Management Advisory Report:
The Small Business/Self-Employed Division Will Substantially Stand Up on October 1, 2000

September 2000

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MEMORANDUM FOR COMMISSIONER ROSSOTTI

Pamela J. Gardiner

FROM: Pamela J. Gardiner
Deputy Inspector General for Audit

SUBJECT: Final Management Advisory Report - The Small Business/ Self-Employed Division Will Substantially Stand Up on October 1, 2000

This report presents the results of our analysis of efforts taken by the Small Business/ Self-Employed (SB/SE) Division to stand-up by October 1, 2000. This management advisory report is being provided for informational purposes to aid Internal Revenue Service (IRS) management in its efforts to modernize the IRS.

The stand-up process is defined as the establishment of a new IRS organization with at least the minimum requirements of operating. These include:

- Filling key management positions.
- Completing actions to realign positions.
- Ensuring workarounds are developed and in place.
- Establishing a finance office and separate budgets.
- Ensuring necessary business authorities are in place.

Stand-up is not the end product of creating a new organizational unit. Additional effort is required to accomplish the target design. The overall objective of this review was to determine if the SB/SE Division will substantially achieve stand-up by October 1, 2000.

In summary, we found that the SB/SE Division is on track to substantially stand-up on October 1, 2000. However, there are several areas which management needs to address or monitor. These areas include: timely obtaining space for the headquarters office, updating Delegation Orders, establishing Memoranda of Understanding with other IRS functions, and implementing the Taxpayer Education and Communication function.

Copies of this report are also being sent to the IRS managers affected by the report. Please contact me at (202) 622-6510 if you have questions, or your staff may call Gordon C. Milbourn III, Associate Inspector General for Audit (Small Business and Corporate Programs), at (202) 622-3837.

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Executive Summary

In early 1998, the Internal Revenue Service (IRS) Commissioner outlined a program to modernize the IRS, offering more efficient work processes and better service to American taxpayers. The Congress subsequently passed the IRS Restructuring and Reform Act of 1998 (RRA 98),[1] mandating that the IRS modernize itself to improve operations and to better serve its customers. As a result, a comprehensive strategy was developed to reorganize the IRS into four operating divisions. The four operating divisions are: Wage and Investment, Small Business/Self-Employed, Large and Mid-Size Business, and Tax Exempt and Government Entities. The Small Business/Self-Employed (SB/SE) Division will service small corporations and partnerships (less than $5 million in assets) and fully and partially self-employed taxpayers.

Part of the modernization process in establishing the four operating divisions is called "standing up." This process is defined as the establishment of a new IRS organization with at least the minimum requirements of operating. These requirements include filling key management positions, completing actions to realign positions, ensuring workarounds are developed and in place, establishing a finance office and separate budgets, and ensuring necessary business authorities are in place.

The Treasury Inspector General for Tax Administration identified the modernization of the IRS as one of the major challenges facing the IRS and, as a result, initiated audit coverage of this area. The overall objective of this review was to determine if the SB/SE Division will substantially achieve stand-up by October 1, 2000.

Results

Important aspects of the overall implementation of the SB/SE Division are already complete, and the implementation team has positioned the Division to substantially achieve stand-up on October 1, 2000. Specifically, most key managers are in place, employees have been realigned, the finance office is in place, many delegation orders are in place, and a detailed plan of workarounds has been developed. However, there are four areas which management needs to address or monitor implementation activities: timely obtaining space for the headquarters office, updating Delegation Orders, establishing Memoranda of Understanding with other IRS functions, and implementing the Taxpayer Education and Communication (TEC) function.

[1] Pub. L. No. 105-206, 112 Stat. 685.

Many Key Management Positions Have Been Filled

Most of the executives for the Headquarters, Customer Account Services (CAS), and Compliance functions have been selected and will be in place on October 1, 2000. As of late August, 7 (70 percent) of 10 Headquarters executives, 7 (88 percent) of 8 CAS function executives, and 20 (80 percent) of 25 Compliance executives had been selected.

Actions to Realign Positions Have Been Substantially Completed; However, Delays Remain in Establishing a Unified Headquarters Space

Employees scheduled to work in the new unit have been identified, and letters have been issued notifying them where they will be placed. However, sufficient space will not be available for all headquarters activities to be together until April 2001. While this condition is temporary and the SB/SE Division apparently has no other options, the ability to start a new headquarters organization will be somewhat hindered when employees are located in different offices.

The Financial Office and Budget Have Been Established

The SB/SE Division has its own budget for Fiscal Year (FY) 2001 and will be responsible for tracking and meeting budget requirements. The Division has also developed its own financial resource structure for FY 2001 and has begun drafting comprehensive financial operating policies and guidelines.

