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IRS MODERNIZATION

Continued Improvement in Management Capability Needed to Support Long-Term Transformation

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Mr. Chairman and Members of the Committees:

We are pleased to be here today as we approach the third anniversary of the Internal Revenue Service (IRS) Restructuring and Reform Act of 1998,[1] which established Congress' expectation that IRS modernize to better meet taxpayer needs. We will discuss (1) how well IRS is providing service to taxpayers and ensuring compliance with the tax laws, and (2) IRS' progress in its long-term effort to modernize. We will also note some issues related to IRS' fiscal year 2002 budget request. Our emphasis will be on the developments over the past year since your last modernization oversight hearing and potential oversight issues for the future.

IRS modernization is a massive and multifaceted effort that will take at least a decade to complete. Historically, IRS has not been able to provide American taxpayers with the quality of service that Congress has demanded. Our past reports chronicle IRS' deficiencies, including inefficient, paper-driven processes; poor management; weak incentives for employees to provide quality service; and antiquated information systems. Because of the breadth and depth of these deficiencies, modernization encompasses changes to virtually every aspect of IRS, from its organizational structure and business processes to its technology and ways of measuring and managing the performance of the agency and its 100,000 employees. Implemented together, improvements in these areas are intended to provide improved service and compliance. At stake is IRS' ability to perform its mission. While the transformation is occurring, IRS is simultaneously challenged to deliver its stay-in-business activities without interruption—answering telephones, processing returns, issuing refund checks, and enforcing tax laws.

Our statement, based primarily on our recent audit work, makes the following points:

- IRS posted mixed results this year in collecting revenues, providing taxpayer service, and enforcing tax laws. On the plus side, during this year's filing season, IRS processed millions of tax returns and issued refunds without significant problems, taxpayers had an easier time getting through to telephone assistors, and IRS said it made progress in correcting weaknesses that threatened the security of electronically filed tax information. On the down side, the quality of service provided

[1]P.L. 105-206, July 22, 1998.

to taxpayers who visited taxpayer assistance centers, trends in audit rates and enforcement programs, and productivity declines continue to be troubling. We share concerns expressed in Congress and by tax practitioners that the declines in audits and enforcement actions may increase incentives for taxpayers either to not report or to underreport their tax obligations.

With respect to modernization, IRS is making incremental progress in overhauling its organization, performance management system, business processes, and information technology. Successful completion of these efforts, each a management challenge unto itself, should give IRS a foundation to dramatically improve service and compliance in the future. IRS made important progress this year. It implemented its new organizational structure, continued to develop a blueprint for modernizing its business processes and information systems, and more fully defined its strategic direction. However, progress has not met expectations. For instance, IRS is not where it should be in implementing management controls over business systems modernization, which has contributed to project delays. IRS' efforts to develop a measure of voluntary compliance did not proceed at the pace IRS anticipated, and absence of this measure continues to compromise the effectiveness of the performance system as a whole. In an effort as complex and risky as IRS' modernization, however, it is important to remember that, while the timetable for change is important, cutting corners to achieve this timetable is not prudent.

A performance management system that establishes goals, objectives, and measures—a structure for guiding and evaluating the transformation of IRS—is essential to meeting Congress' expectations for IRS. In addition, a performance management system gives employees a blueprint of how to do their jobs and incentives to support what IRS wants to accomplish as an agency. While IRS has made progress creating the structure of its performance management system, managers at the working levels of the organization are not yet routinely using data to monitor and manage performance. In some cases, relevant, accurate data, such as financial data, are not available or are not available on a timely basis. In other cases, analyses of past performance are not complete enough to give managers an understanding of how to improve performance.

IRS' Performance Was Mixed

IRS posted mixed results over the past year in processing returns, providing service to taxpayers, and enforcing tax laws. The return-processing and refund-issuing aspects of the 2001 filing season appear to be winding down smoothly, and officials said that they have corrected some internal control weaknesses that we identified in the last filing season that threatened the security of electronically filed tax data. IRS made some progress in improving taxpayers' access to telephone customer service, but concerns remain over the levels of access and the accuracy of information provided. Declines since 1996 in individual audit rates, the use of key enforcement authorities, and resolutions of tax delinquencies are troubling.

