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IRS MANAGEMENT

Business and Systems Modernization Pose Challenges

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IRS Management: Business and Systems Modernization Pose Challenges

Mr. Chairmen and Members of the Subcommittees:

We are pleased to be here today to discuss management challenges facing the Internal Revenue Service (IRS). Over the last several years, the IRS has been the subject of much criticism and increased congressional scrutiny over its perceived inability to serve taxpayers and its failed attempts at replacing its antiquated information systems. Also, several key IRS program areas have been on our high-risk list of government programs susceptible to waste, fraud, abuse, and mismanagement for several years.[1] Increased congressional scrutiny culminated in Congress' passing the IRS Restructuring and Reform Act of 1998. The act, among other things, provides IRS clearer direction about serving taxpayers and assisting them to voluntarily comply with the tax laws.

To align its business practices with the intent of the act, the Commissioner has developed a restructuring initiative that focuses on business and information systems modernization. Business modernization is to make IRS' management and operations results oriented to better address the unique needs of specific groups of taxpayers. Systems modernization is to acquire information systems to support IRS' modernized business operations, including IRS' ability to provide employees and taxpayers with up-to-date account information.

Our statement today is based on our past work on IRS' management challenges and high-risk areas as well as our ongoing work to monitor IRS' progress in implementing its new restructuring initiative.

Our statement makes the following three points:

- IRS' business modernization encompasses changing IRS' organizational structure, adopting new business practices, and managing for results. A key challenge for IRS' business modernization will be developing a balanced measurement system and incorporating that measurement system into reward and employee-evaluation systems. IRS will have little assurance that employees will be motivated to change their behavior unless its reward and evaluation systems are aligned with its new measures.

- IRS' systems modernization is intended to implement IRS' modernized business practices. IRS developed the first two levels of a four-level modernization blueprint in May 1997, which we said was a good first step

[1] High Risk Series: An Update (GAO/HR-99-1, Jan. 1999).

in defining the level of detail and precision needed to effectively and efficiently build modernized systems.[2] However, because the blueprint was developed before the Commissioner's restructuring initiative, we said questions exist about its validity. IRS acknowledges these questions and, in addition to completing the blueprint, plans to validate it in light of the restructuring initiative. Further, IRS is working as a partner with a systems integration services contractor to complete the final aspects of the blueprint. Even so, as we have said in the past, using contractors for systems development is no panacea.[3] The success of systems modernization will depend on whether IRS can effectively partner with and manage its contractors.

- The sheer magnitude of undertaking both business and systems modernization will strain IRS' management and staff. Such an ambitious undertaking, along with the need to "stay in business," makes the restructuring initiative a high-risk venture that will take years to fully implement. The Commissioner acknowledges that the restructuring initiative is a high-risk venture and plans to manage it accordingly.

Business Modernization Holds Promise But Faces Challenges

Equipped with a new mission statement that focuses on customer service,[4] IRS is seeking to fundamentally change the way it does business. Business modernization holds promise for improving service to taxpayers and making managers and employees more accountable in achieving IRS' mission. To be successful, IRS will need to sustain this initiative beyond the term of the current Commissioner and institutionalize managerial improvements. IRS' business modernization will also face challenges in the overlapping areas of performance management and human capital. The challenges we are describing today are not an exhaustive list but are examples to illustrate the magnitude of IRS' endeavor.

Planned Changes and Time Frames

Business modernization encompasses (1) changing IRS' organizational structure and business practices and (2) adopting a results-orientated management approach. Some of the proposed changes in these areas are significant, and could take several years to implement.

[2] Tax Systems Modernization: Blueprint Is a Good Start But Not Yet Sufficiently Complete to Build or Acquire Systems (GAO/AIMD/GGD-98-54, Feb. 24, 1998).

[3] Major Management Challenges and Program Risks: Department of Treasury (GA0/OCG-99-14, Jan. 1999).

[4] IRS' new mission is to provide America's taxpayers top quality service by helping them understand and meet their tax responsibilities and by applying the tax law with integrity and fairness to all.

Notwithstanding a reduction in the number of field offices, IRS' organizational structure has not changed significantly in almost 50 years. Each of its field offices is charged with administering the tax laws for its respective geographic area. Accordingly, every taxpayer is served by at least one service center and a district office. Each of these units is organized along functional lines—for example, examination, collection, and tax return processing. The planned organizational changes include shifting from a geographically-based structure to one organized by different types of taxpayers. IRS' new organizational structure is to include four operating divisions that are to serve four groups of taxpayers: (1) 88 million wage and investment income taxpayers; (2) 40 million small business and self-employed taxpayers; (3) 170,000 large and midsize businesses; and (4) 1.9 million tax exempt organizations. Each operating division is to (1) have end-to-end responsibility for serving its cognizant taxpayer group and (2) reengineer business practices for its respective group.