Delegations of Authority Have Been Received, but Additional Attention in this Area Is Necessary

The creation of the SB/SE Division required the updating of 164 Delegation Orders to realign the authority for collecting tax revenue and operating the IRS with the new positions created by the reorganization. While 154 of the Delegation Orders have been properly updated, 4 were not properly transferred to positions within the new Division, and 6 were transferred based on the authority of an outdated Treasury Order or Treasury Directive. Additionally, although the IRS plans to update the Delegation Orders, which are located in part one of the Internal Revenue Manual (IRM), it does not plan to update the remainder of the IRM to reflect the new organizational titles.

A Detailed Plan to Allow the Division to Function Has Been Completed, but Additional Attention to Inter-Divisional Memoranda of Understanding Is Needed

The SB/SE Division has developed a detailed plan of workarounds to allow it to function after stand-up. As part of this effort, the Division developed, or is developing, Memoranda of Understanding (MOU) covering 33 shared services. However, an effective means of monitoring these agreements still needs to be developed. In addition, the SB/SE Division does not have an agreement with the Agency Wide Shared Services function.

Additional Attention in the Taxpayer Education and Communications Area Is Needed

Management faces several major challenges in attempting to develop a TEC function that will be able to provide specialized programs to small business taxpayers in the near future. The IRS:

- Has not yet identified all of the various business taxpayer education programs offered under its previous structure, nor has it developed a comprehensive plan regarding whether and/or how these services will be continued in the near future.
- Is still in the process of developing an overall strategic plan for implementing the new TEC function.
- Plans to use the newly formed TEC function to provide critically needed customer service support during the filing season (January through April). As a result, the IRS will have a ready pool of staff able to provide vital assistance to all taxpayers during the filing season; however, implementation of small business-oriented TEC programs will not begin until May 2001. Furthermore, providing this assistance during the filing season will potentially delay TEC employees from receiving the specific technical training necessary to assist business taxpayers.
- Has not yet developed a training plan to provide the skills that will be needed in the new TEC function.

Objective and Scope

The objective of our review was to determine if the SB/SE Division will substantially achieve stand-up by October 1, 2000.

The overall objective of this review was to determine if the Small Business/Self-Employed (SB/SE) Division will substantially achieve stand-up by October 1, 2000. The stand-up process is defined as the establishment of a new organization with at least the minimum requirements of operating. These include:

- Filling key management positions.
- Completing actions to realign positions.
- Establishing a finance office and separate budgets.
- Ensuring necessary business authorities are in place.
- Ensuring workarounds are developed and in place.

The Treasury Inspector General for Tax Administration identified modernization as one of the major challenges facing the Internal Revenue Service (IRS). The IRS' modernization includes a multi-year time schedule necessary to accomplish full implementation of the transition process. We plan to continue our reviews of the transition processes as part of our Fiscal Year (FY) 2001 audit program coverage.

We evaluated various modernization design and implementation documents and interviewed National Headquarters officials in the SB/SE Division. We did not perform substantive testing of IRS implementation actions, such as reviewing detailed accounting and personnel data relating to the filling of key management positions.

The review was conducted at the SB/SE Division headquarters in Washington, DC, and limited fieldwork was also performed at the Delaware-Maryland and New England Districts from June through August 2000. The review was performed in accordance with the President's Council on Integrity and Efficiency *Quality Standards for Inspections*.

Details of our objective, scope, and methodology are presented in Appendix I. Major contributors to this report are listed in Appendix II.

Background

In early 1998, the IRS Commissioner outlined a program to modernize the IRS, offering more efficient work processes and better service to American taxpayers. The Congress subsequently passed the IRS Restructuring and Reform Act of 1998 (RRA 98),[1] mandating that the IRS modernize itself to improve operations and to better serve its customers.

The modernization of the IRS is based on five levers of change: 1) revamping business processes; 2) creating management roles with clear accountability; 3) instituting a balanced performance measurement system; 4) overhauling the entire technology base; and 5) establishing customer-focused operating divisions.

The IRS is reorganizing into four operating divisions that will focus on serving specific taxpayer groups with similar needs. The four operating divisions are: Wage and Investment, Small Business/Self-Employed, Large and Mid-Size Business, and Tax Exempt and Government Entities.

The four divisions were designed and will be implemented on a phased approach that will take 2 to 3 years. The phases are defined as follows:

Phase I - The IRS and a contractor validated the operating division concept. Plans were established for the next phases.

Phase IIA - Design teams were assembled that focused on the new IRS operating division structure.

[1] Pub. L. No. 105-206, 112 Stat. 685.