Returns Processed and Refunds Issued Without Significant Problems

Our preliminary review of the 2001 filing season did not identify any significant problems adversely affecting IRS' ability to process returns and refunds.[2] This accomplishment is a proud testament to the dedication and abilities of IRS employees who meet this critical responsibility despite shortcomings in information systems and the challenge of working in a rapidly changing organization. The successes in processing returns and issuing refunds were achieved in a period in which the number of returns filed continues to grow, as does the level of complexity in the returns.[3]

Our review of IRS' electronic filing systems during the 2000 filing season showed that IRS had ineffective controls to ensure the security of those systems and electronically transmitted taxpayer data. We demonstrated that individuals, both inside and outside of IRS, could gain unauthorized access to IRS' electronic filing systems and view, modify, copy, or delete taxpayer data. Although IRS said that it had not had evidence of any such intrusions, IRS did not have adequate procedures to detect intrusions if they had occurred. According to IRS officials, IRS moved promptly to correct the access control weaknesses we identified before this year's filing season. IRS developed plans to improve security over its electronic filing systems and internal networks and said that it had substantially implemented those plans. We plan to test the effectiveness of IRS' actions later this year. Sustaining effective computer controls in today's dynamic

[2] *Internal Revenue Service: 2001 Tax Filing Season, Systems Modernization, and Security of Electronic Filing* (GAO-01-595T, Apr. 3, 2001).

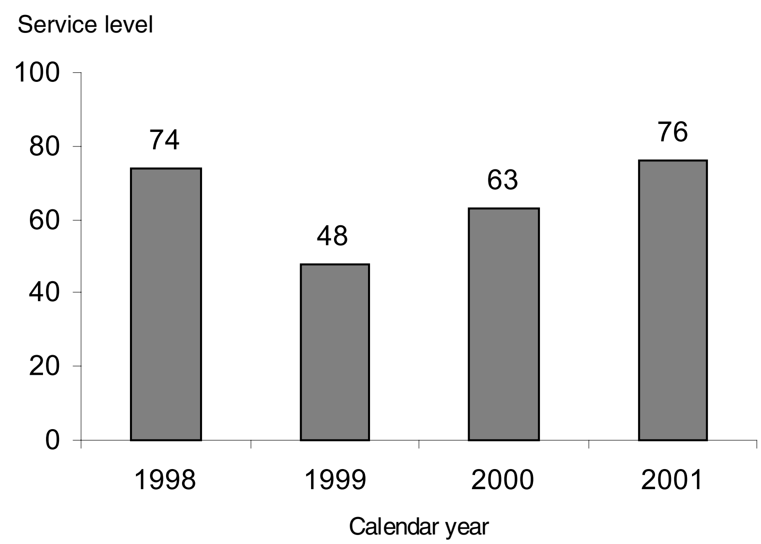
[3] Processing and issuing refunds is one issue; ensuring compliance is another. IRS controls to ensure that refunds are valid are often not applied until months after refunds are disbursed.

computing environment will require top management attention and support, disciplined processes, and continuing vigilance.

Despite Progress, Customer Service Lags Behind Goals

The news on telephone customer service activities is better this year than last, although IRS still has a long way to go to reach its goal of providing assistance comparable to that provided by leading public and private telephone customer service organizations. One indicator of IRS' performance in assisting the millions of taxpayers who call with questions is "level of service"—a measure of the number of calls answered divided by the number of calls attempted. As shown in figure 1, IRS answered a greater percentage of calls during the first 11 weeks of this filing season than it did at the same point in 1998, 1999 and 2000.

Figure 1: Toll-Free Telephone Level of Service for the First 11 Weeks of Filing Seasons 1998 through 2001



Note: IRS' level of service figures measure the percentage of call attempts that ultimately receive assistance—either from a customer service representative or an automated response menu. The figures do not address how long callers waited to receive assistance. The level of service computation for 2001 is not completely comparable to the computation for the other years because IRS is routing some refund inquiry calls this year to its Tele-Tax line for automated responses. In an effort to provide as accurate a comparison as possible to IRS' performance in past years, we adjusted the level-of-service computation to include refund inquiries answered by the automated Tele-Tax line, but Tele-Tax data does not account for taxpayers who may have abandoned their calls before getting an answer.

Source: GAO's analysis of IRS' data.

Despite these improvements in level of service, IRS officials recognize that to achieve the goal of providing telephone assistance comparable to that provided by leading public and private call center operations, IRS needs to do more to improve access to telephone assistance. Almost one-quarter of taxpayers' calls to IRS were not answered. Declines in the productivity of telephone assistors and delays in modernizing call routing technology—issues that we will discuss in detail in other sections of our statement—have prevented even greater improvement.

