BY THE U.S. GENERAL ACCOUNTING OFFICE

Report To The Commissioner Of Internal Revenue

IRS Can Do More To Identify Tax Return Processing Problems And Reduce Processing Costs

IRS detected about 33 million errors on the 94 million individual income tax returns processed in fiscal year 1981. The errors were made by taxpayers when they prepared their returns and by IRS employees when they processed those returns. Although IRS corrects most errors it detects, it does not have a system to collect data on the causes of the errors so that they can be prevented in the future. GAO recommends that IRS begin producing more detailed data for evaluating return processing operations. GAO also proposes several changes to IRS' return processing system which could reduce processing costs by as much as $2.2 million annually.

GAO/GGD-83-8
OCTOBER 14, 1982

Request for copies of GAO reports should be sent to:

U.S. General Accounting Office
Document Handling and Information
Services Facility
P.O. Box 6015
Gaithersburg, Md. 20760

Telephone (202) 275-6241

The first five copies of individual reports are free of charge. Additional copies of bound audit reports are $3.25 each. Additional copies of unbound report (i.e., letter reports) and most other publications are $1.00 each. There will be a 25% discount on all orders for 100 or more copies mailed to a single address. Sales orders must be prepaid on a cash, check, or money order basis. Check should be made out to the "Superintendent of Documents".

UNITED STATES GENERAL ACCOUNTING OFFICE
WASHINGTON, D.C. 20548

GENERAL GOVERNMENT
DIVISION

B-202441

The Honorable Roscoe L. Egger, Jr.
Commissioner of Internal Revenue
Department of the Treasury

Dear Mr. Egger:

This report discusses how the Internal Revenue Service corrects errors that are made by taxpayers when they prepare their individual income tax returns and by Service employees when they process the returns. We made this review to determine how well the Service processes individual income tax returns and if improvements could be made in the tax return processing system. The report points out that the Service does an effective job of correcting tax return errors. It also shows that processing costs could be reduced if better program evaluation data is collected and if several changes are made to the Service's return processing operations.

This report makes recommendations to you on pages 10 and 23. Section 236 of the Legislative Reorganization Act of 1970 requires the head of a Federal agency to submit a written statement on actions taken on our recommendations to the Senate Committee on Governmental Affairs and the House Committee on Government Operations not later than 60 days after the date of the report and to the House and Senate Committees on Appropriations with the agency's first request for appropriations made more than 60 days after the date of the report.

Copies of this report are being sent to the Secretary of the Treasury; Director, Office of Management and Budget; and other interested parties.

Sincerely yours,

W. J. Anderson

William J. Anderson
Director

GENERAL ACCOUNTING OFFICE
REPORT TO THE COMMISSIONER
OF INTERNAL REVENUE

IRS CAN DO MORE TO IDENTIFY TAX RETURN PROCESSING PROBLEMS AND REDUCE PROCESSING COSTS

D I G E S T

The Internal Revenue Service (IRS) could reduce individual income tax return processing costs by gathering and analyzing additional data on return processing problems. More specific data on return processing errors would provide IRS with the detailed information it needs on the causes of processing problems so that preventive action could be taken.

In fiscal year 1981, IRS processed about 94 million individual income tax returns and identified about 33 million errors on those returns. The errors were made either by taxpayers when they prepared their returns or by IRS employees when they processed the returns.

Errors are detected at IRS service centers when the computer used to process tax return data makes various math and validity checks to determine if the tax returns are complete and accurate. Returns which fail these checks appear on an error register for correction by tax examiners.

To determine if changes could be made to the return processing system to reduce the number of errors being made, GAO statistically sampled 2,543 individual income tax returns which appeared on the error registers in four service centers. The returns were selected over a 16-week period in 1981.

IRS CORRECTS MOST TAX RETURN ERRORS

GAO found that IRS corrects most errors it detects on tax returns. The 2,543 sample cases contained 3,270 errors which IRS detected. IRS employees made 63 percent of the errors while taxpayers accounted for 37 percent. About 96 percent or 3,147 of the 3,270 errors were corrected. The remaining 123 errors were not corrected and resulted in IRS either understating or overstating the refund or balance due amounts in 48 (1.9 percent) of the 2,543 sample cases.

GAO/GGD-83-8
OCTOBER 14, 1982

GAO found an additional 159 taxpayer errors which were not found by IRS because the return processing system is not programmed to detect all errors. The 159 errors that IRS did not detect resulted in understating or overstating of refund or balance due amounts in 67 (2.6 percent) of the 2,543 sample cases. (See pp. 4 and 5.)

BETTER PROGRAM EVALUATION DATA NEEDED TO PREVENT ERRORS

GAO found that although IRS corrects most errors it detects, its present quality monitoring activities do not produce the detailed data necessary to readily determine systematic and procedural causes of errors so that it can take corrective action. (See pp. 5 to 10.)

In 1982 IRS started a monitoring activity which examines selected processing procedures to determine if the procedures should be changed. This activity, while a step in the right direction, does not provide information on the total return processing system. Therefore, many procedural weaknesses may still go undetected. (See p. 8.)

In doing its review of the 2,543 error cases, GAO gathered specific data on the types of errors made, who made the errors, what caused the errors, and where on the tax returns the errors occurred. GAO believes that these kinds of data are essential for determining the systematic and procedural weaknesses which cause the errors. IRS could gather similar data under one of the service center's ongoing monitoring activities without increasing service center costs. However, some additional national office costs may be incurred to analyze the data and ensure that the service centers are properly gathering the data. (See pp. 8 to 10.)

Through its evaluation of the return processing system GAO found that IRS could reduce costs by as much as $1.7 million annually if it made several changes to its return processing operations. This would reduce IRS' total error correction costs by about 17 percent. GAO also found that IRS could further reduce processing costs by as much as $495,000 if prompting features were incorporated into its direct data entry equipment. (See ch. 3.)

GAO RECOMMENDATIONS

The Commissioner of Internal Revenue should:

--Have the quality monitoring activity gather more specific data on the types of errors made, who made the errors, why the errors occurred, and where the errors occurred. This data should then be analyzed at both the service center and national office levels to determine the corrective action that can be taken to prevent similar future errors. (See p. 10.)

--Change procedures for correcting tax returns with multiple error conditions so that all readily identifiable independent errors can be corrected when they first appear on the error register. (See p. 23.)

--Require taxpayers who want IRS to compute their tax for them to enter their income tax withholding on their returns. IRS should change its processing procedures so that these returns do not automatically appear on the error register. (See p. 23.)

--Clarify for taxpayers the difference between FICA tax withheld and Federal income tax withheld by changing the wording on the form W-2, clarifying tax booklet instructions, and revising the math error notice message presently sent to taxpayers who mistakenly enter the amount of FICA tax withheld instead of the amount of Federal income tax withheld. (See p. 23.)

--Determine the cost effectiveness of providing new direct data entry equipment with the capability to prompt transcribers when they fail to key certain tax data into the computer. If cost effective, ensure that the new direct data entry equipment includes this prompting feature. (See p. 23.)

--Determine the merits of having data transcribers key into the computer both the money amounts and line numbers from tax returns. (See p. 23.)

