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December 1992

Veterans Affairs Issues





United States
General Accounting Office
Washington, D.C. 20548

**Comptroller General
of the United States**

December 1992

The Speaker of the House of Representatives
The Majority Leader of the Senate

In response to your request, this transition series report discusses major policy and management issues facing the Congress and new administration in the area of veterans affairs. Since we issued our 1988 transition series report, the Department of Veterans Affairs has made progress in (1) developing a strategic management process, (2) preparing and auditing financial statements, and (3) modernizing its information resources. Further actions are needed, however, to enhance the Department's strategic and operational management. This report also discusses our view that the size of the budget deficit and the prospects for national health care reform require a comprehensive reevaluation of veterans' health and compensation benefits.

The GAO products upon which this report is based are listed at the end of the report.

We are also sending copies of this report to the President-elect, the Republican leadership of the Congress, the appropriate congressional committees, and the Secretary-designate of Veterans Affairs.

A handwritten signature in cursive script that reads "Charles A. Bowsher".

Charles A. Bowsher

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Veterans Affairs Issues

The Department of Veterans Affairs (VA) has a profound effect on the welfare of our nation's 27 million veterans. VA's 227,000 workers—nearly 1 for every 120 veterans—deliver a wide array of medical, disability compensation, pension, housing, insurance, education, and burial services in more than 1,000 facilities at an annual cost of \$34 billion.

Efforts to contain the rising federal deficit will likely mean that VA, like other government entities, will have to operate its programs and activities with increasingly constrained resources. VA has numerous opportunities to operate more cost effectively, thereby saving hundreds of millions of dollars while preserving or enhancing the quality of services it provides to veterans. For example, VA now recovers more than \$400 million a year through improved billing and collection procedures for health care. Millions more dollars are lost, however, because VA has not established procedures to verify veterans' reported incomes. If VA is to take advantage of opportunities to improve its cost effectiveness, it must substantially improve its efforts to ensure the timely development and systemwide implementation of policies to correct identified operational problems.

VA and the Congress are likely to face several fundamental policy decisions about the future structure of veterans' benefits. The most significant challenge facing VA could be national health reform. For example, universal coverage could create excess capacity by reducing demand for inpatient care in VA's \$15 billion health care system by almost 50 percent. This could offer the potential to (1) reduce substantially the overall size and cost of the system and (2) limit VA's approximately \$500 million-a-year health facilities construction program. Similarly, decisions may need to be made on whether to provide disability compensation only to veterans whose disabilities were clearly caused by their military service. About 19 percent of the approximately \$10 billion paid in disability compensation now goes to compensate veterans for diseases related to heredity or life-style rather than military service. Other challenges for VA's management include how best to serve an aging veteran population and how to fully incorporate evolving medical treatment patterns and innovative claims-processing technologies into the Department's operations. Meeting all of these challenges will require VA to complete the strategic

management process it started under the previous administration.

Enhancing Strategic Management

As we reported in August 1990, the Secretary of Veterans Affairs initiated strategic management departmentwide. He stated that the goals of this initiative would be to provide the most compassionate and highest-quality service to veterans and their families and become the best-managed federal service organization—a leader in total quality management. Implementation of strategic management is incomplete, however, and achievement of the Department's goals is in jeopardy. To complete implementation, VA will need to

- integrate the planning of its three largely autonomous components—the Veterans Health Administration, Veterans Benefits Administration, and the National Cemetery System—into the Department's overall strategic management;
- develop a more forward-looking, proactive approach to human resource management;
- integrate its information systems; and
- continue efforts to strengthen financial management through preparation of audited financial statements.

Integrating Planning Processes

Strategic management should drive other planning and unify departmental management. Strategic planning and decision-making are fragmented among VA's three components, however, with little involvement by the Secretary. For example, the Veterans Health Administration recently implemented a new planning process independent of Secretarial-level planning. Moreover, VA's annual internal budget process is largely unconnected with the strategic management process. As a result, VA's strategic management will not provide the Secretary with a framework for shaping the future direction of VA's activities. VA's top management needs to continue the previous Secretary's initiative to develop VA's strategic management, integrate the plans of the three components into that process, and periodically assess how each phase of the process can be enhanced.

Strengthening Human Resource Management

In a labor-intensive service organization such as VA, employees are key to achieving management's stated goals of providing high-quality services to its beneficiaries and making the Department the best-managed service delivery organization in the federal sector. Therefore, VA needs effective human resource management focused on such

activities as staffing, employee development, appraisal, and rewards.

VA's traditional approach to personnel management emphasizes compliance with procedural requirements. Although important, such emphasis can limit an agency's ability to develop plans for adapting to change. In recent years, VA has had difficulty dealing with emerging human resource management challenges. For example, it lagged behind the private sector in competing for nursing personnel during the severe shortage in the 1980s.

Developing a forward-looking, proactive approach to human resource management would allow VA to use human resource planning to focus attention on the personnel dimensions of its operations. For example, the trend in the medical community of shifting emphasis from inpatient to outpatient care will undoubtedly require staff with a different mix of jobs and skills. Similarly, efforts to modernize claims processing for veterans' compensation and pension benefits could create a need to retrain VA staff.

With effective human resource management, VA will be able to (1) better anticipate

emerging labor force issues before they become crises and (2) help line managers identify human resource needs and determine what actions to take so that enough employees with the right skills are available when and where they are needed to accomplish goals.

Integrating Information Systems

Major improvements in both the quality of VA's services and the efficiency with which they are provided depend, as we pointed out in our 1988 transition series report, on VA managers' ability to get the right information at the right time. VA has embarked on major systems-modernization efforts to improve its medical and benefit services.

The effectiveness of these efforts is diminished, however, because VA has not integrated currently separate information systems into a system capable of sharing and permitting access to data across all program areas. VA's recent purchase of computer hardware and software for a modernized benefits system may result in a system that requires future replacement because of limited capability, inability to perform as needed, or both.

Strengthening
Financial
Management

VA has been a leader in attempts to strengthen federal financial management, preparing audited financial statements for 1990 and 1991 as required under the Chief Financial Officers Act of 1990. These statements are included in an annual report assessing the overall soundness of VA's financial management and the effectiveness of its internal controls.

Through this effort, VA has identified a number of improvements needed in its financial management. For example, an audit of VA's 1991 financial statements identified several weaknesses in accounting systems, inadequate physical controls over fixed assets and inventory, and improper calculation of future liability for compensation and pension benefits. VA's new Chief Financial Officer should focus special attention on these issues as VA improves its financial management activities.

Strengthening Operational Management

Linked to strategic management is the need for VA to improve its management of departmental operations. Numerous legislative initiatives are unnecessarily delayed, and identified operational problems have gone unresolved for too long. These delays occur because VA's central office is, at times, slow to establish operational policies and ensure that such policies are carried out appropriately and consistently by field facilities.

Implementing Legislative Initiatives

Field facilities either delay implementation of new legislative initiatives or implement them inconsistently because VA's central office does not provide them with timely policy guidance. For example, VA took more than 11 years to finalize procedures to implement a 1980 legislative change. This change expanded the focus of VA's vocational rehabilitation program to emphasize assisting veterans in finding jobs as well as providing training. We found that many veterans dropped out of the program without finding suitable jobs.

Slow development of policies also cost VA an opportunity to use temporary legislative authority to strengthen its collection of copayments for medical care. The Congress

gave VA authority to use tax records to verify veterans' reported incomes during 1991 and 1992. Because VA did not develop a verification system, it lost an estimated \$120 million in copayment revenues for veterans who underreported their incomes to VA. The Congress has recently extended VA's authority to use tax records for an additional 5 years. VA now needs to move quickly to develop and implement policies for using tax records to verify veterans' reported incomes.

Inadequate policy guidance has also resulted in field facilities' inappropriately purchasing millions of dollars worth of medical care from private providers. More than 15 years ago, the Congress authorized VA to make such purchases if the care could be purchased more economically than VA could provide it. Field facilities are purchasing care without making this determination because VA has not provided clear guidance on how cost comparisons are to be made. VA expects to provide the needed guidance to field facilities by early 1993.

Field facilities developed their own interpretations of how a 1986 legislative initiative should be implemented because VA did not provide adequate policy guidance. In

that year, the Congress authorized VA to exempt veterans who were exposed to Agent Orange from copayment liabilities if they were receiving medical care for a condition possibly caused by Agent Orange. Without guidance on how to make this determination, facilities followed policies that ranged from exempting all Vietnam veterans to exempting none, thus providing inequitable benefits to veterans whose cases were similar. VA has said it will correct this problem by early 1993.

Addressing Operational Problems

VA's delays in issuing policy guidance have also impeded correction of identified operating deficiencies. We and others have frequently recommended ways that VA could improve its systems for delivering medical care and processing disability claims. While VA generally responds favorably to such suggestions, its central office is sometimes slow to develop the guidance needed to realize service improvements and cost savings.

A year ago, we recommended that VA modernize its mail-service pharmacies. We found that VA operates too many pharmacies, resulting in uneconomical dispensing practices and labor-intensive processing of

veterans' prescriptions. VA has recently devised a strategy for consolidating and automating its pharmacy operations, but systemwide pharmacy modernization remains several years away. The timely implementation of this modernization offers VA a unique opportunity to substantially improve an important service to veterans while saving millions of dollars in operating costs.

In 1990, the Secretary of Veterans Affairs called for fundamental changes in the way VA provides compensation benefit services to veterans. However, VA's central office has not developed new policies, primarily because it is unsure of what inefficiencies are causing its benefit-claims processes to be burdensome for both VA and claimants. VA could enhance its efforts to improve claims processing by developing a comprehensive approach for determining veterans' service-delivery needs and eliminating barriers to speedy claims resolution. Once this was accomplished, VA would be in a position to develop policies to achieve the Secretary's objectives.

Over the last few years, we have recommended numerous ways that VA could increase its recovery of medical care costs

through improved billing and collection procedures. VA has doubled the amount it has recovered from less than \$200 million to more than \$400 million by developing policies to implement some of our recommended actions. However, VA can accomplish much more. For example, VA is still routinely billing too many veterans for copayments rather than collecting the payments when veterans receive care. VA also has not developed a standard form that billing clerks can use to determine veterans' copayment charges. Timely development of policies to correct these and other identified inefficiencies are needed if VA's recovery of medical care costs is to realize its full potential.

VA also faces the challenge of developing a system for verifying unreimbursed medical expenses that veterans who receive VA pensions report to VA. Veterans may use these expenses to offset income that is used to determine pension eligibility. In 1991, we reported that VA does not know whether millions of dollars in reported medical expenses are valid. VA is currently developing verification procedures, and it needs to ensure that these procedures are completed and distributed in a timely manner to field facilities.

