical Foundation for TSM

Once investment decisions are made, the activities of transforming these ideas into successfully developed and operated systems requires following good business practices. Our work has identified weaknesses in these activities, and IRS' serious technical weaknesses continue to impede successful systems modernization. IRS has initiated a number of actions to address these weaknesses but additional measures are necessary to correct them and, in the interim, to mitigate the risks associated with ongoing TSM spending.

Software Development Activities Are Inconsistent and Poorly Controlled

Unless IRS improves its software development capability, it is unlikely to build TSM timely or economically, and systems are unlikely to perform as intended. IRS said it is committed to developing consistent procedures addressing requirements management, software quality assurance, software configuration management, and project planning and tracking. It also said that it was developing a comprehensive measurement plan to link process outputs to external requirements, corporate goals, and recognized industry standards.

IRS has begun to improve its software development capability, but these actions are not yet complete or institutionalized, and, as a result, systems are still being developed without the disciplined practices and metrics needed to give management assurance that they will perform as intended. Providing this assurance will require IRS to:

- have disciplined processes in place to ensure that all contractors are performing at least at CMM Level 2;[8]
- develop a schedule for conducting software capability evaluations;
- complete procedures for requirements management, software quality assurance, software configuration management, and project planning and tracking; and
- complete a set of metrics and a schedule for institutionalizing the process needed to ensure its use.

[8]The Software Engineering Institute at Carnegie Mellon University has developed a model, the Software Capability Maturity Model (CMM), to evaluate an organization's software development capability. CMM Level 2 denotes that basic project management processes are established to track cost, schedule, and functionality and the necessary process discipline is in place to repeat earlier successes on similar projects.

Systems Architectures, Integration, and Testing Are Incomplete

IRS' systems architectures,[9] integration planning, and system testing and test planning are incomplete. IRS said that it was identifying the necessary actions to define and enforce systems development standards and architectures agencywide. Although IRS has taken actions to prepare a systems architecture and improve its integration and system testing and test planning, these efforts are not yet complete or institutionalized.

As a result, TSM systems continue to be developed without the detailed architectures and discipline needed to ensure success. To provide these architectures and discipline, IRS must, for example:

- complete its integrated systems architecture (the "blueprints" of TSM);
- bring its development, acceptance, and production environments under configuration management control;
- include selected security methods and techniques in its security concept of operations document;
- develop a detailed disaster recovery and contingency plan needed to provide useful guidance in emergencies;
- include in its test and evaluation master plan descriptions of (1) the security testing that should be performed and how these tests should be conducted and (2) the responsibilities and processes for documenting, monitoring, and correcting testing and integration errors; and
- complete plans for its integration testing and control facility and ensure that the permanent facility simulates the complete production environment.

No Single IRS Entity Controls All Information Systems Efforts

IRS has not yet established an effective organizational structure to consistently manage and control systems modernization organizationwide. IRS has made improvements in consolidating management control over systems development. For example, in September 1995, the Associate Commissioner for Modernization assumed responsibility for the formulation, allocation, and management of all information systems resources for both TSM and non-TSM expenditures.

However, the Associate Commissioner still does not have control over all IRS systems development activities. Specifically, systems development conducted by the research and development division has now been redefined as technology research, keeping it from the control of the

[9] A system architecture is an evolving description of an approach to achieving a desired mission. It describes (1) all functional activities to be performed to achieve the desired mission, (2) the system elements needed to perform the functions, (3) the designation of performance levels of those system elements, and (4) the technologies, interfaces, and location of functions.

Associate Commissioner. We continue to believe that it is critical for IRS to establish an organizationwide focus to manage and control all new modernization systems and all upgrades and replacements of operational systems throughout IRS.

Plans Must Be Defined and Capabilities Strengthened Before Obtaining Additional Contractor Support

By increasing its reliance on contractors, IRS expects to improve the accountability for and probability of TSM success. IRS has outlined a three-track approach for transitioning over a period of 2 years to the use of a "prime" contractor that would have, according to IRS, overall authority and responsibility for the development, delivery, and deployment of modernized information systems.

To facilitate this strategy, IRS reported that it would consolidate the management of all TSM resources, including key TSM contractors, in its Government Program Management Office (GPMO). Under the direct control of the Chief Information Officer, the GPMO will be delegated authority for the management and control of the IRS staff and contractors that plan, design, develop, test, and implement TSM components.

