

**The Oversight Board Has Achieved  
Much of Its Original Intent, but There Are  
Opportunities for Increased Effectiveness**

**September 2004**

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DEPARTMENT OF THE TREASURY  
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INSPECTOR GENERAL  
for TAX  
ADMINISTRATION

September 30, 2004

MEMORANDUM FOR CHAIRPERSON, INTERNAL REVENUE SERVICE OVERSIGHT BOARD

*Gordon C. Milbourn III*

FROM: Gordon C. Milbourn III  
Acting Deputy Inspector General for Audit

SUBJECT: Final Audit Report - The Oversight Board Has Achieved Much of Its Original Intent, but There Are Opportunities for Increased Effectiveness (Audit # 200310036)

This report presents the results of our review to evaluate the Internal Revenue Service (IRS) Oversight Board's effectiveness in fulfilling its responsibilities as required by the IRS Restructuring and Reform Act of 1998 (RRA 98).<sup>1</sup> The RRA 98 provides the Treasury Inspector General for Tax Administration (TIGTA) the authority to conduct audits and investigations of the IRS Oversight Board. This audit was conducted as part of our Fiscal Year (FY) 2004 Annual Audit Plan.

In summary, many stakeholders indicate the Oversight Board has improved IRS governance in line with the intent of the RRA 98; however, some stakeholders were concerned that the same issues are brought to the Board's attention each year with no apparent action taken for resolution. A strategy for identifying, prioritizing, and intervening on key issues is needed. Moreover, in line with the best practices of corporate boards, the Board needs a process to perform annual self-assessments which would include assessing and communicating its impact on tax administration.

Some IRS officials expressed concerns about duplicate oversight and the potential for conflicts of interest. While we believe there are sufficient controls to minimize the potential for conflicts of interest, there could be a significant benefit to increased coordination between the Board and other IRS oversight bodies to avoid duplicate or excessive requests for information.

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<sup>1</sup> Pub. L. No. 105-206, 112 Stat. 685 (codified as amended in scattered sections of 2 U.S.C., 5 U.S.C. app., 16 U.S.C., 19 U.S.C., 22 U.S.C., 23 U.S.C., 26 U.S.C., 31 U.S.C., 38 U.S.C., and 49 U.S.C.).

To ensure the budget adequately supports the IRS strategic priorities, the Board must approve the IRS budget before it is submitted to the Department of the Treasury. Notwithstanding, Oversight Board members are concerned that the Board has not had enough influence in the budget process. The IRS budgets submitted by the President and those passed by the Congress have been significantly less than those submitted by the Board. Congressional committee staffs indicated that the Board would be well-served to ensure the Board's budget contains enough detail to support recommendations for increases and also to ensure equal focus is maintained on achieving savings and efficiencies.

One important reason the Board was created was to oversee the modernization of the IRS' information systems. There are indications that better oversight of Business Systems Modernization (BSM) efforts by the Board was needed earlier in the process. The progress of IRS systems modernization is significantly behind schedule and over budget. Many of the recommendations made by the Board in December 2003 were made much earlier through independent assessment by the Government Accountability Office (GAO)<sup>2</sup> and the TIGTA. Better coordination and use of these sources of independent data would have helped the Board develop a more effective oversight strategy.

Universally, Oversight Board members were concerned about lengthy vacancies on the Board because they create a tremendous amount of work for other Board members and reduce the collective business expertise which can be provided by the Board. For most of its history, the Board has had one or two vacancies. A proposed measure designed to avoid prolonged vacancies has been included in new legislation which is now under consideration.<sup>3</sup> If the legislation is enacted, an automatic extension of a Board member's term for up to 1 year would be granted if a successor is not timely confirmed. However, its success would depend on existing Board members' willingness to continue to serve past their terms.

Finally, in line with corporate best practices, the Oversight Board needs to clearly define Board procedures and practices to govern the manner in which it conducts its oversight and documents formal Board decisions. Additionally, because there will be significant turnover on the Board within the next 2 years, the Board needs a defined system to educate and assist new members on IRS operations and issues.

We recommended the Board formalize its process to strategically focus its efforts on the most significant issues facing the IRS, adopt a process for evaluating its effectiveness and impact on tax administration, and include its self-assessment in its annual report to the Congress or other appropriate public document. Additionally, the Board should define practices for coordinating with IRS executives and other oversight bodies to avoid duplicate requests for information. The Board should also develop policies and procedures to evaluate the IRS' efforts and results in achieving savings and efficiencies to be detailed in its budget submission. The Board should make timely use of

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<sup>2</sup> Formerly the General Accounting Office.

<sup>3</sup> Tax Administration Good Government Act – H.R. 1528 108<sup>th</sup> Cong. § 127 (2004).

independent assessments of the IRS' modernization and other programs. Further, we recommended that the Board establish guidance to specify which circumstances will require a formal resolution and establish a process to formally vote and publish resolutions. A system to educate new Board members on IRS operations and strategic issues should also be defined.

Management's Response: In general, the Board agreed with all of our recommendations. The Board agreed that it can more sharply focus on key issues facing the IRS, intervention should be used in unusual circumstances, self-assessments would be useful, it can better coordinate how it gathers information from the IRS, and it will hold more frequent meetings with the GAO and the TIGTA, if requested. The Board will place more emphasis on evaluating the extent to which IRS savings and efficiencies previously estimated were actually achieved and ask the IRS to document ways in which it can be more efficient. The Board agreed with the need to make use of independent assessments of the IRS' modernization and other programs to develop an effective oversight strategy. The Board agreed with the need for documenting its procedures and votes on significant issues; however, it noted that there are circumstances involving sensitive issues that might not be appropriate to publish. Lastly, the Board is developing a more formal process to educate new members in Board and IRS governance issues and will continue to refine this effort with the guidance of new members.

Notwithstanding, the Board did note some general and specific concerns about the report. The Board believes the report overstates its authority and responsibility related to the management of the IRS. It believes the Board's purpose is to oversee strategic issues, not to delve into day-to-day IRS operational functions. Moreover, it believes the very nature of the Federal Government budget process, in which the President proposes and the legislative branch approves and appropriates funds, limits the Board's ability to influence the organization. The Board does not want to publicly report the results of its self-assessments and noted that corporate boards normally do not publicly report the results of their evaluations because such reports would compromise the honesty and effectiveness of the evaluation process. The Board believes its effectiveness must be measured by how well the IRS performs given its operating environment and resources.

The Board also expressed concern about the report's portrayal of its position on funding for the BSM program. The Board believes the BSM program should be accomplished as quickly as possible, but at the same time it believes funds should not be spent beyond the capacity of the IRS and its contractor to manage the BSM program. The Board stated that its emphasis has been on the importance of multiyear funding. It is concerned that, to this day, the multiyear fund has not been restored to its original intent, creating inefficiencies every time the fund approaches a zero balance. The Board's complete response to the draft report is included as Appendix XII.

Office of Audit Comment: We believe our recommendations are oriented to the Board's strategic role and focus and are in line with the Board's authority and responsibility related to the management of the IRS. We further believe the Board can implement the

recommendations without getting involved in the day-to-day operations of the IRS. It is well within the Board's authority to ensure the IRS has strategies to address important issues and is accountable for effectively implementing those strategies. Furthermore, while the Board is generally in agreement that there are times when intervention by the Board is appropriate, we believe the circumstances that warrant intervention by the Board are more frequent than indicated by the Board's response. We believe the Board should adopt such a strategy where needed, rather than waiting for unusual circumstances.

We are concerned with the Board's reluctance to provide an assessment of its impact on tax administration to the Congress and the public. Such an assessment would not only be helpful to the Congress and the public in understanding the Board's impact but would also help the Board gauge and improve its effectiveness. While we agree that IRS successes and shortcomings may be reflective of the Board's oversight, it is difficult to distinguish the Board's role without an adequate self-assessment. Unfortunately, many ineffective corporate boards have been identified only after significant corporate failure. As such, we believe a more transparent assessment would be a better model to follow for a public entity responsible for overseeing the administration of the nation's tax laws. Moreover, the Board is an entity of the Federal Government. Like all Federal Government functions, it too is accountable to the public and its stakeholders. Many people with whom we spoke in the course of this audit inquired about the Board's worth. We believe an honest and public appraisal of the Board's contribution to tax administration is a reasonable expectation.

Notwithstanding the Board's assertions related to the importance of multiyear funding for the BSM program, the Board's funding requests exceeded the IRS' capacity to manage and implement the program. The \$1 billion recommended in the Board's 2001 testimony (which included \$450 million for FY 2002 and \$550 million for FY 2003) was far more than the IRS could effectively manage. We do not believe the Board provided adequate fiscal oversight or accountability to the BSM effort. We are concerned that the Board's focus on increased funding, rather than an effective oversight strategy early on in the process, has limited its impact in this area. As such, many of the same issues and problems are noted in the Board's annual report year after year.

Copies of this report are also being sent to the Congressional committees charged with overseeing the IRS. Please contact me at (202) 622-6510 if you have questions or Daniel R. Devlin, Assistant Inspector General for Audit (Headquarters Operations and Exempt Organizations Programs), at (202) 622-8500.

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but There Are Opportunities for Increased Effectiveness**

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### Background

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In 1996, the National Commission on Restructuring the Internal Revenue Service (IRS) was created to examine and make specific recommendations to address a number of widely acknowledged problems at the IRS. These problems included an outdated management and governance structure, inadequate accountability, lack of responsiveness, and failure to modernize its information systems. In 1997, the Commission issued its report entitled, *A Vision for a New IRS*, with recommendations to help transform the IRS into an efficient, modern, and responsive agency.

One of the primary concerns of the Commission was that the oversight structure did not allow the IRS to set and maintain consistent long-term strategies and priorities. The Commission noted the following contributing factors which hindered the IRS in achieving organizational success:

- Congressional oversight of the IRS was distributed among seven committees.
- The average length of time an IRS Commissioner served was less than 3 years.
- Department of the Treasury officials concentrated more on tax policy than tax administration.
- The IRS budget varied significantly from year to year, which made it difficult to fulfill strategic priorities.

To provide the IRS the management stability needed to develop and implement long-term strategies and priorities, the Commission made a number of recommendations. One key recommendation was to establish a Board of Directors to oversee the IRS in its administration, management, conduct, direction, and supervision of the execution and application of the tax laws.

On July 22, 1998, the President signed into law the IRS Restructuring and Reform Act of 1998 (RRA 98).<sup>1</sup> This law mandated a sweeping reorganization of the IRS and incorporated many of the recommendations of the Commission. One provision of the law was to create the

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<sup>1</sup> Pub. L. No. 105-206, 112 Stat. 685 (codified as amended in scattered sections of 2 U.S.C., 5 U.S.C. app., 16 U.S.C., 19 U.S.C., 22 U.S.C., 23 U.S.C., 26 U.S.C., 31 U.S.C., 38 U.S.C., and 49 U.S.C.).



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IRS Oversight Board. The RRA 98 provides the IRS Oversight Board with the responsibility to oversee the IRS in its administration, management, conduct, direction, and supervision of the execution and application of the internal revenue laws or related statutes to which the United States is a party.

The RRA 98 specifies that the Oversight Board is to be composed of nine members, including the Secretary (or Deputy Secretary) of the Treasury and the IRS Commissioner. The seven other members are appointed by the President, with the advice and consent of the Senate, for 5-year terms. One of these members must be an individual who is a full-time Federal Government employee or a representative of employees. Six members must be individuals who are not otherwise Federal Government officers or employees. They should be appointed, without regard to political affiliation, solely on the basis of their professional experience and expertise in one or more of the following areas:

- Management of large service organizations.
- Customer service.
- Federal tax laws, including administration and compliance.
- Information technology.
- Organization development.
- The needs and concerns of taxpayers.
- The needs and concerns of small businesses.

The private-life members of the Board are paid \$30,000 per year, except for the chairperson (who is elected by the rest of the Board) who is paid \$50,000 per year. The Board is also authorized to appoint staff and as of August 2004 had four staff members assisting it in its duties. The Board also has the ability to contract for temporary or intermittent services if needed. The Board's operating budget of approximately \$2 million per year comes from the IRS budget through an interagency agreement. Any unused funds are returned to the IRS. The IRS Oversight Board began its operations in September 2000.

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Organizational governance and oversight has been a significant concern to the Congress over the last few years, first with corporate governance and recently with the oversight of the United States intelligence and law enforcement agencies. There is a renewed interest in the standards to which oversight bodies, and the individuals serving on them, should be held. The Congress passed the Sarbanes-Oxley Act of 2002<sup>2</sup> to address problems of corporate governance by instituting controls and raising the level of accountability.