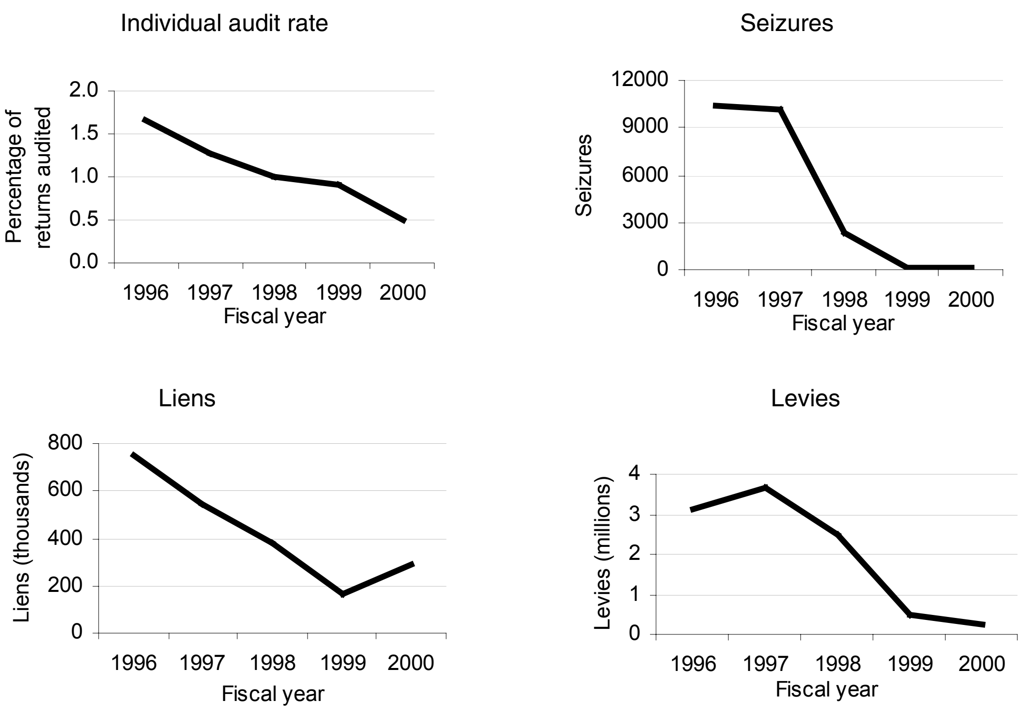
Answering the telephone is only half of the battle. Assistors then have to give taxpayers the right responses to their inquiries. For the 2000 filing season, IRS estimated that it provided accurate answers to tax law questions 73 percent of the time and to account questions 59 percent of the time. The Commissioner recently reported that this fiscal year, IRS provided accurate answers to tax law questions 78 percent of the time and to account questions 88 percent of the time. However, IRS changed its method for measuring accuracy this year, so accuracy rates cannot be compared to prior years.

In an attempt to improve service to taxpayers who visit walk-in sites, IRS changed the structure and increased the staffing of its field assistance program last year, but the quality of the service provided remains a concern. IRS reviewers posing as taxpayers conducted 272 visits to taxpayer assistance centers before the 2000 filing season and another 272 during the filing season. Of the questions asked, 81 percent were not answered correctly, and 21 percent of the reviewers were denied service. A similar but smaller study done in January and February 2001 by the Treasury Inspector General for Tax Administration found that reviewers received inaccurate answers about 48 percent of the time.

Trends in Enforcement Programs Are Troubling

Enforcement program trends continue to be troubling. IRS' audit rate for individuals has steadily declined since 1996, and examinations have declined across the full spectrum of taxpayers—from individual wage earners to businesses large and small. Figure 2 shows the declines in individual audit rates[4] and use of three key enforcement authorities: seizures, liens, and levies.[5] Although the Commissioner had predicted last year that these downward trends would reverse, by and large, they did not.

Figure 2: Declines in Individual Audit Rate and Use of Enforcement Authorities, 1996 Through 2000



