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Report to the Commissioner of Internal Revenue

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TAX ADMINISTRATION

Opportunities to Further Improve IRS' Business Review Process

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General Government Division

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August 13, 1992

The Honorable Shirley D. Peterson
Commissioner of Internal Revenue

Dear Mrs. Peterson:

Because of our continuing interest in the Internal Revenue Service's (IRS) strategic management process, we evaluated a key component of that process—the annual business reviews. These reviews are used to assess field office accomplishments in support of IRS' Strategic Business Plan (SBP).

To provide information that might be useful to IRS in doing the fiscal year 1992 business reviews and in reporting on the results of those reviews, we documented our preliminary observations in a January 13, 1992, letter to the Business Review Executive. Also, on May 29, 1992, we sent you a fact sheet on the results of our survey of 55 of IRS' senior executives.[1]

This report is the final product from our evaluation of the business review process. It discusses issues that we think you need to address to ensure that business reviews generate results that are useful to you in assessing IRS' progress in achieving its goals and objectives. One aspect of the 1991 business review process that we found particularly commendable and that many executives also found very positive was the direct involvement of the former Commissioner in the process, especially in meeting with regional executives to discuss business review results. We believe your continued commitment to the business review process is essential if the process is going to become an effective evaluation tool.

Results in Brief

IRS has taken positive steps to implement a business review process that helps the organization chart its progress toward meeting agency objectives. For example, (1) senior management appears strongly committed to making the business review process work, (2) the process has been structured to include various essential elements that we outlined in a 1988 report,[2] and (3) the process has continued to improve from year to year.

[1] Tax Administration: IRS' Executives' Views on the Business Review Process (GAO/GGD-92-103FS, May 29, 1992).

[2] Managing IRS: Actions Needed to Assure Quality Service in the Future (GAO/GGD-89-1, Oct. 14, 1988).

There are several steps IRS can take to further improve the process. These steps include (1) compiling review results in an overall assessment of IRS' progress in implementing long-term strategies and meeting long-term objectives, (2) doing business reviews of the National Office, (3) ensuring that the number of performance factors being measured is appropriate, and (4) expanding communications about the business review process within IRS. An important step IRS could take to enhance the business reviews would be to improve its measures of performance.

IRS is working toward developing better performance measures and is taking or plans to take other steps to address the opportunities we identified.

Objective, Scope, and Methodology

Our objective was to determine whether IRS' annual business review process provides a useful mechanism for measuring performance toward meeting IRS' business objectives.

To achieve our objective, we did the following:

- We interviewed managers and staff responsible for doing business reviews in three IRS functions—Collection, Human Resources Management and Support, and Returns Processing.
- We examined the SBP, annual business plans prepared by the three functions, reports on visits to regions by National Office analysts, and preliminary and final business review reports.
- We analyzed action plans that described how the regions would implement recommendations in the fiscal year 1991 business review reports.
- We analyzed IRS executives' responses to the Business Review Executive's request for comments regarding the fiscal year 1991 business reviews.
- We examined performance expectations and evaluations for selected IRS managers to determine the link between business review results and individual managers' accountability.
- We sent a questionnaire to all 55 assistant commissioners, regional commissioners, and assistant regional commissioners to obtain their views on the business review process. We received responses from 50 of the 55. Detailed information about the questionnaire and the responses can be found in our May 29, 1992, fact sheet.

We did our work at IRS' National Office; its regional and district offices in Cincinnati, Ohio, and Philadelphia, Pennsylvania; and its service centers in

Covington, Kentucky, and Philadelphia. Because basic procedures for implementing the business review process and reporting on the results were prescribed by the National Office for use throughout IRS, it made little difference where we did our field work. Therefore, we selected field offices that were convenient to GAO staff working on the assignment. Our work focused on the fiscal year 1991 business review process because that was the most recently completed cycle. For comparison purposes, we also looked at aspects of the fiscal years 1990 and 1992 processes.

To better ensure that the results of our work were available to IRS as it prepared for the fiscal year 1992 business review cycle, we documented our preliminary observations in a January 13, 1992, letter to the Business Review Executive. The Executive's response to our letter indicated that the information was useful in helping him plan for the next review cycle, and we incorporated his response in this report where appropriate.

