IRS Oversight Board Annual Report

April 2003

Executive Summary

The American tax system is at a crossroads. Following the enactment of the IRS Restructuring and Reform Act of 1998, the IRS embarked on a ten-year modernization program and is now at its mid-point. During the past five years, the IRS made enormous progress in setting the stage to provide better service and ensure fair treatment under the law for taxpayers. The agency has refocused, redefined, and rebuilt itself, with dramatic changes in its mission, organization, management processes, and governance.

Yet the American tax system is still plagued with two long-term conflicting trends: a steadily increasing demand on tax administration service, and a steady real decline in IRS resources due to budget constraints. From 1992 to 2002, IRS workload increased by 16 percent while at the same time the number of full time equivalent employees (FTEs) decreased 16 percent from 115,205 in FY1992 to 96,714 in FY2002.

But these figures don't tell the whole story. Not only are fewer resources available to handle an increasing number of returns, but the types of returns filed require more and more resources. The tax revenue stream is now dominated by sources that provide greater opportunities for manipulation and for error. The complexities of the tax system have increased and the more complicated types of returns—such as those filed by individuals earning more than $100,000 each year and small corporations—have grown.

Put another way, the IRS faces an increased demand on its resources at both ends of the tax administration spectrum: up front, for improved taxpayer education and customer service, and post-filing, for compliance activities to ensure all taxpayers pay their fair share.

Up front, the IRS faces increased demand for services to educate, inform and otherwise assist the taxpayer. Most Americans want to meet their tax obligations, and the workload reflects their demand for help in dealing with an increasingly complex tax system. In FY2002, the IRS logged 93 million toll-free calls from taxpayers; each year, millions of taxpayers call for assistance. In 2001, another 20 million called regarding the tax rebate. The IRS web site had 3.11 *billion* hits. Almost ten million taxpayers visit IRS assistance centers each year.

However, demand for compliance activities was also steadily increasing, as resources to fulfill that need were waning. Weighed against essential services, such as processing returns and answering correspondence, compliance activities were considered more discretionary. This resource triage shifted dollars and FTEs from compliance activities to customer service.

The result of these trends is a huge gap between what taxpayers need and what the IRS can deliver to them. Closing the gap is one of the IRS' greatest challenges.

Over the past five years, the IRS' performance in meeting that challenge has been mixed. The workload continued to grow. While customer service improved, compliance activities declined. IRS' FY2002 performance shows upward trends in key areas, such as electronic filing by individuals and employee satisfaction. Some compliance activities have recently picked up as well, but these improvements fall short, despite increased budgets since 1998. While the IRS must continue to strive for greater efficiencies, the Board believes that additional resources are essential to close the gap.

The IRS Oversight Board's role is to provide long-term guidance and direction to the IRS. Given the IRS' present situation, we believe that the agency, with the support of the Administration and Congress, must take the following actions if it is to succeed:

- **Close the compliance gap.** The IRS Oversight Board believes that modernizing the IRS and a three percent annual productivity gain alone will not close the compliance gap. In his end-of-term report to the Board, former Commissioner Charles O. Rossotti recommended an annual two percent per year staff growth through 2010. The Board fully endorses this approach.

- **Boost customer service.** Millions of taxpayers are filing electronically. Hundreds of millions of forms and publications are downloaded from the IRS web site. Yet the demand for customer service—over the phone and the internet, and through the mail—grows each year. So too does the complexity of the tax code. Nonetheless, only seven out of ten taxpayers can get help over the phone at tax time, given IRS resource constraints. The Board believes IRS customer service must continue to improve to a long-term level agreed upon by Congress and the Administration. Just as importantly, that level of service must be backed up with the resources needed to achieve it.

- **Commit to modernization.** Until both its processes and supporting information systems are modernized, the IRS cannot become a modern financial services institution. The Board is deeply concerned with the progress of the Business Systems Modernization program. Results have been delayed and both the PRIME contractor and the IRS need to continue to improve their management's ability to handle a program of this scope. Despite this, the Board remains committed to the modernization program, and believes it should be accomplished as quickly as possible consistent with the IRS' ability to manage and implement it. As the systems are brought on line, existing systems need to be maintained. The cost to operate both systems during this transition period must be budgeted for by IRS management.

- **Focus on people resources**. As the IRS modernizes, it must recruit, retain and develop employees who have the knowledge and skills needed to do their jobs. The IRS will also face a dramatic loss of institutional knowledge in the next five years when waves of federal employees retire. In the past five years, the IRS has concentrated on business processes and information technology. Now is the time for the IRS to make the most of its people resources by developing a comprehensive, agency-wide strategic human resources initiative.

- **Measure long-term goals.** The IRS made strides in measuring its progress in the past five years with the implementation of an agency-wide balanced measures approach to performance management. The agency and decision-makers now have a much better sense of the IRS' performance. Yet there is no universal consensus on what constitutes the appropriate level of performance in the long-term, for both customer service and compliance. Two efforts are underway to address this. First, at the Board's recommendation, the IRS Executive Steering Committee will propose and seek consensus among key executive branch agencies, Congress, stakeholders, and the public in determining appropriate levels and strategic goals for IRS long-term performance. The second is the work underway by the National Research Program, which will provide data on taxpayer compliance levels. The Board believes it is necessary for the IRS to set its long-term goals so it can evaluate progress effectively.

- **Simplify the tax code.** For the past five years, 19 public tax laws passed, 293 tax code provisions changed, and 414 alterations were made to forms and instructions. The Board does not endorse any particular tax simplification proposal, but reminds Congress that complexity adds to taxpayers' burdens, and makes it more difficult and expensive for the IRS to enforce the law.

To accomplish all of these actions, the IRS needs stable, additional funding and the support of the Administration and Congress. While the IRS budget has increased each year since 1998, its funding has not been enough to meet its growing workload. The Board is well aware of the challenges now facing our nation, and the need to prioritize government spending to ensure our security and well-being. However, the IRS has direct contact each year with more Americans than any other federal agency. It cannot close the gap or implement a successful modernization effort unless it receives additional and sustained funding over a long period of time. The Board believes that short-term solutions to reduce spending will result in larger challenges in tax administration in the future and endanger the source of revenue collection.