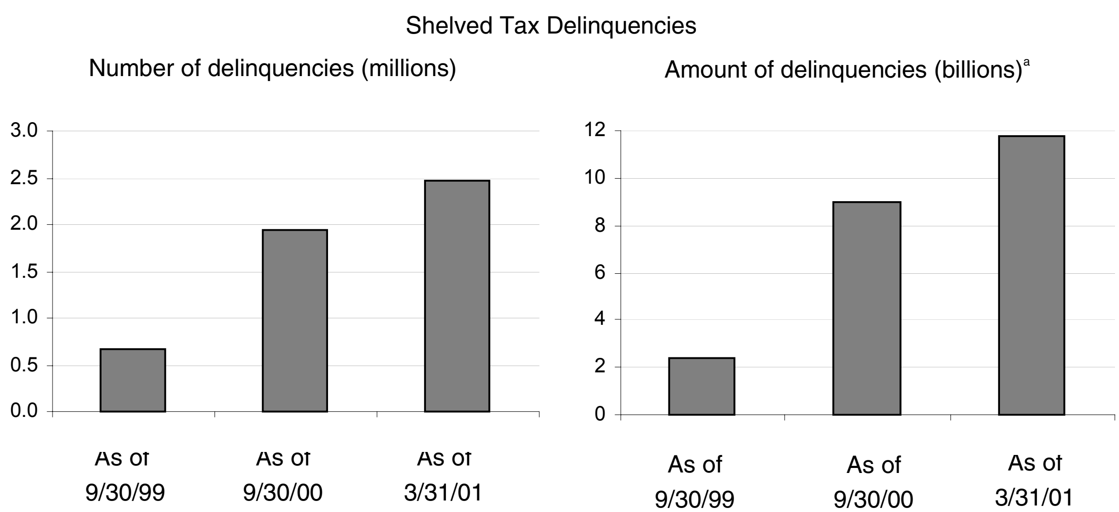
Source: GAO's analysis of IRS' data.

[4]The proportion of tax returns filed by individuals that IRS audits each year.

[5]Under the Internal Revenue Code, levy is defined as the seizure of a taxpayer's assets to satisfy a tax delinquency. IRS differentiates between the levy of assets in the possession of the taxpayer (referred to as a seizure) and the levy of assets such as bank accounts and wages that are the possession of third parties such as banks and employers (referred to as a levy). A lien is a legal claim that attaches to property to secure the payment of a debt. The filing of a lien would prevent the taxpayer from selling an asset, with clear title, without payment of the tax debt.

Also troubling is that IRS' telephone and field collection components have not kept pace with other IRS compliance programs such as audits that make tax assessments when taxpayers do not fully report their tax liabilities. Because of this, commencing in mid-1999, these collection components began closing delinquencies without working them—that is, without making collection contact with taxpayers through either telephone calls or field visits. This type of case closure is referred to as "shelving." As shown in figure 3, tax delinquencies shelved, together with related interest and penalties, totaled almost $12 billion at the end of March 2001. During our fiscal year 1999 and 2000 audits of IRS' financial statements,[6] we found instances of unpaid tax cases in which IRS was not actively pursuing collection despite evidence in IRS' files that the accounts had some collection potential. Once closed, the only provisions for reactivating shelved delinquencies for telephone and field collection action are (1) if the taxpayers had additional delinquencies or if information returns were filed identifying a previously unknown levy source and (2) if IRS found the resources to work the collection cases.

Figure 3: Tax Delinquencies Shelved by IRS



[a]Includes related penalties and interest.

Source: GAO's analysis of IRS' collection activity reports.

[6] *Financial Audit: IRS Fiscal Year 2000 Financial Statements* (GAO-01-394, Mar. 1, 2001) and *Financial Audit: IRS Fiscal Year 1999 Financial Statements* (GAO/AIMD-00-76, Feb. 29, 2000).

Declines in the number and productivity of enforcement staff contributed to the declines in enforcement programs and the shelving of cases. For example, from fiscal year 1996 to 2000, the number of IRS employees working collection cases in the field dropped from about 5,500 to about 3,600, or by about 35 percent. In part, this drop was due to attrition, and, in part, it was due to reassignments intended to provide improved service to taxpayers. IRS does not routinely measure the productivity of staff handling collection cases, but IRS officials agree that it is taking longer for staff to work cases. Our analysis of collection staff time spent on collection cases and the number of cases closed over the period 1996 to 2000 indicates that the amount of time spent to close a case, excluding the processing of offers in compromise, has increased by about a third.[7] While there may be valid reasons for the productivity decline, including additional statutory requirements and extra time spent to ensure quality, IRS officials have not been able to provide us with a data-based explanation of the factors that have affected productivity or the extent to which the productivity decline has contributed to the declines in enforcement programs.

We share concerns that have been expressed in Congress and by tax practitioners that these declines in audits, enforcement actions, and collections of delinquencies may increase incentives for taxpayers either to not report or to underreport their tax obligations. Because IRS lacks a measure of the extent to which taxpayers voluntarily comply with tax laws, it does not know the impact of the recent declines in enforcement activities and delinquency collections. Shelving of collection cases exacerbates our concern regarding voluntary compliance because IRS is not following through on cases in which taxpayers have been found to be noncompliant. (Further details on the implications of the lack of a voluntary compliance measure are discussed in the next section.)