IRS' approach to expanding the use of contractors to build TSM is still in the early planning stages. Because of this, IRS was unable to provide us with formal plans, charters, schedules or the definitions of shared responsibilities between the GPMO and the existing program and project management staff.

Consequently, at this point, it is unclear what these IRS plans entail, or how they will work. However, IRS' approach for expanding the use of contractors must, for example:

- specify how and when it plans to transfer its development activities to contractors, and to what extent contractors could be held responsible for existing problems in these government-initiated systems;
- clarify how the "prime" contractor would direct potential competitors that are already under contract with IRS; and
- include a schedule for transitioning specific responsibilities from IRS to contractors.

Further, plans to use additional contractors will succeed if, and only if, IRS has the in-house capabilities to manage these contractors effectively. Unless IRS has mature, disciplined processes for acquiring software systems through contractors, it will be no more successful in buying software than it has been in building software.

Addressing Serious Financial Management Problems

As part of a pilot program under the Chief Financial Officers (CFO) Act of 1990, IRS began preparing annual financial statements showing the results of its operations starting with those for fiscal year 1992. CFO Act implementation has (1) led to IRS top managers having a much better understanding than ever before of IRS' serious and pervasive accounting and reporting problems, (2) provided information on the magnitude of IRS' tax receivables collection problems, and (3) identified the need for stronger controls over such areas as payroll operations. The CFO Act's requirements also have provided the impetus for efforts to improve IRS operations and address the substantial problems identified by our financial audits.

However, we have been unable to express an opinion on the reliability of IRS' financial statements for any of the 4 fiscal years from 1992 through 1995.[10] We identified fundamental, persistent problems that remained uncorrected and, until they are resolved, will continue to prevent us from expressing an opinion on IRS' financial statements in the future.

IRS worked to resolve these issues during our fiscal year 1995 financial statement audit and progress was made, but many of IRS' efforts were incomplete at the conclusion of the audit. IRS is continuing these efforts, which are being done cooperatively with GAO. Since we testified before the Committee on June 6, 1996, IRS and GAO have worked to further develop a plan and strategies for addressing the major weaknesses preventing IRS from receiving an opinion on its financial statements. The following paragraphs discuss IRS' five major uncorrected financial management problems and short-term plans for resolving them.

First, the amounts of total revenue (reported to be $1.4 trillion for fiscal year 1995) and tax refunds (reported to be $122 billion for fiscal year 1995) cannot be verified or reconciled to accounting records maintained for individual taxpayers in the aggregate. Second, the amounts reported for various types of taxes collected (social security, income, and excise taxes, for example) cannot be substantiated. As a short-term resolution for

[10] Financial Audit: Examination of IRS' Fiscal Year 1995 Financial Statements (GAO/AIMD-96-101, July 11, 1996); Financial Audit: Examination of IRS' Fiscal Year 1994 Financial Statements (GAO/AIMD-95-141, August 4, 1995); Financial Audit: Examination of IRS' Fiscal Year 1993 Financial Statements (GAO/AIMD-94-120, June 15, 1994); and Financial Audit: Examination of IRS' Fiscal Year 1992 Financial Statements (GAO/AIMD-93-2, June 30, 1993).

these two issues, IRS has developed software programs that it believes will capture, from its revenue financial management system, the detailed revenue and refund transactions that would support reported amounts in its future financial statements until longer term system fixes can be made to achieve more reliable reporting of these amounts. In addition, IRS plans call for completing documentation of its revenue financial management system, which is critical to aid in identifying better interim solutions for reporting revenues and refunds and provide better insights on the longer term system fixes needed to enable IRS to readily and reliably provide the underlying support for its reported revenue and refund amounts.

Third, the reliability of reported estimates for fiscal year 1995 of $113 billion for valid accounts receivable and of $46 billion for collectible accounts receivable cannot be determined. IRS initially plans to continue efforts to determine a means of using its current revenue financial management system's coding to identify its accounts receivables. IRS' efforts are focused on correcting known current coding errors through reviewing 100 percent of all receivables over $10 million. In addition, IRS plans to ensure more accurate input and processing of transactions that underpin accounts receivables by intensifying training efforts and improving internal control policies and procedures.