At the same time, the IRS should not expect increased funding without improved productivity. The IRS must work harder and smarter. The IRS must make the most of its limited resources, and continue to find ways to operate efficiently and effectively. The Board believes the IRS' strategy to focus its compliance resources on key high income/high risk areas is an intelligent approach; so too is its efforts to streamline the audit process for qualified companies. The Board encourages these programs and others that boost productivity.

Leadership at the IRS is critical and the Board looks forward to welcoming the next IRS commissioner. The nomination of Mark Everson as the next commissioner is pending before the Senate and it is hoped it will be acted upon soon. The agency has accomplished much, but must do more. Up to this point, the agency focused on planning and developing major programs. Those programs are now being implemented. The Board intends to work closely with the IRS and its new leadership to provide guidance to improve the implementation process. The Board also will work with the Administration and Congress to do all it can to ensure that the IRS gets the resources needed to succeed.

The future is now. It is time for the IRS to begin to produce the tangible benefits for taxpayers envisioned five years ago.

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Preface

In June 1997, the National Commission on Restructuring the IRS recommended the creation of the IRS Oversight Board to provide a new governance and management body that would provide focused attention on strategic issues facing the IRS. The following year, the IRS Restructuring and Reform Act of 1998 (RRA 98) established the Board 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 and tax conventions to which the United States is a party."[1]

The Board is composed of nine members. Seven of the nine members come from private life and are appointed for five-year terms by the President of the United States and confirmed by the Senate. These private life members have professional experience or expertise in key business and tax administration areas. Of the seven, one must be a full-time federal employee or a representative of IRS employees. The Secretary of Treasury and the Commissioner of Internal Revenue also serve as members of the Board.

RRA 98 requires that the private life members of the Board be appointed without regard to political affiliation and 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 tax administration and compliance
- Information technology
- Organization development
- The needs and concerns of taxpayers
- The needs and concerns of small businesses

The Board operates much like a corporate board of directors, but is tailored to fit a public sector organization. RRA 98 gave the Board specific responsibilities to review and approve strategic and performance plans of the IRS, review IRS operational functions, review the selection, evaluation, and compensation of IRS senior executives, and review and approve the budget request of the IRS prepared by the Commissioner.

[1] RRA 98, Sec. 1101

RRA 98 also gives the Board the responsibility to recommend to the President candidates for appointment as IRS Commissioner and recommend to the President the removal of the Commissioner.

This report satisfies a requirement in RRA 98 for the Board to report annually to the President and Congress.

I. Introduction

By the mid-1990s, taxpayers, the public, Congress and most key stakeholders had lost confidence in the IRS' ability to perform its job. Dialing the IRS toll-free number resulted in busy signals for 400 million callers each year. Callers who got through often received inaccurate information about their tax law or account questions. The IRS, meanwhile, linked success to direct enforcement revenues, alienating the public, Congress, and stakeholders. And in 1995, Congress cancelled a major tax systems modernization program after billions of dollars were spent with very little being accomplished.

In 1996, in response to mounting public concern that the IRS was not adequately meeting the needs of taxpayers, the Congress and Administration established the National Commission on Restructuring the IRS to evaluate problems and make recommendations. In 1998, Congress passed the IRS Restructuring and Reform Act of 1998 (RRA 98), incorporating many of the Commission's recommendations, and setting the IRS on a path to transform itself into a modern financial services institution.

To carry out RRA 98's mandate, the IRS developed a Strategic Plan, which the Board approved. In this plan, the IRS established three strategic goals:

- Top-quality service to each taxpayer in every interaction
- Top-quality service to all taxpayers through fair and uniform application of the law
- Productivity through a quality work environment

These goals guide the IRS in its transformation process. This report describes the Board's view of this progress, as well as the major challenges the IRS must meet.

II. IRS Progress and Performance

The American tax system is at a crossroads. Following the enactment of RRA 98, the IRS embarked on a ten-year modernization program. We are now, five years later, at the midpoint of that program. It is a good point to take stock, to evaluate the progress made, and look at the challenges ahead.

Since 1998, the IRS has made enormous progress in setting the stage to provide better service and ensure fair treatment under the law for taxpayers. Under the leadership of former Commissioner Charles O. Rossotti, whose five-year term ended in 2002, the IRS refocused, redefined, and rebuilt itself, with dramatic changes in its mission, organization, management processes, and governance. In the past five years, the IRS:

- Adopted a new mission statement to "Provide America's taxpayers top-quality service by helping them understand and meet their tax responsibilities and by applying the tax law with integrity and fairness to all."

- Emphasized the specific needs of different taxpayer segments by implementing a modern organizational structure with four major customer-focused operating divisions.

- Held senior executives and organizations accountable for performance by developing and implementing a balanced measures program.

- Integrated a performance and budget plan based upon a sound strategic assessment and planning process.

- Began to transform the IRS into a modern financial services institution by designing and implementing a vision and new architecture with redefined business processes and information technology.

- Implemented modern call routing, so taxpayers get to the right person to answer their questions quickly and accurately.

- Promoted electronic tax filing, which continues to grow; so much so that one paper processing pipeline will be closed.

- Provided many services on its web site, so taxpayers can check the status of their refunds, download forms, and get information easily.

- Hired executives with private sector backgrounds to bring to the agency new business knowledge and practices, while creating processes to ensure the effectiveness of its streamlined critical pay authority.

- Implemented new and/or expanded taxpayer rights, such as the Innocent Spouse program.

- Strengthened advocacy for taxpayer rights through the Taxpayer Advocate Service, which is handling a case load far larger than originally anticipated.

- Began to gather and analyze valuable taxpayer information through the National Research Program. The program's data will help the IRS allocate resources more effectively and fairly, resulting in better compliance.

The Board, which began its work in 2000, believes that the IRS made significant progress since 1998. Yet it remains concerned that the IRS is not producing results as quickly as expected or desired. Customer service, while improved, has not risen to desired levels. Enforcement activity has steeply declined, although there are signs it may have bottomed out. Efforts to modernize the IRS business systems and information technology have not produced the tangible benefits promised by managers and contractors.

At this five-year point, the Board felt it important to check the true progress of the IRS. Where is the IRS in the transformation process? Is the IRS on track? What are the greatest challenges the IRS faces, and how can they be overcome?