We did our audit work from July 1991 through April 1992 in accordance with generally accepted government auditing standards. We discussed this report with cognizant IRS officials. Their comments are discussed where appropriate in the body of the report.

Background

In 1984, recognizing the need for the agency to move in unison toward organizational objectives, IRS established a strategic management process. This process was intended to help the Commissioner more effectively communicate a vision of the agency's mission and ensure that all components of the agency work together to implement common goals. A key component of IRS' strategic management process is the SBP, through which IRS establishes long-range objectives and strategies that set the framework for the way it does business. The SBP also identifies corporate critical success factors, defined by IRS as the "vital few" activities IRS must accomplish in the current year to make progress on its long-range objectives and strategies.

In fiscal years 1991 and 1992, each IRS function (such as Collection and Returns Processing) developed an annual business plan to identify functional critical success factors that IRS needed to achieve to help accomplish its objectives. In effect, the annual business plans translated the SBP objectives into day-to-day operations.

In our October 1988 report, we said that IRS needed to establish a way to effectively measure movement toward meeting the objectives set forth in the SBP. Toward that end, IRS developed the business review process and completed its first reviews of regional offices in September 1990. During fiscal year 1991, IRS' National Office completed business reviews of each of IRS' seven regions and guided the regions in developing reviews of the district offices and service centers.

How the Business Review Process Works

In fiscal year 1991, the business review process worked as follows:

- National Office analysts assessed field office performance during the year through site visits and reviews of management information reports.
- Based on information for the first 3 quarters of the fiscal year, each function prepared draft reports showing what each region had done in relation to the critical success factors in the function's annual plan.
- The Business Review Executive used those drafts to prepare draft business reports for each region. The reports included recommendations for corrective action where appropriate.
- Between September 4 and 27, 1991, the Commissioner of Internal Revenue met separately with each of the regional commissioners to discuss the results of the business reviews as documented in the draft business reports. The regional commissioners also received their annual performance evaluations during the meeting.
- Final business review reports, updated with fourth quarter information, were completed around mid-December 1991.
- On January 17, 1992, IRS issued action plans showing what each region intended to do to implement recommendations contained in the final reports.

IRS Has Taken Positive Steps to Improve Its Business Reviews

IRS developed the business review process to establish a way to assess field office contributions toward meeting SBP objectives. We observed several positive features of the process that we think enhance its chances of becoming an effective evaluation tool. Those features include (1) top management's commitment to the process, (2) structural elements of the process that are compatible with criteria we laid out in 1988, and (3) clear evidence that IRS' senior management is trying to improve the process as it evolves.

The Business Review Process Has Top Management Support

Senior IRS management appears strongly committed to making the business review process work. Management's commitment was particularly evidenced in 1991 when the Commissioner reviewed regional performance and personally provided feedback to each regional commissioner. Of the 49 senior executives responding to our questionnaire who said they had a basis to judge, 36 said that IRS' senior management was very committed to making the process work, 12 said that management was somewhat committed, and 1 said management was not committed. Also, several respondents specifically mentioned the involvement of the Commissioner and other top executives as one of the most positive aspects of the 1991 business review process.

The Business Review Process Generally Meets Effective Evaluation Criteria

IRS implemented the business review process in response to a recommendation in our 1988 report that IRS improve the nationwide assessment of its field operations. In that recommendation, we emphasized four criteria that characterize an effective evaluation process: (1) full-time leadership, (2) nationwide coverage on an annual basis, (3) rigorous follow-up of review recommendations, and (4) use of agreed-upon performance measures. IRS' business review process contains the following elements, which we believe generally meet these criteria:

- The Deputy Assistant Commissioner for Planning and Research was designated as IRS' Business Review Executive. He provides high-level full-time leadership to the process.
- IRS provided nationwide field office coverage by doing business reviews in all seven of its regions in 1991. IRS' National Office also helped the regions start reviews of the district offices and service centers. As we will be discussing later, IRS has not achieved complete nationwide coverage because no reviews are done of the National Office.
- Recommendation follow-up procedures were established. Consistent with those procedures, each region prepared an action plan stating what would be done to address recommendations in the fiscal year 1991 business review reports. Progress toward accomplishing the actions is to be assessed as part of the 1992 business reviews and discussed in that year's business review reports.
- IRS recognized the need for performance measures in the business review process and included measures in the fiscal year 1991 reviews. In 1992, measures and measurement tools were more clearly defined in the annual business plans. We will be discussing performance measures in more detail later in this report.