AGENCY COMMENTS AND GAO's EVALUATION

IRS agreed with GAO's recommendations and is in the process of implementing those recommendations concerning (1) having the quality monitoring activity gather more specific information, (2) tax returns with multiple errors, (3) tax returns where IRS computes the tax for taxpayers, and (4) tax returns where taxpayers claim their FICA tax withholding as Federal income tax withholding. (See pp. 10 and 23.)

IRS also stated that it will consider GAO's recommendations to have prompting features for data transcribers incorporated into the direct data entry equipment and to have transcribers key into the computer both money amounts and line numbers when it evaluates vendors' proposals for new direct data entry equipment. IRS stated that if the winning vendor's proposal does not contain these features they can be implemented later. (See pp. 23 and 24.)

IRS did not agree with GAO's proposals to (1) add coding symbols on tax returns and (2) require taxpayers who want IRS to compute their tax returns for them to file a form 1040A. GAO believes that IRS' reasons for not implementing these proposals are sound. (See p. 24.)

Contents

ABBREVIATIONS

FICA	Federal Insurance Contribution Act (Social Security)
GAO	General Accounting Office
IRS	Internal Revenue Service

CHAPTER 1

INTRODUCTION

Processing tax returns and tax-related data is a major tax administration function which accounted for about 24 percent of the Internal Revenue Service's (IRS) $2.5 billion fiscal year 1981 budget. During that year IRS' 10 service centers processed about 139 million tax returns, including about 94 million forms 1040 and 1040A.

This report examines how well IRS corrects errors that are made by taxpayers when they prepare their returns and by IRS employees when they process them. Detecting and correcting errors on tax returns is important to ensure that taxpayers' tax liabilities are accurately assessed and that taxpayers receive correct refunds or tax bills. IRS identified about 33 million errors on the individual income tax returns it processed in fiscal year 1981. Among those were mathematical errors on about 7.1 million returns. Those errors resulted in taxpayers overstating their tax liabilities by about $778 million or understating their tax liabilities by $1.2 billion.

THE TAX RETURN PROCESSING SYSTEM

Tax returns are initially received at IRS service centers in sealed envelopes. There, the envelopes are opened and the returns are counted and sorted by type of return. Returns with a remittance, or payment, are separated from those which have no payment included, and the payments are deposited. The returns are then reviewed, coded, and edited by tax examiners in the Returns Analysis Branch so that they can be processed by a computer. After the returns are coded and edited, data transcribers key the tax data from the returns into the computer. Computer programs subject this data to math and validity checks to determine if the returns are mathematically accurate and all the tax data necessary for processing the returns are present and accurately transcribed. Returns which fail these math and validity checks are printed on an error register and sent to the error correction unit where tax examiners correct the errors. The corrected data is then keyed into the computer.

After the returns pass the service center's computer checks, computer tapes containing the return information are sent to IRS' National Computer Center in Martinsburg, West Virginia, where the returns are posted to the master file. A computer tape is then produced which lists all accounts requiring communication with the taxpayer, including the math errors identified by the service center when it processed the returns. The service centers receive this tape and mail these taxpayers computer-generated notices informing them of the errors or requesting additional information on their accounts.

OBJECTIVES, SCOPE, AND METHODOLOGY

The objectives of our review were to find out how well IRS processes individual income tax returns and if improvements could be made in the tax return processing system. Many factors, such as the volume of returns filed, taxpayer filing patterns, and a service center's physical space, workforce, and equipment, affect the efficiency of the return processing system. However, we concentrated our review activities on tax returns which failed the service center's computer math and validity checks. We did this to determine what systematic and procedural changes IRS could make to reduce return processing errors including those caused by taxpayers.

To accomplish these objectives, we reviewed IRS procedures for processing individual tax returns and interviewed IRS officials responsible for the return processing system at IRS' national office in Washington, D.C., and four service centers in Andover, Massachusetts; Cincinnati, Ohio; Fresno, California; and Ogden, Utah. We also interviewed State tax administration officials in 16 States and the District of Columbia to determine if the States had processing procedures that IRS could adopt which could reduce IRS' return processing error rate.

To assess the effectiveness of the return processing system, we selected a random sample of returns from the error register. To ensure that we could identify problems which occur during both peak and nonpeak periods of the filing season, we selected our sample over a 16-week period starting in February and ending in May 1981. Each week we randomly selected a day at each of the four service centers to sample from the error register. Our sample consisted of 2,543 returns taken from the universe of 1,291,757 individual tax returns which appeared on the error registers at the four service centers on the days we took our samples.

In analyzing the 2,543 sample returns, we assessed the effectiveness of the return processing system in terms of its ability to correct taxpayer and IRS errors, to identify procedural and systematic problems, and to provide the evaluation data needed by IRS management to correct these problems.

IRS officials told us that the four service centers where we did our work should be representative of the other six service centers because IRS' processing procedures are the same at each one. Thus, we projected our findings on error register cases to all 10 service centers.

In making our projections, we applied the percentage of cases with problems to the total universe of error register cases. In fiscal year 1981, the error register universe was

about 33 million cases, and the average cost to correct an error register case was about $0.30. Our estimates of cost reductions are gross of any cost IRS may incur in making the suggested changes. However, we believe that implementation costs in most instances would be minimal.

This audit was performed in accordance with generally accepted Government auditing standards.

CHAPTER 2

IRS NEEDS BETTER PROGRAM EVALUATION DATA TO IDENTIFY AND CORRECT THE CAUSES OF RETURN PROCESSING PROBLEMS

IRS effectively corrects most processing and taxpayer errors it detects on individual tax returns. In addition, it has several review activities which gather data on processing problems. However, the data produced by these review activities are not specific enough for use in determining what causes errors so that corrective actions can be taken. As a result, errors which could be prevented continue to occur. IRS could do a more detailed job of accumulating and analyzing the data needed by management to identify and correct those problems which reduce the efficiency of the tax return processing system.

IRS CORRECTS MOST DETECTED TAX RETURN ERRORS

Our analysis of a random sample of 2,543 tax returns which appeared on the error register at four service centers shows that IRS effectively corrects most of the processing and taxpayer errors it detects on returns. These returns had a total of 3,270 errors that should have been corrected. The following table gives a breakdown of the errors.

Number of Errors by Who Made Them

Who made the errors	Number of errors	Percent of total errors
Taxpayers	1,231	37
Tax examiners	1,134	35
Data transcribers	905	28
Total	3,270	100

IRS made 63 percent of the errors while taxpayers accounted for 37 percent of the errors.

IRS corrected about 96 percent, or 3,147, of the 3,270 errors. The remaining 123 errors were not corrected because the tax examiners did not fully follow the correction procedures. As a result, in 48 (1.9 percent) of the 2,543 sample error cases, overstating or understating of the refund or balance due amounts occurred.

In reviewing the 2,543 cases we found an additional 159 errors which were not found by IRS because the return processing system, either through the computer's math and validity checks or the error correction procedures, was not programmed to detect all errors. These errors, which included taxpayer math errors, went undetected because the errors were made in tax data which were either not required to be keyed into the computer or did not require verification by a tax examiner.