Conflicting Trends

Early in 2002, the Board asked then Commissioner Charles O. Rossotti to assess the state of the IRS and of the tax system. In his end-of-term report, he cited two long-term trends that began more than a decade ago: an increased demand on the tax administration system due to rapid growth in the size and complexity of the economy; and a steady decline in IRS resources due to budget constraints.[1] While the IRS budget has increased since 1998, it has not kept up with the IRS workload, which has steadily increased for the past decade. The number of tax returns filed continues to grow, particularly complex returns, such as those filed by individuals earning more than $100,000 each year and small corporations.

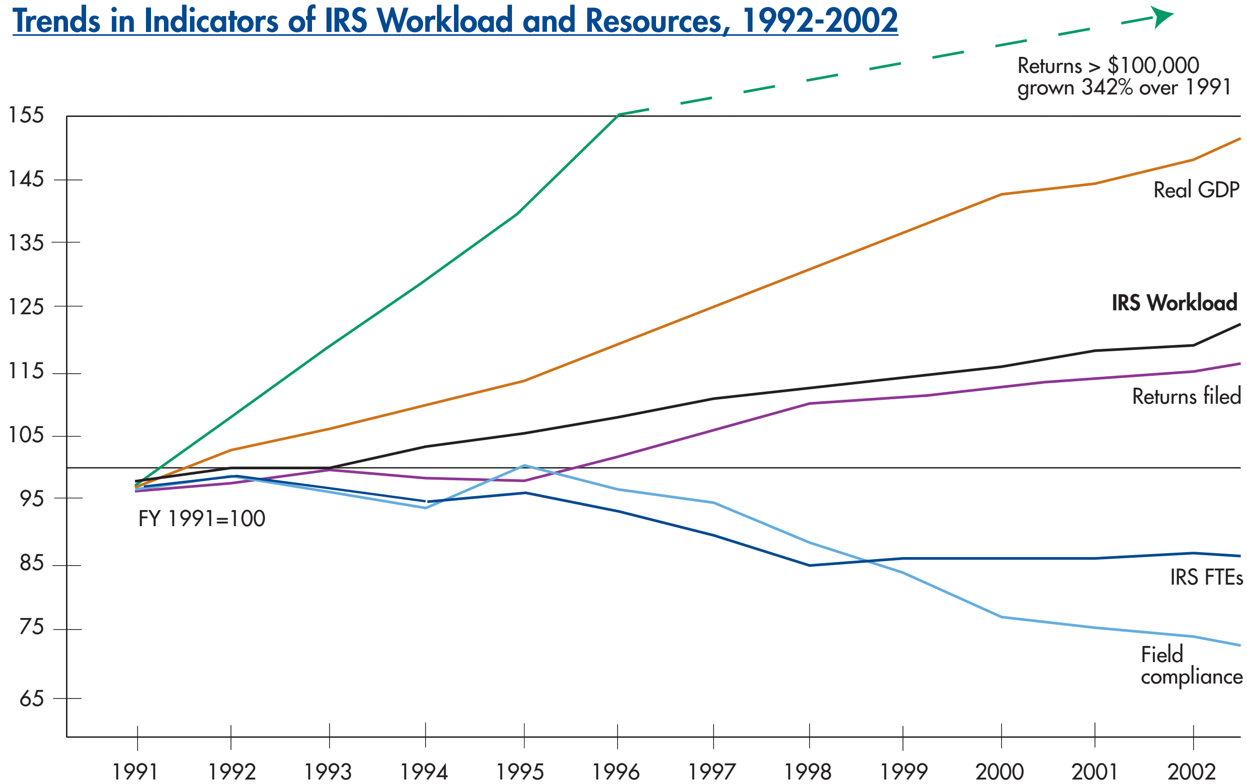
Most Americans want to meet their tax obligations, and the workload reflects their demand for help in dealing with an increasingly complex tax system. Each year, millions of taxpayers call the IRS toll-free number for assistance, and in 2001, an additional 20 million called regarding the tax rebate. In FY2002, the IRS logged 93 million toll-free calls, while the IRS web site had 3.11 billion hits. Taxpayers visit IRS assistance centers about ten million times each year.

At the same time, the number of IRS employees continued to shrink, due to budget constraints. From 1992 to 2002, IRS workload increased by 16 percent, while at the same time, the number of full time equivalent employees (FTEs) decreased 16 percent from 115,205 in FY1992 to 96,714 in FY2002. As more resources were needed for the IRS to perform essential services, such as processing returns and answering correspondence, resources were shifted from discretionary operations, including compliance activities.

Former Commissioner Rossotti reported that the effect of these conflicting trends created a huge gap between the number of taxpayers who are not filing, not reporting, or not paying what they owe, and the IRS' capacity to require them to comply. In addition, the tax revenue stream is now dominated by sources

[1] Charles O. Rossotti, *Assessment of the IRS and the Tax System*, September 2002.

Trends in Indicators of IRS Workload and Resources, 1992-2002



Source: Report to the IRS Oversight Board, *Assessment of the IRS and the Tax System*, by Commissioner Charles O. Rossotti, September 2002. 1991 to 2001 GDP data from the Bureau of Economic Analysis. 2002 & 2003 projections from Office of Management and Budget (OMB). 1991 to 2001 IRS FTE from OMB FY2002 from AFS Month 04 Current Financial Plan. IRS FTE excludes FTE associated with the EITC program. Field compliance FTE from IRS Databook, Pub. 55B.

that provide greater opportunities for manipulation by those who wish to take advantage of the decline in IRS compliance resources.

The compliance gap is a critical problem, with real consequences. According to the report:

- 60 percent of identified tax debts are not pursued
- 75 percent of taxpayers who do not file a tax return are not pursued
- 79 percent of identified taxpayers who use abusive devices (e.g., offshore accounts and abusive tax shelters) to evade tax are not pursued
- 56 percent of identified taxpayers with incomes of $100,000 or more and underreported tax are not pursued
- 78 percent of partnerships and similar document matching are not pursued.

To close the gap, former Commissioner Rossotti emphasized the importance of boosting productivity. He recommended shifting resources, eliminating some submissions processing centers, boosting e-filing, and competitive sourcing some services—steps the IRS is now taking. He noted, however, that the nation's overall productivity increases two percent each year, and the financial services industry, in its best decade ever in the 1990s, increased productivity at about 2.3 percent. He concluded that even if the IRS assumes greater productivity gains, it needs more trained personnel to close the known compliance gap while continuing to protect taxpayer rights and provide essential services.