Fourth, a significant portion of IRS' reported $3 billion in nonpayroll operating expenses cannot be verified. IRS believes the core issue for correcting its receipt and acceptance problems relate to properly accounting for transactions with other federal agencies. IRS, GAO, and a contractor are working together to determine the root causes of and develop solutions to the issue.

Fifth, the amounts IRS reported as appropriations available for expenditure for operations cannot be reconciled fully with Treasury's central accounting records showing these amounts, and hundreds of millions of dollars in differences have been identified. IRS believes that it has completed the reconciliation of its Fund Balance with Treasury accounts except for IRS' suspense accounts that contained reconciling items that were more than 6 months old. However, IRS is still in the process of making the necessary adjustments required to its general ledger and the related Treasury records to complete this effort. We plan to review IRS' reconciliation of outstanding differences and verify the accuracy of adjustments as they are made.

It will be essential for IRS to now follow through and ensure that its planned short-term, interim actions are completed on schedule to improve the reliability of IRS' financial statements. We will continue to work with IRS in doing so. Additionally, some of IRS' corrective actions are longer term and involve reprogramming software for IRS' antiquated systems and developing new systems.

Providing Effective Oversight to Ensure Corrective Actions Are Promptly and Fully Completed

The recommendations we have outlined provide a road map for bringing greatly strengthened management to IRS' operations. IRS needs to fully implement these actions in order to fulfill any business strategy it and the Congress decide upon to provide efficient and effective taxpayer services into the next century. But, bringing these actions to fruition and making financial and information management improvements a reality, will require intense follow through and sustained oversight by IRS top management, Treasury, OMB, and the Congress. This will be especially important, as we have not always observed the close oversight and strong follow through within the Executive Branch that it will take to overcome the substantial problems IRS has experienced in effectively carrying out its business vision, successfully developing TSM, and obtaining an opinion on its financial statements.

Foremost, IRS and Treasury must concentrate on the specific actions we have outlined. We are encouraged that Treasury is taking a more active role in overseeing IRS' efforts to improve its business operations. A joint Treasury-IRS Modernization Management Board, chaired by the Deputy Secretary of the Treasury, has been established as the primary review and decision body for modernization and TSM policy and strategic direction. The Board will review IRS' strategic plans, investment decisions, and progress against implementation plans.

The eight-member board includes (1) from Treasury, the Assistant Secretary for Management and CFO, the Assistant Secretary (Tax Policy), the Deputy Assistant Secretary (Departmental Finance and Management), and the Deputy Assistant Secretary (Information Systems) and (2) from IRS, the Commissioner, the Deputy Commissioner, the Associate Commissioner for Modernization, and the Chief Information Officer. Advisory Board members include the Treasury Inspector General and the IRS Chief of Taxpayer Service/Compliance and the IRS Chief Management and Administration. For the Board to succeed, it will be essential for it to have independent sources of information on IRS' efforts and progress to effectively oversee and track the cost and schedule of all TSM projects.

For its part, OMB should emphasize reviewing, in particular, the investment of the billions of dollars that the government will spend in developing TSM, the use of technology in IRS' changing business environment, and the steps IRS plans to take to improve its financial management. The CFO Act and the Information Technology Management Reform Act give OMB important leadership responsibilities in these areas. In this regard, for example, the Director of OMB is responsible for (1) promoting and directing that federal agencies establish capital planning processes for information technology investment decisions, (2) evaluating the results of those investments, and (3) enforcing accountability for them through the budget process.

The Congress has established the following legislative framework that provides the structure necessary to help IRS achieve better financial and information management and measure the results of implementing its business vision.

- The CFO Act provides the underpinning for identifying and correcting financial management weaknesses and reliably reporting on the results of IRS' financial operations.
- The Government Performance and Results Act emphasizes managing for results and pinpointing opportunities for improved performance and increased accountability.
- Title V of the Federal Acquisition Streamlining Act of 1994 requires agency heads to define costs, schedules, and performance goals for major acquisition programs, including information technology, and for monitoring the acquisitions and taking appropriate corrective actions when necessary.
- The Paperwork Reduction Act of 1995, as amended, and the Information Technology Management Reform Act of 1996 (1) explicitly focus the application of information resources on supporting agency missions and improving agency performance and (2) set forth requirements for improving the efficiency and effectiveness of operations and the delivery of services to the public through an effective use of information technology.