For example, assume a taxpayer with $25,000 in wages files a joint return and properly enters his or her social security number as well as his or her spouse's social security number on the tax return. However, the taxpayer makes a mistake and enters $24,000 on the wage line of the tax return and then accurately calculates his or her tax liability on the basis of the $24,000. Now if IRS fails to key the spouse's social security number into the computer, the return will fail the computer's validity checks and will appear on the error register so that a tax examiner can determine if the social security number is present and, if so, have it keyed into the computer. In this case even though the return appeared on the error register, the tax examiner is not required to verify that the wage entry is correct because the tax liability was accurately calculated.

The 159 errors that IRS did not detect and correct resulted in understating or overstating of the refund or balance due amounts in 67 (2.6 percent) of the 2,543 sample error register cases.

On the basis of our analysis of our 2,543 sample error register cases, we believe IRS does an effective job of correcting return processing and taxpayer errors. However, we found that IRS could do more to prevent the errors from occurring.

IRS' QUALITY MONITORING ACTIVITIES DO NOT PROVIDE ALL THE DATA NEEDED TO CORRECT RETURN PROCESSING PROBLEMS

To prevent errors from occurring, IRS needs program evaluation data which can be analyzed at both the service center and national office levels to determine the causes of return processing and taxpayer errors so that corrective action can be taken. This data should include specific information on the type of errors, who made the errors, why the errors occurred, and where they occurred on the tax forms. IRS' present quality monitoring activities do not provide all of this data.

The present quality monitoring activities at the service centers include a quality review program, an error correction workload review, and a math error notice review. Also, in 1982, the national office developed an error register report and a

monitoring program to assess specific processing procedures. A description of these activities and our evaluation of them follows.

Quality review program

The service center's primary return processing quality monitoring activity is its quality review program through which IRS measures employee compliance with established processing procedures and identifies employee errors. The quality review data is gathered by sampling employee work and recording the number and types of errors that employees make. The samples are analyzed by computer, and various reports are produced which provide employees and managers with the overall results of the quality reviews. These reports are of limited value for evaluating the return processing system because they only address employee errors and not taxpayer errors. Also, the employee error data does not identify specifically where the errors occurred and what the actual errors were.

For example, tax examiners in the Returns Analysis Branch are required to enter total income amounts on the form 1040 from subsidiary tax documents, such as the schedule C, whenever taxpayers fail to do so. When IRS quality reviewers find that the tax examiners fail to enter the total income amount--that is, the examiners failed to perfect the line--reviewers record this error under a heading which states, "Line entries not perfected, incorrectly perfected, or exceed maximum allowable characters." This error statement does not specify which form 1040 line is in error and whether the tax examiner failed to perfect the line or incorrectly perfected the line. Due to the lack of detail, management does not know if a particular processing procedure is faulty and needs revision or if employees need further training in perfecting a particular tax form or schedule. Consequently, management cannot readily use the quality review data for planning corrective action.

IRS' Internal Audit Division has also been critical of the quality review data. In 1979 and 1981, Internal Audit reported that error descriptions used in the quality review program were too broad to be used to isolate and define specific causes of return processing problems. In response to this criticism IRS return processing officials stated that they would refine the error descriptions. At the time of our review this refinement was still taking place.

Review of the error correction workload

A second quality monitoring activity is the error correction workload review which is done to identify taxpayer and service center originated errors. Quality reviewers take weekly samples of error register cases and manually summarize these

samples in terms of a description of the errors and their frequency in an Error Analysis Report. Even though the Error Analysis Report addresses both taxpayer and IRS processing errors, it does not provide detailed data for management to identify specific processing weaknesses.

Regarding the taxpayer errors, the report does not, for the most part, specifically show where on the tax documents the taxpayer errors occurred. For example, the report categorizes taxpayer errors in general terms, such as, "incorrect entry," "wrong line entry," "withholding," and "schedule C, D, F computations."

Regarding tax examiners and data transcribers errors, the report merely gives the frequency of errors and does not describe the type of errors made or specifically where the errors occurred on the tax forms. As a result, the Error Analysis Report cannot be used to determine precisely where the errors are occurring so that corrective action decisions can be made.

Review of math error notices

A third quality monitoring activity is the review of math error notices performed by the service center's notice review unit. The purpose of this review is to prevent erroneous math error notices from being sent to taxpayers and to identify IRS processing errors which caused the erroneous notices. As the notices are reviewed, data on the types of errors made by the various return processing units are gathered and summarized in a weekly report. The data has weaknesses similar to those discussed on the quality review program and the Error Analysis Report--that is, the math error notice review does not identify the specific point of error or the error type. As a result, management has little basis for initiating action to correct the cause of the errors.

Error register report

In 1982, IRS began gathering some national data on returns which appear on the error register. This computer-generated error register report will provide counts of the types of errors by sections of the return where the errors occurred. The report will be analyzed at the national office to assess processing procedures for certain types of errors, such as data transcription errors. This data, while useful, will not fully measure the adequacy of return processing procedures because it does not provide the information needed to identify specifically where the errors occurred, who made the errors, and what caused the errors.

For example, because the report will show errors only by the section of the return, such as the income section which

encompasses lines 7 through 21 of the tax year 1981 form 1040, IRS will know the number of errors in the section but will not know which lines are error prone. Also, because the report is only a summation of all the returns on the error register, it will not show who made the errors or what caused the errors.

Return processing monitoring program

Also in 1982, IRS' national office began a pilot return processing monitoring program which will evaluate selected processing procedures on the basis of data gathered at the Cincinnati service center. For example, IRS is reviewing errors in the medical deduction section of schedule A to determine if certain line items need to be keyed into the computer. IRS is also reviewing returns with self-employment or farm income to determine if taxpayers are erroneously underpaying self-employment taxes, and, if so, whether a computer math verification routine is needed to detect these errors.

This is a good program because IRS will be examining the actual tax returns when evaluating the processing procedures. Thus, IRS will be able to determine the specific errors made, who made the errors, and most importantly, what was done to cause the errors. With this information, IRS will be able to determine what changes, if any, are necessary in its processing procedures.

The monitoring program, however, will only provide information on those areas IRS believes may have problems. In this regard, the program is essentially a special studies program--that is, it examines only specific processing procedures and will not provide information on the total processing system. Therefore, IRS will still not have the data needed to identify other inefficient and ineffective processing procedures.

IRS SHOULD GATHER BETTER PROGRAM EVALUATION DATA

While each of IRS' quality monitoring activities has merit, they are fragmented and do not provide management with all the data needed for evaluating the return processing system and planning corrective action. We believe that IRS could gather more specific data on returns with errors using a method similar to the one we developed during our review of the return processing system. We reviewed returns which appeared on the error register and gathered the following types of data on taxpayer and processing errors:

--What types of errors were made, such as math errors or data transcription errors.

--Who made the errors, whether it was IRS or the taxpayers.

--Why the errors occurred, such as taxpayers failing to make an entry, or tax examiners failing to edit a line.

--Where the errors occurred, that is, the lines on the tax returns and forms that were in error.

This data, which is essential for determining processing weaknesses, was obtained from reviewing the tax returns and error register records.

We essentially did the same type of review that IRS does when it analyzes the error correction workload for the Error Analysis Report. The difference in our approach was that we gathered more detailed data on the errors and then analyzed that data to determine what return processing changes could be made to prevent the errors from occurring. The processing changes we found using this approach are discussed in chapter 3.