IRS Current Performance

The increasing complexity of the tax system has also resulted in increased demands by the taxpayer for assistance and education in meeting their tax obligations. Not only is there a compliance gap, as described by former Commissioner Rossotti, but there is a gap in the level of service demanded by the taxpayer and that which the IRS can provide. In reviewing the IRS' FY2002 performance measures, the IRS Oversight Board found that:

- **Customer service showed some improvement, but not enough.** The IRS has boosted productivity in customer service in some areas, but not enough to meet taxpayers' needs. The number of returns filed electronically by individuals rose 16 percent. The IRS also improved its accuracy in correctly answering questions regarding tax law and taxpayer accounts on its toll-free telephone lines. Yet only seven out of ten callers to the IRS toll-free phone line were assisted. This is an improvement from the year before, and may indicate a trend, but this level is not acceptable to the Board. The IRS must provide to the taxpayers the tools they need to fulfill their obligations under the tax laws. Voluntary compliance is at the heart of the nation's tax system, and the easier it is for taxpayers to meet their tax obligations, the more likely they will be to comply with the law. While increased efficiencies have helped improve customer service, more resources are needed for the IRS to provide the services taxpayers need.

- **Compliance activities increased, but not enough to close the gap.** Overall compliance efforts have increased recently, and in FY2002, collection activities generated $371 million more than the year before —a laudable improvement, but not nearly enough to address the growing compliance gap. The IRS also launched a number of new initiatives aimed at identifying and shutting down abusive tax shelters and offshore accounts. In addition, Limited Issue Focused Exams were undertaken to increase the efficiencies in large business audits. However, other compliance related measures declined. The gap between new delinquent accounts received and the number closed grew again. The exam coverage rate for large businesses over $10 million declined from 25 percent to 15.5 percent. In areas of high growth in returns filed, such as partnerships and mid-sized businesses filing 1120S returns, coverage rates have also declined dramatically.

While the improvements in both areas are welcome, the Board remains concerned with the overall state of customer service and the IRS' ability to ensure that the tax law is enforced. The National Taxpayer Advocate's FY2002 Annual Report to Congress cited access to the IRS as fundamental to the achievement of universal taxpayer rights. The Board agrees that taxpayer accessibility to the IRS is imperative. The vast majority of taxpayers want to do the right thing in an increasingly complex tax system. They must be able to get help from the IRS, whether it is over the phone, in person, or over the internet. Resources must be made available so the IRS can provide the level of service expected by the public.

Equally troubling is the amount of known examination and collection cases that the IRS does not have the resources to work. If the IRS had the resources, it estimates it could produce an estimated $30 billion of additional revenue annually.

Solving these problems requires more work than the IRS can handle. The agency is simply understaffed and outmanned. The number of IRS full-time employees in FY2002 was 96,714. In FY2003, the President's budget request included 98,727 IRS employees. The IRS budget has increased each year since 1998. However, unfunded costs, including a government-wide pay raise and the administration of the Health Coverage Tax Credit program, forced the IRS to lower its projection to 96,802, which are 1,249 fewer FTEs than the President's FY2001 budget requested.

III. Challenges Remain

The IRS Oversight Board's role is to provide long-term guidance and direction to the agency. The Board believes that the IRS is making progress with the improvement projects currently underway, and they should be supported by the Administration and Congress. However, at this critical juncture, it is imperative that the IRS stays focused on addressing these major challenges:

1. Close the Compliance Gap

In its July 2002 survey of taxpayers' attitudes, the IRS Oversight Board concluded that most Americans want the IRS to ensure all taxpayers are reporting and paying their taxes honestly. Of taxpayers surveyed, 83 and 77 percent respectively believe it is very important for the IRS to ensure that corporations and high income taxpayers are reporting and paying their taxes honestly (see Appendix A).

However, the Board believes that the growing gap between what taxpayers need and what the IRS can do is a critical problem that cannot be met by enhanced productivity growth and modernization alone. Although business systems modernization (BSM) will have a major impact on IRS productivity in the long term, the Board believes that a solution to this problem is needed now. The solution is additional, stable funding to support the IRS' compliance activities and boost its customer service.

Former Commissioner Rossotti's end-of-term report to the IRS Oversight Board stated that modernizing the IRS, along with a three percent annual productivity gain would not close the compliance gap. He recommended a steady two percent staff growth per year in order to close the gap by 2010. This followed on the heels of what the National Commission on Restructuring the IRS recommended five years ago—a steady and consistent budget. The Board endorses this approach.

The Board further encourages the IRS' innovative approaches to close the compliance gap and boost its productivity with initiatives that:

- **Focus compliance resources.** The Small Business/Self-Employed Operating Division launched in 2002 a comprehensive strategy to focus its compliance resources on key areas of non-compliance with the tax code. The IRS is zeroing in on noncompliant areas, such as promotions of abusive tax schemes and offshore accounts that hide or improperly reduce income. The strategy will use a wide range of tools and techniques to crack down on tax cheats, including voluntary disclosure, audits, summonses, and criminal investigations.

- **Tailor examinations.** The Large and Mid-Sized Business Operating Division's Limited Issue Focused Examination (LIFE) program gives qualified companies a streamlined audit process where the IRS and the taxpayer agree to a dollar-limit threshold determining an issue's materiality. Using this process, the IRS will agree not to raise issues below the dollar-limit. The new process creates a more efficient, less contentious audit process, yet is highly effective by focusing on the most important issues and reducing the amount of time needed to complete an exam.

- **Streamline the paper pipeline.** The IRS has completed its reorganization to convert ten paper processing centers into two for business and eight for individual tax returns. E-filing now makes up approximately 41 percent of individual returns filed; since 1996, the percentage increase in returns filed electronically has grown 250 percent. This allows the IRS to close the paper tax return processing pipeline at its Brookhaven, New York campus in 2003.

- **Educate taxpayers.** The better taxpayers understand their tax obligations, the more likely they will be compliant. Educating taxpayers before they file their returns can save money, time, and stress by reducing the number of interactions between the IRS and taxpayers, and can prevent future enforcement woes.

- **Measure compliance.** The National Research Program, launched in 2002, will study compliance among taxpayers across the income spectrum. Getting a better understanding of taxpayers' compliance will help the IRS focus its resources appropriately.