The Business Review Process Has Improved Since Its Inception

IRS' business review process is relatively new, having started in fiscal year 1990. Our analysis of the process and information we obtained from IRS' senior executives indicated that the process is improving as it evolves.

We noted, for example, that the fiscal year 1992 annual business plans contained more useful information than those for fiscal year 1991. More specifically, the fiscal year 1992 plans more clearly defined the measures and measurement tools that would be used in assessing accomplishments during the business reviews. In 1991, IRS expanded the review process to cover not only its 7 regional offices but also its 63 district offices and 10 service centers. As we will be discussing in the next section, other changes to the process are planned that should improve it further.

In responding to our questionnaire, IRS' senior executives also indicated that the business review process is improving as it evolves. Of 45 executives who said they had a basis to judge, 37 said that the 1991 process was generally better or much better than the 1990 process.

We also asked the executives whether they expected the 1992 process to be better than the 1991 process based on what they then knew about the 1992 process. Of the 50 executives who responded, 31 said that they expected the 1992 process to be better, 18 said that they expected it to be about the same, and 1 expected it to be worse.

IRS Could Take Steps to Make Business Review Results More Useful to Top Management

As the business review process continues to evolve, IRS needs to take steps to better ensure that information produced by the process is useful to top management. Those steps include (1) converting business review results into a bottom-line assessment of overall performance, (2) making the process truly nationwide by doing business reviews of the National Office, and (3) ensuring that the number of factors being measured during the reviews is appropriate. An important step IRS can take to make the business reviews useful is to improve its measures of performance. Until that is done, IRS will not find it easy to translate review results into a meaningful assessment of its progress in achieving business goals and objectives.

IRS Needs to Convert Business Review Results Into an Assessment of Overall Performance

IRS' three major business objectives are to (1) improve voluntary compliance; (2) reduce taxpayer burden; and (3) improve customer satisfaction, quality, and productivity. To achieve those objectives, IRS has identified several broad strategies, such as Compliance 2000,[3] Tax Systems Modernization, and financial management. To be most useful, the annual business reviews should provide management with a bottom-line assessment of progress toward implementing those strategies and achieving those objectives—something akin to a state of tax administration. The business review reports for fiscal year 1991 did not provide that kind of information. Instead, they provided details on specific aspects of regional office performance.

Several IRS executives, in commenting on the 1991 business review process, pointed to the need for an overall statement on performance. For example, in an internal assessment of the 1991 business review process, one National Office executive said that the business reports did not adequately convey an overall picture of the effectiveness of tax administration in the regions. Similarly, when we asked IRS executives to identify, in their own words, the most negative aspects of the fiscal year 1991 business review process, 10 of the 50 respondents said things that appeared directly related to this issue. They noted, for example, that (1) the business review report did not indicate how well they had done, (2) they still did not know where their region or function stood, or (3) there was a narrow focus on statistical accomplishments.

Partially in response to the preliminary observations in our January 13, 1992, letter, IRS has taken steps to address the need for an overall assessment of performance. For fiscal year 1992, IRS has prescribed a business review reporting format that includes a section on the state of tax administration. According to the business review report guidelines, this section will provide an overall analysis of the region's performance in support of the three major IRS business objectives noted above. The Business Review Executive told us that there will be an emphasis on a more detailed analysis of statistical indicators to look at results and their impact on IRS' objectives. The reporting format also calls for a separate section devoted to assessments of IRS' progress in implementing its various broad strategies, such as Compliance 2000 and Tax Systems Modernization.

[3]Compliance 2000 is a new strategy that IRS has undertaken to help improve voluntary compliance. IRS' intent is to foster compliance by using taxpayer assistance, education, and outreach efforts; making regulations and procedures clearer and simpler; and encouraging legislative changes to help IRS work with taxpayers who unintentionally fail to comply with the laws.