IRS could also gather similar data for determining processing weaknesses by taking daily samples of error correction cases and putting the data in the computer for analysis. Weekly computer reports could be made for use by service center management to determine the types and causes of local processing errors and to initiate corrective action. More importantly, the data could be transmitted to IRS headquarters for nationwide analysis of return processing weaknesses and for planning and initiating corrective actions. In our opinion, using this approach, in conjunction with the recently established return processing monitoring program, would give IRS a systematic means for evaluating how well it processes tax returns and the data needed to determine how the return processing system can be improved.

To gather this data and to get an overview of processing problems, we estimate that each service center would have to analyze an average of 250 error register cases a week during the January-June processing period when most individual income tax returns are processed. The analysis could be done by the quality reviewers who presently analyze cases for the Error Analysis Report. In 1981, the quality reviewers at the four service centers where we did our work analyzed an average of 800 error register cases a week for the Error Analysis Report. Even though the quality reviewers would have to do more detailed analysis of error register cases, it should not take them any longer to do this analysis on 250 error register cases than it took them to review 800 cases for the Error Analysis Report.

Because IRS' national office is responsible for the total return processing system, additional staff at this level may be needed to ensure that the data is consistently gathered and analyzed at the service centers and to develop corrective action plans and recommendations. We do not know how many additional

national staff might be needed. However, we believe it is essential that national office staff be assigned to perform this function.

CONCLUSION

IRS effectively corrects most processing and taxpayer errors it detects on tax returns; however, it needs to devise ways to prevent errors from occurring in the first place. The best way to prevent errors is to gather and analyze specific data on the errors to determine what causes them so that corrective action can be taken to reduce future errors. While IRS has several quality monitoring activities which produce data on return processing weaknesses, these data are not specific to the types of errors made, who made the errors, why the errors were made, and where the errors occurred on the return. As a result, IRS does not have all the data needed for planning and taking corrective action to prevent errors from occurring.

We developed a method for evaluating return processing and taxpayer errors so that corrective action decisions can be made which will prevent future errors. We believe that IRS should gather more specific evaluation data on errors through its quality monitoring activity. Such data could be gathered in the service centers at no additional cost while some additional resources may be needed at the national office level to analyze the data.

RECOMMENDATION

We recommend that the Commissioner of Internal Revenue have the quality monitoring activity gather more specific data on the types of errors made, who made the errors, why the errors occurred, and where the errors occurred. This data should then be analyzed at both the service center and national office levels to determine the corrective action that can be taken to prevent similar future errors.

AGENCY COMMENTS AND OUR EVALUATION

In commenting on a draft of this report (see app.), IRS agreed that it needs to expand its service center quality monitoring program and said that it will actively pursue our recommendation to gather more specific information from the error correction process.

CHAPTER 3

IRS CAN REDUCE PROCESSING AND TAXPAYER ERRORS BY CHANGING RETURN PROCESSING PROCEDURES, TAX FORMS, AND INSTRUCTIONS

Using an evaluation method similar to the one we believe IRS should use to uncover processing problems, we identified several ways by which IRS can reduce its error corrections workload. We estimate that annual processing costs can be reduced by as much as $1.7 million [1/] if IRS

--changes the procedures for correcting tax returns with multiple errors,

--changes processing procedures for returns where IRS computes the tax for taxpayers, and

--modifies the form W-2 and clarifies taxpayer instructions on claiming Federal income tax withholding.

We also believe that IRS can achieve further cost reductions if it adds coding symbols to tax forms and incorporates prompting features in the direct data entry equipment to advise data transcribers when they fail to key certain tax data into the computer. The prompting features could reduce processing costs by as much as $495,000 annually.

In addition, we believe that IRS could increase the productivity of its data transcribers by having them key into the computer both the line number and money amount instead of just the money amount.

PROCESSING COSTS CAN BE REDUCED BY CHANGING ERROR CORRECTION PROCEDURES FOR RETURNS WITH MULTIPLE ERRORS

IRS could reduce annual return processing costs by as much as $545,000 by changing its procedures for correcting tax returns with multiple errors. IRS procedures allow tax examiners to correct only one error condition on a return even though the return may have multiple errors. Consequently, returns with multiple errors go through the correction process more than once before all error conditions can be corrected.

[1/] The cost estimates in this chapter are based on a universe of 33 million error register cases and an average cost of $0.30 to correct an error register case.

When tax return data is keyed into the computer, computer programs subject the data to math and validity checks to ensure that returns are processed accurately. Returns which fail these computer checks are printed on an error register for correction by tax examiners in the error correction unit. When an error condition is detected by the computer, it is classified in priority order as follows:

1. Data transcription error--This error condition indicates that sections of a tax form were not keyed into or were incorrectly keyed into the computer.

2. Error reason code--This error condition indicates that there is data inconsistency.

3. Validity error--This error condition indicates that there is an invalid entry, or that a program validity test was not met.

4. Noncompute--This error condition identifies returns where the tax refund and balance due amount lines are blank because the taxpayers want IRS to compute the tax for them.

5. Math error--This error condition indicates that the computer's computation differs from the taxpayer's computation on the basis of the data that was keyed into the computer.

The error conditions found on the returns are corrected by tax examiners in the priority sequence listed above--from highest priority to lowest priority. Only one error condition is corrected each time a return appears on the error register. The reason for this is that high priority error conditions can cause low-priority errors. Thus, correcting high-priority errors will often automatically correct the other errors.

For example, if a taxpayer filing a joint return claims five exemptions and IRS does not key the exemptions into the computer, the error register record will show both a validity error and a math error. The validity error will indicate on the error register record that the exemptions were not keyed into the computer. The math error shows up on the error register because the computer will calculate the taxpayer's tax liability on the basis of only the two exemptions that taxpayers who file joint returns without other exemptions are entitled to. Thus, the computer's tax liability would be different from the tax liability calculated by the taxpayer which is based on five exemptions. Therefore, correcting the validity error dealing with the number of taxpayer's exemptions will eliminate the math error connected with the taxpayer's tax liability.

On the basis of our analysis of 2,543 returns we sampled from the error register, it appears that correcting just one error condition at a time is a good procedure. About 71 percent, or 1,798, of our sample cases passed the computer checks after the highest priority error condition had been corrected. In most of the remaining 745 sample cases, however, correcting just the highest priority error condition did not eliminate the other error conditions. Therefore, these cases reappeared on the error register.

We found, in analyzing the 745 sample cases that reappeared on the error register, that 141 cases, or 5.5 percent of the 2,543 cases, had at least two error conditions which were completely independent of each other. That is, correcting the higher priority error condition would definitely not eliminate the other error condition. The 141 cases had high-priority errors which involved taxpayer entity information, such as name, address, and social security numbers, and lower priority errors, such as math errors, which had no direct relationship to the taxpayer entity errors.

For example, if a taxpayer files a joint return and fails to enter the spouse's social security number and also makes a tax refund math error, the return will appear on the error register with two error conditions. There will be an error reason code indicating that the social security number is missing and a math error indicating that the taxpayer's refund amount is wrong. Even though the missing social security number error is independent of the math error because it does not affect the taxpayer's refund amount, these errors are not corrected at the same time. Under IRS procedures, the tax examiner would first correct the higher priority error condition dealing with the missing social security number and wait until the return reappeared on the error register before correcting the math error.