- **Collect tax debt earlier.** The number of cases involving taxpayers who are aware of their tax liabilities but fail to pay continues to grow. Many of these cases "go stale" because there are not enough resources to ensure collection quickly enough. A legislative initiative which would allow the IRS to augment its collection resources with private collection agencies is being considered by Congress. The proposal would fund the private collection effort from monies collected from taxpayers. The initiative would allow the private collection agencies to engage in specific, limited collection activities and would allow the IRS to concentrate its resources on more complex cases. The Board supports this initiative, but expects the IRS to continue to research best practices in the field, and consider how this initiative should be managed. If enacted, the Board intends to follow the initiative very closely to ensure taxpayers' rights and confidentiality are maintained and that the private collection agencies activities and performance, including cost-effectiveness, is demonstrated.

- **Improve implementation.** Other programs are well-intended, but must be improved to succeed. The K-1 matching program, which compares K-1 information with tax returns, was launched in 2002, but was suspended due to the large number of erroneous notices sent to taxpayers. Work is underway to educate stakeholders, simplify forms, and improve analysis. The Offer-in-Compromise program, which is intended to help settle delinquent tax accounts, is widely criticized by tax practitioners. Almost 80 percent of offers cannot be processed when first received. The program is confusing and may be subject to abuse, to the detriment of taxpayers who need help. The Board believes the IRS must improve this program by educating taxpayers, simplifying paperwork, and exploring other remedies, including legislation and criminal penalties for those who abuse the program.

The Board believes all these activities are worthwhile, but to be effective, the IRS must have the needed resources to support them. It must have the resources to identify those who promote and use abusive tax shelters and schemes. It must have the resources to provide greater audit coverage. And it must have the resources to answer the questions posed by taxpayers who want to comply with their tax obligations. Reducing the number of mistakes before filing means less compliance activity will be needed in the future.

2. Boost Customer Service

The Board believes that making it easier, faster, and more efficient for Americans to meet their tax obligations is not only the right thing to do; the effort will pay off in better compliance.

In FY2002, taxpayers dialed the IRS' toll-free number almost 100 million times. They visited or called IRS walk-in centers 10 million times. And they wrote 22 million letters. They call to ask honest questions and want to meet their tax obligations.

Taxpayers' demand for help continues to grow. So too does the complexity of the tax code. For the past five years, 19 public tax laws were passed, 293 tax code provisions were changed, and 414 alterations were made to forms and instructions. Complexity adds to taxpayers' burdens, and makes it more difficult and expensive for the IRS to enforce the law. In a recent speech Assistant Treasury Secretary for Tax Policy Pam Olson commented that:

> *Instead of simplifying to increase productivity in tax compliance and administration, we keep adding complexity—more rules, more limitations, more terms, more conditions, more qualifiers, more provisos, more exceptions. The result is that our system gets slower and slower and more inefficient. We burn more fuel, and emit ever more heat and smoke, and yet with all that burning, there's less and less light to show for it.*

Despite the growing complexity in the tax code in the past five years, the IRS made significant strides to ease taxpayers' burdens. More than 40 million taxpayers are filing electronically, many using their home computers. The IRS web site posted 3.11 billion hits in FY2002. Hundreds of millions of forms and publications are downloaded from the IRS web site. The IRS' use of the internet is making it easier for taxpayers to get information, download forms, file returns, and check the status of refunds.

Taxpayers like the ease and speed of electronic tax administration. According to a 2002 survey by the American Customer Satisfaction Index, individual taxpayers filing electronically score their customer satisfaction at 78 out of 100.

Back in the paper world, however, customer satisfaction continues to be low. The same survey showed that taxpayers who file paper returns scored their experience at 53. And in other interactions with the IRS, customers still feel the enormous gap between what they expect and what the IRS can offer.

Phone service is not up to needed standards. Only seven out of ten callers to the IRS toll-free help line can get through. While this is an improvement over previous years, it does not meet taxpayer needs and expectations.

Solving a problem quickly with the IRS is still the exception, not the rule. It takes, on average, 220 days for an IRS service center to complete an individual audit. Account information is rarely current; it still takes days to post changes due to the IRS' outdated computer systems.

Boosting customer service is necessary and achievable. Providing "top-quality" service means that the IRS must be accessible to all taxpayers, whether it is over the phone, in person, or over the internet. While improved efficiencies must continue, improving IRS customer service can only be fully accomplished through additional resources. Working together, the IRS, the Administration, Congress, and stakeholders must find a consensus on the long-term level of performance expected, and the funding needed to meet the level should be provided. The IRS must do its part by continuing to work harder and smarter in helping taxpayers meet their tax obligations. At the same time, the Administration and Congress must understand that the complexity of the nation's tax system comes at a cost to both taxpayers and the IRS, and be committed to meet those costs.

3. Commit to Modernization

The Board believes that until both its processes and supporting information technology systems are modernized, the IRS cannot transform itself into a modern financial institution. The Business Systems Modernization (BSM) program was started in 1998 and is designed to transform both IRS' archaic business processes and information technology into modern, efficient processes and systems that incorporate world-class best practices. The Board believes BSM's vision and architecture is sound, but is concerned with the progress of this program.

In its January 2002 Annual Report, the Board stated that the BSM program was progressing slowly, limited primarily by the IRS' and the PRIME contractor's capacity to manage the program, and viewed 2002 as the year the BSM program had to demonstrate results.

Progress in 2002 was mixed at best. The most important project scheduled for delivery in 2002, the Customer Account Data Engine (CADE) Release 1, was reduced in scope and delayed for several months. Other projects within the BSM program also encountered cost overruns and schedule delays; program implementation was poorly managed.

The Board believes:

- The IRS did not demonstrate its ability to manage the BSM program and did not move as quickly as the Board recommended to strengthen its management capability. the BSM management team lacked depth and was overly dependent on too few people stretched too thinly.

- Although the PRIME contractor improved its team, it still has not proven it can deliver quality results on time and on budget. The FY2002 experiences only serve to emphasize these weaknesses. Key projects have been late and over budget.

The Board recommended that the IRS:

- Continue to monitor its PRIME contractor closely,
- Strengthen its management capabilities, and
- Reduce the number of separate projects it manages until it has proven its capability to manage more projects.