IRS' inability to reduce growing backlogs in two other programs—innocent spouse and offer-in-compromise—negatively affect both taxpayer service and enforcement and will merit oversight in the year ahead. The innocent spouse program allows relief under certain conditions to an innocent spouse from tax liabilities solely attributable to the actions of the other spouse. The offer-in-compromise program allows for contracts between IRS and individual or business taxpayers to settle

[7] Including offers in compromise, the average time to close a case has increased by about 50 percent.

tax debts for less than the amount of the debts. Sizeable inventories of claims and offers and slow processing times under these programs are examples of poor service to taxpayers. IRS staff reassigned to reduce program backlogs, thus far unsuccessfully, have taken resources away from other collection activities.

Both the innocent spouse and offer-in-compromise programs were greatly expanded as a result of provisions of the Restructuring Act. At the end of fiscal year 2000, the inventory of innocent spouse cases being worked had grown to almost 40,000, but the influx of new cases appears to have stabilized in the past 2 years. The inventory of unresolved offer-in-compromise cases was about 87,500 at the end of fiscal year 2000, almost triple the number of unresolved offers IRS had pending at the end of fiscal year 1997. In addition, the timeliness of cases worked declined. The percentage of offers IRS completed within 6 months was down from 64 percent in 1997 to 38 percent in fiscal year 2000.

Modernization Is Progressing, but Transformation Will Be a Long-Term Effort

IRS' modernization, encompassing fundamental changes in organizational structure, business processes, information systems, and performance management, is a long-term effort to transform the agency into a more reliable, accountable, customer-focused organization. Over the past year, IRS has made important progress toward that end; however, work on certain key aspects of business systems modernization and performance management was slower than anticipated. In an effort as complex and risky as IRS' modernization, however, it is important to remember that, while the timetable for change is important, cutting corners to achieve this timetable is not prudent. To IRS' credit, senior officials are making the difficult decisions necessary to manage the modernization for the long term. Still, managers at the working levels of the organization are not yet routinely using a performance-based approach to their work. Such an approach, in which managers at all levels consistently apply performance management skills in their day-to-day work by routinely gathering and using data to define goals and assess progress, will help IRS design improvements and achieve the transformation Congress desires.

IRS Successfully Shifted to Its New Organizational Structure

In October 2000, IRS largely completed its transition to the new organizational structure. In a process that the Commissioner likened to putting together a giant jigsaw puzzle with literally thousands of pieces, IRS put the new organization in place without significant effect—positive or negative—on its processing of millions of returns this filing season. That the reorganization has not yet led to significant changes in filing season or other activities is not unexpected. The reorganization provides a focus on taxpayer segments that IRS expects will help it better understand taxpayers' needs and identify changes to its systems and procedures for meeting those needs. In the course of our work at IRS in the coming year, we will be monitoring how IRS' new operating divisions focus their efforts to address specific compliance and service problems associated with their particular taxpayer segments.

Despite Important Progress, IRS Has Yet to Fully Implement the Capabilities Needed to Effectively Manage the Business System Modernization Program

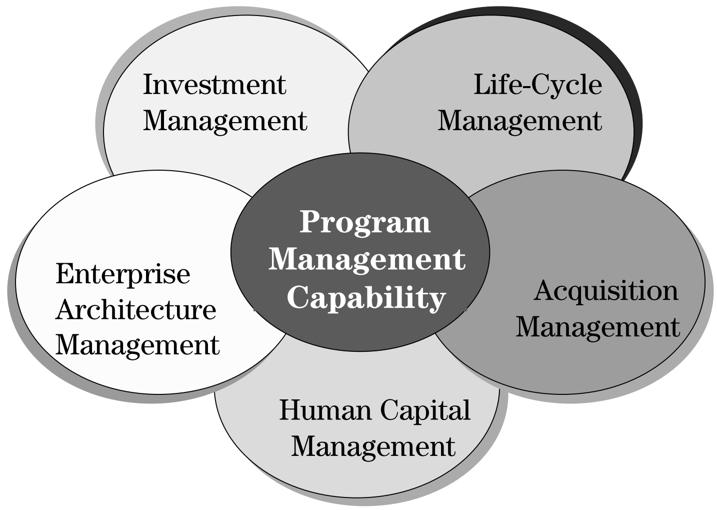
Business systems modernization (BSM)—a multi-year program to revamp business processes and put in place the supporting technology—is vital to achieving IRS' new, customer-focused vision and enabling IRS to meet performance and accountability goals. This multi-billion-dollar program began a little over 2 years ago and as of March 2001, had received congressional approval to obligate about $450 million.[8] BSM consists of a number of new systems acquisition projects that are at differing stages of acquisition and implementation, as well as various program-level initiatives intended to establish the controls and capabilities for IRS to effectively manage the projects.