Correcting all independent error conditions for one return when they first appear on the error register will decrease error correction costs by reducing the number of times returns with multiple errors appear on the error register. The time required for tax examiners to correct two independent errors on the same error register should not be much longer than it presently takes them to correct one error and should require less time than correcting the same errors on two error registers. Therefore, we believe that IRS should revise its error correction procedures to allow tax examiners to correct independent error conditions when they first appear on the error register. We estimate that the error correction workload nationwide in terms of the number of error registers worked could be reduced by about 5.5 percent. Not counting the additional time it may take tax examiners to correct more than one error on an error register, we estimate that IRS could save about $545,000 annually if this change is made.

PROCESSING COSTS CAN BE REDUCED BY CHANGING PROCEDURES FOR PROCESSING RETURNS WHERE IRS COMPUTES THE TAX FOR TAXPAYERS

IRS could reduce processing costs by as much as $1 million annually by changing its procedures for processing returns where IRS computes the tax for taxpayers. Under certain conditions, taxpayers can have IRS compute their tax for them. All of these returns appear on the error register to ensure that the tax data entered on the returns are accurate and have been correctly keyed into the computer. About 10 percent, or 263, of our 2,543 sample error register cases were tax returns where IRS computed the tax for the taxpayers. This type of return would not have to appear on the error register if IRS were to change its processing procedures and require that these taxpayers fill in their Federal income tax withholding on their tax returns.

At present, if taxpayers fill out the income portion of their tax returns, attach copies of their forms W-2, sign and date their returns, and mail them by April 15, IRS will compute their tax for them. Taxpayers who file the form 1040A are instructed not to fill in the amount of their Federal income tax withholding while those who file the form 1040 are instructed to enter their withholding. In any event, tax examiners in the Returns Analysis Branch will enter the withholding amounts from the forms W-2 onto the tax returns and code and edit the returns as they would other returns. The tax return data is then keyed into the computer, and the computer calculates the taxpayers' tax as well as the refund or balance due. The returns then come out on the error register so that tax examiners can verify that the tax data was accurately entered on the returns and keyed into the computer.

We found that most of the errors which affected taxpayers' refund or balance due amounts on the 263 returns where IRS computed the taxpayer's tax dealt with entering the wrong amount for income tax withholding. We found no errors that affected the taxpayers' refund or balance due amounts in 233 cases (about 89 percent). The remaining 30 cases did contain errors. In 20 of the 30 cases the errors were caused by tax examiners entering the wrong amount for income tax withholding, in 4 cases the taxpayers themselves made the same error, and in 1 case the data transcriber failed to key the withholding into the computer. In four of the remaining five cases either the tax examiners or taxpayers made errors dealing with either wages, unemployment compensation, or filing status. In the one remaining case, the taxpayer failed to include his taxable pension income on his return. IRS, however, did not detect this error. We found it during our review.

The rate at which the tax examiners code and edit tax returns could be one reason why they made errors in entering the withholding amounts. The examiners are expected to code and edit, which includes entering withholding data, about 253 forms 1040A per hour or about 75 forms 1040 per hour. Tax examiners entered the taxpayers' withholding in 70 percent, or 183, of our 263 sample cases. In the remaining 80 cases, taxpayers entered their own withholding in 50 cases, while in 30 cases, the taxpayers had no withholding.

If these taxpayers were instructed to enter their own withholding on their tax returns, the returns would not have to appear on the error register. Requiring taxpayers to enter their own withholding would reduce the errors tax examiners make when they enter the withholding. IRS could then change its processing procedures so that these returns do not automatically appear on the error register.

We recognize that other errors besides those dealing with entering the wrong amount for withholding, especially data transcription errors where the wrong tax data is keyed into the computer, could also occur during return processing. However, we did not find any data transcription errors in our sample cases which affected the taxpayers' refund or balance due amounts that were not detected by the computer's math and validity checks. One reason for this is that 87 percent, or 230, of the 263 cases were forms 1040A which are subject to key verification--that is, the entries on the tax return are keyed into the computer a second time before the computer makes its math and validity checks. All the entries on a form 1040A will be keyed in twice if there is no entry for the tax liability, but there is an entry for withholding. In contrast, not all entries on the form 1040 are keyed in a second time. As a result, most original transcription errors on a form 1040A are corrected before the returns appear on the error register.

IRS could ensure that transcription errors are corrected during the key verification process or detected by the computer's math and validity checks if it required taxpayers to file a form 1040A when IRS is to compute their tax for them. We found that in only 33 of our 263 sample cases did the taxpayers file a form 1040 and only 1 taxpayer had to file a form 1040. The remaining 32 taxpayers were eligible to file a form 1040A. Thus, on the basis of our sample, requiring taxpayers to file a form 1040A when they want IRS to compute their tax should ensure that errors are detected and corrected without burdening the taxpayers.

We believe that IRS should consider requiring taxpayers to file a form 1040A when they want IRS to compute their tax for them. Requiring such taxpayers to file forms 1040A would ensure

that data transcription errors are corrected during the key verification process or detected by the computer during its math and validity checks. IRS should also require taxpayers to enter their own withholding on tax returns (1) to reduce possible tax examiner errors and (2) to limit the number of times returns appear on the error register. By making these changes, we estimate that IRS could reduce its error correction workload nationwide by as much as 10 percent, thereby reducing processing costs by as much as $1 million annually.

FORM W-2 AND TAX FORM INSTRUCTIONS FOR DETERMINING FEDERAL INCOME TAX WITHHOLDING NEED TO BE CLARIFIED

IRS could possibly reduce its processing costs by as much as $198,000 annually if it would modify the wording on form W-2 and clarify its tax form instructions on what amount taxpayers should claim as Federal income tax withholding. Sixty-three of our 2,543 error register sample cases had errors where the taxpayers reported their FICA tax withholding from the form W-2 as their Federal income tax withholding on their tax returns. While we do not know why these errors occur, some may have occurred because taxpayers believed that the term "FICA tax withheld" meant Federal income tax withheld instead of the amount of social security tax withheld from wages.

There are several ways IRS can clarify for taxpayers the difference between FICA and Federal income tax withheld. First, the form W-2 could be revised to more clearly show the difference between FICA and Federal income tax withheld. For example, the words "social security (FICA) tax withheld" could be used in place of the term "FICA tax withheld." Taxpayers probably have a better understanding of what is meant by social security taxes and would be less likely to put this amount down as the Federal income tax withholding on their tax returns.

Another way of preventing taxpayer withholding errors would be to explain and illustrate the difference between FICA and Federal income tax withheld in the instructions for completing forms 1040 and 1040A. For example, a sample form W-2 could be printed in the instruction booklets which would show the taxpayers the proper amount to use for the Federal income tax withheld and the instructions for this entry could also explain the difference.

Finally, for those taxpayers who make this error, IRS should send a math error message which specifically explains to the taxpayers that they mistakenly claimed their FICA tax withholding instead of their Federal income tax withholding. The error message that IRS currently sends taxpayers who make this mistake states only that the tax withheld does not agree with the form W-2. The message does not tell taxpayers exactly what error they made and does little to clarify for the taxpayer the

difference between the terms "FICA tax withheld" and "Federal income tax withheld." A more precise explanation of the error may help prevent taxpayers from repeating this error in the future.

