United States General Accounting Office 144322

GAO

Testimony

144322

For Release
on Delivery
Expected at
9:30 a.m.
Tuesday
July 9, 1991

Identifying Options for Organizational and Business Changes at IRS

Statement of

Paul L. Posner
Associate Director, Tax Policy and Administration Issues
General Government Division

Before the
Subcommittee on Commerce, Consumer and Monetary Affairs
Committee on Government Operations
House of Representatives

GAO/T-GGD-91-54

051829 / 144322

GAO Form 160 (12/87)

IDENTIFYING OPTIONS FOR ORGANIZATIONAL AND BUSINESS CHANGES AT IRS

SUMMARY OF STATEMENT BY
PAUL L. POSNER
ASSOCIATE DIRECTOR, TAX POLICY AND ADMINISTRATION ISSUES
GENERAL GOVERNMENT DIVISION
U.S. GENERAL ACCOUNTING OFFICE

Tax Systems Modernization (TSM) is a major IRS effort to modernize its information systems to provide taxpayers and IRS internal users with timely and accurate tax-related services. GAO will address the kinds of programmatic and organizational changes and benefits that we believe TSM can usher in. In committing to an $8 billion effort like this, it is important that Congress understand the options made possible by this investment for changing the way IRS conducts tax administration business in the future.

GAO strongly supports the Service's modernization program and believes that it offers great improvements in tax administration. IRS' Design Master Plan outlines a solid technical blueprint and suggests how automation of current business operations will greatly enhance service to taxpayers and promote more efficient processing of tax returns and compliance program administration.

However, the Plan does not provide a corresponding vision of how the new technology could enable the agency to transform its future organizational structures and business operations. Although automation of current business processes should provide clear benefits, IRS' current organizational structure and business operations--premised on outdated technology--will constrain the agency from becoming all it could be with the new tools. For example, IRS has not recognized the opportunities presented by new technology to consolidate its field office structure.

Many of these changes are actually made possible by the technical architecture selected for TSM. Several changes, however, such as consolidating or changing the functions of the existing 10 service centers, may be constrained as IRS implements its current TSM design plans. We believe that now is the time for IRS to systematically examine options for major changes in business operations, unconstrained by assumptions that limit organizational change.

Mr. Chairman and Members of the Subcommittee:

We are pleased to be here today to assist the Subcommittee in its inquiry into IRS' Tax Systems Modernization (TSM) efforts. Today, I will address the kinds of programmatic and organizational changes and benefits that we believe TSM can usher in. In committing to an $8 billion effort like this, we think it is important that Congress understand the options made possible by this investment for changing the way IRS conducts tax administration business in the future. We will also discuss the status and breadth of IRS' plans to adopt or consider changes to the way it currently does business. Mr. Rhile of our Information Management and Technology Division will present our technical analysis of IRS' Design Master Plan for the modernization and issues the agency needs to address to promote successful implementation.

We strongly support the Service's modernization program and believe that it offers great improvements in tax administration. IRS' Design Master Plan outlines a solid technical blueprint and suggests how automation of current business operations will greatly enhance service to taxpayers and promote more efficient processing of tax returns and compliance program administration.

However, the Plan does not provide a corresponding vision of how the new technology could enable the agency to transform its future organizational structures and business operations. Although automation of current business processes should provide clear benefits, IRS' current organizational structure and business operations--premised on outdated technology--will constrain the agency from using the new systems to provide the best possible service to taxpayers. For example, IRS has not examined the opportunities presented by new technology to consolidate its field office structure to promote more consistent and efficient service to taxpayers.

Many of these changes are actually made possible by the technical architecture selected for TSM. Several changes, however, such as consolidating or changing the functions of the existing 10 service centers, may be constrained as IRS implements its current TSM design plans. We believe that now is the time for IRS to systematically examine options for major changes in business operations--unconstrained by assumptions that limit organizational change--while changes to technical design plans are still practical.

THE PROMISES OF TAX SYSTEM MODERNIZATION

Both GAO and IRS have long recognized the need for a major overhaul of IRS' information systems. In canvassing IRS' executives and our own staff familiar with tax administration, the overwhelming consensus was that IRS' major problem in meeting its mission is the lack of accessible, accurate information--for IRS employees who work taxpayer cases; for IRS managers who need to assess their operations; and for outside parties (such as this and other congressional committees, states, OMB, and GAO) who utilize IRS data or review its operations.