Monitoring Policy Implementation

Under VA's decentralized management structure, as we noted in our 1988 transition series report, systems need to be in place to enable managers in VA's central office to monitor field facilities to ensure that veterans receive high-quality services.

When VA's central office has monitored field facilities' operations, it has been able to make progress in ensuring that its policies have been implemented and problems corrected. For example, systemwide improvements resulted when the central office became actively involved in ensuring that medical facilities properly validated the credentials of their physicians, controlled inventories of addictive prescription drugs, and prepared for surveys conducted by the Joint Commission on Accreditation of Healthcare Organizations.

But the above examples represent focused initiatives to follow up on specific, identified problems. They do not represent a systematic approach to policy implementation. Because VA's central office does not routinely follow up to determine whether its directives are followed, many problems remain uncorrected. For example:

- Many of VA's problems—identified in 1982—in meeting the health care needs of women veterans still exist more than 10 years later. VA's central office directed medical facilities to identify and correct physical barriers to women's access (such as lack of private rooms or separate bathroom facilities) but did not follow up to see that these barriers were removed. Similarly, facilities were directed to provide women with thorough physical examinations, but no follow-up took place to ensure that they did so.
- VA does not know whether medical facilities are setting accurate salary rates under its recently implemented location-based pay system for nurses. This is because VA has not monitored most medical facilities' implementation of the guidance provided by the central office. As a result, numerous internal control weaknesses exist in a rate-setting system that affects about 15 percent of VA's health care budget.
- As we stated in our 1988 transition series report, resident physicians are inadequately supervised at many VA facilities. VA's central office agreed with recommendations we made in 1986 to improve supervision and issued guidance to its medical facilities that

was intended to help ensure adequate supervision of residents. In 1991, however, we found that many medical centers were not following the guidance.

VA needs a monitoring system that encourages medical centers to follow up to see that identified problems are corrected. As initial steps, VA will need to (1) establish more accountability on the part of the facilities' directors for problem resolution and (2) strengthen its oversight of their corrective actions.

Assessing the Future Structure of Veterans' Benefits

The Congress and the administration will be facing two major struggles—the deficit and health care reform—that could have a dramatic effect on the structure of veterans' benefits. In developing its strategic plans, VA needs to consider such things as (1) its role under reformed national health care, (2) how VA's health care eligibility and benefits can be restructured to enable more veterans to be served with limited resources, and (3) how VA's disability compensation benefits can be reformed to ensure that VA's limited resources are targeted to the most deserving.

Planning VA's Role Under Reformed National Health Care

As the new administration's plans to reform the health care system unfold, they will undoubtedly have a significant impact on VA. Any program that would expand health insurance coverage could substantially reduce the demand for VA-sponsored care. This is because veterans without health insurance are much more likely to use VA services than veterans with other health care options. For example, we estimate that enactment of nationwide employer-mandated health insurance would lower demand for inpatient care in VA facilities by about 18 percent. Passage of universal coverage would reduce demand by almost 50 percent. Lower demand for VA care

could reduce VA's operating costs by shifting a portion of the costs of veterans' health care to employers or a new universal insurance program.

Actions that reduce the number of uninsured veterans are also likely to create excess capacity in existing facilities and reduce the need for new VA construction. In recognition of this, the Congress and VA might want to consider limiting construction of additional acute care capacity until the reformed health care system takes shape. This would (1) free up funds for deficit reduction without affecting current VA health care services, and (2) prevent construction of facilities that could quickly lead to excess capacity. VA currently spends about \$500 million a year on construction and renovation of health facilities.

Although many veterans would continue to seek treatment at VA facilities, the magnitude of the likely decrease in demand for VA-sponsored care suggests that plans for restructuring the VA health care system be developed as a part of a national health care reform initiative. Restructuring could include:

- maintaining a smaller direct delivery system strictly for veterans, but focusing on those services, such as treatment of spinal cord injuries and service-connected disabilities, which may not be adequately covered under a reformed national health care system;
- maintaining the current direct delivery system but opening the system to other federal beneficiaries to maintain work loads;
- converting some existing facilities to other uses such as long-term psychiatric care, nursing home care, housing for homeless veterans, or AIDS treatment facilities;
- merging the VA system with one or more of the other federal health care systems, such as that of the Department of Defense; or
- eliminating the separate VA health care system and meeting the nation's commitment to veterans by supplementing the coverage available under a national health care reform initiative.

Restructuring
Veterans' Health
Care Benefits

Any restructuring of the VA system resulting from a reformed national health care system would likely necessitate changes in VA eligibility and benefits. VA would need to

restructure (1) eligibility to better target resources to veterans without other sources of care and (2) benefits to better serve veterans with VA's limited resources.

The Secretary of Veterans Affairs took an important step in this direction through appointment of a Commission on the Future Structure of Veterans Health Care. The commission, in its November 1991 report, made several recommendations for restructuring VA eligibility and benefits. Among other things, the commission recommended reforming health care eligibility to remove differences in eligibility for inpatient, outpatient, and long-term care and providing service-connected and poor veterans with a full range of needed health care services.

The commission's recommendations will likely be the subject of debate during the next year as legislative proposals are submitted. Refocusing veterans' health benefits to better serve those who need help the most and developing a standard, easily understandable "benefit package" could enable the Department to make better use of its available resources. VA's eligibility reform efforts could also position the Department to adjust veterans' benefits, as needed, to

respond to a national health care reform initiative.

Another reform measure that could enable VA to serve more veterans with available resources involves changing cost sharing. For example, states, more than the federal government, are focusing on ways to serve more nursing home patients with available resources by increasing cost sharing. Many states have implemented or increased copayments for state veterans' home residents. Similarly, many states have programs to recover a portion of their costs to provide nursing home care to Medicaid recipients from the estates of the recipients or their spouses. Application of such cost-sharing techniques to VA's long-term care program could enable VA to provide services to more veterans.

Reforming Veterans' Compensation Benefits

The federal deficit increases pressure to control entitlement expenditures. At the same time, adequate benefits must be provided to veterans and their survivors. The Congress and VA are considering ways to reform veterans' eligibility for compensation and pension benefits and the level of benefits available.

One such reform could be changing the definition of a service-connected disability to require a direct causal link to military service. About 19 percent of veterans receiving VA disability compensation, under current law, have disabilities resulting from diseases contracted during military service that were neither caused nor aggravated by military service. Many of the diseases were related to heredity or life-style rather than to military service. We estimate that VA benefits paid for these types of disabling diseases totaled about \$1.7 billion in 1986. Limiting disability compensation to those veterans whose disabilities were clearly caused by their military service could enable the Congress to control entitlement expenditures without penalizing veterans disabled because of their service.

Related GAO Products

Enhancing Strategic Management

Veterans' Benefits: Acquisition of Information Resources for Modernization Is Premature (GAO/IMTEC-93-6, Nov. 4, 1992).

Financial Management: Factors VA Needs to Consider in Implementing the Chief Financial Officers Act of 1990 (GAO/AFMD-91-37, July 23, 1991).

Management of VA: Implementing Strategic Management Process Would Improve Service to Veterans (GAO/HRD-90-109, Aug. 31, 1990).

Veterans Affairs Issues (GAO/OCG-89-14TR, Nov. 1988).

Strengthening Operational Management

VA Health Care: Use of Private Providers Should Be Better Controlled (GAO/HRD-92-109, Sept. 28, 1992).

VA Health Care: Verifying Veterans' Reported Income Could Generate Millions in Copayment Revenues (GAO/HRD-92-159, Sept. 15, 1992).

Vocational Rehabilitation: Better VA Management Needed to Help Disabled Veterans Find Jobs (GAO/HRD-92-100, Sept. 4, 1992).

VA Health Care: Copayment Exemption Procedures Should Be Improved
(GAO/HRD-92-77, June 24, 1992).

VA Health Care: The Quality of Care Provided by Some VA Psychiatric Hospitals Is Inadequate (GAO/HRD-92-17, Apr. 22, 1992).

VA Health Care for Women: Despite Progress, Improvements Needed (GAO/HRD-92-23, Jan. 23, 1992).

VA Health Care: Modernizing VA's Mail-Service Pharmacies Should Save Millions of Dollars (GAO/HRD-92-30, Jan. 22, 1992).

Veterans' Benefits: VA Needs to Verify Medical Expenses Claimed by Pension Beneficiaries (GAO/HRD-91-94, July 29, 1991).

VA Health Care: Better Procedures Needed to Maximize Collections From Health Insurers
(GAO/HRD-90-64, Apr. 6, 1990).

Assessing the
Future Structure
of Veterans'
Benefits

VA Health Care: Offsetting Long-Term Care Costs by Adopting State Copayment Practices (GAO/HRD-92-96, Aug. 12, 1992).

Related GAO Products

VA Health Care: Alternative Health Insurance Reduces Demand for VA Care (GAO/HRD-92-79, June 30, 1992).

VA Benefits: Law Allows Compensation for Disabilities Unrelated to Military Service (GAO/HRD-89-60, July 31, 1989).

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Government Management Issues
(GAO/OCG-93-3TR).

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December 1992

Housing and Community Development Issues



GAO United States
General Accounting Office
Washington, D.C. 20548

**Comptroller General
of the United States**

December 1992

The Speaker of the House of Representatives
The Majority Leader of the Senate

In response to your request, this transition series report discusses major policy, management, and program issues facing the Congress and the new administration in the area of housing and community development. The issues include (1) providing affordable housing for the nation's poor, (2) strengthening the Department of Housing and Urban Development's management, (3) controlling housing loan and lead-based paint cost exposure, (4) promoting community development, and (5) reexamining strategies for responding to disasters.

The GAO products upon which this report is based are listed at the end of the report.

We are also sending copies of this report to the President-elect, the Republican leadership of the Congress, the appropriate congressional committees, and the designated heads of the appropriate agencies.



Charles A. Bowsher

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Housing and Community Development Issues

Three conditions frame today's debate on housing and community development issues. These conditions are (1) the increasing gap between the demand for and the available supply of decent and affordable rental housing for low-income families, (2) the increasing need for investment in our communities, and (3) the shrinking federal resources for dealing with these problems.

For decades, federal legislation has reaffirmed a commitment to decent, safe, and affordable housing for every American family. However, as we reported in 1988, federal housing efforts have not met the needs of many Americans. Today, the supply of affordable rental housing for low-income people continues to decline while the need for such housing continues to grow. Rising costs, declining real wages, and a decreasing number of affordable homes have put a decent place to live beyond the reach of millions of families.