We believe that IRS can reduce the number of errors which involve taxpayers entering their FICA tax withholding instead of their Federal income tax withholding on their tax returns by revising the form W-2, clarifying withholding instructions in the tax booklet, and clarifying the error message on math error notices. We estimate that these changes could reduce the error correction workload nationwide by as much as 2 percent, thereby reducing processing costs as much as $198,000 annually.

CODING SYMBOLS ON TAX FORMS CAN REDUCE PROCESSING ERRORS

IRS could further reduce the error correction workload if coding symbols were printed on the tax forms. Because not all lines on tax returns are transcribed, coding symbols, such as dots or squares, could be placed next to lines that have to be keyed into the computer. The coding symbols would remind tax examiners and transcribers of the lines to key into the computer. Many errors occur in processing tax returns because data transcribers either fail to key in required data or key in data that should not be entered into the computer. Errors also occur because tax examiners fail to edit the lines that are supposed to be keyed into the computer. About 11 percent of the 2,543 tax returns we sampled from the error register contained these types of data transcriber or tax examiner errors. We believe that many of these errors could be prevented if coding symbols were printed on the tax forms.

Before tax data is entered into the computer, tax examiners in the Returns Analysis Branch review the tax returns to determine if information necessary for processing the returns is present and legible. If not, the examiners edit the returns which includes moving taxpayers' entries to proper lines and totaling lines taxpayers fail to total. After the returns are edited, data transcribers key the tax data into the computer. When tax examiners fail to edit a line that has to be keyed into the computer, or when data transcribers either fail to key in required data or key in data that should not have been entered into the computer, the returns will appear on the error register for correction.

About 11 percent or 286 of our 2,543 sample error register cases had editing or transcription errors. The following table shows a breakdown of these errors by type of tax return.

Editing and Transcription Errors by Type of Tax Return

	Number of returns	Edit errors	Transcription errors	Total errors	Percent of errors
Forms 1040	1,758	140	97	237	13
Forms 1040A	785	32	17	49	6
Total	2,543	172	114	286	11

We also found editing and transcription errors on subsidiary tax forms and schedules in 248 of the 2,543 sample error register cases.

The rate at which tax examiners edit tax returns and data transcribers key data into the computer could be one reason why these errors are made. Tax examiners are expected to edit about 75 forms 1040 an hour while data transcribers are expected to key in about 25 forms 1040 an hour. Also, some of the errors may have been made because tax examiners and data transcribers forgot which lines needed to be edited and keyed into the computer.

State tax administration officials in 16 States which use coding symbols on tax returns told us that the coding symbols help prevent editing and data transcription errors and improve return processing quality and production. Six of the 16 States we contacted had error rate data. Officials in those States told us that their error rates for all data transcription entries are 2 percent or less. Similarly, the average error rate for all data transcription entries in the four IRS service centers where we did our work was over 10 percent for the first 6 months of 1981.

The State officials said that coding symbols are especially helpful for new employees. One State official estimated that coding symbols reduce by half the training time needed for new data transcribers. Considering that each year IRS hires hundreds of temporary data transcribers, coding symbols should help them to learn the lines that have to be keyed into the computer, thereby reducing their training time and increasing their productivity.

We discussed the use of preprinted coding symbols on various tax forms and schedules with IRS Examination Division officials to determine if coding symbols would compromise the examination process. The officials were not in favor of having coding symbols on subsidiary tax forms and schedules, such as the schedules A, C, and F, because not all lines on these documents are transcribed. They said the symbols would alert taxpayers to the specific tax information kept on the computer and, with this knowledge, taxpayers may report incorrect or inflated tax information, thereby manipulating IRS' system for scoring returns for audit. The IRS officials, however, did not foresee these problems with using coding symbols on the forms 1040A and 1040. They said almost all the lines on these forms are transcribed and those that are not transcribed can either be calculated by computer or transcribed from subsidiary tax forms and schedules.

Accordingly, we believe that coding symbols on the forms 1040A and 1040 will not create any compliance problems and should reduce both training and return processing costs. On the basis of our sample of 2,543 error register cases we estimate coding symbols could reduce the error correction workload nationwide by as much as 11 percent.

PROCESSING COSTS CAN BE REDUCED WITH BETTER DATA TRANSCRIPTION EQUIPMENT AND PROCEDURES

IRS could reduce return processing costs by as much as $495,000 annually if its direct data entry system had the capability to prompt data transcribers when they fail to key certain tax data into the computer and then allow transcribers to key in the omitted data. IRS may also be able to achieve substantial increases in data transcription productivity if it changes its procedures for keying in money amounts from tax return lines. IRS is planning on replacing its direct data entry system by 1984 and is recommending that the new system have features which allow transcribers to key in omitted data. It should also consider having prompting features that advise transcribers when they fail to key in data and changing procedures for keying in money amounts from tax returns.

Prompting features could reduce data transcription errors and processing costs

About 5 percent, or 120 of our 2,543 error register sample cases, had errors where the data transcribers either did not key in data from subsidiary tax documents, such as a Schedule D: Capital Gains and Losses, or failed to enter the form 1040 line items associated with certain other subsidiary tax documents, such as Form 5695: Energy Credits. When these errors occur, the

data transcribers cannot go back and key in the omitted data unless they realize their mistake before they finish keying in the rest of the data for that tax return. Even if the omissions are detected during key verification, to which all returns are subjected, the data still cannot be keyed into the computer. The returns must go to the error register for correction.

These errors could be prevented if IRS' direct data entry equipment had the capability to prompt data transcribers when they fail to enter data from tax forms and schedules or the corresponding lines of the form 1040. For example, assume the data transcriber is entering data from a tax year 1981 form 1040 return which has an entry on line 14 for capital gains and losses and the schedule D is attached. Further assume that the transcriber keys in all required data from the form 1040 including that from line 14, but fails to key in any of the schedule D data. The return will appear on the error register because there is an entry on line 14 of the form 1040 but no schedule D data. If, however, the data entry equipment had the capability to advise the transcriber through a prompting message that schedule D data must have been omitted because an entry had been keyed in for it from the form 1040, the transcriber could enter the data right then, instead of having the return appear on the error register for correction.

The equipment should also have the reverse capability. That is, the equipment should have the capability to advise the transcriber when a subsidiary tax document has been keyed in but there is no corresponding entry from the form 1040. By adding this prompting capability, these types of errors could be corrected during the data transcription process, thereby reducing the volume of returns going to the error register for correction.

IRS is planning to replace, by 1984, the direct data entry systems which are used to enter tax return data into the computers. The planned replacement equipment provides not only for entering original data from the tax returns but also for automating the error correction process, thereby eliminating the need to print error register records and to manually match these records with the tax returns. According to IRS officials, the feasibility study for the new direct data entry equipment includes a recommendation that the new equipment have the capability to allow data transcribers to enter data when they realize that they have omitted entries. IRS was not considering having prompting features which tell the transcribers when they omit data. However, all of the equipment specifications had not been determined and approved at the time of our review.