The RRA 98 provides the Treasury Inspector General for Tax Administration (TIGTA) the authority to conduct audits and investigations of the IRS Oversight Board. This audit was performed at the IRS National Headquarters and the IRS Oversight Board office in Washington, D.C., during the period September 2003 through August 2004. We interviewed members and staff of selected Congressional committees or subcommittees, the cochair of the National Commission on Restructuring the IRS, Oversight Board members and several former Board members, the IRS Commissioner and two former Commissioners, as well as IRS senior executives and tax practitioner groups. The audit was conducted in accordance with *Government Auditing Standards*. Detailed information on our audit objective, scope, and methodology is presented in Appendix I. Major contributors to the report are listed in Appendix II.

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### The Oversight Board Has Significant Responsibility and Authority

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The RRA 98 provided the IRS Oversight Board far more authority than advisory boards such as the Social Security Advisory Board. An advisory board is responsible for advising the head of the agency and can make recommendations on issues but does not have authority to compel action on its recommendations. In contrast, the IRS Oversight Board has the authority and responsibility to be directly involved in the management, direction, strategy, and long-term operation of the IRS. The Board was specifically granted review and approval authority for strategic plans (including the establishment of mission and objectives, standards of performance, and annual and long-range plans), the Commissioner's plans for any major

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<sup>2</sup> Pub. L. No. 107-204, 116 Stat. 745 (2002).

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reorganization of the IRS, and the IRS budget request submitted by the Commissioner (see Appendix V). With respect to those matters over which the Board has approval authority, the Board's decisions are determinative.

In addition, the Board was given the responsibility to review, but not to approve, the following:

- Operational plans and functions of the IRS including modernization of the tax system, outsourcing or managed competition, and training and education.
- The Commissioner's selection, evaluation, and compensation of IRS senior executives who have program management responsibility over significant functions of the IRS.

The Board also has the responsibility to recommend to the President candidates for appointment as the IRS Commissioner and, if it believes necessary, to recommend to the President the removal of the Commissioner.

The IRS Oversight Board's structure is similar to that of a corporate board of directors, with part-time members who have full-time jobs in the private sector. There are Federal Government boards with similar or broader authorities than those of the IRS Oversight Board, such as the United States Postal Service Board of Governors. A comparison of the authorities of the United States Postal Service Board of Governors and Social Security Advisory Board with those of the IRS Oversight Board is shown in Appendix IV.

### **IRS Oversight Board committees**

Corporate boards of directors generally set up committees of specific board members to oversee specific areas. The IRS Oversight Board also follows this practice. It set up three committees for specific oversight activities.<sup>3</sup> Each committee is composed of three Board members. The committees are:

**Business Transformation Committee** – Oversees the modernization of the IRS' information systems. It reviews the progress of the modernization effort to evaluate whether

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<sup>3</sup> See Appendix VI for details about the Oversight Board committees.

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the IRS is meeting its strategic and operational goals and objectives in this area.

**Human Capital Committee** – Reviews performance evaluations and compensation of certain IRS senior executives, the use of critical pay to recruit for high-level positions requiring special skills, staffing issues, and training.

**Performance Management Committee** – Monitors the IRS' progress in meeting its strategic and operational goals and objectives. It conducts quarterly performance reviews on the four IRS operating divisions, as well as the Modernization and Information Technology Services organization, and biannual reviews of the Offices of Appeals, Chief Human Capital Officer, and Agency-Wide Shared Services.

### **Limitations on the Oversight Board's authority**

With Board members from the private sector overseeing the operations of a tax enforcement agency, there is the potential for conflicts of interest. To alleviate this potential, the RRA 98 places certain restrictions on the Board's authority.

Because of the sensitive nature of tax information, disclosure of tax information to any member of the Oversight Board, or to any employee or detailee of the Board, is prohibited. Any request for information not permitted to be disclosed and any contact relating to a specific taxpayer, made by any such individual to an officer or employee of the IRS, must be reported by such officer or employee to the Secretary of the Treasury, the TIGTA, and the Joint Committee on Taxation.

Further, the Board has no responsibility or authority with respect to specific law enforcement activities of the IRS, including specific compliance activities such as examinations, collection activities, and criminal investigations.

The RRA 98 also provides that the Board has no responsibility or authority on tax policy, specific procurement activities of the IRS, or specific personnel actions other than the selection, evaluation, and

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compensation of IRS senior executives who have program management responsibility over significant functions of the IRS.

### **Responsibilities to review the selection and performance of senior executives**

One of the most important powers of a corporate board in holding executives accountable for performance is the power to select and remove a corporation's top executives as well as to set their compensation. The Oversight Board does not have such authority; it only has the responsibility to review and recommend in this area. The Human Capital Committee<sup>4</sup> reviews senior IRS executives' performance evaluations and proposed bonuses and makes recommendations to the Commissioner based on these reviews. The number of executives subject to this review can change and is limited to those who have program management responsibility over significant functions of the IRS. In Fiscal Year (FY) 2004, the Board concluded that only 18 of the 285 executive positions met the review criteria. The 18 include both Deputy Commissioners, as well as the heads of the operating divisions and major business units and selected modernization positions.

Additionally, the IRS informs the Board of any impending vacancies in these designated senior executive positions and consults with the Board regarding any proposed plans to fill these vacancies. After the Commissioner has made a selection, the IRS submits information about the individual to the Board. The Board reviews the selection and informs the Commissioner of the results of its review. The Board does not, however, have the power to bar the Commissioner from selecting whomever he or she chooses. The Board also reviews the IRS' Streamlined Critical Pay authority program but does not evaluate each critical pay position.<sup>5</sup>

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<sup>4</sup> See Appendix VI for more details about the Human Capital Committee.

<sup>5</sup> The IRS is authorized to hire and have on the rolls 40 individuals with unique skills not readily available in the Federal Government workforce. These individuals are hired for a term of up to 4 years and are eligible for pay up to the amount of the United States Vice President's salary.

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### Many Stakeholders Indicate the Oversight Board Has Improved Internal Revenue Service Governance

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There is proposed legislation currently under consideration which would provide the Board more authority in this area. The legislation requires that the Oversight Board approve the IRS Commissioner's selection, evaluation, and compensation of senior executives. This would be much more in line with the authorities of corporate boards in holding senior management accountable for achieving results. Corporate best practices indicate that pay should be strongly linked to performance and that independent board members are in the best position to objectively evaluate the reasonableness of the compensation based upon executive performance.<sup>6</sup>

Universally, IRS officials and stakeholders we interviewed shared the view that the Board members are dedicated and hard-working individuals who devote a great deal of time and effort to providing oversight to the IRS. Board members attend bimonthly meetings and spend additional time on IRS Oversight Board committees as well as consulting with IRS executives. Board members also travel to meet with and discuss the concerns of IRS employees and tax practitioners.

Stakeholders also provided examples of the benefits of the Board as a new element of governance to the IRS. The creation of the Board put people with expertise important to tax administration, such as information technology, management, customer service, organizational development, and reorganization, in a position to provide effective oversight, guidance, and strategic direction to the IRS. Stakeholders also stated that the Board has made senior IRS management more accountable for implementing its strategic plan than it has been in the past.

IRS officials and external stakeholders believe one of the most important roles of the Board has been to provide continuity to the management of the IRS. When the former Commissioner completed his 5-year term and the current Commissioner was appointed, the Board was in a position to ensure the strategic initiatives and priorities were understood and maintained. The continuity provided by the

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<sup>6</sup> Business Roundtable Guide entitled, *Executive Compensation: Principles and Commentary* (November 2003).

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Board protects against unwarranted shifts in direction or operation.

Additionally, several of the IRS stakeholder groups have complimented the Board for soliciting the stakeholders' concerns. The private-life Board members hold a public meeting annually to seek input on various tax-related issues.<sup>7</sup> Fifteen stakeholder groups made presentations at the last meeting, held in January 2004. During that meeting, the Board received specific concerns or suggestions for improvements within the IRS. Board members also attend the annual IRS Tax Forums to speak to tax professionals and IRS employees.

IRS officials stated that the opportunity to consult with individual Board members on issues and plans has been valuable because of the Board members' experience and expertise. IRS officials also stated that the Board has been active in the strategic planning and budgeting process and has helped the IRS to develop a process intended to provide realistic budget allocations needed to support the IRS strategic and annual plans. As the IRS developed its 5-year strategic plan in early 2004, the Board reviewed the draft plan and provided comments and suggestions to the Commissioner and his staff.

Over the last 3 years, the Oversight Board has also conducted an annual survey of taxpayers to determine their attitudes toward the IRS and complying with the tax laws. Information from these surveys has been used by the Board and others to focus attention on the need for the IRS to balance its resources and attention among its compliance, customer service, and modernization efforts.

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### **Some Stakeholders Believe the Oversight Board Needs to Do More to Positively Affect Tax Administration**

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While stakeholder groups were appreciative of the Board's openness and willingness to discuss concerns with IRS operations, some were concerned that the same issues are brought to the Board's attention each year with no apparent action taken to remedy them. Without an effective strategy for addressing these concerns, the opportunity to contribute to their resolution is diminished.

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<sup>7</sup> The Secretary of the Treasury (or Designee) and the IRS Commissioner do not attend these sessions. They believe their presence could inhibit the free flow of ideas from the presenters to the Board.

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Moreover, some stakeholders expressed the concern that the IRS does not need another advisory group, and, if “providing advice” becomes the Board’s primary mission, there is no need for the Board. There was additional concern by certain former Federal Government officials that, if the Board reaches the point at which people are not taking it seriously, the existence of the Board could be viewed as a negative rather than a positive. Board members could be perceived as meddling and consuming a lot of time with no productive result.

The Board creates an annual plan for each upcoming year, and by law the Board must cover certain topics such as computer modernization and the budget. Nonetheless, it does not have a strategy for prioritizing and addressing operational issues. Examples of potential sources of issues that could be considered when setting the annual plan are the President’s Management Agenda, major management challenges identified by the Government Accountability Office (GAO)<sup>8</sup> and the TIGTA, and the annual IRS National Taxpayer Advocate’s report. Whatever source is used, the Board needs a formal process to ensure it is focused on the most significant issues facing the IRS.

In addition to a strategic plan to identify key issues, the Board needs a strategy for intervention. The intervention strategy should include such matters as determining who should be engaged, designing remediation actions, determining the types and sources of information needed, and developing performance and reporting responsibilities of IRS officials, timelines, and standards to measure accomplishments.

The Oversight Board’s recent comprehensive efforts to address the training shortcomings of the IRS constitute a good model to follow. The training project involves many of these components, including working with the IRS Chief Human Capital Officer and top officials in the IRS operating divisions and business units, the TIGTA, and potentially, external consultants. Over time, it is expected to bring attention and accountability to this pressing matter. The oversight plan under consideration will closely follow the

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<sup>8</sup> Formerly the General Accounting Office.



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GAO's guidelines,<sup>9</sup> will assess the adequacy of training and professional development, and will include clear expectations for operating divisions and business units to follow in documenting their training investment and results. The expected protocol will also call for routine presentations to the Board and will draw from related GAO and TIGTA audit work on the subject.

### **Board self-assessments**

The June 2003 Business Roundtable Corporate Governance survey states, "The performance of the full corporate board should be evaluated annually, as should the performance of its committees. The board should conduct periodic, generally annually, self-evaluations to determine whether it and its committees are following the procedures necessary to function effectively."

The Oversight Board conducted a self-assessment during 2002. The assessment included recommendations the Board members or staff believed should be adopted to improve the effectiveness of the Board. However, the self-assessment was performed only once. The Board does not have any procedures or proposed procedures requiring that it routinely conduct self-assessments. These self-assessments should include what impact the Board has had on improving the operations of the IRS and what issues it has communicated to IRS stakeholders and oversight bodies. The need to assess the Oversight Board's contribution and impact was evident in the reaction from stakeholders to our questions on the topic. When asked, most stakeholders volunteered that the Oversight Board has been beneficial to the IRS, but few could point to any specific ways in which the IRS had changed as a result of the Board's efforts.

The IRS Oversight Board should develop these procedures and detail how the assessments should be performed and how the results will be used. The Board should also determine which measures to use to evaluate its impact on tax administration to enhance the usefulness of these assessments. In addition, the Board should include its

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<sup>9</sup> *A Guide for Assessing Strategic Training and Development Efforts in the Federal Government* (GAO-03-893, dated July 2003).

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impact on tax administration in its annual report to the Congress or other public document.