We have long held—and communicated to IRS—the importance of establishing sound management controls to guide its BSM projects.[9] In general, the management controls and capabilities that IRS needs fall into five interrelated and interdependent categories as shown in figure 3—investment management, system life-cycle management, enterprise architecture management, software acquisition management, and human capital management.

[8] IRS requested and Congress established a multi-year systems modernization account and funded it with about $578 million via IRS' fiscal years 1998, 1999, and 2001 appropriation acts. In addition to the $450 million provided so far, Congress is currently considering a plan submitted by IRS to obligate the remaining $128 million to, among other things, fund program-level initiatives through mid-November 2001 and ongoing projects through their next life-cycle milestones.

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

Figure 3: Information Technology Management Control Areas



Source: GAO.

In addition, we have reported on the risks associated with IRS' approach of concurrently building systems while developing and implementing these controls and capabilities.[10] We have also reported that the risks associated with building systems without the requisite management controls and capabilities are not as severe early in projects' life cycles when they are being planned (project definition and preliminary design), but escalate as projects are built (detailed design and development).[11] In this latter case, the risk of performance shortfalls and rework due to missing controls increases, both in terms of probability and impact.

To its credit, IRS has made important progress in implementing modernization management controls and capabilities. For example, IRS has (1) largely defined and has begun implementing its system life-cycle methodology that incorporates software acquisition and investment management processes, (2) defined program roles and responsibilities of IRS and its modernization contractors, (3) begun formally managing

[10]For example, see *Internal Revenue Service: Progress Continues But Serious Management Challenges Remain* (GAO-01-562T, Apr. 2, 2001).

[11]See *Tax Systems Modernization: Results of Review of IRS' Third Expenditure Plan* (GAO-01-227, Jan. 22, 2001).

modernization risks in an effort to proactively head off problems, and (4) made progress toward completing its enterprise architecture. IRS has also taken steps in response to our recommendations to strengthen the management of individual BSM projects as well. In addition, IRS recently hired experienced technical and managerial executives and augmented existing modernization staff with experienced IRS information systems and acquisition personnel.

We are concerned, however, because projects are proceeding past critical milestones without certain essential management controls in place and functioning. In particular, in our ongoing work for IRS' appropriations subcommittees, we found that IRS is proceeding with building systems—including detailed design and software development work—before it has implemented key controls. For example, IRS has yet to develop a sufficiently defined version of its enterprise architecture to effectively guide and constrain acquisition of modernization projects. In addition, it has not yet implemented rigorous, disciplined configuration management practices on key projects. IRS also has not ensured that the projects are following mature software acquisition processes. As we have concluded in our past reports, attempting to acquire modernized systems before having the requisite management controls increases the risk that systems will experience cost, schedule, and performance shortfalls, and these risks increase as projects move from planning into design and development.

Key IRS projects are now beginning to experience these shortfalls. For example, IRS data shows that a critical infrastructure project (called the Security and Technology Infrastructure Release) was 1.5 months late and $2 million over budget in completing its preliminary design phase in January 2001. However, these project shortfalls are understated because not all preliminary design phase commitments were completed then, and, as of mid-April 2001, IRS was still working to finalize 6 of 19 work products needed to complete this phase–meaning that the project is actually almost 5 months late.

We discussed these missing controls with the Commissioner and his BSM executives; they recognize the need to address these control weaknesses and have initiated steps to do so. IRS plans to fully implement many of these controls by the end of June 2001. In addition, the Commissioner decided recently to slow ongoing projects and new projects, giving priority to first putting in place missing management capacity and then building systems. For example, the Customer Account Data Engine (CADE) project is being delayed to a yet-to-be-determined time to, among other things, ensure that its design is sufficiently defined. In addition, the start dates for several new projects planned to begin in April 2001 are being delayed. IRS also plans to stagger these project starts, rather than initiate them all at once, with the first to begin this month.