These laws also provide a basis for the Congress to hold IRS accountable for resolving the weaknesses and taking the actions we have discussed. In this regard, the Committee's recent hearings on these matters have brought greater attention to the consequence of continued delays in solving IRS' management problems. We encourage this Committee, and other congressional oversight and appropriations committees, to use these management statutes to help focus on the progress IRS is making to correct these important issues.

Role of the New Commission on Restructuring IRS

In the appropriations act providing funds for IRS for fiscal year 1996, the Congress established the National Commission on Restructuring the Internal Revenue Service and gave the Commission a broad, sweeping charter. It is charged with reviewing:

- present IRS practices, especially its organizational structure, paper and return processing activities, infrastructure, and collection process;
- what is required for improvements in (1) making returns processing "paperless," (2) modernizing IRS operations, (3) improving the collections process without major increases in personnel or funding, (4) improving taxpayer accounts management, (5) improving accuracy of information requested by taxpayers in order to file returns, and (6) changing the culture of IRS to make it more efficient, productive, and customer oriented;
- whether IRS could be replaced with a quasi-governmental organization with tangible incentives for managing its programs and activities, and for modernizing its activities; and
- whether IRS could perform other collection, information, and financial service functions of the federal government.

The Commission's 17 members were appointed by congressional leaders and the President in May 1996. Cochairing the Commission are Senator Bob Kerrey and Representative Rob Portman.

The Congress provided $1 million in direct funding for the Commission to examine IRS' organization and identify and recommend actions to expedite the implementation of TSM and improve service to taxpayers. We will work with the Commission as it addresses these areas and explores alternatives to IRS' organization, activities, infrastructure, and processes. The Commission's report, which is to be completed 1 year after its first meeting, should provide the Congress a current in-depth, comprehensive look at operations and management structures across IRS and fresh insights for resolving IRS' persistent uncorrected financial and information management problems.

Through the Commission, the Congress has created an excellent opportunity to bring about long-term, fundamental organizational and management changes at IRS. The Commission's work could help provide the added impetus necessary to (1) develop an effective implementation strategy for IRS' business vision, (2) manage information systems as investments, (3) build a strong technical foundation for TSM, and (4) ensure the reliability of financial information and systems.

Agency Comments and Our Evaluation

In commenting on a draft of this report, IRS provided information on its efforts to address problems with TSM, customer service, and financial management. For TSM, IRS said it (1) was continuing to refine its investment review process and had made substantial progress in updating the business cases for TSM projects, (2) had initiated the tax settlement reengineering project to further reduce the volume of paper transactions, (3) would continue work on the systems life cycle and was developing a schedule for completing the TSM architecture, (4) was establishing the GPMO which will be responsible for directing and monitoring the activities of all modernization contractors, and (5) would deliver a revised strategic plan to the Congress and OMB by September 30, 1997. In addition, IRS described the status of actions underway to resolve deficiencies in its financial management systems. IRS reaffirmed its commitment to ensuring the integrity of its financial data. IRS' response to the report, along with our comments, is in appendix I.

An OMB representative agreed with the overall content of the report, adding that it provided a good summary of IRS' progress and problems with TSM, customer service, and financial management.

We are sending copies of this report to the Chairmen and Ranking Minority Members of (1) the Senate and House Committees on the Budget, (2) the Subcommittee on Taxation and IRS Oversight, Senate Committee on Finance, (3) the Subcommittee on Oversight, House Committee on Ways and Means, and (4) the House Committee on Government Reform and Oversight. We are also sending copies to the Director of the Office of Management and Budget, the Secretary of the Treasury, and the Commissioner of Internal Revenue. Copies will be available to others upon request.

The work that was the basis for this report was performed under the direction of Lynda D. Willis, Director, Tax Policy and Administration of the

General Government Division who can be reached at (202) 512-8633; Dr. Rona B. Stillman, Chief Scientist for Computers and Telecommunications, Accounting and Information Management Division, who can be reached at (202) 512-6412; and Gregory M. Holloway, Director, Governmentwide Audits, Accounting and Information Management Division, who can be reached at (202) 512-9510.

Gene L. Dodaro
Assistant Comptroller General

Comments From the Internal Revenue Service

Note: GAO comments supplementing those in the report text appear at the end of this appendix.