Under the current system, employees and taxpayers alike have to deal with a tax processing system that relies heavily on paper-driven, labor-intensive processes. Data from tax returns is input to centralized master file records in a largely manual fashion, prompting considerable errors in posting payments and liabilities to the correct account. IRS staff do not have on-line access to the central files--rather, they have access to limited information on active accounts at particular service centers. IRS staff working on enforcement cases or answering questions from taxpayers also do not have immediate access to tax return data, causing delays of up to one month while paper tax returns are recalled from Federal Records Centers.

GAO strongly supports the Service's efforts to modernize its tax system. TSM's goals are to modernize tax document input processing, minimize paper processing, provide accurate information that is readily accessible and responsive for tax administration needs, and reduce administrative costs. TSM should help employees use information resources more effectively, thereby improving service to the taxpaying public.

The main characteristics of the future system are the use of electronic data and document images in place of paper documents and an integrated, on-line taxpayer account database that is quickly available to any authorized end user. Under TSM, most paper handling would be eliminated and IRS employees will be able to track and process tax cases quickly and respond to taxpayer requests for information.

POTENTIAL OF TSM GOES FAR BEYOND IRS' PLAN

IRS' Design Master Plan makes no reference to a vision of how the agency should conduct its business in the future.[1] The Plan also does not address changes in organizational structures or new ways of doing business that the new technology makes possible. The Service has opted to retain its current organizational structure, premising its technical architecture on the continued existence of 10 service centers. IRS suggests that the benefits of modernization discussed above result primarily from automating current business practices.

It is true that TSM offers IRS a dramatically "new way of doing business" simply by providing employees with accurate information that is quickly and easily retrieved. Indeed, the Design Plan

---

[1]TAX SYSTEM MODERNIZATION: An Assessment of IRS' Design Master Plan, (GAO/IMTEC-91-53BR, June 25, 1991).

suggests a number of major improvements in IRS operations that could arise from automation within the current organizational framework. But TSM can offer the Service much more in mobilizing itself to deliver quality service to taxpayers--that is, in changing the way IRS does business in the future.

Opportunities for Change

IRS' current organizational structure and business operations--established during the 1950s and 1960s--create barriers to effectively serving the taxpayer and promoting compliance with the tax laws. IRS' current organizational structure takes a fragmented view of the taxpayer, with distinctly separate operations for returns processing, taxpayer service, examination, collection, and other enforcement activities. These different IRS functions generally maintain their own case files, records, and management information systems. As a result, taxpayers may deal with many different IRS employees to resolve problems.

This functional fragmentation manifests itself in a variety of ways--for example, taxes that are assessed by Examination's auditors are frequently overturned at the appeals stage or are abated by the Collections function; multiple contacts are made with the same taxpayer by different IRS functions without coordination; and a baffling and complex organization faces taxpayers seeking to resolve problems. A further consequence has been the creation of management information systems that cannot track taxpayers, programs, or issues across various functions in the IRS system.

Redundancy and inefficiencies are fostered by the longstanding IRS field structure. Programs and services, such as corresponding with taxpayers and identifying underreporters, are replicated in each of IRS' 10 service centers. Other services that depend on service center files, such as telephone call sites, are scattered at even more geographic locations. Collection calls are made from 23 automated call sites while taxpayer assistance calls are answered at 32 different locations.

This field structure was premised on the constraints of the technology that was adopted by the Service over 30 years ago. Limited central computer capacity and accessibility to the central master files of taxpayer accounts encouraged the Service to decentralize these programs to connect with smaller databases of taxpayers located at service centers. However, operating redundant programs at all of IRS' field locations is costly, fosters recruiting problems at various locations, and has led to disparate treatment of taxpayers across the different IRS field offices. For example, the 32 taxpayer assistance call sites have differing track records on accuracy and accessibility, resulting in uneven service to taxpayers across the country.

TSM should support considerable organizational flexibility since it plans to allow employees to access data quickly, regardless of the geographic location of the employees or the data source. Given this flexibility, IRS has the opportunity to reconfigure its activities and field locations to improve the efficiency of its operations and better serve the needs of today's, not yesterday's, taxpayers.