At the same time, the federal government is facing large real and potential cost exposure in several areas. For example, the nation's public housing stock, valued at over \$70 billion, has fallen into serious disrepair. The cost to meet existing needs is estimated at over \$20 billion, and modernization needs

continue to accrue. Moreover, the cost to renew expiring contracts that provide rental subsidies to lower-income families is expected to more than double over the next 5 years—rising from an estimated \$7.5 billion in fiscal year 1993 to about \$17.1 billion in fiscal year 1997.

Regarding potential cost exposure, the Federal Housing Administration's (FHA) single-family home ownership insurance program has lost an average of almost \$900 million a year from fiscal years 1979 to 1990 and has an economic value of negative \$2.7 billion. If these losses continue, the Treasury may be called upon to fund the program for the first time in FHA's 50-year history. Finally, the federal government faces billions of dollars in costs to clean up lead-based paint from its housing inventories, such as public housing. Estimates of these costs range from \$6 billion to \$16 billion. Resolving these issues will likely require significant funds at a time when federal budget choices are becoming increasingly limited.

Finally, other economic and social problems are putting tremendous strains on communities. Opportunities to provide additional funds are sharply constrained

because of the federal budget deficit and the relatively limited capacity of federal, state, and local governments for dealing with these problems. Under these circumstances, reinvigorating our communities will require careful leveraging of our investments in both the physical and human resources that communities provide. New partnerships and creative solutions will be needed.

Providing Affordable Housing for the Nation's Poor

The federal government has invested tens of billions of dollars in rental housing assistance to provide decent and affordable housing for low-income families.

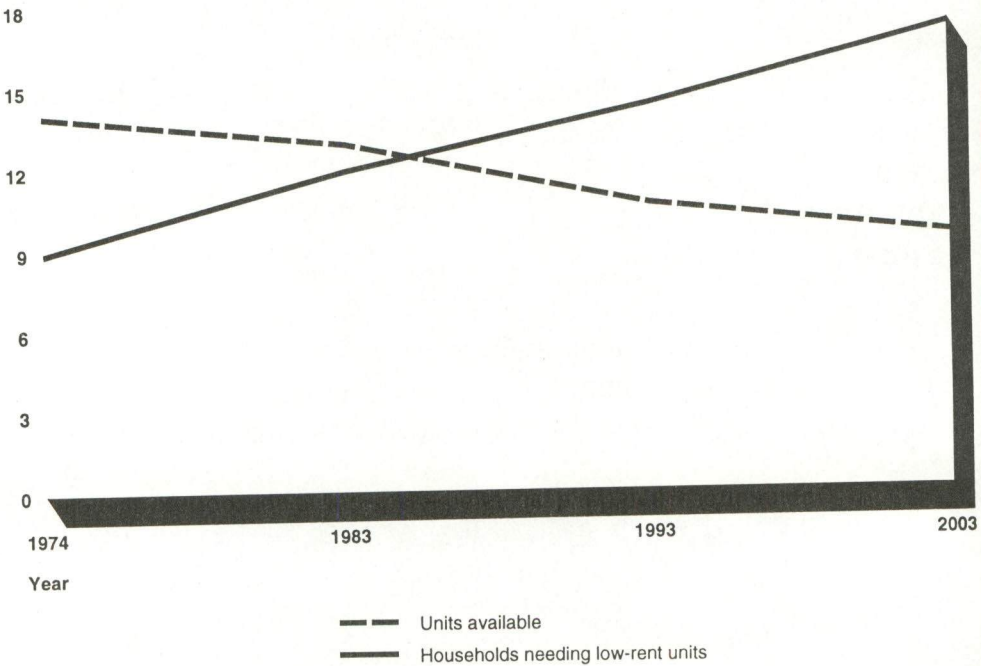
Nevertheless, an increasing share of our poor families are living in inadequate and unaffordable housing. In addition, much of the past federal investment is in danger of being lost—a condition that will only worsen an already dismal situation.

The gap is widening between the number of decent, affordable rental units and the demand for these units. In the early 1980s, demand and supply were in relative equilibrium. Since then, demand has been outstripping supply (see fig. 1). The gap is expected to grow over the next 10 years, when nearly one of every two low-income families may not be able to find affordable rental housing. Furthermore, it should be emphasized that this analysis understates the housing problems of low-income families, since the analysis is not adjusted for factors such as the location of available housing and household size.

Providing Affordable Housing for the
Nation's Poor

Figure 1: Number of Low-Rent Housing Units Available and Households Needing These Units, 1974-2003

Number of units (in millions)



Source: Neighborhood Reinvestment Corporation, At Risk of Loss: The Endangered Future of Low-Income Rental Housing Resources.

To address the growing housing shortage,
we will need to preserve private sector

low-income units, modernize the public housing stock, obtain sufficient permanent financing for affordable multifamily units, and continue to provide rent subsidies to poor families in private housing.

**Preserving
Private
Low-Income
Housing**

During the 1960s and 1970s, the federal government provided mortgage insurance, loans at below-market rates, and direct subsidies to stimulate the private sector's production of low-income housing. Within the coming 5 years, about 3,000 properties containing over 350,000 units could be withdrawn from the low-income rental market as restrictions limiting their use to low-income rental expire. The National Affordable Housing Act of 1990 provides financial incentives from the federal government, such as rent subsidies, to retain this inventory as a low-income housing resource. However, providing these incentives to preserve this stock for low-income use could cost the federal government hundreds of millions of dollars a year.

**Modernizing
Public Housing**

Too much of the public housing stock, particularly in urban areas, has fallen into serious disrepair. Home to many of the

nation's poorest households, the public housing stock consists of approximately 1.4 million units whose value exceeds \$70 billion. Modernization costs to meet existing capital improvement needs are estimated at over \$20 billion. These needs, coupled with new repair needs, would require annual appropriations over the next 20 years estimated at \$3.4 billion—about \$600 million per year more than the average annual appropriation of \$2.8 billion for this purpose in fiscal years 1991 to 1993.

**Stimulating
Investment
Through
Mortgage Credit
Enhancements**

Changes in government policies and regulations during the 1980s, along with the poor performance of inadequately managed multifamily housing loans insured by FHA and other loans purchased by the Federal Home Loan Mortgage Corporation, led to a steep decline in mortgage funds available for affordable rental housing. A variety of participants representing a cross section of the financial market believe that significant barriers exist in accessing capital for rental housing targeted to low-income and very low-income rental households.

In this climate, the secondary market for multifamily housing mortgages (buyers and sellers of mortgage loans) has taken on

increased importance. However, such a market has not evolved for several reasons, including the risk—both real and perceived—associated with affordable housing and the reluctance of FHA and key secondary market institutions to expand their support for financing this housing as they attempt to balance support for affordable housing with the safety and soundness of their operations. New forms of federal credit enhancement—such as insurance on individual loans and pools of loans—recently authorized by the Congress can help to address this problem if the enhancements get support from FHA and the secondary market institutions charged with carrying out the new law. We expect to issue a comprehensive report discussing these issues in spring 1993.

**Rent Subsidies
Becoming
Increasingly
Costly**

Rent subsidies—provided through certificates, vouchers, and project-based assistance—are a mainstay in federal efforts to enable low-income families to live in decent and affordable privately owned rental housing. Currently, about 2.7 million families receive this assistance through HUD's contracts with private owners and local housing agencies, such as public housing agencies. Yet contracts covering assistance

to an estimated 1.6 million families are expected to expire in the next 5 years, and the cost to renew these contracts will grow, in current dollars, from an estimated \$7.5 billion in fiscal year 1993 to an estimated \$17.1 billion in fiscal year 1997.

This increase is due primarily to the larger number of contracts expected to expire in the next few years than in the recent past. The Congress and HUD have pursued a policy of renewing all expiring contracts so that low-income families can continue to live in affordable and decent housing. Yet the cost to continue this policy will more than double within the next 5 years, creating increasing pressures on an already strained federal budget.

Strengthening HUD's Management

Since the publicizing of scandals at HUD in 1989, a great deal of attention and energy has focused on improving the Department's management. However, while HUD has undertaken a series of reform measures, many fundamental management problems remain unresolved. Solutions are needed so that HUD can shift more of its attention to program results.

In April 1989, a series of major, well-publicized problems began unfolding at HUD, involving widespread fraud, waste, abuse, and mismanagement. The full array of problems became widely known as the "HUD scandal." Some of these problems were departmentwide; others were confined to individual programs. Some of the most notable problems included influence-peddling, theft by private real estate agents of millions of dollars in HUD funds, inadequate enforcement of requirements designed to minimize defaults on HUD-backed mortgages, and poorly designed programs and controls that made it relatively easy for developers and lenders to exploit the program—at billions of dollars in costs to the government.

HUD
Management
Deficiencies
Unresolved

Although the Congress and HUD made major efforts to address these management and program design problems, the underlying causes of HUD's long-standing management deficiencies remain largely unresolved. These deficiencies include inadequate information and financial management systems, weak internal controls, an inappropriate organizational structure leading to ill-defined responsibilities and authority, and insufficient staff resources to perform necessary functions, such as monitoring and enforcing program requirements. These problems leave HUD's multibillion-dollar programs open to fraud, waste, abuse, and mismanagement. In fact, a recent report by the HUD Office of Inspector General cautioned that unless the Department acquires sufficient resources, another HUD scandal is a distinct possibility.

Although HUD has implemented many program-specific corrective actions, it is only beginning to resolve the underlying, departmentwide deficiencies. Until corrective actions for these departmentwide problems are implemented, actions focused on individual programs, no matter how extensive, cannot fully guarantee that the earlier abuses will not recur.

For these reasons, it is important to continue to review HUD's progress to ensure that HUD sustains its efforts to rectify problems, that corrective actions become an integral part of program operations, and that actions have a lasting effect. Only continued support and oversight can assure the public that HUD's resources are being efficiently used to serve the intended beneficiaries.

Controlling Increasing Cost Exposure

Substantial losses from federal insurance programs and costs to be incurred to abate lead-based paint in the government's housing inventory have substantially increased the federal government's cost exposure.

Limiting FHA's Insurance Losses

FHA's home ownership assistance program is the largest source of mortgage financing for low- and moderate-income Americans. As of the end of fiscal year 1990, \$303 billion in federally insured mortgage loans were outstanding under the program, which encourages home ownership by providing more liberal credit terms than private sector lenders would offer. Unlike private sector mortgage lending, FHA's program is to strike a balance among certain social and financial goals—to help relatively risky borrowers with mortgage financing while remaining actuarially sound. As such, FHA's program is inherently more risky than private sector programs.