The IRS has begun to implement these recommendations, and the Board believes the agency has taken action to improve its capability to manage BSM. One important step was achieving Level Two in the Software Engineering Institution's Software Acquisition Capability Maturity Model. This model, widely accepted by the software industry, sets a five-step evolutionary framework used to measure and improve an organization's software acquisition efforts. The IRS is only the second federal agency to reach this level.

In addition, during FY 2001-2002 the IRS successfully delivered several convenient, secure and easy-to-use BSM services for taxpayers that:

- **Improve phone service.** The Customer Communications 2001 project boosted the efficiency and effectiveness of IRS' systems to receive, route, and respond to more than 150 million taxpayer calls each year. The improvement was activated just in time to help handle the significantly higher levels of calls on IRS toll-free hotlines that were received due to the tax rebates.

- **Expand accessibility.** The system includes voice-activated programs that recognize English or Spanish-speaking callers. Following the installation, abandon rates decreased from 76% to 41%.

- **Make it easier to check refunds.** The Internet Refund/Fact of Filing (IR/FoF) project allows taxpayers to use the Internet to check on the status of their refunds in a secure environment. Millions already use the system, and customer satisfaction surveys indicate a 92% satisfaction rate with its ease of use.

- **Secure data.** The IRS implemented the first project of its new security system — the Security and Technology Infrastructure Release (STIR) — which provides one standard for ensuring the security of all future IRS data and systems.

And in FY2003, the IRS plans to offer a suite of electronic services to tax practitioners, allowing those qualified to conduct business with the IRS electronically 24 hours a day, seven days a week.

Funding Technology

The Board underscores its position, made in last year's annual report:

- The BSM program is a major long-term investment that will require significant ongoing and growing investment

- BSM should be implemented as quickly as possible to lower the program's ultimate cost and risk. Funding reductions, while seemingly attractive in the short term, have long-range consequences, which outweigh any short-term savings.

The longer it takes to modernize the IRS' computer systems, the longer it will take for taxpayers to receive the services and the IRS to collect the revenues these systems will help generate. For example, the Filing and Compliance Payment project has a benefit stream of $27 billion over a 15 year period. A one-year delay in this project costs taxpayers $1.5 billion.

The Board believes the IRS is beginning to improve its ability to manage the BSM program. If the IRS can indeed demonstrate this ability to the satisfaction of Congress and the Administration, the funding to move the program forward must be available. The Board urges Congress to appropriate the level of funds requested in the budget. 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. Safeguards are in place to ensure that if performance does not improve to an acceptable level, the funds appropriated will not be expended.

Setting Priorities

The IRS Oversight Board favors projects that will provide quicker and more efficient interactions between the IRS and taxpayers. Taxpayer-focused projects relieve taxpayer burden, and permit the IRS to significantly improve service and compliance with tax laws in a way that benefits all taxpayers.

Initial BSM priorities were on setting the fundamental infrastructure that established the foundation for future efforts, including the development of an enterprise architecture and life cycle development process. This was followed by projects designed to build a modern hardware and security infrastructure and replace the IRS' master files. With these projects underway, the IRS vision calls for the development of application projects that build on earlier projects and deliver direct benefits to taxpayers.

Unfortunately, the decision in FY2002 to reprioritize funds for projects that strengthen the IRS' internal financial management processes diverted resources from projects that improve the IRS' ability to serve taxpayers. The IRS has used manual methods to obtain clean financial opinions from the General Accounting Office for the last three years. Although manual methods come at a cost, it is far less than the collective burden experienced by taxpayers forced to deal with IRS legacy systems.

Supporting Parallel Systems

IRS archaic "legacy" systems are extremely complex, and the risk to the country's financial well-being is immense should these systems break down. The IRS plans to maintain its existing legacy computer systems while bringing modernized systems on line. The Board believes that operating legacy and modernized systems in parallel is absolutely necessary to reduce the risk of disruptions to tax administration. The alternative approach, a massive total systems switchover, presents difficulties that are virtually impossible to surmount

The consequences of this phased approach are that as the BSM program progresses, the IRS will face a transition period during which costs will be incurred to maintain and operate both the modernized environment and IRS' legacy systems. In the Board's view, this funding requirement must be squarely faced and realistic budgets provided to assure that the IRS can effectively maintain and operate both its new and older systems while it progresses to a thoroughly modernized system environment.

4. Focus on People Resources

At the same time as the IRS modernizes its business processes and information technology, it could face the loss of institutional knowledge as more IRS employees become eligible to retire. The Board views strategic human resource management, including recruiting, hiring, training, and retaining employees, as an important, and continuing necessity for the IRS to operate effectively. The IRS must invest in its people resources. This focus requires long-term agency-wide attention and investment.

The Board believes now is the time for the IRS to address the varied human capital needs of its operating divisions by developing an agency-wide human capital strategic plan that focuses on:

- **Replacing lost critical talent.** The IRS must prepare to replace a large number of individuals in key senior positions in enforcement, computer, and human capital areas in the next few years as they become eligible to retire.

- **Building skills for complex work.** As the modernization program progresses, IRS employees must be skilled and adaptable in order to work with new, constantly changing technology. At the same time, the knowledge and skills involved in maintaining the IRS "legacy" systems must be maintained.

- **Managing change.** The IRS must coordinate its business operations among its four major operating divisions to ensure consistency, effectiveness, and efficiency in service to taxpayers.

- **Enhancing performance.** The IRS must continue to improve its management skills, while encouraging high performance throughout the agency.

- **Engage the entire workforce.** The IRS must find ways to motivate and involve employees at all levels of the organization.

The IRS' approach to including its workforce in its transformation has not been strategic to this point, but it is making some progress in human capital management since the passage of RRA 98.

The IRS' annual Gallup survey of employee satisfaction increased four percent over the previous year, and may indicate an upward trend. One reason may be that the realignment of the IRS is now settling in, and employees, particularly at the senior levels, are beginning to embrace the transformation. The Board believes it is important that the IRS pay close attention to this trend and focus efforts on those not engaged, particularly front-line employees and managers.

Training
How IRS employees develop and expand their skills is of great importance to the agency. The Board initiated a study of training in 2002, and based on information provided to date, concluded that the IRS has yet to implement a systemic approach to training throughout the agency. The Board will continue to bring strategic attention to agency-wide training and will work with the IRS to identify appropriate changes, including incorporating private-sector best practices, as it develops training and learning programs using modernized technology.