We think that the modernization effort should prompt IRS to engage in a comprehensive and thorough reexamination of not only its organizational structure but of its work processes and program strategies--in short, the way it does business across the entire agency. Among the large number of issues that should be addressed in this effort, let me suggest several that appear promising to us and warrant further evaluation. Let me emphasize that these do not constitute GAO recommendations and that their costs and benefits would have to be more thoroughly studied. We offer these ideas to begin a dialogue on the future possibilities inherent in the modernization effort.

Consolidate Number of Field Locations

Currently, staff involved in enforcement or taxpayer assistance have ready access only to account data on taxpayers filing returns within the service center area, thereby tying the location of each program to the service center boundaries. The

TSM plan envisions quick access to the files and accounts of all taxpayers throughout the country by authorized IRS staff regardless of location. This offers IRS the opportunity to consolidate numerous activities now being conducted at each IRS field location. Consolidation of sites could offer many benefits--more consistent adherence to procedures, enhanced quality control, more consistent treatment of taxpayers, and economies of scale.

For example, TSM could permit IRS to reduce the number of the 32 taxpayer assistance call sites that handle taxpayer account inquiries and tax law questions. Currently, IRS has difficulty recruiting qualified job candidates at some of these call sites. Further, call site accuracy rates have varied, with lower rates for those areas experiencing recruiting difficulties. Under TSM, taxpayer assistance call sites could be consolidated based on such factors as where the labor market offers the best candidates for IRS recruitment, with taxpayer calls from across the country routed to those locations. We think that this process could result in cost efficiencies and higher accuracy rates.

Establish Cross-Functional Telephone Service

The Service could also consider consolidating the different types of telephone operations under one functional roof. In addition to the 32 taxpayer assistance call sites in the Taxpayer Service function, IRS has 23 automated collection call sites in its Collection function to contact taxpayers with delinquent accounts and 3 sites in the Human Resources and Support function to distribute tax forms. Staff at both the taxpayer assistance and automated collection call sites already handle inquiries about delinquent taxpayer accounts.

Under TSM, a call site could become multifunctional since employees will have easy access to the full range of information needed to respond to inquiries on any of these topics. Co-locating all of these functions at a single site could allow IRS to take advantage of the peaks and valleys in the current workload, maximize the use of equipment and space, and provide a single contact point for taxpayers. Once it adopted this concept, IRS would need to work out ways to balance competing demands from Collections and Taxpayer Service and train staff to handle the broader responsibilities.

Merge Enforcement Functions Into Single Compliance Unit

IRS' major enforcement-related organizations--Examination and Collection--are highly segmented operations within IRS. IRS takes an "assembly-line" approach to pursuing noncompliance, with separate programs and staffs for each step of the process--auditing a tax return and assessing tax due and collecting taxes due or securing delinquent returns. A separate program within the Examination function with separate staffs at the service centers identifies and pursues underreporter cases where the taxpayer did not report all income. Each enforcement function operates somewhat in a vacuum driven by its own goals--with each function establishing its own taxpayer databases and management information systems, determining its own case and workload priorities, and developing its own measures of performance success and its own reward structure.

One consequence of fragmented information systems is that IRS cannot tell how much revenue its enforcement functions actually collect.[2] Another consequence of the fragmented enforcement approach is that examiners are held accountable primarily for how much tax they assess, not how much is ultimately collected. The subsequent write-off and abatement of as much as 75 percent of the accounts receivable inventory suggests that many of the underlying assessments may be either erroneous or uncollectible.[3]

With TSM's promise for creating a single data source on taxpayers accessible to authorized staff, IRS could consider merging some of these functions into a single "compliance

---

[2]See Tax Administration: IRS Needs More Reliable Information on Enforcement Revenues (GAO/GGD-90-85, June 20, 1990). IRS has a project underway to develop a comprehensive enforcement management information system to track the revenue impact of its enforcement programs.

[3] Management Challenges Facing IRS, Statement before the Committee on Governmental Affairs, United States Senate (GAO/T-GGD-91-20, June 25, 1991).

program" to achieve a more coherent and comprehensive enforcement effort when dealing with potentially noncompliant taxpayers. The ability of IRS staff to share data could permit a single staff to perform both auditing of tax returns and collecting taxes due. Reinforcing accountability of enforcement staff for the ultimate collection consequences of their actions could help reduce the large number of write-offs and abatements and offer tax examiners who have knowledge about a taxpayer's fiscal condition the opportunity to collect taxes due. Further, this change could permit IRS to reorganize at least some of its compliance staff to focus on types of taxpayers with common noncompliance problems, thereby enhancing the expertise of the agency in dealing with industries with special or complex tax situations. Merging enforcement functions would require that staff broaden their knowledge and expertise, thereby requiring that IRS refocus their recruitment and training strategies.