With respect to BSM funding, IRS expects to totally exhaust congressionally-approved BSM funds by about November 2001 and is seeking approximately $397 million in its fiscal year 2002 budget to continue the program. Given that it has been slow to completely implement the full array of controls necessary for a modernization effort of this magnitude, this is a good time to ensure that the overdue modernization management controls are emphasized as a BSM priority.[12]

IRS' Oversight Board is recommending $450 million for BSM in fiscal year 2002, a $53 million increase over IRS' budget request. The Board stated that the additional $53 million is needed to fully carry out fiscal year 2002 BSM initiatives. Since the Board submitted its budget request, IRS, as mentioned above, has decided to slow ongoing and new projects in order to avoid exceeding its current capacity to effectively manage the program. Consequently, while we recognize that IRS needs funding to continue the BSM program, it is unclear whether IRS needs the additional $53 million in fiscal year 2002. Nonetheless, in the event that Congress does appropriate the $450 million, IRS' past appropriations acts and IRS' fiscal year 2002 budget request require such BSM spending to be submitted to Congress via an expenditure plan before BSM funds can be obligated. This provides a follow-on control mechanism to ensure that appropriated funds are managed and spent in an effective manner.

Effective Performance Management Is an Essential Element of IRS' Transformation

Through modernization, Congress expects IRS to provide top-quality service and, in doing so, to efficiently collect revenues for the Treasury. A performance management system that establishes goals, objectives, and measures—a structure for guiding and evaluating the transformation of IRS—is essential to meeting these expectations. In addition, when this structure successfully cascades down through the organization, a performance management system gives employees a blueprint of how to do their jobs and incentives to support what IRS wants to accomplish as an agency. IRS has continued to make progress in revamping its

[12]Congress limited IRS' ability to obligate funds until certain controls were in place by establishing a multi-year capital account—the Information Technology Investments Account—to fund IRS' systems modernization initiatives.

performance management system and has most fully developed it at the agencywide level. The system is less developed at the division level and is weakest at the front-line, where interactions with taxpayers occur. In the long run, if managers at all levels consistently apply performance management skills in their day-to-day work by routinely gathering and using data to define goals, assess progress, and design improvements, IRS will be better able to achieve the transformation it and Congress desire. IRS still has a long way to go in establishing this type of performance-based management culture.

Progress in Defining IRS' Strategic Direction

IRS made progress over the past year in defining its strategic direction. For example, IRS

- published a strategic plan for fiscal years 2000 to 2005 that lays out IRS' mission, strategic goals, and objectives; and
- implemented a strategic planning and budgeting process designed to reconcile competing priorities and initiatives with the realities of available resources.

However, IRS is still missing key measures of voluntary compliance. Because these measures are vital to understanding the ultimate impact of IRS' service and compliance programs, their absence from IRS' array of organizational performance measures continues to compromise the effectiveness of the performance system as a whole. In May 2000, the Commissioner appointed a project director to oversee the development of voluntary compliance measures, including filing, reporting, and payment compliance. This planning was not completed as quickly as anticipated and will probably not be finalized this fiscal year.

Mixed Success at the Division and Employee Levels

Clear strategic direction for IRS as a whole, while essential, is not sufficient. For its performance management system to act as a blueprint for employees throughout IRS, the elements of IRS' system must cascade down through the organization. In keeping with this principle, IRS' performance management plan calls for each operating division to have complementary goals, objectives, and measures and for front-line managers to develop plans identifying the actions they need to take to support operational objectives.

IRS has had mixed success in the challenging task of implementing its performance management system.[13] For example:

- While most division performance goals reflected IRS' agencywide goals and priorities, none of the 72 supporting objectives was stated in terms that were specific and measurable—that is, they did not include a time period, a numeric target, or a means to measure the objective. Also, with a few exceptions, the objectives did not include an expected result or program impact.
- In fiscal year 2000, IRS began requiring managers to develop plans that identify the actions they intend to take to meet their objectives. The action items in the plans developed by front-line managers were consistent with IRS' mission, but 91 percent of the items we reviewed were not specific, measurable, or outcome- or output-oriented.

Increasing the specificity of objectives and action plans could increase managerial accountability and create stronger incentives for front-line employees to achieve IRS' goals.

Our work on IRS' management of its telephone customer service operations illustrates how goals and objectives have not cascaded down through the organization. In a recent review of IRS telephone assistance,[14] we found that IRS does not have long-term goals for the level of service to be provided to taxpayers or annual goals aimed at achieving the long-term goal over time. Without them, IRS lacks meaningful targets for strategically planning and managing call center performance and measuring improvement.

Revamping IRS' evaluation systems for managers and front-line employees is another important means of establishing a clear link between individual employees' work and IRS' mission and goals. In February 2000, IRS implemented a realigned performance evaluation system for executives, managers, and supervisors. IRS had expected to implement a similarly aligned evaluation system for front-line employees last fall. However, negotiations with stakeholders are taking longer than expected, and IRS is uncertain about when the new evaluation system will be in place.