We believe that IRS should ensure that its new direct data entry equipment can be programmed to prompt transcribers that

they have omitted data and for allowing the omitted data to be entered at that time. On the basis of our sample of 2,543 error register cases at the four service centers, we estimate that these data transcription features could reduce the error correction workload nationwide by about 5 percent, thereby reducing processing costs by as much as $495,000 annually. This cost savings is gross of the one time computer programming costs of adding these prompting features.

Transcribing both the line number and money amounts could increase data transcription productivity

IRS may be able to reduce return processing costs if the new direct data entry equipment would allow transcribers to key in both the line number and the money amounts off the tax returns. With IRS' present direct data entry equipment, transcribers can enter only the money amounts from tax return lines. If there is no money amount on a transcription line, the transcribers usually have to make a keystroke which is called a "breaker" to indicate to the computer that the line is blank. Data we obtained from the California State Franchise Tax Board and our analysis of our sample error register cases show that transcribing the line numbers as well as the money amounts can increase data transcription productivity, which is the number of keystrokes per hour, with only a slight increase in the number of keystrokes per return.

Prior to 1981, California, like IRS, keyed in the money amounts from tax return lines and entered a breaker for blank transcription lines. Beginning in 1981, California began keying in both the line number and the money amounts. This procedure eliminated the need to enter a breaker for blank transcription lines because the State's direct data entry system and associated returns processing computer has the capability to sort the data by the line numbers. California found that while the average number of keystrokes per return increased 13 percent, the production rate of its data transcribers increased by about 26 percent for the first 6 months of 1981 compared with the first 6 months of 1980. California also found that its training time for new data transcribers decreased 14 percent. One reason for the productivity increase is that the transcribers did not have to worry about keying in breakers for blank transcription lines and could concentrate on those lines with entries.

California's average number of keystrokes per return increased 13 percent when it keyed in both the line numbers and the money amounts. However, we found in analyzing the forms 1040 and 1040A in our sample of 2,543 error register cases that the average number of keystrokes per return would only increase

by one keystroke if IRS adopted this data transcription procedure because there would be no need to enter breakers or line numbers for blank lines.

We do not know if returns with errors have more or fewer tax return lines keyed in than returns without errors because we did not review returns which did not appear on the error register. Therefore, we do not know if, in total, the average number of keystrokes per return would increase or decrease if both the line number and money amounts were keyed into the computer. We believe IRS should do its own evaluation on a sample of returns with and without errors to determine the merits of this data transcription technique. This is a good time to make such an evaluation because IRS is in the process of replacing its direct data entry system. The potential savings in data transcription productivity is great. For example, a 10 percent increase in transcription productivity could reduce processing costs by about $2.2 million annually.

CONCLUSIONS

While IRS has an effective return processing system considering the large number of tax documents it processes annually and the age of some of its processing equipment, IRS could do more to increase the efficiency of the system and thereby reduce processing costs. On the basis of our analysis of a random sample of 2,543 tax returns which appeared on the error register at four service centers, we found that IRS' national returns processing costs may be as much as $2.2 million higher than necessary because

- --IRS' error correction procedures allow tax examiners to only correct one error condition at a time on tax returns with multiple errors,
- --IRS manually reviews all tax returns for which it computes the tax for the taxpayers,
- --taxpayers sometimes mistakenly claim FICA withholding as Federal income tax withholding,
- --tax returns do not have coding symbols to alert tax examiners and data transcribers to the lines that are keyed into the computer, and
- --direct data entry equipment does not have prompting features to advise transcribers when they fail to key certain tax data into the computers.

We believe that if these processing practices are changed, IRS can have a more efficient and less costly return processing system. We also believe that, in most instances, implementation costs will be minimal.

We also found that IRS might be able to increase the productivity of its data transcribers if it were to have the transcribers key both the money amounts and line numbers from the tax returns instead of just keying the money amounts into the computer. We believe that IRS should give serious consideration to adopting this data transcription procedure.

RECOMMENDATIONS

We recommend that the Commissioner of Internal Revenue:

--Change procedures for correcting tax returns with multiple error conditions so that all readily identifiable independent errors can be corrected when they first appear on the error register.

--Require taxpayers who want IRS to compute their tax for them to enter their income tax withholding on their returns. IRS should change its processing procedures so that these returns do not automatically appear on the error register.

--Clarify for taxpayers the difference between FICA tax withheld and Federal income tax withheld by changing the wording on the form W-2, clarifying tax booklet instructions, and revising the math error notice message presently sent to taxpayers who mistakenly enter the amount of FICA tax withheld instead of the amount of Federal income tax withheld.

--Determine the cost effectiveness of providing new direct data entry equipment with the capability to prompt transcribers when they fail to key certain tax data into the computer. If cost effective, ensure that the new direct data entry equipment includes this prompting feature.

--Determine the merits of having data transcribers key into the computer both the money amounts and line numbers from tax returns.

AGENCY COMMENTS AND OUR EVALUTION

In commenting on a draft of this report, IRS indicated that it is in the process of implementing our recommendations concerning (1) tax returns with multiple errors, (2) tax returns where IRS computes the tax for taxpayers, and (3) tax returns where taxpayers claim their FICA tax withholding as Federal income tax withholding.

IRS also stated that it will consider our recommendations to have prompting features for data transcribers incorporated into the direct data entry equipment and to have transcribers key into the computer both money amounts and line numbers when

it evaluates vendors' proposals for new direct data entry equipment. IRS stated that if the winning vendor's proposal does not contain these features they can be implemented later.

In a draft of this report we proposed that IRS consider requiring taxpayers who want IRS to compute their tax for them to file form 1040A. IRS, in commenting on the draft, took exception to our proposal. IRS stated that this change would not allow taxpayers who have investment credit, credit for the elderly, and credit for Federal tax on special fuels to elect to have IRS compute their tax. IRS also stated that denying these taxpayers the option of having IRS compute their tax could be viewed as a further reduction in service to taxpayers. We agree with IRS on this point. We believe that the action IRS is taking on handling returns where it computes the taxpayers' tax, which is to not automatically have these returns appear on the error register unless the refund or balance due amount is $2,000, or more, will achieve our primary intent--that is, to reduce return processing costs.

We also proposed in the draft report that IRS add coding symbols on forms 1040A and 1040 to indicate which tax return lines are to be keyed into the computer. IRS did not totally agree with this proposal. IRS said that having coding symbols on only forms 1040 and 1040A could cause problems for data transcribers because they would have to be trained to look for the symbols on these forms but not look for them on related schedules. IRS also said that coding symbols would add additional clutter to the forms 1040 and 1040A which may make it more difficult for taxpayers to complete these forms. IRS also pointed out that because almost all lines on the forms 1040 and 1040A are transcribed, it did not see a need to have coding symbols to indicate the lines which are keyed into the computer. IRS did say, however, that it would consider having coding symbols for lines where both dollars and cents are required to be keyed into the computer. We believe that IRS' objections to our proposal have merit. We also believe that IRS will reduce processing costs if it does ultimately decide to have coding symbols for lines where both dollars and cents are required.

COMMISSIONER OF INTERNAL REVENUE

Washington, DC 20224

AUG 1 3 1982

Mr. William J. Anderson
Director, General Government Division
United States General Accounting Office
Washington, DC 20548

Dear Mr. Anderson:

Thank you for the opportunity to review your draft report entitled, "IRS Can Do More to Identify Tax Returns Processing Problems and Reduce Processing Costs."