Changes in Work Processes

The modernization also permits the Service to rethink some of the strategies used by various programs to audit and collect taxes. Possessing current information on all taxpayers and enhanced computer capacity, the Service can make significant improvements in the timeliness, productivity, and quality of its enforcement programs.

The information returns program provides a good example. IRS currently completes the matching process to identify underreported income some 3 years after the returns are filed, resulting in collection difficulties due to taxpayer relocations or lost records. Limited computer capacity and delays involved in retrieving and reconciling paper-based records prevent the Service from performing the match sooner while returns are being processed. IRS' modernization plan proposes automating the current process, which promises to improve overall quality, but may not go far enough because it does not expedite the matching process itself. Ultimately, a program could be envisioned where the match would be conducted as the return itself is processed, resulting in one notice to taxpayers identifying underreported income as well as other problems with the return, such as math errors and other adjustments.

Expanded computer capacity could permit the agency to enhance the matching of information from a variety of sources to aid its compliance programs. For example, the auditing of business tax deductions could be supplemented by using information documents filed by those businesses on payments they make to individuals for such outlays as wages, interest, and rents. Although IRS currently uses these documents to detect unreported income for individuals receiving these payments, it does not use them to verify the businesses' related tax deductions for the reported payments.

IRS' OPTIONS FOR FUTURE ORGANIZATIONAL CHANGE MAY BE CONSTRAINED UNDER TSM

Mr. Chairman, we believe that the Service needs to begin considering some of these fundamental changes in business as it continues to develop its modernization program. Change, to some extent, is an iterative process and we have been assured by top IRS officials that the organization will still be able to consider these kinds of business changes as modernization takes shape and managers become more aware of the potential it holds for the broader operations of programs. We are concerned, however, that the design of the new systems may constrain the consideration of certain business options before they have been adequately exposed and discussed.

Our concern lies with the major assumption underlying IRS' modernization plans--that the current number of service centers and their relative workload will remain the same. In developing its modernization plan, IRS reports that it considered 20 system design alternatives, but it acknowledges that these options did not differ greatly from each other. Significantly, all of these alternatives assumed that the current 10 service centers would be retained to receive and process tax returns. The major difference among the options considered was whether the files containing taxpayer accounts would reside in one central location, as is done now, or be distributed among the 10 centers, as IRS ultimately decided.

Given the basic decision to retain 10 service centers, IRS' adoption of the 10 distributed databases alternative is consistent with this decision. This decision, however, does tend to reinforce the current organizational structure and may inhibit the flexibility that IRS has in reorganizing its functions and its other field offices under TSM. For example, if IRS should decide that it wants to change the way it conducts its underreporter or correspondence programs--such as consolidating one or both in a single service center--it might be constrained from doing so because of the costs involved in transferring data files from the 10 service centers to a central location.

It may very well be that upon careful analysis the decision to retain 10 service centers would be well founded. But when we looked at IRS' support for this fundamental decision, we did not find the kind of careful analysis of costs and benefits that we expected to find. For example, no analysis was done comparing alternatives to the current 10 service center structure on the basis of such considerations as costs of operations, staff recruitment and training, program efficiency and consistency, quality control, and taxpayer relations. We think there is still time to do such an analysis while adjustments to the plan are still practical.

EXPERIENCE OF PRIVATE SECTOR IS INSTRUCTIVE

Our work surveying 25 private companies showed that many have undergone major computer systems modernization and that such modernization can result in major organizational change. A number of the companies we surveyed have consolidated operations when modernizing certain aspects of their operations, including three companies that we visited during our study--Ford Motor Company, J.C. Penney Company, and the Royal Bank of Canada. In the private sector, such reorganizations are prompted by the need to be more competitive, provide better customer service, and achieve economies of scale by centralizing operations--goals that we believe should be shared by IRS. All three companies report great success with consolidation:

-- In 1987, Ford consolidated all of its customer telephone and correspondence assistance--which had been conducted in 28 locations across the country--into one central location. Ford officials told us that customer assistance under the old system was inconsistent and product owner satisfaction and loyalty were low. These officials report great success with the consolidation. The customer accessibility rate--that is, the percent of customers' first calls that are answered with less than 30 seconds on hold--went from 54 to 90 percent after the consolidation.