[13]See *IRS Modernization: IRS Should Enhance Its Performance Management System* (GAO-01-234, Feb. 23, 2001).

[14]*IRS Telephone Assistance: Opportunities to Improve Human Capital Management* (GAO-01-144, Jan. 30, 2001).

Managers Not Routinely Using Data to Monitor and Manage Performance

Performance evaluation—the collection of data on performance and the analysis of that data to determine the factors that explain performance—is a key part of performance management. IRS managers do not consistently evaluate the performance of their programs to make decisions about how to improve performance. In some cases, relevant, accurate data are not available or are not available on a timely basis to support program evaluations. In other cases, analyses of past performance are not complete enough to give managers an understanding of how to improve performance.

Financial information is an example of management information that is not available on a timely basis to IRS managers. IRS was able this year to use data from its financial systems to produce, for the first time, financial statements that received an unqualified opinion.[15] However, it did so through the use of substantial, costly, and time-consuming processes that provided data months after the fact for a single point in time. As a routine matter, IRS' financial management systems do not produce information that is current or accurate and that can be used to assist managers in day-to-day decisionmaking. For example, IRS does not track the cost accounting information needed to prepare cost-based performance information. Consequently, managers do not have the basic information needed to prepare reliable cost-benefit data for internal decisionmaking and for budget justifications, which could lead to inappropriate management or budgetary decisions.

IRS' analyses of the declines in productivity referred to earlier in this statement are examples of incomplete program performance evaluations. Taxpayer access to telephone assistors is less than it could be because telephone assistor productivity has declined for the third filing season in a row. IRS has done several studies of productivity, but only considered time spent handling a taxpayer call. IRS did not study other segments of assistors' time that would affect overall productivity, including time spent waiting to receive a call, time spent away from the telephone, and time assistors were not assigned to answer calls. Similarly, IRS officials could not give us an empirically-based explanation for declines in enforcement staff productivity. With more complete evaluations of the causes of productivity changes, IRS managers would have a more informed basis for making decisions about how to improve productivity and be more likely to meet performance goals.

[15] An unqualified, or clean, opinion means that financial statements are fairly presented.

Understanding the factors that drive productivity changes at IRS is important when evaluating IRS' budget. While the increase in IRS' workload and the complexity of its work might justify additional resources, declines in productivity raise questions about whether IRS is using existing resources efficiently. However, IRS' evaluations of productivity are not complete enough to use in making informed judgments about the extent to which existing resources could be used more efficiently. As a consequence, it was difficult to analyze IRS' budget request for additional staff (the STABLE initiative[16]). In a letter last week to the Chairman, Subcommittee on Oversight, House Committee on Ways and Means, we said we were generally supportive of IRS' request on the grounds that the initiative targeted areas of need.[17] However, we also recognized that opportunities exist to improve productivity in those areas.

As IRS moves forward with modernization, the capacity to conduct sound performance evaluations will be one building block for success. Indeed, the Commissioner has written about the need for research and analysis that will help IRS decisonmakers find the best ways to improve performance against strategic and operational measures. We recently reported that it must address longstanding challenges to produce research results that meet the needs of managers and decisionmakers. These include, for example, ensuring that staff have the right mix of skills for the work and that research focuses on managers' needs. IRS recently established a Research Council to coordinate research activities, including standardized training, data needs, and quality standards.

Conclusion

Modernization of IRS' organizational structure, business processes, performance management system, and information technology is necessary if IRS is to achieve its goals of improving service to taxpayers and compliance with tax laws. While important progress has been made in laying the foundation for a new IRS, parts of the modernization effort have gone slower than expected. Clearly, this is disappointing. Unfortunately, it reflects the continuing need to build management capability. The goal of improving service to taxpayers quickly must be balanced with the need to prudently manage a massive, long-term effort like IRS modernization. As

[16]STABLE (Staffing Tax Administration for Balance and Equity) is designed to boost staff levels in tax compliance and customer service programs.

[17]*Fiscal Year 2002 Budget Request for the Internal Revenue Service* (GAO-01-698R, May 1, 2001).

of today, IRS does not have all the program management capabilities it needs to manage a very large systems acquisition program. Nor do IRS managers routinely use results-oriented management tools such as clear goal-setting and data-based evaluations of performance.

Mr. Chairman, that concludes our statement. We would be pleased to respond to any questions that you or other members may have at this time.