IRS' National Office Should Be Included in Performance Assessment

If IRS is to assess its overall performance, it needs to include the entire agency. The National Office was not included in the fiscal year 1991 business reviews even though it was responsible for implementing many strategies and accomplishing corporate critical success factors in the SBP.

For example, each National Office function was responsible for developing measures of accuracy, timeliness, quality, and customer satisfaction for key products and/or services with a particular emphasis on reducing taxpayer burden. Likewise, various National Office officials were responsible for such things as (1) developing a plan for IRS to become a total quality organization, (2) taking steps to implement a management information system for accounts receivable, (3) completing the Automated Financial System, and (4) managing various activities associated with implementation of Tax Systems Modernization. Because the National Office functions were excluded from the 1991 business review, IRS could not measure how well the functions accomplished these tasks.

IRS appears to be taking steps to include the National Office in the review process. In response to our January 1992 letter, the Business Review Executive said "we recognize the need to implement a business review process at the National Office level. During [fiscal year] 92 we plan to develop a method for doing National Office reviews."

It is also our understanding that in fiscal year 1993, instead of each function issuing its own annual plan, IRS will have broader cross-functional plans. The Chief Operations Officer, for example, will issue one plan that encompasses all of the activities under his purview (such as Returns Processing, Collection, and Examination). IRS officials said that the agency planned to implement cross-functional reviews based on those cross-functional plans and that the reviews would include National Office activities.

IRS Employees Believe That Business Reviews Measure Too Many Critical Factors

As noted earlier, the SBP includes corporate critical success factors—activities that IRS has determined must be accomplished in the current year to make progress on its long-term objectives. Likewise, each of the functions, in its annual plan for fiscal year 1991, added its own success factors on top of the corporate factors and then each region added its own success factors on top of those. This layering resulted in each region being responsible for accomplishing multiple critical success factors. We do not know how many critical success factors, if any, are too many. However, most of the IRS officials and executives we asked thought that IRS had too many critical factors.

Twenty-four of 27 field office officials that we interviewed, for example, expressed concern about the number of critical success factors measured in the business review process. A frequent statement was that "everything cannot be critical." The results of our questionnaire also indicated a strong consensus among IRS executives about the number of critical success factors. In the questionnaire, we asked executives whether they thought the number of corporate/functional critical success factors covered by the fiscal year 1991 business reviews was too many, about right, or too few. Of the 49 executives who answered that question, 40 said that there were too many critical success factors, 4 said there were too few, and 5 said the number was just about right.

The belief that there are too many critical success factors seems to conflict with the agency's attempt to concentrate on the "vital few" activities that must be accomplished to address long-range objectives. The executives may be frustrated in understanding the agency's focus and determining which factors have priority. In responding to the Business Review Executive's request for input on the business review process, for example, one office commented that perhaps IRS' focus has not been on the critical few but rather on the "ambitious many."

In commenting on a draft of this report, the Business Review Executive agreed that there have been too many critical success factors. He said that the draft SBP for fiscal year 1993 has only 12 corporate critical success factors compared to 18 in the fiscal year 1992 SBP. He further noted that the move from functional to cross-functional annual plans should also result in fewer critical success factors.

Improved Performance Measures Would Enhance Business Reviews

An important step IRS could take to enhance its business reviews would be to improve its performance measures. Improved measures would help IRS move from measuring process to measuring results and would also facilitate IRS' ability to use the business review results in assessing the agency's movement toward achieving short-term goals and long-term objectives.

To effectively assess performance, IRS must develop appropriate measures—those that measure results, not process. IRS' 1991 business reviews sometimes focused more on measuring process. In discussing activities with respect to attracting and maintaining a quality workforce, for example, the reports cited various regional office activities, like publication of a college newsletter and use of the Automated Training System, but said nothing about the impact of those activities on workforce quality. Conversely, in taxpayer service and returns processing, the reports dealt with results—the region's success or lack of success in achieving accuracy and productivity goals—rather than process.