-- About 10 years ago, J.C. Penney went through a major restructuring of its credit operations in response to technological change. At that time, the company consolidated its credit processing operations (which includes billing customers, printing and mailing statements, and processing payments) from 11 regional offices to 3 credit processing centers. Company officials reported many benefits from the consolidation--economies of scale; employee reductions; dramatic increases in productivity (e.g., the volume of payments received and processed the same day increased by over 38 percent); and broadening of employees' expertise.

-- The Royal Bank of Canada changed its organizational structure and reengineered its work processes following installation of a comprehensive, on-line computer system which permits direct access to all data on retail customer accounts. The organizational changes included reducing its distributed data base locations from 6 to 3 and consolidating its operations centers from 30 to 10 because of the expanded capabilities of the new technology in processing, storing, and transmitting information.

IRS NEEDS A MORE COHERENT VISION AND CONSISTENT PLAN TO ADDRESS THE BUSINESS IMPLICATIONS OF TSM

During the preparation of the modernization plan, IRS deliberately chose a strategy to minimize organizational change. Significant changes to business operations were expected to evolve over time as agency users became familiar with the new system's potential. Agency officials told us they were motivated by concern for minimizing disruption of tax processing during the transition to the new system. Further, officials told us they wanted to avoid the political ramifications that may accompany restructuring, such as consolidating field locations.

Nevertheless, the agency does have a number of ad hoc efforts underway to assess and redefine several aspects of its business operations, but these have not been linked to the new systems contemplated in the TSM Design Master Plan. For example, the Service established an initiative known as Compliance 2000 where it articulated its desire to diversify its enforcement tools and consider a broader array of incentives to induce voluntary compliance. In another example, the Service has just established a task force to study ways to implement one-stop service, with the goal of handling taxpayer inquiries in a single contact by 1997--a goal which is referenced in the public version of the TSM plan. Both of these projects have yet to link their goals with the capabilities provided by the modernized system and to assess their impact in changing the organizational structure.

The most direct effort to address the business implications of TSM was to establish in January 1991 an executive steering group called the Committee on More Effective Ways of Doing Business. While the purpose of this committee was to develop and evaluate proposals for alternative ways of doing business under TSM, it was placed "on hold" in April 1991 because its members felt that they were not in the best position to fulfill their assigned task. They believed that IRS' Executive Committee (consisting of the Commissioner, Deputy Commissioner, Chief Operations Officer, Chief Information Officer, and Chief Financial Officer) needed to personally determine the direction of change that IRS will take in the future, rather than delegate that task to the More Effective Ways of Doing Business Committee or to other ad hoc groups that have been established to evaluate new ways of doing business.

Several members of the Executive Committee told us they agreed that they need to lead the agency in determining, implementing, and managing the many changes in IRS that will result from TSM. They acknowledged that they have not yet successfully articulated an agencywide business vision and integrated it with TSM. One vehicle to do this could be the agency's strategic business planning process, which provides a platform for defining the

Commissioner's goals for the future and holding the agency accountable for meeting these goals. To date, however, the plan simply restates the TSM time frames and does not explicitly address changes to business operations that may occur under a modernized framework.

CONCLUSIONS

Now is the time for IRS to begin a systematic effort to examine options for major changes in business processes to fully realize the significant opportunities offered by the modernization effort. The systematic effort we have in mind should not be constrained by assumptions regarding the continuance of existing organizational structures. Such an effort should be initiated soon so that any needed changes to TSM's design plan can be accommodated with minimal disruption.

We recognize that such changes involve risks as well as opportunities, and a prudent organization should be fully aware of both. Some painful adjustments may in fact be necessary to realize improvements. Unlike the private sector, the forces of competition provide no immediate impetus to a public agency to overcome the barriers to change. Accordingly, undertaking needed changes at IRS calls for strong leadership, inspired by a vision of what IRS could become.

Mr. Chairman, this concludes my statement and I would be pleased to respond to any questions.