As Service representatives indicated to your staff during GAO's initial review, we have been and are aware of the ongoing need to continually monitor and improve tax return processing to improve its quality and reduce its cost. Obviously, therefore, we agree with the general thrust of your recommendations and had, in fact, already taken actions before release of the draft report to implement some of the recommendations contained in it.

As noted in our detailed comments the Request for Proposal for a replacement data entry system is written in functional terms. Thus, we cannot now make a specific commitment to incorporate your suggestions for improving the data entry system.

With kind regards,

Sincerely,

Attachment

Department of the Treasury Internal Revenue Service

APPENDIX

Detailed Response to Report Recommendations

Recommendation

We recommend that the Commissioner of Internal Revenue have the quality monitoring activity which presently reviews the error correction workload gather more specific data on the types of errors made, who made the errors, why the errors occurred, and where the errors occurred. This data should then be analyzed at both the service center and national office levels to determine the corrective action that can be taken to prevent similar future errors.

Comments

We agree that the Service needs to expand its quality monitoring program in our service centers. As noted in the report, the Service initiated two new evaluative tools during 1982 to secure more specific information on taxpayer and Service errors, i.e., the error register report and the monitoring program. The GAO recommendation to gather more specific information from the error correction process will be actively pursued.

Recommendation

Change procedures for correcting tax returns with multiple error conditions so that all readily identifiable independent errors can be corrected when they first appear on the error register.

Comments

We conducted a study in February, 1982, on the priority of correcting error registers, and have revised the procedures for January 1983.

We identified the most common independent errors that could be corrected without affecting other areas on the return. We also combined into one corrective action both types of data transcription errors. Previously, only one could be corrected on a register.

Recommendation

Require taxpayers who want IRS to compute their tax for them to enter their income tax withholdings on their returns. IRS should change its processing procedures so that these returns do not automatically appear on the error register. IRS should also consider requiring all these taxpayers to file Forms 1040A.

Comments

The first part of this recommendation was recommended earlier this year by the Tax Forms Coordinating Committee. Subject to final approval, taxpayers filing Form 1040A who want IRS to compute their tax will be required to enter the amount of their income tax withholding. Taxpayers making this election on Form 1040 are already required to enter their income tax withholding.

APPENDIX

The second part of this recommendation is being implemented by having only non-compute returns with a balance due or refund of $2,000 or more appear automatically on the error register, as the probability of an error in those cases is high. We will also conduct a sample review during 1983 of the non-compute returns to determine if the need for error register review should be reinstituted.

The third part of this GAO recommendation, which suggests that IRS require all these taxpayers to file Form 1040A, gives some concern. Current regulations specifically allow taxpayers who have investment credit, credit for the elderly and credit for Federal tax on special fuels to elect to have IRS compute their tax. Since taxpayers claiming these credits are not permitted to file Form 1040A, the regulations would have to be changed before we could adopt this recommendation, or in the alternative (which we view as unacceptable), Form 1040A would have to be altered to permit such credits to be claimed. The latter course of action would do violence to the basic simplicity of the Form 1040A. While it is possible to change these regulations, to do so could result in denying taxpayers with any of these credits the option of electing to have IRS compute their tax. While the number of taxpayer affected would probably be small (total IRS computes on Form 1040 for 1980 were 184,000) it could be viewed as a further reduction in service to taxpayers.

Recommendation

Clarify for taxpayers the difference between FICA tax withheld and Federal income tax withheld by changing the wording on the Form W-2, clarifying tax booklet instructions, and revising the math error notice message presently sent to taxpayers who mistakenly enter the amount of FICA tax withheld instead of the amount of Federal income tax withheld.

Comments

We plan to begin referring taxpayers to specific boxes on Forms W-2 and W-2P on the 1983 Forms 1040 and 1040A and in the related instructions. In addition, we plan to substitute the words "Soc. Sec." for "FICA" in boxes 11, 13, and 14 of the 1983 Form W-2. We feel these changes should eliminate the problem of taxpayers incorrectly entering their FICA tax as income tax withholding on Forms 1040 and 1040A.

We also have revised the math error notice message as suggested for 1983 processing.

Recommendation

Add coding symbols on Forms 1040A and 1040 to indicate which tax return lines are to be keyed into the computer.

APPENDIX

Comments

We think this could cause problems for DDES operators because they would have to be trained to look for the symbols on Forms 1040 and 1040A but not look for them on the related schedules. This may slow down the processing of the schedules as well as increase our error rate. To add the symbols to Forms 1040 and 1040A would also add additional clutter to both forms which may make it more difficult for taxpayers to complete.

Also, as GAO notes, almost all the lines on Forms 1040 and 1040A are transcribed. Therefore, we do not see a need for adding coding symbols to these forms to indicate which lines are to be keyed into the computer. Further, we are concerned that the addition of coding symbols to these forms would be graphically unacceptable.

We agree with the concept of identifying lines for data transcription when a transcribed line is in the midst of many lines that are not transcribed. In the case of Form 1040 and 1040A, however, the majority of lines are transcribed. A major problem in transcription has been in switching from "dollars only" fields to "dollars and cents" fields. Therefore, we will consider that those lines which require dollars and cents entries have coding symbols.

Recommendations

Determine the cost effectiveness of providing new direct data entry equipment with the capability to prompt transcribers when they fail to key certain tax data into the computer. If cost effective, ensure that the new direct data entry equipment includes this prompting feature.

Determine the merits of having data transcribers key in to the computer both the money amounts and line numbers from tax returns.

Comments

The draft report points out that the Service is replacing its Direct Data Entry System (DDES). Since both of the above recommendations relate to capabilities which could be included in the DDES replacement system, we have chosen to combine our comments rather than deal with the recommendations separately.

The DDES replacement system is to be a turnkey system using essentially off-the-shelf software. The requirements in the Request for Proposals (RFP) have been written in functional terms. These requirements describe the input and output formats and the volumes, and specify the functions which must be performed; i.e., check digit analysis, key verification, etc. Beyond that though, the vendors have been given wide latitude to propose cost-effective methods which perform these functions.

APPENDIX

Recommendations, such as those in the GAO draft report, will be considered as a part of the technical features evaluation process. In the DDES replacement procurement, the technical evaluation carries approximately equal weight to the cost evaluation in selecting the winning vendor. If, however, the winning vendor's proposal does not contain the features recommended by GAO, they can almost certainly be implemented later because of the versatility of the replacement system over the existing DDES.

(268092)

AN EQUAL OPPORTUNITY EMPLOYER

UNITED STATES
GENERAL ACCOUNTING OFFICE
WASHINGTON, D.C. 20548

OFFICIAL BUSINESS
PENALTY FOR PRIVATE USE, $300

POSTAGE AND FEES PAID
U. S. GENERAL ACCOUNTING OFFICE

THIRD CLASS

AN EQUAL OPPORTUNITY EMPLOYER

UNITED STATES
GENERAL ACCOUNTING OFFICE
WASHINGTON, D.C. 20548

OFFICIAL BUSINESS
PENALTY FOR PRIVATE USE, $300

POSTAGE AND FEES PAID
U. S. GENERAL ACCOUNTING OFFICE

THIRD CLASS