Reviewing Critical Pay
Leadership is another element of human capital management. The IRS has taken advantage of its streamlined critical pay program authorized by RRA 98, and recruited executives with private sector experience for leadership roles in the transformation of the agency. The Board believes the critical pay program must be operated effectively, and has paid close attention to the hiring, compensation, and other important matters relating to the program. The Board is particularly interested in how the expertise of critical-pay hires aligns with the agency's needs and how critical pay authority has helped it address major challenges of modernization. Overall, the Board believes the critical pay provision has helped provide needed talent and should continue.

Evaluating Performance
The Board supports the use of performance agreements to link individual performance expectations to agency-wide goals. The IRS has implemented this approach at the executive level and for senior managers, and is implementing a similar performance management system and pay banding for front-line managers. The Board believes this approach should by used throughout the organization, so that each individual will be able to align his or her performance to the organization's goals. The Board worked with the IRS to refine its processes and procedures for the evaluation of executive performance, and continues to review the Commissioner's evaluation and compensation of senior IRS executives.

5. Measure Long-term Goals

The IRS made strides in measuring its progress in the past five years. The agency and decision-makers now have a much better sense of the IRS' performance. The Board also believes that the IRS must set measures to allow it to gauge its progress in reaching long-term strategic goals.

For most measures, performance targets are developed annually and project anticipated performance for a year or two based on budgetary resources. While the IRS has set long-term strategic goals, there is no universal consensus on what constitutes or defines the appropriate long-term measures, or what its appropriate long-term performance levels should be, especially for levels of compliance.

Two efforts are now underway by the IRS to correct this situation. The first is the establishment, at the IRS Oversight Board's recommendation, of an Executive Steering Committee to develop such goals. This committee will propose the appropriate measures and strategic goals for long-term IRS performance objectives. Once the Executive Steering Committee recommends a proposed set of measures and strategic goals, the next step will be to establish public consensus around those goals. Achieving consensus among key executive branch agencies, the Congress, external stakeholders, and the public will be challenging, but will represent an important step in measuring the gap between IRS services that are currently being delivered and the levels of those services that taxpayers need. Once this is accomplished, the Board and others can quantifiably measure the level of resources required to meet these goals and determine whether the IRS is successfully meeting taxpayers' needs given the resources they receive from the Administration and Congress.

The second effort that will help the IRS meet this challenge is the National Research Program (NRP), which will provide data on taxpayer compliance levels. By determining the level of voluntary compliance among various types of taxpayers, the IRS will be able to allocate resources more effectively. The Board expects that some of the NRP results will provide useful information in the effort to establish IRS long-term strategic objectives.

IV. Conclusion

The IRS Oversight Board believes that at this critical juncture, the IRS can overcome its major challenges, boost its productivity, build upon its improvements, and eventually succeed in meeting RRA 98's mandates. But the IRS cannot do it alone.

To meet taxpayers' needs, the IRS, the Administration, and Congress must address the agency's challenges head on, with an unwavering focus on long-term results. All have a role and stake in improving the IRS.

The Administration and Congress should hold the IRS accountable for its performance, but at the same time, understand that the IRS workload is likely to increase, and that continued underfunding can only result in a wider gap—and poorer performance for taxpayers. Additional, stable funding is a crucial component for the IRS to improve.

The IRS' performance is pivotal. The IRS can and must boost productivity by making the most efficient use of its resources, such as its innovative compliance programs. It must help its workforce embrace change, with rich learning opportunities and the chance to contribute their talents to achieving the agency's goals. It must better manage and speed up the implementation of its information technology programs. And together, the IRS, Administration, Congress, and stakeholders must build consensus on compliance levels so the IRS can work toward closing the gap.

The Board does not endorse any particular proposal for tax code simplification, nor should it, but feels obligated to remind Congress that tax code complexity impedes sound tax administration and adds to enforcement difficulty. It also greatly burdens taxpayers, who find it both difficult and costly to determine their true tax obligations. The Board urges Congress to consider complexity issues as part of every tax bill, and encourages it to make tax code simplification a theme for future legislation.

The Board will continue to work closely with the IRS and its new leadership to provide guidance and direction, with a long-term view, and will work with the Administration and Congress to ensure that the IRS gets the resources needed to succeed.

Together, we can ensure that the IRS stays the course to achieve the vision of RRA 98.

Appendices

Appendix A: Taxpayer Feedback
Appendix B: IRS Oversight Board Private Life Members' Biographies
Appendix C: IRS Oversight Board Operations, FY2002

Appendix A: Taxpayer Feedback

In July 2002, to better gauge taxpayers' attitudes and expectations, the Board asked three questions of Americans in its second survey of taxpayer attitudes. One question related to customer service and two questions related to taxpayers' attitudes about compliance.

The question on customer service asked taxpayers about the value they attach to various services the IRS offers. The results are shown in Table A-1, and it is not surprising that toll-free telephone service heads the list. All four services in the survey question, toll-free telephone service, office locations, web site, and electronic filing opportunities, were thought to be very important by a majority of taxpayers, and 79 percent or more of taxpayers thought all four services were either very important or somewhat important. Access to the IRS is a critical taxpayer expectation.

Table A-1: Taxpayers' Views on IRS Services

How important is it to you, as a taxpayer, that the IRS provides each of the following services to assist taxpayers:

	Very important	Somewhat important	Not very important	Not at all important	Don't know
1. A toll-free telephone number to answer your questions	77	13	4	5	2
2. Office locations you can visit where an IRS representative will answer your questions	66	19	7	7	2
3. A web site to answer your questions	59	21	6	11	3
4. Opportunities for electronic filing of tax returns	55	24	6	11	3

The results of the two questions related to compliance are shown in Tables A-2 and A-3, respectively. One question asked taxpayers where they believe the IRS should focus its enforcement efforts. Results indicate that large numbers of taxpayers, 83 and 77 percent, respectively, believe it is very important that the IRS ensures that corporations and high income taxpayers are reporting and paying their taxes honestly.

The second question asked taxpayers what factors influence them to report and pay their taxes honestly. Results indicate that 74 percent of taxpayers are influenced a great deal by personal integrity, which had twice as much importance in influencing taxpayers to be honest and voluntarily pay their taxes than other factors such as fear of an audit, the belief their neighbors are honest, or third party income reporting.