IRS is completing detailed plans for the new divisions and is planning for a multiyear transition. According to IRS' preliminary time line, employees will be realigned to the new organizational structure beginning this fall and throughout calendar years 2000 and 2001. By the end of this year, IRS plans to establish the Tax Exempt Division and much of the Large and Midsize Business Division. Starting in 2000, IRS plans to begin the transition of about (1) 21,000 employees to the Wage and Investment Income Division; and (2) 39,000 to the Small Business and Self-Employed Division. In addition to creating new management structures and aligning employees accordingly, the plans recommend business process changes, implementation of which may extend beyond 2001. For example, the Wage and Investment Income plans include new examination and collection business processes that are scheduled to begin in 2002.

Another component of business modernization is redefining management roles by defining the skills and experience required for senior executives. In the hope of broadening the perspective of IRS managers, the new operating divisions are to be managed by teams that may include a knowledgeable IRS executive teamed with managers with experience outside IRS. Once these teams are established, IRS will need to devolve responsibility to these managers so that they can identify business process changes and be held accountable for achieving results.

Revamping IRS' performance measurement system and aligning that system throughout the organization is another aspect of business modernization. The new measurement system, referred to as a balanced measurement system, is to support achievement of IRS' mission and goals.[5] The system is to encompass three types of measures—business results, customer satisfaction, and employee satisfaction. These measures are to be aligned from the top of the organization down to IRS' frontline employees.

Challenges Are Significant

Implementing performance-based management includes, among other things, (1) adopting a results orientation, which includes defining appropriate results-oriented goals and measures and aligning them throughout the organization; and (2) building, maintaining, and marshalling the human capital needed to achieve results.[6] We identified the following challenges in performance management, especially in the area of human capital, simply to illustrate the magnitude of IRS' undertaking. These challenges are not intended to be an exhaustive list.

For example, as IRS implements its new performance-based management system, it will need some new business results measures that can be aligned throughout the entire organization. For many years, enforcement statistics were used as part of a composite measure to rank the performance of IRS' district offices. Accordingly, it was an important factor in evaluating the performance of managers of those offices. Yet IRS is prohibited from using these measures to evaluate frontline employees. Our work showed that IRS employees perceived that enforcement statistics affected evaluations despite the prohibition.[7] According to IRS, the disconnect between using the measures for managers but not for frontline employees did, in fact, contribute to widespread violations of IRS' prohibition.

As IRS seeks to develop more appropriate business results measures, such as voluntary compliance, it faces the obstacle of having limited data for a baseline. IRS believes that it will need to develop something similar to its discontinued Taxpayer Compliance Measurement Program (TCMP) before it can develop a reliable measure for voluntary compliance. TCMP studies

[5] IRS' three corporate goals are serving each taxpayer, serving all taxpayers, and fostering productivity through a quality work environment.

[6] Implementing performance management also includes establishing financial management capabilities that support effective decisionmaking and accountability and effectively using technology to achieve program results. We testified on IRS' financial management weaknesses in before the Subcommittee on Government Management, Information and Technology, House Committee on Government Reform, in March 1999. (Internal Revenue Service: Results of Fiscal Year 1998 Financial Statement Audit (GAO/T-AIMD-99-103, Mar. 1, 1999.) Later in this statement, we discuss the effective use of technology.

[7] IRS Personnel Administration: Use of Enforcement Statistics in Employee Evaluations (GAO/GGD-99-11, Nov. 30, 1998).

involved doing detailed audits of a statistically valid sample of tax returns to determine the extent of voluntary compliance among various groups of taxpayers. IRS discontinued these studies because of concerns regarding the additional burden placed on the taxpayers who were the subject of these audits. Since then, IRS has not considered TCMP studies to be a viable option for assessing voluntary compliance. We believe a modified version of the TCMP studies, that reduces burden on taxpayers, could be useful in assessing voluntary compliance.

Once IRS develops new measures, reward and employee evaluation systems for managers and frontline employees must be aligned with those measures if IRS is to use them to help accomplish its mission and achieve its three corporate goals. Instilling a results orientation throughout all levels of the organization is particularly important to the success of performance-based management. Without reward and performance evaluation systems that are in accord with IRS' new mission statement and aligned with its measures, managers and frontline employees may have inconsistent or inappropriate incentives.

Our ongoing review of IRS' current employee evaluation system raises questions about the extent to which the system focuses on rewarding customer service. Preliminary results indicate that employee evaluations tend to emphasize efficiency and revenue over customer service. IRS plans to develop a new evaluation system as one of its short term customer service improvements. Until that system is effectively implemented, IRS will be without a key tool for instilling its new values throughout the organization.

Another human capital implication of IRS' business modernization is a significant training challenge. IRS is currently assessing its ability to deliver the requisite training and the associated costs. IRS' training plan for calendar years 1999 and 2000 associated with business modernization includes (1) orientation training for all 100,000 employees and managers; (2) leadership courses for managers and executives; and (3) technical training for employees whose job functions are to be expanded. During this same time period, IRS is to provide other training required by the Restructuring and Reform Act of 1998.