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

COMMISSIONER

August 16, 1996

Mr. Gene L. Dodaro
Assistant Comptroller General
United States General Accounting Office
441 G Street, N.W.
Washington, DC 20548

Dear Gene:

We appreciate the opportunity to comment on the General Accounting Office draft report, Business Operations Need to Continue Improving. As you indicated, the draft report draws heavily from prior GAO reports and testimonies and does not contain any new recommendations. However, we would like to make the following comments regarding the Tax Systems Modernization Program, customer service and our financial management activities.

Tax Systems Modernization

The Secretary's May 1996 Progress Report on IRS' Management and Implementation of Tax System Modernization provides evidence of the important changes that are underway at the Internal Revenue Service to improve our management of the TSM Program. The Secretary's report demonstrates that the IRS has taken the concerns raised about the TSM Program very seriously and that we are taking aggressive steps to address the weaknesses that have been identified.

Since issuance of the Secretary's report, the Associate Commissioner for Modernization has monitored the status of our ongoing improvements to ensure that the IRS fulfills its commitments to Congress and fully addresses the concerns that have been raised by GAO. Additional progress has been made in several critical areas including:

- Investment Review Process: We are continuing to refine our investment review process and have made substantial progress in updating the business cases for TSM projects. The Investment Review Board has reviewed the first series of business cases and approved the business cases for Customer Service/Integrated Case Processing, Integrated Collection System, Compliance Research Information System, Service Center Replacement System Consolidation, TeleFile and Automated Self-Service Applications. The remaining

- 2 -

Mr. Gene L. Dodaro

business cases are scheduled for completion in September. In addition, we have completed four investment evaluation reviews during 1996 and are on schedule to complete two additional reviews by the end of the fiscal year.

- Electronic Commerce/Tax Settlement Reengineering: We have initiated the Tax Settlement Reengineering project to further reduce the volume of paper transactions handled by the IRS. The Reengineering effort is making progress in documenting current work processes, designing future processes and linking reengineering efforts to Modernization initiatives. We also have established an executive lead task force to develop a comprehensive business strategy for all aspects of electronic commerce including filings and payments.

- Information Systems: The Chief Information Officer continues work on completing the Systems Life Cycle and is developing a schedule for completion of the TSM architecture. In addition, work continues on implementing contractor Capability Maturity Model reviews, establishing software development metrics, establishing the Integration Testing and Control Center and assessing the compliance level of developmental information systems.

- Accountability and Responsibility: We are in the process of establishing the Government Program Management Office which will be responsible for directing and monitoring the activities of all Modernization contractors. We recently selected the Director and brought on board members of the Presidential Technology Team to join existing IRS, Federally Funded Research and Development Center and Integration Support Contract personnel. Additional actions underway to strengthen the overall management of the TSM Program include reassessing control over research and development activities within the IRS.

- Strategic Planning: In addition, we are on target for the timely delivery of the strategic plan to Congress and the Office of Management and Budget by September 30, 1997. In preparation for this submission, we have worked with both the Department of Treasury and OMB to improve the plan through Fiscal Year 2001 to ensure that the requirements of the Government Performance and Results Act are adequately covered.

In addition, we wish to point out that the Modernization Management Board (MMB), which is chaired by the Deputy Secretary of the Treasury, provides a structure for Treasury's direct oversight of the TSM Program. The MMB will help to ensure that the IRS exercises the management disciplines and practices needed to make our Modernization plans successful.

Customer Service

See comment 1.

In your draft report, you indicated that the percentage of taxpayer calls that IRS assistors answered decreased from 58 percent for the 1989 filing season to 8 percent for the 1995 filing season. You further indicated that although the accessibility rate improved during the 1996 filing season, assistors were still only able to answer 20 percent of taxpayer telephone calls. IRS measures the level of access based on the number of taxpayers assisted divided by the number of taxpayers that called. Through June 1996, the IRS provided a 46 percent level of access (39.7 million calls) in comparison to 38 percent (34.7 million calls) the prior year.

While 46 percent represents a significant increase in the level of access achieved to date, we are not satisfied and are continuing to take aggressive steps to reduce demand and increase access for taxpayers. Demand for assistance was reduced from 54 million in the 1995 filing season to 48 million in the 1996 filing season through several initiatives including the elimination of 18 million notices and the utilization of the Internet to provide information to taxpayers.