### **Communication of issues**

The communication between the Board and other oversight bodies, such as the seven Congressional committees responsible for oversight, varied significantly over the first few years of the Board's operation. Some Congressional committee members and staffs believed the contact and information from the Board was adequate and helpful; however, there was some concern from Congressional committee staffs as well as the Board members themselves that contact between the Board and the Committees had been too infrequent. Committee staffs were concerned that the Oversight Board was not doing enough to make its work known, either to the Congress or the public.

Since the Board's formation, it has continued to take steps to improve its communication. It contracted with a media specialist, created a public web site, and is working to formally define its overall strategy to effectively disseminate the issues and findings it has developed to all the appropriate IRS stakeholder groups. Additionally, Board members advised us that they are beginning to contact Congressional oversight committees after every bimonthly Board meeting to discuss oversight issues.

### **Recommendations**

The Oversight Board should:

1. Formalize its process to strategically focus its efforts on the most significant issues facing the IRS. This should include developing intervention strategies when appropriate.

Management's Response: The Board agreed that it could sharpen the focus of its efforts on key strategic issues. Where possible, the Board prefers to establish desired outcomes that it wants the IRS to achieve rather than to prescribe activities the IRS must perform. The Board also prefers to limit intervention to unusual circumstances.

Office of Audit Comment: While we recognize the Board's general agreement with this recommendation, we believe

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the circumstances that warrant intervention by the Board are more frequent than indicated by the Board's response. We believe the Board should adopt such a strategy where needed, rather than waiting for unusual circumstances.

2. Adopt a formal process for evaluating the Board's effectiveness and its impact on tax administration. In addition, the Board should include its impact on tax administration in its annual report to the Congress or some other formal document that would be publicly released.

Management's Response: The Board agreed that a formal self-assessment is valuable and intends to conduct another assessment before the end of 2004. However, the Board does not want to publicly report the results of its self-assessment. It noted that corporate boards normally do not publicly report the results of their evaluations because such reports would compromise the honesty and effectiveness of the evaluation process. The Board believes its effectiveness must be measured by how well the IRS performs given its operating environment and resources.

Office of Audit Comment: We are concerned with the Board's reluctance to provide an assessment of its impact on tax administration to the Congress and the public. Such an assessment would not only be helpful to the Congress and the public in understanding the Board's impact but would also help the Board gauge and improve its effectiveness. While we agree that IRS successes and shortcomings may be reflective of the Board's oversight, it is difficult to distinguish the Board's role without an adequate self-assessment. Unfortunately, many ineffective corporate boards have been identified only after significant corporate failure. As such, we believe a more transparent assessment would be a better model to follow for a public entity responsible for overseeing the administration of the nation's tax laws. Moreover, the Board is an entity of the Federal Government. Like all Federal Government functions, it too is accountable to the public and its stakeholders. Many people with whom we spoke in the course of this audit inquired about the Board's worth. We believe an honest and public appraisal of the Board's contribution to tax administration is a reasonable expectation.

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### **Some Internal Revenue Service Officials Expressed Concerns About Duplicate Oversight and the Potential for Conflicts of Interest**

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While the Oversight Board's powers are significant, the legislation which created it did not reduce the authority of other oversight bodies. One former IRS official noted that the Federal Government is intended to be divided powers and there is no more extreme case of it than the IRS, which is subject to the review of seven Congressional Committees (including small business), the GAO, the Department of the Treasury, the Office of Management and Budget (OMB), the TIGTA, and others. Unlike a corporate board, the Oversight Board is not the only governance body. In its 2001 annual report to the Congress, the Oversight Board noted, "Oversight organizations must rationalize their roles to the extent possible and eliminate unnecessary overlap, leverage assets to advise in a more effective manner; and recognize that quality cannot be achieved by repetitious, and at times, inefficient inspection."

However, some IRS officials we interviewed expressed concerns that the Board did not adequately coordinate with other oversight bodies and spent too much time and energy delving into operational issues instead of focusing on strategic issues. They indicated that the level of detail required by the Board was using too much of some IRS executives' time and that requests for information by Board members confuse the lines of authority between the Commissioner and his staff and diffuse accountability.

Board members acknowledged these concerns; however, they stated that a sound knowledge of IRS operations was needed to provide adequate strategic direction. The Board has the responsibility to provide its collective professional management expertise to the IRS; it has the charge to oversee the IRS in its administration, management, conduct, direction, and supervision of the execution and application of the internal revenue laws. Board members further explained that the types of requests for information made by the Oversight Board did not materially differ from requests made by private boards. Notwithstanding, Board members did agree that voluntary coordination among oversight functions could provide a significant benefit to oversight and reduce the time and resources needed to obtain necessary information.

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### **Oversight of enforcement activities**

In line with its responsibilities, the IRS Oversight Board has monitored many aspects of the IRS' enforcement and compliance efforts. The minutes of Board meetings show the Board addressed compliance activities including the following: compliance measurement, examination coverage, corporate tax shelters, contracting out collection, the Earned Income Tax Credit precertification program, Offers in Compromise, Form K-1<sup>10</sup> matching program, National Customer Research Study, activities of the Criminal Investigation function, and overseas credit cards.

However, certain IRS officials expressed concerns that, for the private-life Board members, there are inherent conflicts of interest in providing oversight to enforcement activities because of the potential to act on behalf of their own or associates' business interests. Moreover, because the RRA 98 prohibits the Board's involvement in specific enforcement activities, the IRS officials believe the Board should refrain from any oversight or involvement in evaluating IRS enforcement and compliance activities. They pointed out that other law enforcement agencies, to avoid potential conflicts of interest, have only advisory boards.

In addition, IRS officials expressed concern that the Board's responsibility to review and provide input on the selection and compensation of IRS executives could affect IRS executives' decisions related to Board members and their associates' businesses on tax matters. They believe new proposed legislation to provide the Board approval authority over the selection and compensation of certain IRS executives would increase the potential for influence.

These concerns are serious and fundamentally tie to the intent and interpretation of the legislation that established the Board. It is clear from the legislative history that the Congress intended (1) for the Board to provide oversight of enforcement and compliance activity and (2) to exclude the Board from any involvement in specific taxpayer cases only. The Joint Explanatory Statement of the Committee of

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<sup>10</sup> Form 1065 Schedule K-1, Partner's Share of Income, Credits, Deductions, etc.

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Conference states, “This provision is not intended to limit the Board’s authority with respect to review and approval of strategic plans and the budget of the Commissioner or to preclude the Board from review of IRS operations generally.”<sup>11</sup>

The Senate Amendment provided that the Board had no authority (1) to intervene in specific taxpayer cases, including compliance activities involving specific taxpayers such as criminal investigations, examinations, and collection activities, and (2) to intervene in specific personnel matters. The Senate Amendment further provided that the Board does have authority with respect to general law enforcement matters, and it has the responsibility to ensure the organization and operation of the IRS allows it to carry out its mission.<sup>12</sup>

Moreover, the risk that the Board’s authorities over the selection and compensation of executives could influence IRS executives’ decisions related to Board members or their associates’ businesses is no greater than the possibility that the Commissioner, IRS officials, Department of the Treasury officials, or members of the Congress could exert the same influence based upon present or past associations.

Further, within the IRS, there are procedures to help prevent such influence. The private-life members are subjected to the same vetting and review process as are the Secretary of the Treasury and the IRS Commissioner before appointment to their positions; they are also subject to removal at the will of the President. Private-life members must also file a public financial disclosure statement, are subject to restrictions on postemployment, and are treated as special Federal Government employees during their terms on the Board.<sup>13</sup> As such, they are subject to ethical rules applicable to special Federal Government employees who serve more than 60 days during any 365-day period. For example, private-life members of the Board may not represent clients before the IRS, Department of the Treasury, or Tax Court

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<sup>11</sup> H.R. Conf. Rep. No. 105-599, at 196 (1998).

<sup>12</sup> H.R. Conf. Rep., *supra* at 199.

<sup>13</sup> I.R.C. § 7802(b)(3) (1998).

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on matters involving certain parties during their terms as Board members.

Further, disclosure of tax information to any member of the Oversight Board, or to any employee or detailee of the Board, is prohibited. Any request for information not permitted to be disclosed and any contact relating to a specific taxpayer, made by any such individual to an officer or employee of the IRS, must be reported by such officer or employee to the Secretary of the Treasury, the TIGTA, and the Joint Committee on Taxation. Additionally, supervisory reviews and the separation of duties across IRS operations help prevent improper influence on tax matters without significant collusion on the part of IRS officials.

Based on the intent of a board to ensure accountability of the organization through its senior executives, the proposed legislation to provide the Oversight Board approval authority over the selection and compensation of certain IRS executives would be in line with a board's normal authority. Corporate board staff members we interviewed indicated this is an important authority and that, without this authority, a corporate board would have minimal power to hold executives accountable.

### **Recommendation**

3. The Oversight Board should define practices for coordinating with IRS executives and other oversight bodies to avoid duplicate requests for information. This could include direct access to IRS information systems, when permissible, to minimize requests for information from IRS operating components.

Management's Response: The Board agreed with this recommendation and, where appropriate, supports the idea of direct access to IRS information. The Board will work with the IRS to determine the appropriate measures and review cycles to minimize information collection activities. Additionally, the Board will continue to seek information from outside stakeholders and will meet with the GAO and TIGTA more often, if requested.

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**Oversight Board Members Are Concerned That the Board Has Not Been Influential in the Internal Revenue Service Budget Process**

To ensure the budget adequately supports the IRS strategic priorities, the Oversight Board must approve the IRS budget before it is submitted to the Department of the Treasury. However, because the Department of the Treasury and the OMB make revisions to the IRS budget in formulating the President’s budget request, the RRA 98 requires the President to submit the Board’s request to the Congress without revisions, along with the President’s annual budget request for the IRS. This provision is intended to ensure the Congress may consider the Board’s submission in its own budget deliberations.

It is difficult to assess whether the Board’s involvement in the budget process has had an effect on the budget passed by the Congress. The IRS budgets submitted by the President and those passed by the Congress have been significantly less than those submitted by the Board. The budgets approved by the Board and those passed by the Congress are shown in Table 1.

**Table 1: IRS Budget Amounts Requested and Approved –  
FYs 2002 through 2005 (amounts are in billions)**

Fiscal Year	Amount Requested by:		Amount Approved by the Congress
	Oversight Board	President	
2002	\$10.260	\$9.422	\$9.437
2003	\$10.056	\$9.916	\$9.835
2004	\$10.724	\$10.437	\$10.185
2005	\$11.204	\$10.674	<i>Pending</i>

*Source: The President’s Budgets and Congressional Testimony.*

A concern of Board members is that the OMB has not been receptive to discussions with the Board when formulating the President’s budget. Additionally, the OMB includes the budget submitted by the Oversight Board as only a footnote to the President’s budget. Although the IRS Commissioner and the Secretary of the Treasury are members of the Board, they must support the budget request of the President. To help ensure the budget submitted by the Oversight Board is not constrained by this, recently proposed legislation would change the budget process so private-life members of the Board would submit the Board’s recommended budget without prior review or approval of the IRS Commissioner,



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the Secretary of the Treasury or other employees of the Department of the Treasury, and the OMB.

The Board's focus on the importance of its budget request is due in large part to the significant declines in the numbers of IRS enforcement employees and the effect these reductions have had on compliance and tax revenue. Collection and Examination function enforcement staffing combined declined from around 25,000 at the beginning of FY 1996 to around 16,000 at the end of FY 2003, a 36 percent decrease. The IRS' gross accounts receivable is approximately \$280 billion; however, revenue collected as the result of enforcement has only recently begun to return to its FY 1996 level of \$38 billion.

In each of its four annual budget requests, the Board routinely requested additional funding for compliance efforts. Since his confirmation in May 2003, the new Commissioner has advocated a significant increase in enforcement activities and personnel to strengthen enforcement of the tax laws, and the Board has supported these efforts. In its last budget request, the Board cited a tax gap of \$311 billion<sup>14</sup> and requested funding for an additional 3,315 Full-Time Equivalents (FTE)<sup>15</sup> in FY 2005 to boost compliance efforts. The original proposed hiring plan for FY 2005 was greater; however, the Board advised IRS executives that the original hiring plan be changed to allow increases to happen over a longer period to ensure enforcement staff are not hired at a rate faster than that at which they can be trained and assimilated.