Over the past 12 years, the economic value of FHA's largest program—the single-family home ownership program—has been decreasing by an average of about \$891 million a year, dropping from \$8 billion in fiscal year 1979 to a negative \$2.7 billion in fiscal year 1990. This has occurred because

of rising foreclosures in economically stressed regions during the 1980s, particularly the Rocky Mountain and Southwest regions of the country, poor HUD management, and lax HUD monitoring. More recently, the economic recession and the slower-than-expected recovery have increased claims. If these conditions continue to play out, the Treasury may be called upon to fund the program for the first time in FHA's 50-year history. While there is no way to predict how much this remedy could cost, it could be substantial. In dealing with this issue, policymakers must balance the desire to assist home buyers against the federal government's potential financial risk and the possible need for assistance from the Treasury.

Facing
Lead-Based Paint
Abatement
Liability

The federal government also faces billions of dollars in costs to clean up lead-based paint from its housing inventories. Lead poisoning—mostly caused by lead-based paint—is, according to the Centers for Disease Control, the most common and socially devastating environmental disease of young children. Estimates of the cost to abate lead-based paint in public housing units range from \$6 billion to \$16 billion. In addition, federal agencies that sell

foreclosed residential housing to the public—HUD, the Farmers Home Administration, and the Department of Veterans Affairs—must comply with certain testing and abatement requirements that will probably cost the government hundreds of millions of dollars. The federal government's exposure to these large costs could result in substantial outlays.

Promoting Community Development

How best to revitalize our communities is a question central to today's public policy debates. While much of this question has focused, appropriately, on the problems of inner cities, other important economic and community development issues warrant increased attention, such as the effectiveness of federal efforts to develop small businesses, particularly for minority groups.

Curing Urban Ills

For decades the nation has attempted to address the problems of inner-city, urban America. However, the recent unrest in Los Angeles has demonstrated that we have made only slight progress at best. Residents of low-income neighborhoods commonly face difficulties finding jobs and attaining a reasonable standard of living. Similarly, neighborhood businesses confront a variety of barriers in creating and expanding job opportunities for inner-city residents.

Federal efforts have been limited to formulating and designing programs to address specific problems. Overall, these efforts have been piecemeal, and more attention has been paid to symptoms than to the underlying need to develop human resources. The price the country pays for

these continuing urban problems is tremendous—both in social and economic terms.

Impact of Small Business Loans Unclear

A critical element in developing and maintaining the economic well-being of communities—rural, urban, and suburban—is small business. There are over 20 million businesses in the United States. All but about 200,000 of them are small businesses. Within the federal government, the Small Business Administration (SBA) is charged with developing and nurturing small business by providing financial, technical, and other assistance, giving particular attention to small minority businesses. SBA is to provide this support while protecting the taxpayers' interests.

There has been no recent assessment of what sector of small business, if any, would receive financial assistance if SBA did not exist. Nor has there been a recent assessment of the economic impact that has resulted from the billions of dollars in federal guarantees that SBA has provided to small businesses. Yet in fiscal year 1992, SBA almost doubled the value of the business loans that it guaranteed—from \$3.8 billion in fiscal year 1991 to \$6.4 billion in fiscal year

1992. Our work has shown that SBA's loss rate is greater than that of private lenders and that SBA has not adequately overseen the operations of lenders receiving government loan guarantees. Without adequate resources to oversee its existing loan portfolio, SBA cannot ensure the quality of the new loans that it guarantees and protect the government against loan losses. SBA's impact on stimulating small business development also needs to be determined.

**Minority Business
Development
Problems**

Our work and that of others has shown that SBA has been ineffective in developing minority firms into viable, independent businesses. As far back as 1975, we reported that SBA's success at helping minority firms become self-sufficient and competitive was minimal. In the 1980s, SBA's Office of Inspector General, the National Academy of Public Administration, the Senate Small Business Committee, and we found that SBA's management of the program fell far short of requirements and expressed grave concerns about the lack of progress in making the program a true business development program. Most recently, we reported in 1992 that SBA has made little progress in implementing the Congress' third major attempt to improve the program's

effectiveness. In addition, a 1992 Presidential Commission on Minority Business Development reported that the federal government—specifically SBA—has failed to develop the talents and creativity of minority businesses. Our work on this program over the years, as well as the work of others, raises serious concerns about SBA's overall commitment to the goals of the program. Until problems with the minority business development program are corrected, federal funds will continue to be spent ineffectively, and community development will be hindered.

Reexamining Strategies for Responding to Disasters

Recent experience has called into question how well federal efforts assist communities suffering the effects of natural disasters. Since 1989, when the country experienced the back-to-back disasters of Hurricane Hugo in South Carolina and the Loma Prieta earthquake in California, dissatisfaction with the federal government's responsiveness to these kinds of devastating occurrences has grown. Hurricane Andrew reinforced these concerns and raised them to an even higher level on the Congress' agenda.

Basic questions are now being raised about whether the federal government is properly organized to respond to major disasters. In this context, the roles of the Department of Defense, Federal Emergency Management Agency, and federal and state governments in responding to disasters are being reexamined.

Our work clearly indicates that substantial policy, organizational, and operational changes are needed. We are continuing to study these issues and plan to identify and report on a series of options for dealing with them by spring 1993.

Related GAO Products

Low-Income Housing

Public Housing: Housing Persons With Mental Disabilities With the Elderly (GAO/RCED-92-81, Aug. 12, 1992).

Mortgage Credit Enhancements: Options for FHA in Meeting the Need for Affordable Multifamily Housing (GAO/T-RCED-92-52, Apr. 3, 1992).

Homelessness: Transitional Housing Shows Initial Success but Long-term Effects Unknown (GAO/RCED-91-200, July 15, 1991).

Rental Housing: Implementing the New Federal Incentives to Deter Prepayments of HUD Mortgages (GAO/PEMD-91-2, Apr. 30, 1991).

Managing HUD

HUD Reforms: Progress Made Since the HUD Scandals but Much Work Remains (GAO/RCED-92-46, Jan. 31, 1992).

HUD Reforms: Limited Progress Made Since the HUD Scandals (GAO/T-RCED-91-62, June 12, 1991).

Increasing the Department of Housing and Urban Development's Effectiveness Through Improved Management (GAO/RCED-84-9, Jan. 10, 1984).

Related GAO Products

Increasing
Exposure to
Costs

Home Ownership: Loan Policy Changes Made to Strengthen FHA's Mortgage Insurance Program (GAO/RCED-91-61, Mar. 1, 1991).

Impact of FHA Loan Policy Changes on Financial Losses and Homebuyers (GAO/T-RCED-90-95, July 10, 1990).

Impact of FHA Loan Policy Changes on Its Cash Position (GAO/T-RCED-90-70, June 6, 1990).

Economic
Support and
Developing
Communities

Industrial Development Bonds Are Generally Not Targeted and Benefits Unclear (GAO/RCED-92-247R, July 24, 1992).

Small Business: Problems in Restructuring SBA's Minority Business Development Program (GAO/RCED-92-68, Jan. 31, 1992).

Small Business: Financial Condition of SBA's Business Loan Portfolio Is Improving (GAO/RCED-92-49, Dec. 3, 1991).

Disaster
Assistance

Earthquake Recovery: Staffing and Other Improvements Made Following Loma Prieta Earthquake, (GAO/RCED-92-141, July 30, 1992).

Related GAO Products

Disaster Assistance: Federal, State, and Local Responses to Natural Disasters Need Improvement (GAO/RCED-91-43, Mar. 6, 1991).

General

Housing and Urban Development Issues
(GAO/OCG-89-22TR).

Transition Series

Economics

Budget Issues (GAO/OCG-93-1TR).

Investment (GAO/OCG-93-2TR).

Management

Government Management Issues
(GAO/OCG-93-3TR).

Financial Management Issues
(GAO/OCG-93-4TR).

Information Management and Technology
Issues (GAO/OCG-93-5TR).

Program Evaluation Issues (GAO/OCG-93-6TR).

The Public Service (GAO/OCG-93-7TR).

Program Areas

Health Care Reform (GAO/OCG-93-8TR).

National Security Issues (GAO/OCG-93-9TR).

Financial Services Industry Issues
(GAO/OCG-93-10TR).

International Trade Issues (GAO/OCG-93-11TR).

Commerce Issues (GAO/OCG-93-12TR).

Energy Issues (GAO/OCG-93-13TR).

Transportation Issues (GAO/OCG-93-14TR).

Food and Agriculture Issues
(GAO/OCG-93-15TR).

Environmental Protection Issues
(GAO/OCG-93-16TR).

Natural Resources Management Issues
(GAO/OCG-93-17TR).

Education Issues (GAO/OCG-93-18TR).

Labor Issues (GAO/OCG-93-19TR).

Health and Human Services Issues
(GAO/OCG-93-20TR).

Veterans Affairs Issues (GAO/OCG-93-21TR).

Housing and Community Development
Issues (GAO/OCG-93-22TR).

Justice Issues (GAO/OCG-93-23TR).

Internal Revenue Service Issues
(GAO/OCG-93-24TR).

Foreign Economic Assistance Issues
(GAO/OCG-93-25TR).

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Foreign Affairs Issues (GAO/OCG-93-26TR).

NASA Issues (GAO/OCG-93-27TR).

General Services Issues (GAO/OCG-93-28TR).

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December 1992

Justice Issues





United States
General Accounting Office
Washington, D.C. 20548

**Comptroller General
of the United States**

December 1992

The Speaker of the House of Representatives
The Majority Leader of the Senate

In response to your request, this transition series report discusses major policy, management, and program issues facing the Congress and the new administration in the justice area. These issues include (1) strengthening leadership and management functions at the Department of Justice, (2) investigating and prosecuting white collar crime, (3) making needed policy and management decisions on immigration issues, (4) responding to a rapid rise in the federal prison population, and (5) making the government's antidrug efforts more effective.

The GAO products upon which this report is based are listed at the end of the report.

We are also sending copies of this report to the President-elect, the Republican leadership of the Congress, the appropriate congressional committees, and the Attorney General-designate.

A handwritten signature in cursive script that reads 'Charles A. Bowsher'.