Assistors are available to respond to taxpayer inquiries 10 hours each business day. In addition, beginning in March 1996, many callers responding to a notice were provided as much as 16 hours access to our telephone assistors. After hours callers continue to have access to tax law and refund information via TeleTax.

You also state that even when the taxpayer reaches the IRS, our assistors do not have easy access to the information needed to resolve that taxpayer's problem. We share your concern about this, and we are trying to answer taxpayer questions more quickly and more efficiently. Last year, we began providing nationwide access to certain taxpayer account information, and over this year and the last, we have rolled out nationwide over 3,000 additional computer terminals that have allowed our assistors to access additional information. As a result, over the past year (July 1, 1995 - June 30, 1996,) 79 percent of taxpayers' inquiries on account issues were resolved during their initial contact with the IRS.

Financial Management

The IRS, one of the pilot agencies to be audited under the Chief Financial Officers (CFO) Act of 1990, has made progress but also faced unexpected challenges in meeting financial audit requirements. As you are aware, prior to enactment of the CFO Act, the IRS was not required to prepare financial statements or to have financial

- 4 -

Mr. Gene L. Dodaro

audits. When the GAO began auditing our financial statements in 1992, we were not working with systems designed to provide data in accordance with the CFO Act. Our revenue and administrative accounting systems were desiged many years ago to complement our processing systems.

Since the CFO Act became effective, we have made significant improvements in our financial management systems and now have a new administrative accounting system. As the GAO noted in the most recent audit report, however, there are still two areas of concern: reconciling our administrative cash accounts with Treasury and the receipt and acceptance documentation for some non-payroll payments, such as rent payments to the General Services Administration and printing payments to the Government Printing Office. We expect to have these issues resolved this year. We are also working on short-term solutions and long-term redesigns that will modernize our revenue accounting system and ensure that it provides information that is needed for the financial statement audit. In addition, we have an action plan which addresses the 59 recommendations that the GAO made as a result of the financial statement audits; 17 have been completed and the remaining are actively being addressed in cooperation with the GAO.

For example, in June, the CFO met for three days with GAO representatives to review the FY1995 audit of the financial statements and plan for the FY1996 audit. Representatives from the CFO organization, Taxpayer Service, Information Systems, Treasury IG, Treasury DCFO and the GAO discussed two broad issues: the administrative statements and the custodial or revenue-related statements. A detailed action plan for each set of statements was jointly agreed to. We will hold follow-up meetings with your office to ensure that the FY1996 audit stays on schedule and that issues raised are resolved promptly.

See comment 2.

One final point concerns the perceived relationship between the financial statement audits and the quality of tax administration. I and my IRS colleagues are quite concerned that the IRS has not "passed" its financial audit, and we are working diligently to get an unqualified opinion. But it is important to understand, as is explained in your draft report, that the GAO is unable to reconcile amounts reported in the financial statements to the detailed accounting records. It does not mean that the money the IRS is supposed to be collecting or spending has simply disappeared or somehow been misappropriated. This has not occurred. Nor does it mean that we are doing a poor job of tax administration.

Mr. Gene L. Dodaro

As the collector of over 90 per cent of the nation's revenues, we fully understand that we have a special obligation to taxpayers to be accountable for each tax dollar we collect and spend. The IRS has strong systems and controls to ensure that taxpayers' individual accounts are accurate. These systems work. Any complex system will produce some errors, and ours does, but we make great efforts to detect and correct them promptly. Our real challenge is to alter these systems to provide the necessary data to meet the financial requirements of the CFO Act. This is where we are focusing our efforts to improve financial management.

Sincerely,

Margaret M. Richardson

Margaret Milner Richardson

The following are GAO's comments on the Internal Revenue Service's letter dated August 26, 1996.

GAO Comments

1. IRS' performance statistics differ from ours primarily because IRS has historically measured performance on taxpayer telephone assistance differently than we do. We included, on page 9, the performance measure IRS calculated for the years ending June 30, 1995, and June 30, 1996. We are currently working with IRS to develop an agreement on the data to be reported in the future by GAO and IRS for telephone taxpayer assistance.

2. As discussed on page 17, the amounts of total revenue cannot be verified or reconciled to accounting records maintained for individual taxpayers in the aggregate. Thus, IRS did not know and we could not determine if the reported amounts were correct. These discrepancies further reduce our confidence in the accuracy of the amount of total revenues collected.

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