Certain members of the Congress stated that the Board's requests were beneficial to the budget deliberations and did result in a higher budget than otherwise would have been passed. However, there was also some concern by Congressional committee staff members that the Board's requests for additional funding were not adequately justified. Proposed legislation requires that the Board's

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<sup>14</sup> The tax gap is the difference between what taxpayers are supposed to pay and what is actually paid.

<sup>15</sup> An FTE is a measure of labor hours in which 1 FTE is equal to 8 hours multiplied by the number of compensable days in a particular fiscal year. For FY 2004, 1 FTE is equal to 2,096 hours. For FY 2005, 1 FTE will be equal to 2,088 hours.

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budget submission be detailed and contain analysis to support the Board's recommendations. Congressional committee staffs were also concerned that the Board focused too much on increasing the IRS budget and not enough on holding the IRS accountable for using its resources economically.

Recent testimony provided by the Director of Tax Issues for the GAO<sup>16</sup> noted that the IRS has been unable to increase its enforcement staff because other priorities, including unbudgeted expenses and taxpayer service, have consumed budget increases and internally generated savings. Moreover, in the past, the IRS has been unable to realize all the projected savings (from operational efficiencies such as program reorganizations and consolidations) which were anticipated to help fund enforcement staffing increases.

### Recommendation

4. The Oversight Board should develop policies and procedures to evaluate the IRS' efforts and results in achieving savings and efficiencies. These efforts should be detailed in the Board's IRS budget submission.

Management's Response: The Board agreed that it is appropriate to place more emphasis on achieving savings and efficiencies and asking the IRS to document ways in which it can be more efficient. The Board also stated that the IRS' estimated savings should be evaluated after the fact to determine whether the estimated savings were achieved. Additionally, the Board will use the GAO's annual audit of the IRS and the GAO's assessment of how realistic IRS savings estimates are.

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### Better Oversight of Business Systems Modernization Was Needed Earlier in the Process

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One important reason the Oversight Board was created was to oversee the modernization of the IRS' information systems. It was expected that the Board would provide focus, expertise, and continuity to the IRS' modernization efforts. The IRS was dependent on obsolete computer systems which reduced the efficiency and effectiveness of tax administration. The IRS had spent approximately

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<sup>16</sup> *Assessment of Fiscal Year 2005 Budget Request and 2004 Filing Season Performance* (GAO-04-560T, dated March 2004).

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\$4 billion over several years on its Tax System Modernization project; however, the efforts to modernize its outmoded and inefficient systems were largely unsuccessful.<sup>17</sup> The IRS began a new modernization effort known as Business Systems Modernization (BSM) in 1998. An essential element of this effort is the Customer Account Data Engine, which is expected to provide a modern system for storing, managing, and accessing taxpayer accounts.<sup>18</sup>

The Oversight Board created the Business Transformation Committee<sup>19</sup> to monitor the IRS' modernization efforts. Through this Committee, the Oversight Board monitors the modernization program, and a representative of this Committee regularly attended the IRS Core Business Systems Executive Steering Committee meetings. In addition, the progress of modernization has been addressed at each of the Oversight Board meetings.

By the time the Board was in place, problems and delays with the BSM effort had already begun to surface. The Board initially believed increased funding was needed, despite the indications that there were problems with the IRS' and the PRIME contractor's<sup>20</sup> performance. In testimony to the Joint Committee on Taxation on May 8, 2001, the Chairperson of the Oversight Board recommended a \$1 billion appropriation for the IRS Information Technology Investment Account and that \$450 million of this be released to fund BSM spending in FY 2002. The \$450 million for FY 2002 was \$53 million more than the IRS had sought or justified in the official budget submission by the President. The Oversight Board Chairperson stated that the additional funds would allow the IRS, in its efforts to modernize its systems, "to go faster and get more done but still do it in an efficient manner."

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<sup>17</sup> *Business Systems Modernization – IRS Needs to Further Strengthen Program Management* (GAO-04-438T, dated February 2004).

<sup>18</sup> This and other BSM systems are defined in Appendix X.

<sup>19</sup> See Appendix VI for a more complete description of the Oversight Board Committee structure.

<sup>20</sup> To facilitate success of its modernization efforts, the IRS hired the Computer Sciences Corporation as the PRIME contractor and integrator for the BSM program and created the Business Systems Modernization Office to guide and oversee the work of the PRIME contractor.

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However, at the same hearing, the Chairperson of the Joint Committee on Taxation expressed reservations about the Board's approach. The Chairperson of the Joint Committee on Taxation characterized the Board's approach as "more gas, step on the pedal," and suggested that the goals needed to be readjusted. The TIGTA also expressed concerns about the Board's approach at this hearing and stated that improved performance would need to be demonstrated by the IRS and the PRIME contractor before additional funding should be considered.

Some high-level IRS executives expressed the concern that the Board was late in understanding the problems and appropriate solutions for the BSM effort. They also believed the Board was on the wrong side of the issue of whether increased funding would be wise, given the problems with the IRS' and the PRIME contractor's performance on the modernization effort. According to these executives, the problem was the IRS had too much money and too many projects to adequately manage what it had been given. Increased funding for modernization could not be effectively used, given the problem of inadequate management capacity. Some IRS executives believe the Board should have reached such a conclusion much sooner than it did and put forth a recommendation to proceed with more reasonable expectations, given the inadequate IRS capacity to oversee such a large project.

IRS executives, as well as certain Congressional committee staff members, were also concerned that the Oversight Board's early position indicated it did not maintain adequate independence from the former IRS Commissioner and was acting more as an advocate than as an independent overseer. As a result, it was left to the Congress and the OMB to provide leadership and fiscal oversight to the IRS BSM effort, when, in fact, one of the very reasons the Board was created was to provide this type of independent oversight.

After continued delays and missed expectations by the PRIME contractor, the IRS Commissioner and the Board became concerned about the potential for significant cost overruns because of the structure of the modernization contract. At the April 2002 Oversight Board meeting, the

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PRIME contractor was present to provide its perspective on problems affecting the development and implementation of the Customer Account Data Engine. Board members provided their perspective on the importance of the modernization program, the importance of resolving problems quickly, and their expectations for action from the IRS and the PRIME contractor. The contractor agreed to certain contract modifications which changed a portion of the cost of the Customer Account Data Engine to a fixed price contract so the Federal Government would not absorb all of the costs of future problems and delays.

The Oversight Board issued a special report in December 2003<sup>21</sup> with its recommendations to remedy problems with the IRS modernization program. In its report, the Board also endorsed the recommendations offered by a private consultant, the Software Engineering Institute (SEI), who had been hired by the Commissioner as part of an independent review of BSM projects. However, the recommendations of the Board and the SEI largely matched those of the TIGTA and the GAO, which had been made public months or years earlier.<sup>22</sup> For example, in June and November 2000, the TIGTA reported on the need for improved skill sets among the BSM staff. In 2002, the GAO recommended the IRS slow down ongoing projects and reduce the number of new projects, to better match IRS modernization staff resources. In March 2003, the TIGTA recommended the IRS ensure the business rules for the Customer Account Data Engine were properly defined and modeled. In its December 2003 report, the Oversight Board made similar recommendations.

Timely use of these types of data (the GAO and the TIGTA have published over 30 reports addressing modernization issues in the past 4 years that were available to the Oversight Board) may have helped to address these problems earlier and avoided the expense of hiring a

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<sup>21</sup> Special Report: *An Independent Analysis of IRS' Business Systems Modernization Program*, December 2003.

<sup>22</sup> See Appendix IX for a list of selected TIGTA BSM recommendations made since the beginning of FY 2000.

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consultant to confirm these problems.<sup>23</sup> Nonetheless, a representative of the Board's Business Transformation Committee stated that he did not read or make use of these audit reports. We are concerned with the Board's apparent disregard of a significant body of work by qualified specialists in the field of computer modernization. Putting forth a set of recommendations that replicates those from other authoritative sources, already publicly available, highlights the need for the Board to bring its expertise and influence to bear more timely. It further suggests that the Board does not recognize the technical expertise of other specialists working in this area.

Modernization is one area in which the Board needs to use the information at its disposal to develop a strategy for addressing pressing issues. It also needs to ensure the IRS is using the appropriate tools for correcting problems. For example, while the Board has acknowledged that a significant cause of the BSM problems is inadequate management capacity, this has been an ongoing problem since the beginning of the program in 1998. The Congress recognized the importance of having the skill sets needed to manage such a large undertaking. As such, the RRA 98 authorized the IRS to use Streamlined Critical Pay authority for up to 40 positions so a higher level of pay could be used to attract people with the needed skills. However, the IRS used only 10 of the authorized positions (25 percent) for the BSM effort. In FY 2002, members of the Congress expressed concern that the IRS was not using these positions as intended. However, in its review of the use of Streamlined Critical Pay authority, the Board did not take issue with the way in which the IRS allocated its critical pay positions; the Board only expressed the opinion that the use of Streamlined Critical Pay authority has helped provide needed talent and should continue.

The problems with IRS modernization remain, and progress is significantly behind schedule and over budget. Of the 4 major modernization projects that have been completed, all were delayed by 3 to 14 months, and all but 1 have incurred cost overruns that range from approximately

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<sup>23</sup> See Appendix VIII for a list of TIGTA reports related to the IRS BSM efforts issued during the period FYs 2000 through 2003.

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\$5 million to \$13 million. Of 5 major projects that had not been completed as of February 2004 (including the Customer Account Data Engine<sup>24</sup>), all were behind schedule (from 4 months to 2.5 years) and all had exceeded their original cost estimates (by approximately \$17 million to \$86 million). See Appendix VII for details of the modernization projects.

### Recommendation

5. The Oversight Board should make timely use of independent assessments of the IRS' modernization and other programs to develop an effective oversight strategy.

Management's Response: The Board agreed with the need to make independent assessments of the IRS' modernization and other programs to develop an effective oversight strategy. The Board stated that it can and will hold the IRS and appropriate executives accountable to the extent of its authorities. However, the Board expressed concern about the report's portrayal of its position on funding for the BSM program. The Board believed the BSM program should be accomplished as quickly as possible, but at the same time it believed funds should not be spent beyond the capacity of the IRS and its contractor to manage the program. The Board stated that its emphasis has been on the importance of multiyear funding. Its request for additional funds of \$550 million (for FY 2003) was to ensure the multiyear Information Technology Investment Fund Account did not run out, so projects that crossed fiscal years did not get delayed or shut down. The Board is concerned that, to this day, the multiyear fund has not been restored to its original intent, creating inefficiencies every time the fund approaches a zero balance.

Office of Audit Comment: Notwithstanding the Board's assertions related to the importance of multiyear funding for the BSM program, the Board's funding requests exceeded the IRS' capacity to manage and implement the program.

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<sup>24</sup> In July 2004, CADE Release 1.1 was implemented to process the most basic tax returns. At the time of our review, this subrelease was scheduled for final delivery in September 2004.

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The \$1 billion recommended in the Board's 2001 testimony (which included \$450 million for FY 2002 and \$550 million for FY 2003) was far more than the IRS could effectively manage. We do not believe the Board provided adequate fiscal oversight or accountability to the BSM effort. We are concerned that the Board's focus on increased funding, rather than an effective oversight strategy early on in the process, has limited its impact in this area. As such, many of the same issues and problems are noted in the Board's annual report year after year.

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### **Lengthy Vacancies on the Oversight Board Can Negatively Affect Its Operations**

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For much of its history, there have been vacancies on the IRS Oversight Board. The legislation establishing the Board was signed into law on July 22, 1998; however, the process to nominate and confirm all of the initial Board members took 25 months. The original Board members were confirmed on September 8, 2000.

Since then, two of the original members have resigned, one in November 2001 and the other in February 2003. Two replacements have been selected to fill the remainder of those original terms, but only one has been confirmed and both terms will expire in October 2004. Two of the other original five terms expired in October 2003. The President nominated two individuals to fill those vacancies. One individual has withdrawn from consideration and the other (nominated in December 2003) was appointed on July 30, 2004; his term will expire in 2005. Table 2 shows the number of Board members (not including the IRS Commissioner or Secretary of the Treasury) and the number of vacancies since the creation of the Board.



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**Table 2: Board Vacancies**

Time Period	Number of Board Members	Vacancies
January 1999* – September 2000		All
September 2000 – November 2001	7	0
November 2001 – February 2003	6	1
February 2003 – June 2003	5	2
June 2003 – September 2003	6	1
September 2003 – June 2004	5	2

\* The RRA 98 required the President to submit nominations for the Oversight Board to the Senate by January 22, 1999.