One senior executive told us that IRS has not done a good job of developing measures and that IRS measures processes but does not measure results. He said that "when you measure everything, you measure nothing." Another executive said that IRS needs to change its corporate thinking—evaluate impact instead of just measuring what it is doing. He said IRS needs to concentrate on developing measures as the key to future success.

In responding to our questionnaire, 29 of 50 respondents said the 1991 performance measures were very adequate or somewhat adequate. Another 19 respondents said the measures were somewhat or very inadequate. The remaining two respondents were uncertain. When asked if new or revised performance measures are needed, 41 of 48 respondents said yes and 7 respondents said no. Among other things, those answering yes said that measures

- need to address the entire tax system,
- should focus less on functions and more on IRS objectives,
- need to be more comprehensive,
- do not measure what they are intended to measure,
- measure process not results, and
- need to be cross-functional and have baselines.

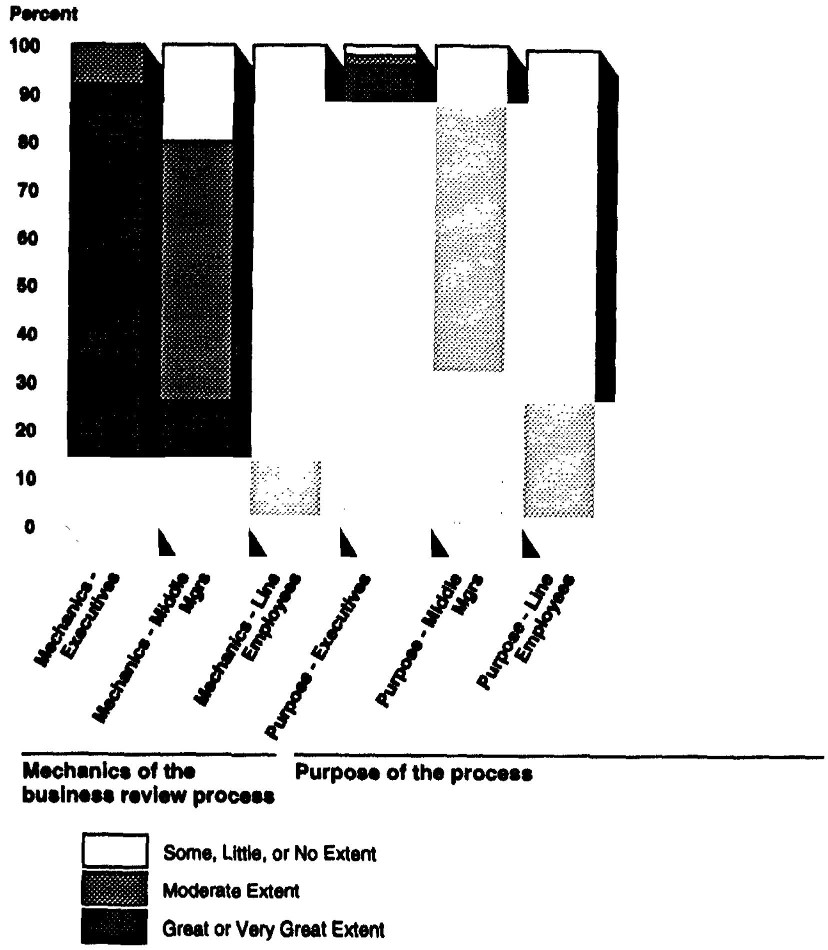
IRS is in the process of developing new measures. For example, it is developing corporate measures that are intended to assess the agency's overall progress in increasing voluntary compliance; reducing burden; and improving quality, productivity, and customer satisfaction. It is also working on developing measures for major product lines, such as accounts maintenance, assistance, and enforcement. These product lines reflect a shift in IRS' thinking, which has traditionally viewed IRS' work along functional lines.

IRS Needs to Improve Communications About the Business Review Process

Our interviews and analysis of responses to our questionnaire show that the business review process is not clearly understood by everyone in IRS. During our interviews, 15 of 27 field office respondents said the business review process was not communicated effectively so that all employees understood the process. For example, one official said the process needs to be communicated more effectively so line employees "buy into" the process and understand how the specifics of their jobs support the success factors identified in the business review.