Phase IIB - This was the implementation planning phase where teams identified the infrastructure requirements for implementing the new organization.

Phase III - This is the final phase of the organizational effort to actually implement the design. Stand-up of the new organization takes place in this phase. However, stand-up is not the end product of creating a new organizational unit. Additional effort is required to accomplish the transition to the operating division as designed.

The SB/SE Division, which is scheduled to stand-up on October 1, 2000, will service small corporations and partnerships (less than $5 million in assets) and fully and partially self-employed taxpayers.

Results

Important aspects of the initial implementation of the SB/SE Division have been completed, and the implementation team has positioned the Division to substantially achieve stand-up on October 1, 2000. However, there are several areas which management needs to address or monitor. These areas include: timely obtaining space for the headquarters office, updating Delegation Orders, establishing Memoranda of Understanding with other IRS functions, and implementing the Taxpayer Education and Communication (TEC) function.

Many Key Management Positions Have Been Filled

Most of the executives for the Headquarters, Customer Account Services (CAS), and Compliance functions have been selected and will be in place on October 1, 2000. As of late August, 7 (70 percent) of 10 Headquarters executives, 7 (88 percent) of 8 CAS function executives, and 20 (80 percent) of 25 Compliance executives had been selected.

However, the TEC function has filled only 8 (44 percent) of 18 executive positions. The IRS is actively attempting to fill the vacant positions and additional selections are expected before stand-up.

Actions to Realign Positions Have Been Substantially Completed; However, Delays Remain in Establishing a Unified Headquarters Space

Employees scheduled to work in the new unit have been identified, and letters have been issued notifying them where they will be placed. However, delays remain in efforts to establish a permanent Headquarters space.

The SB/SE Division's Headquarters operation includes various activities, such as Management and Finance, Human Resources, Research and Performance Management, Business Systems Planning, Equal Opportunity and Diversity, and Communications. All of these activities are to be located in the New Carrollton, Maryland, office.

The SB/SE Division headquarters employees were scheduled to be moved to the New Carrollton space in November 2000; however, this move has been delayed until approximately April 2001.

Employees were scheduled to move to the New Carrollton space in November 2000; however, this move has been delayed until approximately April 2001. This schedule change is due to delays in the design of the new facilities as well as a delay in the move of the present tenant from the space. Therefore, some of the SB/SE Division employees will be located temporarily in Oxon Hill, Maryland. As additional employees are selected from current IRS activities, there will not be sufficient space to locate them all in one location until April 2001. While this condition is temporary and the SB/SE Division apparently has no other options, the ability to start a new headquarters organization will be somewhat hindered when employees are located in different offices.

The Financial Office and Budget Have Been Established

The SB/SE Division has its own budget for FY 2001 and will be responsible for tracking and meeting budget requirements. The Division has also developed its own financial resource structure for FY 2001 and has begun drafting comprehensive financial operating policies and guidelines.

Delegations of Authority Have Been Received, but Additional Attention in this Area Is Necessary

The creation of the SB/SE Division required the updating of 164 Delegation Orders. This updating was necessary to realign the authority for collecting tax revenue and operating the IRS with the new positions created by the reorganization.

Four Delegation Orders have not been properly transferred to positions within the SB/SE Division, and six Delegation Orders were transferred based on an authority which is outdated.

Our review determined that 154 Delegation Orders have been properly updated. However, we identified four Delegation Orders that were not properly transferred to positions within the new SB/SE organization, and six Delegation Orders that were transferred based on authority provided by a Treasury Order or Treasury Directive which is outdated. Additionally, although the IRS plans to update the Delegation Orders, which are located in the Internal Revenue Manual (IRM), it does not plan to update the IRM to reflect the new organizational titles.

A Detailed Plan to Allow the Division to Function Has Been Completed, but Additional Attention to Inter-Divisional Memoranda of Understanding Is Needed

An effective means of monitoring MOUs needs to be developed.

The SB/SE Division has developed a detailed plan of workarounds to allow it to function after stand-up. As part of this effort, the SB/SE Division developed, or is developing, Memoranda of Understanding (MOU) covering 33 shared services. These MOUs are agreements between organizational functions so that each understands what services are to be delivered by the servicing function. For example, the Large and Mid-Size Business Division will provide appraiser specialist support to the SB/SE Division.

However, an effective means of monitoring these agreements does not exist. Developing a comprehensive and formal approach to monitoring these agreements would help ensure that MOUs are timely and effectively executed. In addition, the SB/SE Division does not have an agreement with the Agency Wide Shared Services (AWSS) function.

While service-related functions, such as AWSS, have historically provided support across all IRS organizations, formal agreements, such as MOUs, would be helpful in clarifying procedures and expectations.