*Source: IRS Oversight Board.*

While there is generally no set industry standard as to how many directors should sit on a board or how many should be on each committee, lengthy vacancies make it more difficult for the Oversight Board to accomplish its responsibilities and limit the collective private sector experience and insight these private-life members are expected to bring. Additionally, the vacancies affect the Board's committees. Two of the three committees have vacancies. With some Board members on more than one committee, their workload is increased significantly. If the three nominations currently before the Senate are not confirmed by October 1, 2004, it may be difficult for the Board to continue to function. At that point, there would be only three private-life members serving on the Board. This would not leave enough members to effectively conduct committee work. In October 2005, the terms of the last three original Board members will expire, and, if those three positions were not filled, the Board would then have only two private-life members.

The Board, on advice of the Department of the Treasury, has concluded that a Board member may "hold over" after the conclusion of his or her term until the appointment and qualification of a successor. As such, one Board member elected to continue serving on the Board after his original term had expired. A measure included in proposed

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### Following Best Practices on Process Guidelines and Member Continuing Education Could Improve the Oversight Board's Effectiveness

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legislation<sup>25</sup> would grant an automatic extension of a Board member's term for up to 1 year if a successor is not timely confirmed. However, it is unclear whether extensions of Board members' terms will significantly contribute to the continuity of the Board's operations because the Board members would have to be willing to continue to serve past their terms. Two members of the Board have indicated they will not serve past their 5-year terms. The Board expressed its concern about the lengthy process to fill vacancies in its recently issued 2004 Annual Report.

A good corporate governance practice is to clearly define where a board's duties begin and end. This is best documented in board policies. While the Oversight Board has been functioning for the past 3 years, for much of that time it did not have formally adopted procedures (the Board refers to its procedures as "Operating Philosophies").<sup>26</sup> A best practice of boards in general is that they have formal procedures that govern the manner in which they conduct their oversight and document formal board decisions. As of March 2004, the Oversight Board had formally approved only one of the five procedures developed for its Human Capital Committee.<sup>27</sup> While the statute creating the Board requires that five members be present to establish a quorum, it does not specify any additional procedures that the Board must follow.

To the extent possible, the Oversight Board should define its practices in other areas, particularly where the statute creating the Board is vague. For example, the RRA 98 requires the Board's approval for any major reorganizations of the IRS. However, it is not clear what level of reorganization at the IRS would constitute a major reorganization.

Shortly after his confirmation, the new Commissioner announced a plan to create two deputy commissioner positions within the IRS and to create new reporting lines of authority; however, the Board did not come to a formal

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<sup>25</sup> Tax Administration Good Government Act – H.R. 1528 108<sup>th</sup> Cong. § 127 (2004).

<sup>26</sup> See Appendix XI for a list and the status of the Oversight Board's Operating Philosophies.

<sup>27</sup> See Appendix VI for details about the Committee.

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resolution to approve this reorganization, which caused concerns among some Board members. Based on the legislative history covering the intent of this provision, we believe the Commissioner's actions were appropriate and formal approval by the Board was not required. Nonetheless, the uncertainty of some Board members as to whether this change required its approval, as well as strong Congressional concern over the Board's acquiescence to the Commissioner's organizational changes, illustrate the need for a clear policy.

The Board has since formulated a procedure that would cover the Board's policy on reviewing and approving any major IRS reorganization. Further, after we brought our concerns to the Board about the delays in adopting procedures, the Board formally adopted 12 of 13 of its proposed operating philosophies in July 2004.

### **Oversight Board member education**

Corporate governance best practices also recommend requiring board members to engage in continuous learning about the organization they oversee. The Business Roundtable Corporate Governance survey (July 2003) determined that "Ninety percent of Roundtable companies now encourage, require, or have in place education programs for new, and in some cases all, directors." A Harvard Business Review article<sup>28</sup> recommends giving directors tasks—for example, meeting with customers, suppliers, and distributors or visiting plants or stores in the field—and requiring them to inform the rest of the board about the company's strategic and operational reviews as a means to assimilate new members and promote continuity among established members.

The importance of having a defined system to ensure new Board members have an adequate understanding of IRS operations and issues will be increased due to the significant turnover of Board members within the next 2 years. While the Board currently does meet with stakeholder groups and attends meetings such as the IRS Tax Forums, a defined system to educate and assist new members would help

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<sup>28</sup> *What Makes Great Boards Great* (September 2002).

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ensure the continuity of management oversight and strategic direction and accelerate new members' ability to apply their expertise.

### Recommendations

The Oversight Board should:

6. Establish guidance to specify which circumstances will require a formal resolution by the Board and establish a process to formally vote and publish resolutions.

Management's Response: The Board agreed that transparency regarding the Board's processes and votes is good where appropriate. However, it noted that publication of some actions, such as the evaluation of executive performance, might not be appropriate. The Board will continue its practice of issuing media releases after every meeting and will strive to communicate its resolutions to taxpayers as fully as possible.

7. Institute a defined system to educate new Board members on IRS operations and strategic issues.

Management's Response: The Board agreed and is using the experiences of its current Chairperson to develop a more formal process to educate new members in Board and IRS governance issues. The Board will continue to refine this effort with the guidance of new members.

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### Appendix I

#### Detailed Objective, Scope, and Methodology

The overall objective of this review was to evaluate the Internal Revenue Service (IRS) Oversight Board's effectiveness in fulfilling its responsibilities as required by the IRS Restructuring and Reform Act of 1998.<sup>1</sup> We interviewed members and staff of selected Congressional committees or subcommittees, the cochairs of the National Commission on Restructuring the IRS, Oversight Board members and several former Board members, the IRS Commissioner and two former Commissioners, as well as IRS senior executives and members of tax practitioner groups. To accomplish this objective, we:

- I. Determined whether the Oversight Board adequately fulfilled its responsibility to review the IRS' plans for modernization of the tax system.
- II. Determined whether the Oversight Board fulfilled its responsibilities to review and approve the budget request of the IRS.
- III. Determined the Oversight Board's involvement with the IRS' compliance and enforcement actions.
- IV. Determined the Oversight Board's involvement in the selection, evaluation, and compensation of IRS senior executives.
- V. Determined the resources available to the Oversight Board and how those resources are used to carry out the Board's statutory responsibilities.
- VI. Evaluated the impact of the Oversight Board as perceived by the Board, the IRS, the Congress, and outside stakeholders.
- VII. Determined whether the Oversight Board follows private sector governance best practices.

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<sup>1</sup> Pub. L. No. 105-206, 112 Stat. 685 (codified as amended in scattered sections of 2 U.S.C., 5 U.S.C. app., 16 U.S.C., 19 U.S.C., 22 U.S.C., 23 U.S.C., 26 U.S.C., 31 U.S.C., 38 U.S.C., and 49 U.S.C.).

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**Appendix II**

**Major Contributors to This Report**

Daniel R. Devlin, Assistant Inspector General for Audit (Headquarters Operations and Exempt Organizations Programs)

Michael E. McKenney, Director

Kevin P. Riley, Audit Manager

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Michael J. Della Ripa, Auditor

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**Appendix III**

**Report Distribution List**

Commissioner C  
Office of the Commissioner – Attn: Chief of Staff C  
United States Senate Committee on Finance  
United States Senate Committee on Governmental Affairs  
United States Senate Committee on Governmental Appropriations  
United States House of Representatives Committee on Appropriations  
United States House of Representatives Committee on Government Reform  
United States House of Representatives Committee on Ways and Means  
Mr. Charles A. Lacijan, Staff Director, IRS Oversight Board

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**Appendix IV**

**Comparison of Federal Government Boards and Their Responsibilities**

	<b>Social Security Advisory Board</b>	<b>United States Postal Service Board of Governors</b>	<b>Internal Revenue Service (IRS) Oversight Board</b>
<b>Date Created</b>	1994	1970	1998
<b>Board Size</b>	7	11	9
Private Sector	7	9	7
Government	0	2	2
<b>Member Selection</b>	3 by the President, 2 by the President of the Senate, 2 by the Speaker of the House.	9 by the President, 2 by the Board.	All by the President, with the advice and consent of the Senate.
<b>Quorum</b>	4	6	5
<b>Terms</b>			
Chairperson	4 years	1 year	2 years
Other Members	6 years	9 years	5 years
<b>Compensation</b>			
Chairperson	Varies <sup>1</sup>	\$30,000	\$50,000
Other Members	Varies	\$30,000	\$30,000
<b>Removal</b>	Not mentioned.	Removed only for cause.	Removed at the will of the President.
<b>Meeting Requirements</b>	At least quarterly.	On a regular basis.	At least quarterly.
<b>Reporting Requirements</b>	Not mentioned.	Not mentioned.	Annual report and interim reports deemed necessary.
<b>Review Authority</b>			
Strategic Plan	Make recommendations.	Conduct long-range planning and set policies.	Review and approve.
Operating Plans	Make recommendations.	Direct the exercise of the powers of the Postal Service.	Review the operational functions of the IRS.

<sup>1</sup> Board members are compensated at the daily rate of basic pay for level IV of the Executive Schedule while engaged in the business of the Board.



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	<b>Social Security Advisory Board</b>	<b>United States Postal Service Board of Governors</b>	<b>Internal Revenue Service (IRS) Oversight Board</b>
Management	None	Select Postmaster General and Deputy Postmaster General.	Recommend candidates for Commissioner; review the selection, evaluation, and compensation of executives; and review and approve reorganizations of the IRS.
Budget	None	Approve the budget program, including requests for appropriations, and approve the operating budget.	Approve the IRS budget request and submit request to the Secretary of the Treasury. The Secretary submits the budget request to the President who shall submit such request, without revision, to the Congress together with the President's annual budget request for the IRS.
Constituent Rights	Make recommendations on programs.	Represent the public interest.	Ensure the proper treatment of taxpayers by the IRS.
<b>Approval Authority</b>			
Agency Head	None	The Postmaster General serves at the pleasure of the 9 Board members.	None
Agency Inspector General (IG)	None	The IG is appointed by and reports directly to the appointed Governors.	None
<b>Other</b>	Major role is to make recommendations.	Not more than 5 of 9 from same political party. Most powerful of Boards analyzed and most like a corporate board.	None

*Source: Treasury Inspector General for Tax Administration analysis of selected Federal Government Boards.*

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**Appendix V**

**INTERNAL REVENUE SERVICE RESTRUCTURING AND REFORM ACT OF 1998**

Public Law 105-206

General and specific responsibilities of the Internal Revenue Service Oversight Board as they  
appear verbatim in the Law

TITLE 26. INTERNAL REVENUE CODE

SEC. 1101. INTERNAL REVENUE SERVICE OVERSIGHT BOARD

(c) GENERAL RESPONSIBILITIES-

(1) OVERSIGHT-

(A) IN GENERAL - The Oversight Board shall oversee the Internal Revenue Service in its administration, management, conduct, direction, and supervision of the execution and application of the internal revenue laws or related statutes and tax conventions to which the United States is a party.

(B) MISSION OF IRS - As part of its oversight functions described in subparagraph (A), the Oversight Board shall ensure that the organization and operation of the Internal Revenue Service allows it to carry out its mission.

(C) CONFIDENTIALITY - The Oversight Board shall ensure that appropriate confidentiality is maintained in the exercise of its duties.

(2) EXCEPTIONS - The Oversight Board shall have no responsibilities or authority with respect to:

(A) the development and formulation of Federal tax policy relating to existing or proposed internal revenue laws, related statutes, and tax conventions,

(B) specific law enforcement activities of the Internal Revenue Service, including specific compliance activities such as examinations, collection activities, and criminal investigations,

(C) specific procurement activities of the Internal Revenue Service, or

(D) except as provided in subsection (d)(3), specific personnel actions.

(d) SPECIFIC RESPONSIBILITIES - The Oversight Board shall have the following specific responsibilities:

(1) STRATEGIC PLANS - To review and approve strategic plans of the Internal Revenue Service, including the establishment of:

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- (A) mission and objectives, and standards of performance relative to either, and
  - (B) annual and long-range strategic plans.
- (2) OPERATIONAL PLANS - To review the operational functions of the Internal Revenue Service, including:
- (A) plans for modernization of the tax system,
  - (B) plans for outsourcing or managed competition, and
  - (C) plans for training and education.
- (3) MANAGEMENT - To:
- (A) recommend to the President candidates for appointment as the Commissioner of Internal Revenue and recommend to the President the removal of the Commissioner;
  - (B) review the Commissioner's selection, evaluation, and compensation of Internal Revenue Service senior executives who have program management responsibility over significant functions of the Internal Revenue Service; and
  - (C) review and approve the Commissioner's plans for any major reorganization of the Internal Revenue Service.
- (4) BUDGET - To:
- (A) review and approve the budget request of the Internal Revenue Service prepared by the Commissioner;
  - (B) submit such budget request to the Secretary of the Treasury; and
  - (C) ensure that the budget request supports the annual and long-range strategic plans.
- (5) TAXPAYER PROTECTION - To ensure the proper treatment of taxpayers by the employees of the Internal Revenue Service.