Charles A. Bowsher

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Justice Issues

The role of the Department of Justice in dealing with the nation's crime problems has expanded significantly in recent years. Today, the Department has more staff and is conducting more investigations than ever before. Between 1981 and 1992, the Department's budget increased from \$2.35 billion to \$10.4 billion. The Bureau of Prisons (BOP) is housing the largest number of federal inmates in its history. Between 1986 and 1992, the federal prison population grew by more than 70 percent to 80,000, as of November 1992; from now through 1996, the government will have to spend more than \$2 billion to build new prisons. Inmates convicted of drug offenses now comprise 57 percent of all federal inmates, demonstrating that the Department's antidrug efforts have met with some success. Nevertheless, significant challenges remain.

When we issued our first transition series report on justice issues 4 years ago, we said that the Department needed to strengthen its central management capabilities and to set priorities for its antidrug programs. Both of these issues still pose major challenges today. Greater progress has been made in resolving other issues that we raised in 1988—reforming sentencing, reforming

immigration, and preventing discrimination caused by immigration reform.

The decentralized operations and independence of organizations like the Federal Bureau of Investigation (FBI) and U.S. Attorneys complicate efforts by the Department of Justice to coordinate and direct a wide variety of initiatives and programs to fight crime. The central issue facing the Department of Justice is how best to provide leadership and ensure that its priorities are carried out as effectively as possible.

Since 1988, the Department has taken new steps in the area of immigration, built new federal prisons at a record pace, and dramatically increased its budget for drug control. It has also had to respond to significant new challenges, such as the wave of criminal referrals and prosecutions generated by the savings and loan and banking crises. Financial institution fraud has also become a major problem. In some areas, the volume of work is overwhelming the justice system.

In this environment, the issue of leadership is even more important today than it was in 1988. Additionally, to respond effectively to a

rising crime rate, an exploding prison population, and an intractable drug problem, the Department requires strong management processes and systems.

Strengthening the Department of Justice's Leadership and Management Functions

Leading the nation's law enforcement and administration of justice effort has always been a difficult task. A balance must be struck between the need for strong leadership in important areas and the benefits of a decentralized law enforcement mechanism in the hands of U.S. Attorneys. As world history has shown, too much central police authority can lead to grave abuses. In our country's system of justice, the creative tension that exists between centralized and decentralized management and leadership functions has led to progress on various issues. Nonetheless, given the national scope of some of the law enforcement issues that we face today, it may be necessary to reexamine the leadership role of the Attorney General and the relationship between the Department of Justice and its components and the U.S. Attorneys. Too little central direction can stymie implementation of national initiatives as well as lead to inconsistency and inefficiency.

During the 1980s, mounting public concern over crime in general and drugs in particular turned law enforcement into a growth industry at the state, local, and federal levels. However, after a decade of higher spending and promises to reduce the nation's

vulnerability to crime, the incidence of violent crime continues to grow. In view of this growth, the efficiency and effectiveness of the Department of Justice is critical.

However, the success of the Department in accomplishing its mission is complicated by its highly decentralized operations and the independence afforded its agencies and offices. The Department needs to strengthen its central management systems to ensure that they provide the Attorney General with the information necessary to effectively establish, communicate, coordinate, and oversee national goals and priorities.

There is an issue as to whether the Department is currently able to give proper perspective to the interrelationships among its components. Coordination among the various components of the criminal justice system is essential. At present, in enforcing drug laws, FBI and the Drug Enforcement Administration (DEA) independently develop investigative strategies and priorities, operate separate intelligence systems, and use different systems for reporting and measuring their effectiveness. This degree of independence requires good central oversight to ensure overall efficiency and effectiveness. Anticipated federal budget

cuts and the continued growth in violent crime—particularly in the use of firearms—further highlight the need for better interagency coordination.

It is also important to ensure that field level decisions are sufficiently in keeping with national law enforcement priorities. Justice components, located throughout the country, have the flexibility to structure their programs differently. They are able, for example, to set different operating thresholds for investigating and prosecuting offenses for which mandatory sentences have been established by law. Yet despite the existence of workload constraints and local priorities, as well as the desirability of prosecutorial discretion, strong central oversight is needed to ensure that national law enforcement programs are focused on—and consistent, efficient, and effective in pursuing—national goals and priorities.

Such oversight, however, cannot be brought to bear without good management information systems and meaningful measures of performance. In each of these areas, there is room for the Department to improve. For example, after a number of false starts and over a decade of effort, the Department still does not have in place a

case management system that can track cases being litigated and the total number of staff in the litigating organizations working on them. Similarly, while the Department has several numerical measures of its activities, these measures do not readily indicate the degree to which the Department's national goals are being achieved.

The Department also needs to resolve jurisdictional disputes. For example, within the Office of Justice Programs (OJP), conflicts exist between the five OJP bureaus and OJP management over individual bureau autonomy. To address the disputed lines of authority, the Attorney General in 1991 conferred on the Assistant Attorney General for OJP certain grant-related authorities traditionally held by the bureau directors. This solution not only created additional management problems but violated the statutes establishing the bureaus. Although OJP and the bureaus are working to resolve the management conflicts, tensions remain.

Given the national significance of law enforcement issues and the problems inherent in addressing them, it is important to assess the appropriate leadership role for the Office of the Attorney General. Central to this assessment is achieving consensus

**Strengthening the Department of
Justice's Leadership and Management
Functions**

within the Department on how to focus
federal resources effectively on key issues.

Investigating and Prosecuting White Collar Crime

The staggering costs of the financial institution debacle, Wall Street insider trading, the Department of Housing and Urban Development scandal, fraud in the growing number of bankruptcies, and fraud associated with health care all reflect the magnitude of “crime in the suites.” Often, perpetrators of white collar crimes occupied positions in government, industry, and civic organizations and were highly regarded within their communities. By abusing their positions of trust, white collar criminals undermine the integrity of their professions and of government and, ultimately, are responsible for the loss of billions of dollars annually from the nation’s economy.

Increasingly, white collar crime cases are overwhelming the justice system, as the following examples show.

- Criminal financial institution fraud referrals continue to increase. More than 35,000 referrals were submitted to FBI in fiscal year 1992—up from 25,000 in fiscal year 1991.
- U.S. Attorneys in several large districts generally decline to prosecute health care fraud cases under \$100,000.

- FBI reports that bankruptcy fraud is largely unaddressed and that bankruptcies are ripe for abuse: The number of filings has more than tripled over the last 10 years.
- As of September 1992, Justice had received referrals of alleged criminal activity by former directors, officers, and principal shareholders associated with 336 of the 723 savings and loans under Resolution Trust Corporation control. As of July 1992, Justice had indicted directors, officers, and principal shareholders in 72 of these savings and loans.

In response, the Department has applied significantly more resources. FBI, for example, has tripled the number of agents working on white collar crime since 1985. Congressional appropriations have allowed a tripling of U.S. attorney resources dedicated to financial institution fraud. As the available resources have grown, so have the number of indictments, arrests, and convictions. For example, the number of defendants sentenced to prison for white collar crimes increased from 4,350 to 5,300 between fiscal years 1985 and 1991.

However, the Department alone cannot adequately address white collar crime.

Effective intervention requires a more cohesive federal response, using the full range of the government's resources and expertise. Yet Justice's ability to address white collar crime is hampered both by the decentralized nature of the Department and by the structure of the government as a whole. Individual U.S. Attorneys around the country exercise great discretion in managing their programs and resources. In addition, Justice has little, if any, influence over agencies outside the Department—such as the Internal Revenue Service—that are often critical for effective investigations and prosecutions. These organizational barriers have resulted in a fragmented approach to pursuing white collar crime. For example, efforts to form financial institution fraud task forces around the country were largely unsuccessful because Justice and non-Justice agencies could not agree on the appropriate level of non-Justice resources and on which agency should pay for these resources. In addition, some U.S. Attorneys, who preferred to work independently, rejected the task force concept.

Another issue associated with white collar crime is whether the punishment is severe enough for the offense committed. For example, the median prison sentence in 1991

for fraud was 21 months. Fewer than 7 percent of the fraud convictions since 1988 involving savings and loan and bank losses of \$100,000 or more received prison sentences of 60 months or more. While fines and restitutions ordered in these cases have totaled nearly \$850 million, less than 5 percent of these funds had been collected through mid-1992. Justice says that most of the balance is not collectible. Whether or not this is the case, Justice's collection efforts lack a consistent approach and an adequate database.

We recognize that the Department does not control the specific sentences and monetary penalties imposed for crimes. However, the Department is the logical focal point for (1) determining whether the punishment being meted out provides the necessary deterrent effect and (2) seeking change if needed. Furthermore, the Department needs to make a stronger effort to ensure the collection of as large a portion as possible of the total monetary penalties imposed.

Justice, working with other departments and agencies, needs to take a number of steps to better address the growth in white collar crime. Paramount is the need to better integrate the efforts of Justice and

non-Justice agencies into a cohesive national response. Finally, Justice, working with the Administrative Office of the U.S. Courts, should improve its management of debt collection.

Making Needed Policy and Management Decisions on Immigration Issues

As long as political unrest and economic hardships persist throughout the world, refugees will continue to flee to the United States. Hence, the United States will continue to face complex and difficult immigration issues, such as

- who should be permitted to legally enter the country,
- what should be done to prevent aliens from entering illegally, and
- what should be done to remove aliens who remain here illegally.

In addition to these policy issues, management problems within Justice's Immigration and Naturalization Service (INS) need to be resolved.

From without and from within, the United States is pressured to allow refugees to enter the country legally to escape intolerable conditions in other countries. For example, as civil unrest, poor economic conditions, and natural disasters occur in other countries, refugees look to this country as a safe haven. U.S. citizens are often eager to facilitate the entry of refugees whose ethnic background is the same as their own. This

pressure can lead to different immigration policies being applied to refugees from different ethnic backgrounds. For example, Cubans are readily permitted to enter and remain in the country, whereas Haitians are interdicted at sea and returned to Haiti.

In addition to regulating the access of aliens seeking legal entry, INS is responsible for stopping millions of aliens trying to enter the country illegally. Some of these aliens smuggle contraband, such as drugs. Preventing illegal entry raises several issues, including (1) the feasibility and effectiveness of different approaches to, and technologies for, improving border control; (2) humanitarian concerns, such as equitable treatment of aliens of different nationalities and divided families; and (3) cost considerations and trade-offs, such as choosing between detaining aliens and preventing their illegal entry. Conflicting with INS' border enforcement role are trade facilitation objectives calling for the efficient flow of goods across the border.

In removing aliens from the country, INS is confronted with the almost impossible task of trying to locate and deport aliens that it believes should not remain here. For example, aliens who have committed certain

crimes are subject to deportation but are required to have a hearing before an immigration judge to establish their deportability. INS does not have sufficient resources to detain the millions of aliens who are subject to detention or who have been ordered deported. Consequently, most of the aliens whom INS apprehends are released pending the resolution of their deportation hearings. However, these aliens usually do not appear for their hearings and remain here illegally.