Training for employees whose jobs are to be expanded may be significant for some employees and may be critical to the success of the restructuring initiative. For example, in lieu of having a mass influx of seasonal employees for filing season activities, IRS is planning to increase the number of permanent employees and expand their job responsibilities to encompass both filing season activities and non-filing season compliance activities, such as examining returns. This expansion would require significant training so that employees who were traditionally involved in filing season activities can learn the compliance work. Our past work on IRS' challenges in consolidating its customer service functions found that attempts to expand customer service representatives' responsibilities encountered some pitfalls. The pitfalls stem from expecting too much too soon from employees.[8] The challenge lies in finding the degree of generalization and specialization that IRS can reasonably expect of its employees.

Successful Systems Modernization Is Essential to Business Modernization

To achieve IRS' business modernization goals, including serving taxpayers in a coherent fashion, IRS must successfully modernize its information systems. Modernized systems would provide, for example, IRS employees and taxpayers with up-to-date account information. We have made numerous recommendations to address the serious managerial and technical weaknesses in IRS' past systems modernization efforts. IRS is committed to addressing these recommendations but has not fully implemented them. For IRS' systems modernization to be successful, it must do so.

In July 1995, we reported that IRS (1) did not have a comprehensive business strategy to reduce paper tax return filings in a cost-effective manner; and (2) had not fully developed and put in place the requisite management, software development, and technical infrastructure necessary to successfully implement its ambitious systems modernization. We also reported that IRS lacked an overall systems architecture to guide the modernization's development and evolution. At that time, we made over a dozen recommendations to address these weaknesses, including calling for IRS to (1) implement processes for investment management; (2) implement disciplined procedures for software development; and (3) complete and enforce an integrated systems architecture, including data and security subarchitectures.[9] IRS agreed with our recommendations.

IRS has made progress in addressing the managerial and technical weaknesses in its systems modernization effort that we identified in 1995. However, to minimize the risk of IRS' investing in systems before our recommendations were implemented, Congress directed IRS, among other

[8] Tax Administration: IRS Faces Challenges in Reorganizing for Customer Service (GAO/GGD-96-3, Oct. 10, 1995).

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

things to (1) establish a schedule for implementing our recommendations and (2) submit an information systems architecture for modernization by May 15, 1997. IRS completed a modernization blueprint in May 1997 that included the first two levels of a four-level modernization architecture or blueprint. In February 1998, we reported that IRS' modernization blueprint was a good first step in defining the precision needed to build a modernized set of interrelated systems effectively and efficiently.[10] However, IRS' blueprint was completed 8 months before the Commissioner announced his business modernization plans. Because business modernization may change the very business processes and requirements on which the modernization blueprint was based, it raises questions about the modernization blueprint's validity. IRS acknowledges that these questions exist and plans to validate the blueprint in light of business modernization.

In March 1998, a little less than a year after completing the first two levels of the blueprint, IRS issued a request for proposal for a prime systems integration services contractor (PRIME). In December 1998, IRS awarded its PRIME contract for systems modernization. IRS is working as a "partner" with the PRIME contractor to complete the modernization blueprint as we recommended. For the PRIME contractor and partner strategy to be successful, IRS will need to effectively manage its contractors. Our past work has found that IRS has had difficulties in managing contractors.[11]

IRS is also working with the PRIME contractor to account for (1) changes in system requirements and priorities caused by IRS' organizational restructuring and (2) changes to accommodate new technology and to implement the requirements in the IRS Restructuring and Reform Act of 1998. Additionally, IRS is in the process of establishing disciplined life-cycle management processes and structures and mature software development and acquisition capabilities, including the capability to manage contractors, before it begins building modernized systems.

[10] Tax Systems Modernization: Blueprint Is a Good Start But Not Yet Sufficiently Complete to Build or Acquire Systems (GAO/AIMD/GGD-98-54, Feb. 24, 1998).

[11] High Risk Series: Information Management and Technology (GAO/HR-97-9, Feb. 1997).

Scope of Restructuring Initiative Makes it a High-Risk Venture that IRS Acknowledges

IRS' restructuring initiative focuses on both business modernization, including organizational changes, and systems modernization. However, the sheer magnitude of the changes will strain IRS' management and staff. This major restructuring initiative, with its focus on customer service, also entails a cultural change for IRS. Such an ambitious undertaking, along with the need to "stay-in-business," makes this initiative a high-risk venture that will take years to fully implement.

The Commissioner has concluded, and we agree, that the business and systems modernization components of IRS' restructuring initiative must be addressed in an integrated fashion. The Commissioner acknowledges that the restructuring initiative is a high-risk venture and plans to manage it accordingly.

We plan to continue to monitor IRS' progress in implementing the business and information systems aspects of its restructuring initiative. This concludes my prepared statement, and I would be happy to answer any questions.

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