The Secretary shall submit the budget request referred to in paragraph (4)(B) for any fiscal year to the President who shall submit such request, without revision, to Congress together with the President's annual budget request for the Internal Revenue Service for such fiscal year.

**Internal Revenue Service Oversight Board  
Committee Structure and Responsibilities**

**Business Transformation Committee**

- Larry Levitan (Chairperson)
- Nancy Killefer
- Vacancy

**Responsibilities:**

The Business Transformation Committee was established to fulfill the Oversight Board's responsibility for reviewing the Internal Revenue Service's (IRS) plans for modernization of the tax system. The Committee's responsibilities include reviewing the proposed modernization portfolio and performing periodic reviews of modernization progress and periodic reviews of the transition to support readiness. A member of the Committee or a member of the Board's staff attends the Core Business Systems Executive Steering Committee meetings. In addition, the Committee directs the preparation of the Electronic Filing Report that is submitted to the Congress annually.

The Business Transformation Committee has also general responsibility for the Modernization and Information Technology Services (MITS) organization performance reviews to monitor the MITS organization's progress in meeting its strategic and operational goals and objectives. The Committee's responsibilities include reviewing the MITS organization budget, performing a periodic review of the performance of the MITS organization, and conducting an annual review of mission assurance.

**Human Capital Committee**

- Raymond Wagner (Chairperson)
- Robert Tobias
- Charles Kolbe

**Responsibilities:**

The Human Capital Committee's responsibilities include reviews of the senior executive performance evaluations and compensation, the critical pay program, training, outreach to stakeholders, and the effectiveness of the Office of the National Taxpayer Advocate (NTA) in providing protection to taxpayers.

The Committee conducts an annual review of the performance evaluations and compensation of designated senior executives to determine whether their evaluations and compensation packages are compatible with their personal commitments and whether the executives achieved

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performance levels for the organizational units they manage and overall IRS strategic goals. The Committee is also responsible for working with the IRS Commissioner to provide advice from the Oversight Board's perspective to assist the IRS in filling designated senior executive positions with qualified executives, including any proposal to use Streamlined Critical Pay authority.

The Human Capital Committee has principal responsibility for coordinating public outreach, which may include public meetings, nationwide IRS Tax Forums, public surveys, speaking engagements, etc. The Committee also reviews the effectiveness of the NTA in providing protection to all taxpayers. The Committee is responsible for bringing strategic attention to agency-wide training and working with the IRS to identify appropriate changes, including incorporating public and private sector best practices as it develops training programs using modernized technology.

### **Performance Management Committee**

- Robert Tobias (Chairperson)
- Raymond Wagner
- Vacancy

#### **Responsibilities:**

The Performance Management Committee is responsible for performance reviews to monitor the IRS' progress in meeting its strategic and operational goals and objectives. The Committee monitors IRS performance on a continuing basis to try to identify potential problems, successes, and issues. At quarterly performance meetings, each IRS organization being reviewed is allotted a specific time period within which to discuss its progress toward meeting the annual performance targets, its successes and best practices, factors that inhibit better performance levels, its problem areas, and the efforts to reduce the problems. At the conclusion of each performance meeting, a summary of issues discussed and pending action items is prepared; the action items are shared with the IRS.

The Committee currently conducts quarterly performance reviews of the four major operating divisions (Wage and Investment, Small Business/Self-Employed, Large and Mid-Size Business, and Tax Exempt and Government Entities), as well as the MITS organization, and biannual reviews of the Offices of Appeals, Chief Human Capital Officer, and Agency-Wide Shared Services.

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**Appendix VII**

**Modernization Schedule Delays and Cost Increases**

Table 1 lists schedule delays and cost increases for some of the Business Systems Modernization (BSM) projects as of February 2004.

**Table 1: BSM Project Delays and Cost Increases**

Project <sup>1</sup>	Cost Variance (in thousands)	Reported/Revised Estimated Cost (in thousands)	Schedule Variance (in months)
<b>Completed Projects</b>			
Security and Technology Infrastructure Release 1	+\$7,553	\$41,287	+5
Customer Communications 2001	+5,310	46,420	+9
Customer Relationship Management Exam	-1,938	7,375	+3
Internet Refund/Fact of Filing	+12,923	26,432	+14
<b>Ongoing Projects<sup>2</sup></b>			
Modernized e-File Release 1	+17,057	46,303	+4.5
e-Services	+86,236	130,281	+18
Customer Account Data Engine (CADE) Release 1	+36,760	97,905	+30 <sup>3</sup>
Integrated Financial System (IFS) Release 1	+53,916	153,786	To be determined (TBD)
Custodial Accounting Project (CAP) Release 1	+72,058	119,219	TBD

*Source: Treasury Inspector General for Tax Administration report entitled, Annual Assessment of the Business Systems Modernization Program (Reference Number 2004-230-107, dated June 2004).*

<sup>1</sup> See Appendix X for project information.

<sup>2</sup> Projects ongoing as of September 30, 2003.

<sup>3</sup> Project schedules for the CADE, the IFS, and the CAP are currently under review.

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**Appendix VIII**

**Internal Revenue Service Business Systems Modernization-Related Final Reports  
Issued by the Treasury Inspector General for Tax Administration  
Information Systems Programs Business Unit in  
Fiscal Years 2000 – 2003**

**Fiscal Year (FY) 2000 (2 reports)**

*Significant Risks Need to be Addressed to Ensure Adequate Oversight of the Systems Modernization Effort* (Reference Number 2000-20-099, dated June 2000)

*Additional Actions Are Needed to Strengthen the Development and Enforcement of the Enterprise Architecture* (Reference Number 2000-20-158, dated September 2000)

**FY 2001 (8 reports)**

*Implementation of the New Methodology for Systems Modernization Needs Increased Focus and Support* (Reference Number 2001-20-015, dated November 2000)

*The Business Systems Modernization Office Has Made Solid Progress and Can Take Additional Actions to Enhance the Chances of Long-Term Success* (Reference Number 2001-20-039, dated February 2001)

*Progress in Developing the Customer Communications Project Has Been Made, But Risks to Timely Deployment in 2001 Still Exist* (Reference Number 2001-20-055, dated March 2001)

*The Customer Relationship Management Examination Project Experienced Delays and Increased Costs, But Lessons Learned Should Improve Future Modernization Projects* (Reference Number 2001-20-140, dated August 2001)

*The Telecommunications Modernization Project Provided Some Benefits, But Process Improvements Are Needed for Future Projects* (Reference Number 2001-20-143, dated August 2001)

*Improvements Are Needed in the Management of the e-Services Project to Enable Timely Progress Towards Future Goals* (Reference Number 2001-20-144, dated September 2001)

*Letter Report: Authoritative Guidelines and Processes Are Needed for Classifying Information Technology Projects* (Reference Number 2001-20-152, dated September 2001)

*Uncertainties Facing the Customer Communications 2002 Project May Jeopardize Its Timely Deployment* (Reference Number 2001-20-179, dated September 2001)

**FY 2002 (12 reports)**

*Modernization Project Teams Need to follow Key Systems Development Processes* (Reference Number 2002-20-025, dated November 2001)

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*The Customer Communications Project 2001 Release Was Deployed, But Testing Processes Did Not Ensure All Applications Were Working As Intended* (Reference Number 2002-20-056, dated March 2002)

*The Business Systems Modernization Office Needs to Strengthen Its Processes for Overseeing the Work of the PRIME Contractor* (Reference Number 2002-20-059, dated March 2002)

*Critical Processes and Dependencies Need to Be Addressed to Avoid Future Delays in Deployment of the Enterprise Systems Management Project* (Reference Number 2002-20-084, dated May 2002)

*Management Advisory Report: Progress Has Been Made in Establishing a Secure Modernization Infrastructure; However, Continuing Risks Could Impact Timely Deployment of Modernization Projects* (Reference Number 2002-20-112, dated June 2002)

*Processes to Effectively Manage the Development of the Custodial Accounting Project Are Improving* (Reference Number 2002-20-121, dated June 2002)

*Management Advisory Report: Most Taxpayer Communication Enhancements Planned for 2002 Will Be Delivered, Although Some Are Later Than Originally Expected* (Reference Number 2002-20-122, dated July 2002)

*The Latest Update to the Enterprise Architecture Improves on Previous Versions, But Processes to Develop Future Updates Could Be Improved* (Reference Number 2002-20-124, dated July 2002)

*Management Advisory Report: Comprehensive Measures for Interim Business Systems Modernization Status Reporting Are Needed* (Reference Number 2002-20-128, dated July 2002)

*Management Advisory Report: Progress Has Been Made in Developing Transition to Support Guidance for Modernization Projects* (Reference Number 2002-20-146, dated August 2002)

*Additional Improvements Are Needed in the Application of Performance-Based Contracting to Business Systems Modernization Projects* (Reference Number 2002-20-170, dated September 2002)

*Annual Assessment of the Internal Revenue Service's Business Systems Modernization Program* (Reference Number 2002-20-189, dated September 2002)

**FY 2003 (10 reports)**

*Analysis of Business Systems Modernization Cost, Schedule, and Functionality Performance* (Reference Number 2003-20-007, dated October 2002)

*Improvements in the Customer Account Data Engine Pilot Plan Need to Be Considered to Help Ensure the Pilot's Success* (Reference Number 2003-20-018, dated November 2002)

*Enhancements to the Internet Refund Project Need to Be Completed to Ensure Planned Benefits to Taxpayers Are Realized* (Reference Number 2003-20-053, dated February 2003)



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*The Business Systems Modernization Quality Assurance Function Has Established a Solid Set of Policies and Procedures That Can Be Further Enhanced* (Reference Number 2003-20-067, dated February 2003)

*Adhering to Established Development Guidelines Will Help to Ensure the Customer Account Data Engine Meets Expectations* (Reference Number 2003-20-089, dated March 2003)

*Security Testing and Certification of the Modernized Infrastructure Needs to Be Strengthened* (Reference Number 2003-20-127, dated June 2003)

*Improvements to the Modernized Infrastructure Are Needed to Support the Deployment of Business Systems Modernization Projects* (Reference Number 2003-20-161, dated August 2003)

*Testing Practices for Business Systems Modernization Projects Need Improvement* (Reference Number 2003-20-178, dated September 2003)

*Annual Assessment of the Business Systems Modernization Program* (Reference Number 2003-20-208, dated September 2003)

*The Cost and Schedule Estimation Process for the Business Systems Modernization Program Has Been Improved, but Additional Actions Should Be Taken* (Reference Number 2003-20-219, dated September 2003)

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**Appendix IX**

**Selected Treasury Inspector General for Tax Administration  
Business Systems Modernization Recommendations**

Number	Principal Business Systems Modernization (BSM)-Related Recommendation	Dates of Treasury Inspector General for Tax Administration (TIGTA) Recommendations
1	Harvest Internal Revenue Service business rules.	March 2003
2	Institutionalize system engineering.	March 2003
3	Institutionalize management discipline.	June 2000 March 2001 November 2001 March 2002 May 2002 August 2003 September 2003
4	Enforce compliance for requirements definition and program management processes.	November 2000 November 2001 March 2002 May 2002 June 2003
5	Bolster broadly defined skill areas/personnel.	November 2000
6	Strengthen BSM program management with experienced project managers.	June 2000
7	Balance the scope of the modernization portfolio with IRS capacity.	September 2002 September 2003
8	Better allocate responsibility for certain BSM program management functions (budget, audit personnel, contracting, etc.).	June 2000
9	Implement a “fixed-price” contract policy.	September 2002
10	Use more realistic assumptions for testing estimates/plans/schedules.	March 2001 November 2001 March 2002

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<b>Number</b>	<b>Principal Business Systems Modernization (BSM)-Related Recommendation</b>	<b>Dates of Treasury Inspector General for Tax Administration (TIGTA) Recommendations</b>
11	Establish a rigorous process for requests for information services/change requests.	August 2003
12	Make diagnostic tools (e.g., dashboard) work.	June 2000
13	Streamline Modernization Information Technology Services-wide Government process for entire information technology portfolio.	June 2000
14	Request spend plan changes timely – eliminate funding “emergencies.”	February 2001
15	Employ performance-based acquisition more broadly.	February 2001 March 2002 September 2002

*Source: TIGTA report entitled, Annual Assessment of the Business Systems Modernization Program (Reference Number 2004-230-107, dated June 2004).*

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**Appendix X**

**Business Systems Modernization Projects and Descriptions**

The following are brief descriptions of the projects listed in Appendix VII.