In addition to these difficult policy issues needing congressional and administrative attention, INS needs strong leadership and management to

- balance the demanding roles of enforcement and service and
- overcome problems in the management of its enforcement efforts and of the services that it provides to aliens.

Managing such competing enforcement and service functions means making hard decisions about allocating resources to ensure the agency's most effective operations. Over the past decade, weak management systems and inconsistent

leadership at INS led to segmented autonomous programs, each of which tried to handle its own set of problems and gave little attention to interrelationships among programs. Without coherent overall direction and basic management reforms, the organization was unable to effectively address changing enforcement responsibilities and long-standing service delivery problems. In response to these problems, INS reorganized its management and operations.

Financial management at INS was weak, and the agency did not have fiscal accountability over its resources. Its outmoded accounting system, weak internal controls, and lack of management emphasis on financial management contributed to this situation. INS could lose millions of dollars in revenue because accurate and reliable financial information is not available to effectively bill, collect, or litigate amounts owed the government. Furthermore, the agency's primary accounting system contained incomplete and inaccurate financial data. These weaknesses remained uncorrected for many years. Addressing these problems, which INS can do in implementing its Chief Financial Officers Act, will require strong

and sustained management commitment and leadership.

In the past, INS' budget development process was chaotic. The agency's budgets were simply compilations of program submissions with little accountability for funds or attention to agencywide priorities. The current INS reorganization addresses some concerns but has not fully resolved the issue of segmented management. Although INS is addressing some of these management problems, action is still needed to improve program enforcement and service. For example, even though aliens pay fees to cover processing costs, they still have to wait months to have their applications processed. While expenditures nearly doubled between fiscal years 1986 and 1989, overall processing times have not improved, and in key INS districts processing times have substantially exceeded INS' criteria.

During the last several years, the Office of the Attorney General has focused much more effectively on management issues relating to INS. New people have been recruited for key positions, and a renewed effort has been made to deal with the long-term problems that exist at INS. Achieving progress will be difficult, but we

**Making Needed Policy and
Management Decisions on Immigration
Issues**

are encouraged by the departmental commitment to bring about change. It is important that this commitment be sustained in the years to come.

Responding to a Rapid Rise in the Federal Prison Population

A growing prison population was perhaps the most visible result of the increases in federal resources—investigative, prosecutorial, and judicial—devoted to federal criminal law enforcement in the 1980s. Policy initiatives—such as an expanded “drug war,” implementation of federal sentencing guidelines, and the enactment of mandatory minimum sentences for a number of drug and firearms offenses—have led to a rapidly growing federal prison population that generally serves longer sentences. This rising population has strained prison capacity and budgetary resources. Indeed, the major issue facing the federal corrections system is finding less costly ways of achieving the corrections goals of deterrence and public safety while providing inmates with humane care and services that equip them to become law-abiding citizens upon release.

Between fiscal years 1986 and 1992, the federal prison population grew from 41,500 to 70,630; by 1996, a population of about 106,000 is projected. One reason for this expected future growth is the implementation of federal sentencing guidelines, which took effect on November 1, 1987. Reflecting the “get tough on crime” policies of the last decade, the

guidelines offer judges fewer nonprison sentencing options for most offenders. Consequently, a greater proportion of convicted offenders are going to prison for longer terms, decreasing the turnover in the federal prison population and increasing capacity requirements. In 1990, about 74 percent of offenders sentenced under the guidelines were sent to prison, as compared with 53 percent in 1986, before the guidelines took effect. The length of the average sentence in 1990 had increased by about a year—from 53 to 61 months. Moreover, because parole had been eliminated under the guidelines, an inmate could expect to serve, on average, almost 3 years longer—from about 19 to 52 months.

Drug offenders will continue to have a major impact on the federal corrections system. Inmates convicted of drug offenses now comprise 57 percent of all federal inmates, and they are expected to constitute about two-thirds (71,000) of the 1996 population. Under the guidelines, almost 9 in 10 convicted drug offenders are sentenced to prison for an average of 83 months—at least 70 months of which they can expect to serve.

The costs of housing and caring for this growing population continue to rise.

Between 1986 and 1992, corrections budgets, primarily for federal prisons, nearly quadrupled from about \$600 million to about \$2.3 billion. Despite the increased use of 2-person cells and plans to activate 44 additional facilities with a capacity of about 30,000 inmates between 1992 and 1996, BOP expects the growth in the inmate population to outstrip the increase in capacity by about 6,000 inmates. The estimated cost of constructing these new facilities is almost \$2.2 billion. BOP estimates the costs of operating these new facilities, over their useful life, at about 15 to 20 times the construction costs.

These rapidly rising costs have focused attention on the costs of traditional incarceration. Given an average annual cost of about \$18,000 per inmate for traditional imprisonment, the Sentencing Commission, BOP, and the courts need to explore means of reducing corrections costs. Where possible, less costly minimum security facilities should be used. The current limited use of prison alternatives—such as “boot camps” (also called “shock incarceration”) for first offenders, halfway houses, electronic home detention, and intensified supervision—should be evaluated and expanded where feasible. Furthermore, BOP

may need to use intermediate forms of confinement, such as halfway houses, more extensively to reintegrate long-term inmates into the community upon release. To do this, BOP must also work more closely with the federal courts' probation service to provide prerelease plans that include an inmate's medical profile, substance abuse history, and other information needed to develop an appropriate supervision plan.

Regardless of the form of confinement used, BOP faces a challenge in meeting the medical needs of its growing and aging inmate population, many of whom have special needs. About half of all entering inmates have a substance abuse or dependency problem, but fewer than half of these are receiving treatment. In 1992, BOP spent almost \$5 million treating about 1,200 HIV positive inmates, about 200 of whom had AIDS—a problem that is expected to grow as the prison population expands. In the close confines of prison life, the emergence of a drug-resistant strain of tuberculosis is also a potentially grave medical problem. The female inmate population, now about 8 percent of the total federal prison population, is growing faster than the male population and requires special medical procedures, such as breast cancer screening.

BOP is grappling with the rising costs of meeting inmates' medical care needs and hiring trained medical staff. BOP reprogrammed over \$4 million in 1991 and 1992 to provide for increased outside medical care costs and requested an additional \$4.5 million in fiscal year 1993. BOP must decide whether to increase its own medical care capacity or meet rising medical care needs through contract care. Even with the additional capacity planned between now and 1996, BOP anticipates that its ratio of medical beds to inmates will fall from the current 27 beds per 1,000 inmates to about 23.

Building even more medical facilities would add to an already costly construction program, and BOP may have difficulty staffing any new facilities. Despite an enhanced recruitment effort, at the end of fiscal year 1991, BOP had filled about 59 percent of its authorized positions for nurses and 66 percent of its positions for medical officers. Given the difficulties of recruiting qualified medical personnel, predicting the amount and type of medical care that inmates may need, and meeting the costs of increasing existing medical care capacity to accommodate those anticipated needs, BOP should consider alternative methods of

health care delivery. These alternatives might include contracting out for prison medical services and enhancing preventive care programs. In contracting out, health maintenance organizations or preferred provider models might be used.

Making Antidrug Efforts More Effective

To combat the drug problem, the Congress created a Drug Czar—Director, Office of National Drug Control Policy (ONDCP)—in the Executive Office of the President. Starting in 1989, ONDCP was to plan a drug war (establish a national drug control strategy, including long- and short-term goals), annually develop a governmentwide budget to carry out the war, and annually report to the Congress on the progress of the war and revise the underlying strategy as appropriate. Despite the creation of ONDCP, the drug problem persists.

Under ONDCP's guidance, the federal government dramatically increased drug control funding in three key program areas: (1) stopping drugs from entering the country, (2) enforcing domestic laws against drug trafficking and possession, and (3) providing drug treatment and prevention services. For fiscal years 1989 through 1992, the federal government committed \$39 billion to reduce drug use. Of the \$12 billion currently spent each year on drug programs, over 70 percent is expended on law enforcement as opposed to treatment; almost \$3 is spent on law enforcement for every \$1 spent on treatment.

While the number of illicit drug users has declined somewhat, the numbers of drug-related homicides and hospital emergency visits and deaths remain near record highs, as does drug use by arrested criminals. Policymakers will be asked to consider what more can be done to alleviate our nation's persistent long-term drug problem and halt the spread of drug-related crime and violence. Should the new administration stay the course, as ONDCP advocates, or place greater emphasis on drug prevention and treatment?

ONDCP's annual strategies have not set clear expectations for each drug control program. Without such expectations and without objective data to measure progress toward meeting those expectations, there is little basis for judging either the efficiency of the strategy in committing resources or the efficacy of the strategy's program components. For example, intelligence data indicate that overseas production of cocaine has grown consistently over the past 10 years and that domestic prices are much lower today than they were 10 years ago. Neither the strategy nor the drug budget relates these conditions to the missions of drug programs or evaluates the implications of these conditions for current strategy. In

short, accountability is lacking for the billions of dollars being spent on the nation's drug control programs.

ONDCP, through its annual drug strategy, should and must establish accountability for the billions being spent on the drug war. Developing accountability and performance measures is difficult. However, tying the financial costs of drug control programs to program results is fundamental to making informed policy decisions.

To achieve accountability over the nation's drug control efforts, ONDCP needs to develop outcome-oriented goals for each drug control program. Currently, the drug strategy does not include such goals. Furthermore, there is little information for judging whether the new administration should place more or less emphasis on drug prevention and treatment programs. Specifically, ONDCP needs to develop databases to collect baseline data on law enforcement and treatment efforts.

During 1993, the Congress will hold hearings on the reauthorization of ONDCP. As a focal point for these hearings, ONDCP, the drug control agencies—including the Department of Justice and the Department of Health and

Human Services—and the oversight committees need to focus on identifying appropriate measures of accountability. By and large, these collaborative efforts should be aimed at reaching agreement on the best available benchmarks of performance and the most reasonable expectations for programs, given the level of resources committed.

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Bank and Thrift Criminal Fraud: Information on Justice's Investigations and Prosecutions (GAO/GGD-93-10FS, Oct. 5, 1992).

Sentencing Guidelines: Central Questions Remain Unanswered (GAO/GGD-92-93, Aug. 14, 1992).

Immigration Control: Immigration Policies Affect INS Detention Efforts (GAO/GGD-92-85, June 25, 1992).

Asset Forfeiture: U.S. Marshals Service Internal Control Weaknesses Over Cash Distributions (GAO/GGD-92-59, May 8, 1992).