To further examine communications about the process, we asked executives their opinion as to what extent they, middle level managers, and line employees understand the mechanics and purpose of the process. As shown in figure 1, almost all of the executives felt that they had a great or very great understanding of the mechanics and purpose of the process. A large percentage of the executives felt that the level of understanding fell off considerably as one went farther down into the organization.

Figure 1: IRS Executives' Opinions on the Extent to Which Select Employee Groups Understand the Business Review Process



Note: The totals do not sum to 100% due to rounding.

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Source: Responses to GAO questionnaire.

The Business Review Executive said that communications about the business review process needed improvement and that IRS had already taken steps toward that end. For example, every employee was given a "slim jim" folding version of the 1992 SBP, which provided information about the objectives, strategies, and corporate critical success factors around which the business review process is focused. Additionally, the Business Review Executive said IRS (1) is developing business review guidelines that will ensure improved communications between the National Office and the field and better define roles and responsibilities and (2) plans to include a discussion of business reviews in the fiscal year 1993 SBP.

Conclusions

Annual business reviews are a key part of IRS' strategic management process. They are the vehicle for assessing the agency's progress in implementing long-term strategies and meeting long-term business objectives. IRS has done a good job in getting the business review process under way and has shown the management commitment needed to make the process work.

We recognize that the business review process is relatively new and that IRS has been making and will continue to make changes as it gains experience with doing reviews and reporting results. As part of that evolution, there are several steps we think IRS needs to take to better ensure that business reviews produce results that are useful to management.

For the results to be most useful, they need to be reported in a way that gives management a bottom-line assessment of the agency's progress in implementing long-term strategies (like Compliance 2000) and achieving long-term objectives (like reducing taxpayer burden). Management needs that kind of assessment in order to determine whether the agency is moving in the right direction and what, if any, adjustments might be needed. Before IRS can provide meaningful bottom-line assessments, it needs to develop appropriate performance measures and integrate those measures into the business review process. IRS is working toward developing such measures, and we recognize that it will probably be a long and arduous process.

If the reviews are to provide a comprehensive assessment of what IRS accomplished in the past year and where it stands in relation to its long-term goals, the National Office needs to be included. By excluding the National Office, the business review process is giving top management an assessment of field office performance, not agency performance. IRS also needs to deal with the belief expressed by most of the officials we interviewed and executives we surveyed that there are too many critical success factors. We have no formula to offer in helping to decide the right number of factors, if indeed there is a "right" number. The problem may take care of itself if IRS moves away from functional annual plans toward broader cross-functional plans. No matter how many success factors IRS ends up with, this seems like one area that might benefit from better communication. IRS needs to think about what more it can do to inform all of its employees as to what is critical, how those decisions were reached, and what those determinations mean in terms of all the other things managers and line employees are expected to do that are not deemed critical.

Recommendations to the Commissioner of Internal Revenue

We recommend that IRS:

- Incorporate business review results into a bottom-line assessment of IRS' overall progress in implementing long-term strategies and achieving long-term objectives.
- Do business reviews of the National Office.
- Address concerns raised by many officials and executives about the number of critical success factors.
- Incorporate appropriate measures into the business review process to better ensure that the reviews generate results-oriented information that will be most helpful to IRS' senior managers.
- Look for opportunities to improve communications about the business review process. As discussed in our conclusions, one such opportunity would seem to be in the area of critical success factors.

Agency Comments

IRS officials responsible for the business review program agreed with our recommendations and, as noted throughout the report, IRS has various actions under way or planned to address them. If those actions are implemented as intended, they should satisfy the intent of our recommendations.

As head of a federal agency, you are required by 31 U.S.C. 720 to send a written statement on actions taken on our recommendations to the Senate Committee on Governmental Affairs and the House Committee on Government Operations not later than 60 days after the date of this letter and to the House and Senate Committees on Appropriations with the agency's first request for appropriations made more than 60 days after the date of this letter.

Copies of this report are being sent to the Secretary of the Treasury, the Director of the Office of Management and Budget, and other interested parties.

The major contributors to this report are listed in the appendix. Please contact me on (202) 275-6407 if you or your staff have any questions concerning the report.

Sincerely yours,

Jennie S. Stathis

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