**Security and Technology Infrastructure Release (STIR)** – The STIR project is designed to provide a secure technical infrastructure to support and enable the delivery of the Internal Revenue Service’s (IRS) modernized business systems.<sup>1</sup>

**Customer Communications (CC)** – The CC project has improved customer service by increasing the capacity of the toll-free telephone system and providing the ability to route taxpayers’ calls to the appropriate IRS employees.

**Customer Relationship Management (CRM) Exam** – The CRM Exam project provides a commercial off-the-shelf software solution to Large and Mid-Size Business Division revenue agents that will allow them to accurately compute complex corporate transactions.

**Internet Refund/Fact of Filing (IRFOF)** – The IRFOF project improves customer self-service by providing instant refund status information and instructions for resolving refund problems to taxpayers with Internet access.

**Modernized e-File (MeF)** – The MeF project develops the modernized web-based platform for filing approximately 330 IRS forms electronically, beginning with the U.S. Corporation Income Tax Return (Form 1120), U.S. Income Tax Return for an S Corporation (Form 1120S), and Return of Organization Exempt From Income Tax (Form 990). The project serves to streamline filing processes and reduce the costs associated with a paper-based process.

**e-Services** – The e-Services project provides a set of web-based business products as incentives to third parties to increase electronic filing, in addition to providing electronic customer account management capabilities to all businesses, individuals, and other customers.

**Customer Account Data Engine (CADE)** – The CADE is the foundation for managing taxpayer accounts in the IRS’ modernization plan. It will consist of databases and related applications that will replace the IRS’ existing Master File processing systems and will include applications for daily posting, settlement, maintenance, refund processing, and issue detection for taxpayer tax account and return data.

**Integrated Financial System (IFS)** – The IFS is intended to address administrative financial management weaknesses. The first release of the IFS will include the Accounts Payable, Accounts Receivable, General Ledger, Budget Execution, Cost Management, and Financial

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<sup>1</sup> The STIR is now a part of the Infrastructure Shared Services program.

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Reporting activities. A future IFS release will be needed to fully resolve all administrative financial management weaknesses.

**Custodial Accounting Project (CAP)** – The CAP will be a single, integrated data repository of taxpayer account information, integrated with the general ledger<sup>2</sup> and accessible for management analysis and reporting. The first release of the CAP will extract taxpayer account data from the Individual Master File (IMF) for the Taxpayer Account Subledger.<sup>3</sup>

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<sup>2</sup> A general ledger is a set of accounts used to summarize an organization's financial transactions by transaction type (e.g., cash receipts, accounts receivable, or rental expenses).

<sup>3</sup> The IMF is the IRS database that maintains transactions or records of individual tax accounts. The Taxpayer Account Subledger will be an integrated data repository of taxpayer account information containing detailed taxpayer account history and unpaid assessment information.

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**Appendix XI**

**Status of the Oversight Board's Operating Philosophies**

Operating Philosophy	Status of Operating Philosophy
<b>Internal Revenue Service (IRS) Oversight Board Operating Philosophies (Full Board)</b>	
Administration Operations	Adopted in July 2004
Annual Budget Review and Approval	Adopted in July 2004
Communications	Adopted in July 2004
Commissioner Nomination and Removal Recommendation	Adopted in July 2004
<b>Human Capital Committee Operating Philosophies</b>	
Stakeholder Outreach	Adopted in July 2004
Oversight of IRS Senior Executives	Adopted by Committee in October 2003
Major IRS Reorganization Review and Approval	Draft
Oversight of Training and Education	Adopted in July 2004
Oversight of the Office of the National Taxpayer Advocate	Adopted in July 2004
<b>Performance Management Committee Operating Philosophies</b>	
Performance Review	Adopted in July 2004
Strategic and Operating Plan Review and Approval*	Adopted in July 2004
<b>Business Transformation Committee Operating Philosophies</b>	
Modernization Portfolio Review	Adopted in July 2004
Modernization and Information Technology Services Organization Performance Review	Adopted in July 2004

\* Strategic and Operating Plan Review and Approval is being moved from the Performance Management Committee to the full Board.

Source: IRS Oversight Board.

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Appendix XII

Management's Response to the Draft Report

IRS  
OVERSIGHT  
BOARD

RECEIVED  
SEP 23 2004

MEMORANDUM FOR TREASURY INSPECTOR GENERAL FOR TAX  
ADMINISTRATION

September 23, 2004

FROM Raymond T. Wagner, Jr.  
Chair, IRS Oversight Board



SUBJECT: Response to Draft Audit Report—The IRS Oversight Board Has Achieved Much  
of Its Original Intent, but There are Opportunities for Increased Effectiveness  
(Audit # 2003100360)

The Internal Revenue Service (IRS) Oversight Board has reviewed the draft audit report. We appreciate the efforts by the Treasury Inspector General for Tax Administration (TIGTA) in performing this unique and difficult audit.

Before presenting our response, we want to express our appreciation for your conduct of this audit. We know that, unlike many of TIGTA's audits, this audit required a qualitative evaluation of the Board's effectiveness, a much more difficult task than the quantitative evaluations TIGTA normally performs during its audits. TIGTA personnel performed a great deal of research on the characteristics of effective private and public sector boards, and interviewed many professionals, both inside and outside of government, who are familiar with the workings of the Board and helped to develop the conclusions and recommendations in this report.

Your recommendations for future action to improve the Board's effectiveness are generally sound and based on valid findings. The Board will work toward incorporating your recommendations. However, we believe that in some areas, the audit report reflects some misconceptions about the proper role of the IRS Oversight Board compared with the enabling legislation and the legislative history.

**Background:** The report notes on page 3 that the "Board has the authority and responsibility to be directly involved in the management, direction, strategy and long-term operation of the IRS." This statement is inconsistent with both the legislative history and the common practice of most private sector boards. It seems to be a continuation of confusion over the Board's scope and purpose which stems from disputes in the legislative debate surrounding the Board's creation. The Board wants to directly address this characterization as it appears to be the basis of several findings in the audit report.

Both the plain language of the statute and the legislative history make it clear that the Board was established to oversee strategic direction of the IRS, overarching issues of the organization, and the performance of top management. It should not, indeed it cannot, be expected to micromanage the IRS' operations in any area, particularly one as large and complex as modernization. By the very nature of the government budget process, in which the President proposes and the

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legislative branch approves and appropriates funds, the Board's ability to influence the organization is unlike a private sector corporate Board.

These excerpts from the legislative history emphasize that the Board is to be a strategic player. In a statement before the Senate Finance Committee, Congressman Rob Portman described the Board this way:

"The oversight board's role, simply put, is to guide the development and oversee the implementation of long-term strategies at the IRS, . . . and to hold IRS management accountable for its performance.

In my view, to be effective, the board must focus on the big picture; strategic issues – like the modernization plan . . .

Senate Finance Committee, January 29, 1998, Statement of Rep. Rob Portman (Sen. Hearing 105-529)

Similarly, Senator Kerrey, in describing the board, noted that "[i]t is not expected to be micromanaging (Sen. Kerrey, May 4, 1998, 144 Cong. Rec. S4194).

The purpose of the Board, as illustrated by these statements, is to oversee strategic issues, not to delve into day-to-day IRS operational functions. This role is important to keep in mind as we discuss certain findings of the audit report, which I believe are based on a misunderstanding of the Board's function.

**Recommendation 1:** *Formalize its process to strategically focus its efforts on the most significant issues facing the IRS. This should include developing intervention strategies when appropriate. (This recommendation addresses issues and concerns highlighted on pages 9-11.)*

**Response:** The Board agrees that it needs to focus its efforts on the most significant issues facing the IRS. As TIGTA is aware, the Board has identified the following five issues as the most important in both its 2003 and 2004 Annual Reports:

- Close the compliance gap
- Boost customer service
- Commit to modernization
- Focus on people resources
- Measure long-term goals

These issues overlap with the ten most serious issues identified by TIGTA and the high risk areas identified by the GAO. Although they were developed independently by the Board, GAO and TIGTA reports, IRS performance, and outside stakeholder recommendations all influenced the Board's selection of these issues.

The Oversight Board develops an annual operating plan at the beginning of each fiscal year that identifies key issues the Board wishes to address during the year, but the Board agrees that this plan can be improved by a sharper focus on key strategic issues that the Board wants to evaluate in the upcoming year. Where possible, the Board prefers to establish desired outcomes it wants the IRS to achieve than to prescribe activity the IRS must perform. This approach is consistent with how private sector corporate boards perform. Private sector boards do not run companies.



## The Oversight Board Has Achieved Much of Its Original Intent, but There Are Opportunities for Increased Effectiveness

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chief executive officers (CEOs) do. Corporate boards hold the CEO and the company leadership accountable for running the company.

We have further concerns about the use of the term “intervention.” A board should never rule out intervention as a strategy, but any intervention by a board must be done with a great deal of caution and only under unusual circumstances.

A board of directors operates best when it uses the following time-tested approach:

- Set strategic goals for the organization
- Identify desired outcomes and measures that will be used to evaluate whether the desired outcomes have been achieved
- Evaluate the results
- Hold the organization’s executives accountable for achieving the results

The TIGTA report calls for the Board to have a strategy for intervention that includes determining who should be engaged, designing remediation actions, determining the types and sources of information needed, and developing performance and reporting responsibilities of IRS officials, timeliness, and standards to measure accomplishments. The Board believes that these recommendations are appropriate should the Board decide an intervention is necessary, but cautions that an intervention should not be the normal way of doing business.

**Recommendation 2:** *Adopt a formal process for evaluating the Board’s effectiveness and its impact on tax administration. In addition, the Board should include its impact on tax administration in its annual report to Congress or some other formal document that would be publicly released. (This recommendation addresses issues and concerns highlighted on pages 9-11.)*

**Response:** The Board agrees that formal “self-assessment” of the Board’s effectiveness is valuable, and intends to conduct another self-assessment before the end of 2004. However, the singular outcome the Board desires to achieve is a highly effective IRS, and any assessment of the Board’s effectiveness must be measured by how well the IRS performs given its operating environment and resources. Normal practice in the private sector is for boards to conduct annual evaluations of board and CEO effectiveness, but public reports, such as annual and 10-K reports, describe corporate performance and let this speak to the effectiveness of the board and CEO. Boards normally do not publicly report the results of their evaluations; such a report would compromise the honesty and effectiveness of the evaluation process. In its annual reports, the Board will continue to describe how IRS performance is impacting tax administration and the needs of taxpayers.

**Recommendation 3:** *The Oversight Board should define practices for coordinating with IRS executives and other oversight bodies to avoid duplicate requests for information. This could include direct access to IRS information systems, when permissible, to minimize request for information from IRS operating components. (This recommendation addresses issues and concerns highlighted on pages 12-15.)*

**Response:** The Board believes, as a matter of policy, that it should not request information or data from the IRS that is not already gathered, collected or reported by the IRS, unless absolutely necessary. Direct access by the Board to IRS information systems, where appropriate, clearly supports this objective.

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Many of the requests for information and data from the IRS occur in preparation for the quarterly performance meetings conducted by the Performance Management Committee and in review and analysis of the IRS performance budget. The board has agreed to work with the IRS to identify appropriate measures to be used in these reviews and to coordinate the review cycle with the IRS to minimize extraordinary information collection.

The Board believes that it is wise to complement information obtained from the IRS with information from outside stakeholder organizations that are directly affected by IRS' performance. Hence, the Board conducts a vigorous stakeholder outreach program, with public meetings and frequent contact with tax practitioner and employee groups, to obtain outside views of IRS performance.

The Board also finds information reported by other organizations that have IRS oversight responsibilities, including the Treasury Department, TIGTA, and the GAO, to be valuable, and uses their reports to complement its own evaluations. The Board operates in a fundamentally different way than TIGTA and GAO, who can dedicate far more resources to evaluating specific issues than the Board would find practical or even desirable. However, the results of both GAO and TIGTA evaluations inform the Board about specific issues that complement its own strategic views based on overall performance data and stakeholder views.

The Board, GAO, and TIGTA management meet periodically to assess its identification and evaluation of key issues facing the IRS, and historically the views of these three organizations are normally in close alignment. The Board is committed to continuing these meetings, and increasing their frequency if the other two parties find it useful to do so.