Drug Control: Difficulties in Denying Federal Benefits to Convicted Drug Offenders (GAO/GGD-92-56, Apr. 21, 1992).

The Drug War: Counternarcotics Programs in Columbia and Peru (GAO/T-NSIAD-91-9, Feb. 20, 1992).

Bank and Thrift Fraud: Overview of the Federal Government's Response (GAO/T-GGD-92-12, Feb. 6, 1992).

Adolescent Drug Use Prevention: Common Features of Promising Community Programs (GAO/PEMD-92-2, Jan. 16, 1992).

Prison Alternatives: Crowded Federal Prisons Can Transfer More Inmates to Halfway Houses (GAO/GGD-92-5, Nov. 14, 1991).

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The War on Drugs: Arrests Burdening Local Criminal Justice Systems (GAO/GGD-92-40, Apr. 3, 1991).

Border Patrol: Southwest Border Enforcement Affected by Mission Expansion and Budget (GAO/GGD-92-72BR, Mar. 28, 1991).

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Financial Management: INS Lacks Accountability and Controls Over Its Resources (GAO/AFMD-92-20, Jan. 24, 1991).

Immigration Management: Strong Leadership and Management Reforms Needed to Address Serious Problems (GAO/GGD-91-28, Jan. 23, 1991).

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(GAO/GGD-88-39, Mar. 1, 1988).

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Processes Would Enhance Justice's
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Transition Series

Economics

Budget Issues (GAO/OCG-93-1TR).

Investment (GAO/OCG-93-2TR).

Management

Government Management Issues
(GAO/OCG-93-3TR).

Financial Management Issues
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Information Management and Technology
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Program Areas

Health Care Reform (GAO/OCG-93-8TR).

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Food and Agriculture Issues
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Environmental Protection Issues
(GAO/OCG-93-16TR).

Natural Resources Management Issues
(GAO/OCG-93-17TR).

Education Issues (GAO/OCG-93-18TR).

Labor Issues (GAO/OCG-93-19TR).

Health and Human Services Issues
(GAO/OCG-93-20TR).

Veterans Affairs Issues (GAO/OCG-93-21TR).

Housing and Community Development
Issues (GAO/OCG-93-22TR).

Justice Issues (GAO/OCG-93-23TR).

Internal Revenue Service Issues
(GAO/OCG-93-24TR).

Foreign Economic Assistance Issues
(GAO/OCG-93-25TR).

Transition Series

Foreign Affairs Issues (GAO/OCG-93-26TR).

NASA Issues (GAO/OCG-93-27TR).

General Services Issues (GAO/OCG-93-28TR).

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December 1992

Internal Revenue Service Issues





United States
General Accounting Office
Washington, D.C. 20548

**Comptroller General
of the United States**

December 1992

The Speaker of the House of Representatives
The Majority Leader of the Senate

In response to your request, this transition series report discusses major policy, management, and program issues facing the Congress and the new administration in the Internal Revenue Service. The issues include (1) devising structures, systems, and processes for administering the tax system in the next century; (2) modernizing computer systems to support redesigned processes; (3) strengthening human resources; (4) supporting IRS' strategic business process; (5) reducing the tax gap; (6) improving financial management; (7) managing criminal investigation resources; and (8) responding to calls for a consumption tax.

As part of our high-risk series on program areas vulnerable to waste, abuse, and mismanagement, we are issuing a related report, Internal Revenue Service Receivables (GAO/HR-93-13, Dec. 1992).

The GAO products upon which this transition series report is based are listed at the end of this report.

We are also sending copies of this report to the President-elect, the Republican leadership of the Congress, the appropriate congressional committees, the Secretary-designate of the Treasury, and the Commissioner-designate of Internal Revenue.

A handwritten signature in cursive script that reads 'Charles A. Bowsher'.

Charles A. Bowsher

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IRS Issues

In our 1988 transition series report on the Internal Revenue Service, (IRS) we discussed four tax administration issues facing the agency. The most pressing overall issue then was to modernize IRS' outdated and inefficient tax processing system. It still is. Nonetheless, IRS has made substantial progress in the intervening years in addressing the problems discussed in our 1988 report. IRS took steps to alleviate an impending computer capacity problem, appointed a Chief Information Officer and a Chief Financial Officer to provide needed leadership, and produced a design plan for the systems modernization that it periodically updates as new elements of the design take shape. Today much more work remains to be done to ensure that this project—which is one of the largest of its kind and is expected to cost \$23 billion through the year 2008—is successfully implemented.

The three other issues discussed in our 1988 report remain to be resolved. Although IRS can point to much work in those areas, the agency still needs to strengthen human resources, collect \$30 billion in delinquent taxes, and reduce the \$114 billion tax gap (the difference between what taxpayers owe and what they voluntarily pay).

In addition to the four areas noted above, this report discusses five other areas that will require the new Commissioner's priority attention—ongoing efforts to change the way IRS does business, the strategic business process, financial management, management of criminal investigation resources, and the need to respond to calls for a consumption tax.

Two themes cut across all these issues—the need to foster and manage change and the need for effective communication in such a large, decentralized organization.

Changing the Way IRS Operates

IRS is on the threshold of what could be the agency's most significant change in decades. IRS staff are at work reassessing the way the agency does business, reengineering major work processes, and rethinking the traditional functional and organizational alignment. We have long recommended this critical step in modernizing the agency. IRS has suffered from a fragmented organization, inefficient work processes, antiquated systems, and parochial views of its component work—all of which have frustrated IRS-wide efforts to improve taxpayers' satisfaction and maximize collections. The new administration will have to decide what IRS will look like in the next century and exert strong leadership to implement the needed changes.

The way IRS provides telephone assistance illustrates the agency's fragmentation. Over the years, in an effort to satisfy taxpayers' demands for assistance, IRS has established 32 telephone sites in the Taxpayer Service function to answer tax law and account questions, 23 telephone sites in the Collection function to handle calls on overdue accounts, and 3 telephone sites in the Human Resources and Support function to handle calls requesting copies of tax forms and publications. IRS also handles calls

relating to document-matching issues and other matters at the 10 service centers managed by its Returns Processing function. As a result of this fragmented organization, callers seeking help from IRS are asked to use one of dozens of telephone numbers. When taxpayers call IRS, they are likely to get a busy signal and, once they get through, often find it necessary to speak to more than one person before getting the information they need.

IRS is now exploring the feasibility of consolidating its telephone sites and designating a common or single telephone number for taxpayer assistance nationwide. To really streamline its telephone service to taxpayers, IRS must look at having a single organization responsible for uniformly measured telephone service and organized to respond to taxpayers' questions in a way that reduces anxiety and eliminates the need for time-consuming, laborious written correspondence. Because taxpayers deserve from IRS the same level and caliber of service that they receive from world-class financial institutions, IRS must be able to give taxpayers accurate information with minimal delay.

Managing Tax Systems Modernization

Central to any change in the way IRS does business is Tax Systems Modernization (TSM)—the redesign of automated systems so critical to IRS' work. To provide the type of service taxpayers deserve, IRS must make taxpayer information quickly available to every employee who needs it. Recent IRS Commissioners, recognizing how important computer modernization is to tax administration, have built on their predecessors' efforts to bring TSM to fruition. This should be no less of a priority for the new Commissioner.

With an estimated cost of about \$23 billion through the year 2008, TSM is perhaps the largest civilian computer modernization in history. IRS has developed a basic design concept for the modernization, but that technical design was developed before IRS had thoroughly reassessed its basic business processes. The details of the technical design may have to change to support the new vision of IRS. In that regard, the new Commissioner will need to give priority attention to the following:

- Finalize an operational strategy soon. Too many other decisions hinge on this one, and dollars may be wasted if IRS does not reach

closure on this issue.

- Once an operational strategy has been finalized, verify that major procurements proceeding from the technical design fit the needs of the new operating environment. Contracts for several of these procurements have been awarded, and others are about to be. It is important to act quickly in order to avoid wasteful spending, even if this means putting the brakes on certain TSM initiatives.
- Give top priority to making on-line access to taxpayer information available to every IRS employee who needs to work with that information. Make that happen first and soon by putting the taxpayer file on-line to every workstation and implementing the kind of telecommunication network that can send this information anywhere, anytime. The new workstations and telecommunication networks put in place must be capable of handling features such as image, fax, and high-volume data transactions, even though those applications are not yet ready.

Because TSM is so large, it is expected to take more than a decade to complete. Getting the budgetary support and the right people to manage it will be a long-term concern. To

avoid the kinds of project delays and procurement problems that have arisen in the past, IRS needs experienced senior and project managers to oversee and direct TSM. These managers must have technical expertise as well as management acumen and commitment to deliver results within agreed upon time frames.

Throughout the TSM initiative, IRS needs to ensure that its systems designs will produce good management information. Perhaps the most consistent theme over the past 2 decades of GAO reports is how often IRS managers do not have the right information to do their jobs. One significant effort to improve management information that needs continuing emphasis is the work being done to implement the Enforcement Management Information System. That system, when fully implemented, should provide management and the Congress with much needed information on the actual results and costs of IRS' enforcement efforts.

Strengthening Human Resources

The changes that are sure to come as IRS redesigns the way it does business will transform the agency into one that depends less on manual labor and more on technology-based skills. The technical implications of modernization have received most of the emphasis in IRS. It is critical that IRS also pay attention to the significant human resource implications. IRS must develop human resource strategies that support the new business direction and technical environment. As part of that effort, IRS needs to determine workforce levels, reassess skill needs, identify strategies for meeting those needs, and manage workforce adjustments.

Fulfilling IRS' policy of protecting employees' jobs from modernization-generated staff reductions will be a formidable challenge. IRS must bridge the gap between existing workforce skills and abilities and those that will be needed in the modernized environment. By planning far enough in advance and using the intervening years for training, IRS should be better able to meet that challenge. IRS has taken a critical step toward that end by recently drafting a much needed human resources plan. The new Commissioner will need to ensure that

aggressive action is taken to implement that plan.

Another critical human resource issue facing the new Commissioner relates to employee ethics and integrity. IRS' record in this area has come under increasing scrutiny. IRS must continue vigorous efforts to promote open communication, strengthen employee awareness, and increase managerial accountability. IRS employees must recognize and accept the fact that they will be held to a high ethical standard to protect the integrity of this country's voluntary tax system.