Additional Attention in the Taxpayer Education and Communication Area Is Needed

The TEC function is an essential component in the reorganization. The IRS anticipates that by providing up-front assistance to business taxpayers via educational programs, the need for future contacts (e.g., compliance actions) will be minimized. This proactive approach will potentially result in the need for fewer interactions to correct problems, thereby reducing taxpayer burden and IRS operating costs.

We have identified some major concerns with the future implementation of TEC.

Management faces several major challenges in attempting to develop a TEC function that will be able to provide specialized programs to small business taxpayers in the near future. First, the IRS has not yet identified all of the various business taxpayer education programs offered under its previous structure, nor has it developed a comprehensive plan regarding whether and/or how these services will be continued in the near future. In addition, the IRS is still in the process of developing an overall strategic plan for implementing the new TEC function.

Furthermore, the IRS plans to use the newly formed TEC function to provide critically needed customer service support during the filing season (January through April). As a result, the IRS will have a ready pool of staff able to provide vital assistance to all taxpayers during the filing season; however, implementation of small business-oriented TEC programs will not begin until May 2001. Providing this assistance during the filing season will potentially delay TEC employees from receiving the specific technical training necessary to assist business taxpayers.

Finally, the IRS has not yet completed development of a comprehensive training plan to ensure new TEC managers and representatives timely receive training essential to the successful beginning of this new organization. Adequate training is critical to establishing the educational products offered by the IRS. In order to maintain the quality of service provided to taxpayers, these employees should be trained before they begin to interact with taxpayers. In addition, the amount and level of training for TEC employees is unclear because employees will be recruited from several sources and their levels of knowledge may vary.

External stakeholders are very interested in the TEC approach. At the Senate Small Business Committee meeting in May 2000, small business owners stated the TEC function is the most important change that the IRS is making. One owner was concerned that the IRS would not provide the necessary resources and training for the program. Furthermore, at the IRS Advisory Council meeting in June 2000, the head of the SB/SE Division subgroup was concerned that the TEC function would be too slowly implemented over several years. The IRS prefers the TEC function be started with approximately 329 employees in FY 2001 and intends to incrementally add employees until the TEC function reaches an employee level of approximately 1,200 by FY 2002. IRS management believes this approach to implementing the new function is consistent with its goals of maintaining program quality while developing new products and work processes.

Conclusion

While the SB/SE Division is positioned to substantially stand-up on October 1, 2000, several areas need to be addressed or monitored. Management attention is needed to secure all necessary Memoranda of Understanding with other functions, update Delegation Orders, and timely obtain space for the headquarters office. In addition, management attention is needed to ensure the effective implementation of the TEC function.

Appendix I

Detailed Objective, Scope, and Methodology

The overall objective of this review was to determine if the Small Business/Self-Employed (SB/SE) Division will substantially achieve stand-up by October 1, 2000. To accomplish this objective, we performed the following:

I. Evaluated the Internal Revenue Service's (IRS) progress in filling essential SB/SE Division positions prior to the stand-up on October 1, 2000.

A. Using the proposed SB/SE Division organizational charts and the planned restructuring milestone document, identified the essential positions needed to successfully impact the divisional stand-up.

B. Interviewed management charged with placement oversight and determined the status of filling the selected positions.

C. Ascertained the estimated reporting dates for the employees identified in B above.

II. Ascertained if the Treasury Integrated Management Information System validation and staffing realignment will be completed by the stand-up.

A. Interviewed Personnel Systems management to determine if the new SB/SE organization in Personnel Systems would be completely established by October 1, 2000.

B. Interviewed key personnel to ascertain if the new organization structure (Non-Competitive Realignment) would be fully populated and in place by stand-up.

C. Ensured that procedures had been established to notify all SB/SE Division employees of their new positions by the stand-up date.

III. Ascertained if a SB/SE Division finance office was established and a separate budget was completed.

A. Determined if the Chief Financial Officer would be provided with new financial codes to update the Automated Financial System.

B. Interviewed essential personnel to determine those responsible for developing Modified Financial Codes. Ascertained those responsible for updating the Financial System with the modified Financial Codes, and if this updating would be achieved by stand-up.

IV. Ascertained if essential personnel would receive required training by the stand-up.

V. Determined if Delegation Orders had been transferred, and determined if legislative approval was required for the transfer.

VI. Ascertained if the SB/SE Division had developed Memoranda Of Understanding and a plan of workarounds to allow it to function after stand-up.

VII. Ascertained if the preliminary Infrastructure and Facilities for the SB/SE Division would be met by the stand-up.

Appendix II

Major Contributors to This Report

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Appendix III

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