**Recommendation 4:** *The Oversight Board should develop policies and procedures to evaluate the IRS' efforts and results in achieving savings and efficiencies. These efforts should be detailed in the Board's IRS budget submission. (This recommendation addresses issues and concerns highlighted on pages 16-18.)*

**Response:** Since the establishment of the Oversight Board, the IRS has been "out-manned and out-gunned." The Board has recognized this situation and articulated its concerns in budget reports and in testimony before Congress. Each year, the appropriated budget for the IRS has fallen short of the budget levels recommended by the Board and does not often contain the funds required to cover mandatory and unanticipated expenses. A recent hearing by the Senate Finance Committee in July 2004 highlighted the fact that the current estimate of the tax gap, the amount that the IRS would collect if all taxpayers paid what they legally owed, and what the IRS actually collects, is approximately \$311 billion a year. Such a gap speaks volumes about the funding needs of the IRS. The Board believes that closing the tax gap is critical, and has argued that a strong business case can be made for providing the IRS with several hundred million dollars so it can collect billions in revenue.

The large tax gap highlights the need for the IRS to become as effective and efficient as possible with the resources it receives. Each year, the IRS identifies as part of the President's budget request, estimated savings from the previous year's budget and a description of how these savings can be reinvested in high priority functions. These savings and reinvestments have been approved by the Oversight Board as part of its budget submission to the Treasury Department. However, the GAO has testified to Congress that the IRS has experienced difficulty in achieving its estimated savings. In some cases, the application of the projected savings has changed

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because of budget shortages, requiring that they be used to pay for unfunded costs, such as pay raises.

Notwithstanding these difficulties, the Board does believe that the current federal planning and budgeting process places program increases under intense scrutiny while at the same time under-evaluating current service levels. The IRS has made good strides in recent years in linking budget and performance data, making it easier to identify and understand the performance levels the requested budget is achieving. It is appropriate under these circumstances to place more emphasis on achieving savings and efficiencies and asking the IRS to document ways it can become more efficient. These estimated savings should be evaluated after the fact to determine if the estimated savings were achieved. GAO already performs an annual audit of the IRS that includes an evaluation of whether the IRS achieved savings estimated the previous year. In FY2005, the Oversight Board will use GAO's findings to place more emphasis on evaluating the extent to which savings and efficiencies previously estimated were actually achieved. Although such a review may not reflect IRS' ability to achieve future estimated savings, it would provide some insight into its past performance that would serve as a guide for the future.

**Recommendation 5:** *The Oversight Board should make timely use of independent assessments of the IRS' modernization and other programs to develop an effective oversight strategy. (This recommendation addresses issues and concerns highlighted on pages 18-22.)*

**Response:** The Board agrees with the need to make independent assessments of the IRS' modernization and other programs to develop an effective oversight strategy. As noted in its response to Recommendation 3, the Board uses information obtained from multiple sources, including the IRS, external stakeholders, and oversight organizations as it assesses the IRS' performance, and the Board will continue to do so. However, the Board is concerned that TIGTA may not see the Board's role in the strategic context that was described earlier.

Your report criticizes the Board for recommending additional funding for the BSM program even as the program was experiencing difficulties meeting cost and schedule commitments and with failing to recognize those same difficulties even as they were being reported by both the Government Accountability Office (GAO, formerly the General Accounting Office) and TIGTA.

The audit report fails to portray the complex nature of funding for the IRS' Business Systems Modernization (BSM) program. Originally called the Information Technology Investment Account (ITIA), this account was established to provide the IRS with management flexibility to fund BSM projects without specifying during the budget formulation process how much was needed for each project or how quickly the IRS would be able to progress. The ITIA was to serve as a multi-year account with additional controls that required the IRS to develop a funding plan and obtain the approval of both appropriation committees prior to obligating funds, making the ITIA a pool of funding for BSM projects with special Congressional oversight over expenditures. In practice, the additional controls over the BSM funding have contributed to a great deal of complexity, as the IRS must obtain approvals from the Treasury Department, OMB, GAO, and two Congressional appropriation committees for each expenditure plan prior to spending the funds.

In 2001, the ITIA reached a zero balance and no longer functioned as originally intended. This situation caused the Board to testify to the Joint Committee on Taxation (JCT), in May 2001:

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[T]he Board recommends providing ITIA with an additional year of expenditures, \$550 million for 2003, to insure that projects that cross fiscal years will not have to experience inefficient delays and slowdowns. This multi-year funding of the investment account was part of the original strategy for the fund and this will be the first year since the fund was set up that it will drop to a zero balance. The President's budget does not recognize the importance of multi-year funding for ITIA, which the Board believes is a critically important concept as the IRS moves forward in developing and implementing these highly complex information systems over multiple years.

The Board believed then, as it still does today, that the BSM program should be accomplished as quickly as possible. Stretching out the program will only delay benefits and cost more in the long run. At the same time, the Board also believed that funds should not be spent beyond the capacity of the IRS and its contractor to manage and implement the BSM program, and issued the following cautionary statements in its January 2002 Annual Report:

The **IRS** must accomplish the following:

- Improve its program management ability
- Work more effectively with the PRIME Contractor
- Manage/implement change more effectively (e.g., reorganization)

The **PRIME Contractor** must accomplish the following

- Understand and achieve its responsibilities to deliver business results within budget and on schedule
- Improve its breadth and depth of skills
- Reach out to acquire the best skills available, both with the PRIME Alliance team, its subcontractors, and other unique sources of expertise

The **Administration** must do the following:

- Understand the importance and critical nature of the situation
- Understand and then support the long term plan, especially the financial investment requirements
- Hold the IRS responsible for meeting the plan

The **Congress** must accomplish the same tasks as the Administration, and, in addition, speed up the process for review and release of BSM funding.

**Oversight organizations** must do the following:

- Rationalize their roles to the extent possible and eliminate unnecessary overlap
- Leverage assets to advise in a more effective manner; and recognize that quality cannot be achieved by repetitious, and at times, inefficient inspection

The TIGTA report never explains why the Board recommended additional appropriations at a time when the IRS could not manage the program effectively. As noted in the Board's testimony to the JCT in May 2002, the Board wanted to restore this account to its original intent: to provide a pool of funding under the control of the appropriations committees that would be available to fund BSM projects as needed. To this day, that fund has not been restored to its original intent, creating additional inefficiencies every time the fund approaches a zero balance.

Despite this difference of opinion, what matters most is how to proceed in the future, and on that issue, the Board and TIGTA are in agreement. To clarify the Board's position, the Board presents in the table below its public testimony on the BSM program at various Congressional hearings that took place from May 2001 to May 2004. The testimony clearly states that the Board has always supported BSM program funding for the multi-year account, but not to be spent in excess of IRS' capacity to manage the program using the controls in place for this

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account, while acknowledging the implementation problems that were occurring throughout the period in question.

### IRS Oversight Board Testimony on the BSM Program 2001 to 2004

May 8, 2001 Testimony to JCT	The long-range solution to many of the IRS' problems is to modernize its business processes and information technology. The IRS' Business Systems Modernization (BSM) program is designed to transform both IRS' business processes and information technology into modern, efficient processes and systems that incorporate world-class best practices. The BSM program has been progressing slowly, limited primarily by IRS' capacity to manage the program. Efforts from inception to date have focused on establishing an enterprise life cycle, a standard architecture, and low-risk projects. In 2002, however, several major deliverables are scheduled, and the upcoming year will be a test of the IRS' ability to manage this program.
May 14, 2002 Testimony to JCT	To successfully implement the modernization program, all organizations involved in BSM must do a better job. The Oversight Board's recommendations for key organizations include: <ul style="list-style-type: none"> <li>• The IRS must improve its program management ability, work more effectively with the PRIME Contractor, and manage/implement change more effectively.</li> <li>• The PRIME Contractor must understand and achieve its responsibilities to deliver business results within budget and on schedule and improve its breadth and depth of skills.</li> <li>• The Administration must understand the importance and critical nature of the situation, support the long-term plan, including increased investment levels, and hold the IRS responsible for meeting the plan.</li> <li>• The Congress must accomplish the same tasks as the Administration, and, in addition, speed up the process for review and release of BSM funding.</li> </ul>
April 8, 2003 Testimony to House Ways & Means Subcommittee on Oversight	Clearly the (BSM) program execution needs improvement, and the Oversight Board believes that approval of expenditures must be consistent with the IRS' ability to manage and implement the program. The Oversight Board believes that the current process of having Congress approve the BSM expenditure plan provides safeguards against spending funds on projects the IRS cannot manage.  The Board believes the IRS is beginning to improve its ability to manage the BSM program. If the IRS can demonstrate its ability to manage the program, the funding to move the program forward must be available. On the other hand, if the IRS cannot demonstrate its ability to manage the BSM program in an acceptable manner, additional changes must be made prior to starting any new projects. Poor performance is not acceptable.
May 7, 2003 Testimony to House Appropriations Subcommittee on Transportation/ Treasury	Admittedly the BSM program had disappointing results in FY2002, and we are not suggesting that more money should be spent in 2003. However, these are three-year funds. Underfunding the program in the long term only delays the delivery of benefits to taxpayers.  Clearly the program execution needs improvement, and the Oversight Board believes that approval of expenditures must be consistent with the IRS' ability to manage the program. The Oversight Board believes that the current process of having Congress approve the BSM expenditure plan provides safeguards against spending funds on projects the IRS cannot manage.  The Board believes the IRS is beginning to improve its ability to manage the BSM program. If the IRS can demonstrate its ability to manage the program, the funding to move the program forward must be available in FY2004. On the other hand, if the IRS cannot demonstrate its ability to manage the BSM program in an acceptable manner, additional changes must be made prior to starting any new projects.
March 30, 2004 Testimony to House Ways & Means Subcommittee on Oversight	The Board's proposed budget provides the stable resources needed to focus and stabilize the steady stream of funding for the IRS' computer modernization initiative. Special controls are in place to ensure that no funding in this account is spent until the IRS has the capability to spend it effectively. If the IRS does not correct the weaknesses in the BSM program by FY2005, the Board advocates that the funds earmarked for modernization should not be spent. However, the Board does not believe the IRS should plan for failure. The agency must be poised to move forward with BSM once it has demonstrated that it has corrected the program's weaknesses. The funding level recommended by the Board sets the foundation for genuine progress for the program in FY2005.  If the IRS' FY2005 BSM funding is reduced to \$285 million, as it is in the Administration's budget, future funding likely will be adversely affected. If that happens, the projects will drag on, risk will increase, and ultimately, the program will cost taxpayers much more.

The Board's goal is to provide the employees and taxpayers with the systems they need for tax administration as quickly as possible. Holding the IRS and the PRIME accountable for getting

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the job done is key to the Board's oversight. The Board can and will hold the IRS and appropriate executives accountable to the extent of its authorities.

**Recommendation 6:** *Establish guidance to specify which circumstances will require a formal resolution by the Board and establish a process to formally vote and publish resolutions.* (This recommendation addresses issues and concerns highlighted on pages 23-26.)

**Response:** Over the last year, the Board has recognized the importance and benefits of establishing more specific guidance on its processes and activities. The Board has already taken action to establish these procedures and TIGTA notes in its report that the Board has already taken action to approve all but one of its procedures. In generally, transparency regarding Board processes and votes is good, although there are circumstances where the Board's resolutions involve sensitive issues (such as its review of IRS executive performance), when publication might not be appropriate. The Board will continue its practice of issuing media releases after every meeting and will strive to communicate to taxpayers its resolutions as fully as possible.

**Recommendation 7:** *Institute a defined system to educate new Board members on IRS operations and strategic issues.* (This recommendation addresses issues and concerns highlighted on pages 23-26.)

**Response:** The Board agrees with this excellent recommendation, which is very timely considering the expiration dates of current members' terms. One new member, Mr. Paul Jones, is currently joining the Board in September 2004, and much information has already been provided to him. The previous new member to join the Board was Raymond T. Wagner, Jr., who was sworn in on June 23, 2003. The Board is using Mr. Wagner's experiences to develop a more formal process in educating new members in Board and IRS governance issues. The Board will continue to refine this effort with the guidance of new members.

I would like to note one last item of possible confusion the audit report may create. Page two of the report notes that the Board's operating budget is \$2 million dollars. While this amount has been in the past set aside for the Board, in no previous year have the actual expenditures exceeded \$1.5 million. While the report does note that excess monies are returned to the IRS, the reference to \$2 million dollars misrepresents the Board's actual costs by 25 percent.