Supporting the Strategic Business Process

IRS is building a strategic business process that could serve as a model for other federal agencies. The cornerstone of that process is a strategic plan, which is updated annually. As part of that plan, IRS has identified three broad business objectives—improving voluntary compliance, reducing taxpayer burden, and improving quality-driven productivity and customer satisfaction—and various strategies and actions to help IRS achieve those objectives. Annual plans are developed to guide headquarters and field office activities in support of the business plan, and annual business reviews are done to assess progress.

If IRS' strategic business process is to be effective, it is critical that IRS develop appropriate performance measures. Without the right measures, IRS will be unable to assess progress in achieving its business goals. The measures IRS now uses are focused largely on processes rather than outcomes. For example, IRS tracks the number of auditors and audits completed but does not track the effect of audits on voluntary compliance. IRS recognizes the need for better measures and has efforts under way in that regard. The new Commissioner needs to lead those efforts and to hold managers accountable for

**Supporting the Strategic Business
Process**

meeting outcome goals. Because IRS is so decentralized, holding managers accountable for agency goals is critical to IRS' operating with a shared understanding of its mission and direction.

Collecting Back Taxes

The new administration will have to give continuing priority attention to the collection of taxes owed the government. In general, IRS has reported accounts receivable that are significantly higher than could ever be collected; IRS itself estimated that less than \$30 billion of 1991's \$111 billion inventory was collectible. Yet because IRS does not know how many records are valid, no one really knows the true number of receivables, much less how many of them are collectible. In a separate high-risk report on IRS receivables, we discuss the steps needed to better manage this area—1 of 17 throughout the government designated by us as high risk.

That report discusses several problems that have interfered with IRS' ability to collect unpaid taxes, including (1) inaccurate and insufficient IRS records; (2) a lengthy, antiquated, rigid, and inefficient collection process; (3) difficulty in balancing collection efforts with the need to protect the taxpayer; (4) IRS' decentralized structure; and (5) inadequate information on how to allocate staff effectively. The report also summarizes our various recommendations for improvement.

Reducing the Tax Gap

IRS has estimated the tax gap for 1992 to be about \$114 billion. That estimate is conservative because it only relates to income taxes and excludes taxes associated with illegal-source income. In an attempt to reduce the tax gap, IRS recently announced a goal to increase voluntary compliance with the tax laws from 84 percent to 94 percent in 8 to 10 years. To achieve that goal, important decisions will have to be made on research efforts, enforcement programs, and resource allocations. Those decisions need to be made cohesively, in ways most likely to improve overall compliance. The time is also right, as IRS goes about changing the way it does business, to rethink its entire approach to enforcement.

Measuring Compliance

An early decision facing the new Commissioner will involve the design of next year's Taxpayer Compliance Measurement Program (TCMP)—the only reliable measure of compliance and a program that provides data used in tax policy decisions, revenue estimating, and estimation of U.S. income accounts. The current direction appears to be toward eventual elimination of TCMP on the grounds it is too costly, too intrusive, and untimely. We believe that would be a mistake. TCMP needs to be fixed, not

eliminated. TCMP is critical to IRS and the whole tax community. It should provide an important outcome measure for IRS' strategic business process, enough information to make informed decisions on enforcement program and resource allocations, and sufficient data for tax policy decisions.

TCMP did not provide an empirical base for IRS' latest enforcement strategy—Compliance 2000. Instead, IRS launched Compliance 2000 by asking the 63 district offices to nominate “taxpayer segments” as prototypes. Because TCMP has not provided estimates at that disaggregated level, prototype selection necessarily depended on judgments. Thus, IRS has no assurance that it is working on the most noncompliant segments or that prototype results—however positive—will improve overall compliance levels. Had it relied on TCMP data that were valid at the regional office level, IRS would have had a firmer foundation from which to launch Compliance 2000.

**Enforcement
Considerations**

Under Compliance 2000, more emphasis is being placed on the role of taxpayer education and assistance in improving compliance and reducing the tax gap. Even

so, enforcement is still critical. Audit coverage, a key indicator of the level of IRS' enforcement effort, has shown a disturbing trend in the past few years. Overall coverage is only about 1 percent, and the coverage of corporations decreased from 5 percent in 1981 to less than 3 percent in 1991. Faced with this declining audit presence, the new Commissioner needs to determine

- the role of audits and the proper balance between auditing returns, doing computer matches, and tracking down nonfilers;
- acceptable audit coverage rates and whether those rates should be at similar levels around the country;
- the proper balance of coverage among corporate, individual, partnership, and other types of returns;
- whether audit quality is high enough and how quality should be measured; and
- whether and how IRS' traditional approach to doing audits should be changed to better serve both IRS and taxpayers.

Such issues are particularly pertinent with respect to the largest corporations—those

1,600 now covered by IRS' Coordinated Examination Program. Of continuing concern is IRS' capacity to collect the right amount of tax from these highly complex corporations. Much of the additional taxes recommended from IRS audits is not billed to the corporations after the appeals process. IRS has made changes in the last 2 years to better manage this program. In a forthcoming report, we will discuss more fundamental changes that may be warranted.

The new administration will also need to deal with various audit issues that recur time and time again, consuming significant IRS resources, often without realizing for the government the additional revenues proposed by its examiners. Audits of large multinational corporations, for example, are beset by transfer pricing issues that involve deciding whether related corporate entities have calculated correctly the arm's-length price for goods brought into or taken out of the United States. The Congress has legislated some changes in an attempt to deal with certain troublesome audit issues, and IRS has made other changes administratively, but the problem is likely to persist with the globalization of trade.

Rethinking the Enforcement Approach

Given intractable issues such as transfer pricing, worrisome compliance levels for some segments of taxpayers, and continuing resource constraints, it is a good time for IRS to rethink its enforcement approaches. Following are several questions the new Commissioner needs to ask:

- How could the design of the tax system be changed to produce higher compliance levels?
- Is there a need for more withholding at the source, incentives for cash businesses, or simplified ways to file returns and pay taxes?
- Does everyone have to file a tax return?
- Are there more opportunities to improve compliance through additional information reporting or increased information sharing among governmental entities?
- How could compliance checks be designed into TSM?
- Is IRS using the right enforcement tools at the right time?

Improving Financial Management

IRS has determined that in order to achieve its three broad business objectives it needs, among other things, a strong financial management system. As discussed in our transition series report Financial Management Issues (GAO/OCG-93-4TR, Dec. 1992), IRS, like other federal agencies, has serious financial management weaknesses.

IRS' financial management systems were generally designed to track information on identified program objectives and were not integrated to ensure that agencywide activity was fully captured and reported. As a result, IRS is unable to accurately segregate and substantiate tax revenues collected and the related accounts receivable. For example, IRS cannot reliably identify the amount of taxes collected for Social Security or any of the trust funds for which IRS collects excise taxes. Also, IRS cannot identify the actual amount of accounts receivable because a large number of invalid accounts and errors are contained in the financial management systems used to track receivables.

IRS' ability to identify program costs is also significantly impaired. This limitation minimizes the agency's ability to properly evaluate program performance and identify

needs. In addition, financial management weaknesses have resulted in accounting and control problems over assets and spending.

As the new administration seeks to reduce the budget deficit and improve federal agencies' performance, it will be important for the Commissioner of Internal Revenue to give urgent focus to converting these ineffective and often outdated financial management systems to systems that will provide accurate and reliable financial information for use in policymaking and other decisions that affect American taxpayers.

The Chief Financial Officers (CFO) Act of 1990, which represents the most comprehensive financial reform package in 40 years, provides a blueprint for change that, if fully implemented, would enable IRS to correct its financial management systems problems. Over the past 2 years, IRS has made important strides in establishing a CFO structure and in beginning to implement the full range of requirements in the CFO Act. But the process of change under the CFO Act has just begun.

Sustained support and top-level attention by the new administration, IRS, and the

Congress is needed to build on the efforts now under way at IRS to improve financial management through implementation of the CFO Act. The tone at the top will be critical to ensuring meaningful reform. As discussed in greater detail in our transition series report on financial management issues, among the key actions are the need to

- make clear that financial management reform is a continuing high priority and hold managers accountable for results;
- expand the role of the CFO to encompass the full range of duties and authorities in the CFO Act;
- promote and closely oversee efforts to build first-class financial management infrastructures—both people and systems;
- emphasize the development of cost systems and performance measures and the integration of accounting, program, and budget systems to develop more useful and relevant financial information; and
- foster continuing efforts to develop auditable financial statements and to expand financial reporting to encompass the full range of accountability contemplated by the

**CFO Act and the Office of Management and
Budget's implementing guidance.**

Managing Criminal Investigation Resources

The new Commissioner will be faced with competing priorities for IRS' criminal investigation work. Other law enforcement agencies seek the financial expertise of IRS' special agents for cases that increasingly involve sophisticated financial transactions. This leaves IRS fewer resources to investigate criminal violations of the tax law. During congressional deliberations on the administration's fiscal year 1993 budget request for IRS, the criminal investigation area came under considerable scrutiny.

The Senate passed a provision, for example, that would have changed IRS' organization by providing the Assistant Commissioner for Criminal Investigation with direct line authority over tax fraud investigations. Although that provision was defeated in conference, IRS has been directed to study the Criminal Investigation Division to determine whether it is adequately funded and staffed.

The new Commissioner will also have to be concerned about the adequacy of controls over IRS' special agents. IRS is working to implement several of our recommendations for strengthening controls over one particular technique—undercover investigations.

Responding to Calls for a Consumption Tax

More groups this year than ever before have proposed that the United States adopt some type of consumption tax. For example, the first report of the Strengthening of America Commission, chaired by Senators Sam Nunn and Pete Domenici, proposed a consumption-based income tax. While IRS will not have to decide whether there should be such a tax, IRS will need to advise policymakers of its implications.

One important consideration is whether the proposed tax would be a fundamentally new federal level tax, such as a value-added or retail sales tax, or a variant of existing taxes, such as a cash-flow business tax or a personal expenditure tax. A new tax would potentially require a new enforcement approach with additional administrative resources. A variant of existing taxes, while presenting new and difficult enforcement challenges, might be more easily managed within existing approaches and resources. In any form, such a tax would have great ramifications for IRS. IRS needs to be in a position to quickly analyze how it would administer the various forms of such a tax that may be proposed. In that regard, we will report in several months on how a value-added tax would be administered and

**Responding to Calls for a Consumption
Tax**

how much it would probably cost to
administer it.

Related GAO Products

Internal Revenue Service Receivables
(GAO/HR-93-13, Dec. 1992).

Tax Administration: Opportunities to
Further Improve IRS' Business Review
Process (GAO/GGD-92-125, Aug. 13, 1992).

International Taxation: Problems Persist in
Determining Tax Effects of Intercompany
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