Table A-2: Taxpayers' Views on IRS Compliance Efforts

How important is it to you, as a taxpayer, that the IRS does each of the following to ensure that all taxpayers honestly pay what they owe?	Very important	Somewhat important	Not very important	Not at all important	Don't know
1. Ensures low income taxpayers are reporting and paying their taxes honestly	56	28	8	5	3
2. Ensures small businesses are reporting and paying their taxes honestly	68	25	3	3	2
3. Ensures high income taxpayers are reporting and paying their taxes honestly	77	16	1	3	2
4. Ensures corporations are reporting and paying their taxes honestly	83	10	1	3	3

Table A-3: Taxpayers' Views on Influencing Factors for Honest Reporting and Paying

How much influence does each of the following factors have on whether you report and pay your taxes honestly?	Great deal of influence	Somewhat of an influence	Very little influence	Not at all an influence	Don't know
1. Fear of an audit	29	25	13	30	4
2. Belief that your neighbors are reporting and paying honestly	20	18	15	40	7
3. Third parties reporting your income (e.g., wages, interest, dividends) to the IRS	33	27	11	22	7
4. Your personal integrity	74	14	4	4	4

The Board draws two conclusions from its July 2002 survey results:

- **Most Americans want the IRS to ensure all taxpayers are reporting and paying their taxes honestly.** Eighty-three percent of taxpayers surveyed believe it is very important for the IRS to ensure that corporations are reporting and paying their taxes honestly, and 77 percent believe it is very important for the IRS to ensure that high income taxpayers are reporting and paying their taxes honestly.

- **Most Americans value honesty and integrity**. Seventy-four percent of those surveyed believe that their personal integrity is the most important factor that influences them to report and pay taxes honestly, more than twice as much as any other factor.

Appendix B: IRS Oversight Board Private Life Members' Biographies

The Oversight Board, by statute, consists of nine members, including the Secretary of the Treasury and the IRS Commissioner. Profiles of the seven private life members, who are appointed by the President and confirmed by the Senate without regard to political affiliation and solely on the basis of their professional experience and expertise, follow.

Nancy Killefer, Chair
Senior Partner, McKinsey and Company

Nancy Killefer is a senior partner at McKinsey and Co., an international management consulting firm in Washington, DC, specializing in developing market strategies and improving organizational effectiveness. In 1997, President Clinton appointed Ms. Killefer as Assistant Secretary for Management/Chief Financial Officer of the Department of the Treasury. She held this post until returning to McKinsey in December 1999. At the Department of the Treasury, Ms. Killefer reported directly to the Secretary on all matters involving financial and internal management of the Department and its Bureaus-including budget, personnel, management, and procurement policies. Ms. Killefer co-chaired the Vice President's IRS Customer Service Task Force and was a major contributor to the reform and restructuring of the IRS. Ms. Killefer received a graduate degree in finance from the Massachusetts Institute of Technology and an undergraduate degree from Vassar College, where she received a degree in economics.

Charles L. Kolbe
Owner, Kolbe Cattle Company

Chuck and his wife Sue have managed Kolbe Cattle Co. since graduating from Iowa State University in 1965. They still do this today on land that has been in the family for the last 125 years. In 1986, Kolbe started Midland Cattle Co., a cattle trading partnership which yearly purchases and places over 150,000 head of cattle from many locations in North America. In the early 1990s, Kolbe was a founding partner in Red Oak Farms, a branded beef company that specialized in high quality fresh and pre-cooked beef products. Midland Cattle was sold to Red Oak Farms and subsequently Red Oak Farms is under the management of Premium Quality Foods. Kolbe is past president of the Iowa Cattlemen and chairman of the Iowa Beef Industry Council. A serious bicycle accident in 1997 forced him to cut back on some of the more rigorous aspects of his life but he still remains active in much of it. He was inducted into the Iowa Cattlemen's Hall of Fame in 2000.

Larry R. Levitan
Retired Partner, Andersen Consulting (now Accenture)

Larry R. Levitan retired from a 34-year career with Andersen Consulting in 1997. He held key leadership positions at the firm, which grew during his career from 500 to over 50,000 employees. Mr. Levitan became a partner in 1974 and served as managing partner of numerous Andersen Consulting operational entities. He worked with world-class clients to create business strategies, restructure organizations, management processes, and mission critical information systems. Mr. Levitan currently serves on a number of corporate boards. He received a degree in accounting from the University of Florida. He chairs the Oversight Board's committee on business transformation. Mr Levitan served as the Board's first Chairman from 2000 to 2002.

Steve H. Nickles
Professor, Wake Forest University

Steve H. Nickles is a professor at Wake Forest University's School of Law, Babcock Graduate School of Management, and Divinity School in Winston-Salem, North Carolina. He is a technical advisor and consultant to the publishing industry on a wide range of issues in the areas of legal education and technology.

Mr. Nickles is a national expert in commercial law and specializes in payment systems and the rights of creditors and debtors, including the rights of taxpayers as debtors of government. Mr. Nickles is a graduate of the University of Arkansas and received law degrees from both the University of Arkansas and Columbia University. He chairs the Oversight Board's committee on human capital. *Resigned February 3, 2003.*

Robert M. Tobias
Professor, American University

Robert M. Tobias is a professor at American University in Washington, DC, and is also the Director of the Institute of Public Policy Implementation. Mr. Tobias retired in 1999 after 31 years with the National Treasury Employees Union (NTEU), where he served as General Counsel from 1970 to 1983, and as National President from 1983 until his retirement. At NTEU, and as a member of the President's National Partnership Council, Mr. Tobias focused on establishing cooperative/collaborative labor-management relationships in the Federal government. In 1996, President Clinton appointed him to the National Commission on Restructuring the IRS. Mr. Tobias also was a member of the IRS Executive Committee. He is a graduate of the University of Michigan, where he also received a Masters degree in Business Administration, and from The George Washington University, where he received his law degree. He chairs the Oversight Board's committee on performance management.

Raymond T. Wagner, Jr.
Legal & Legislative Vice-President, Enterprise Rent-A-Car

Raymond T. Wagner, Jr. is Legal & Legislative Vice-President for Enterprise Rent-A-Car, headquartered in St. Louis, Missouri. Previously, he served in the cabinet of Illinois Governor Jim Edgar as the Illinois Director of Revenue from 1993 to June 1995. Prior to that, he was Director of the Missouri Department of Revenue from then-Governor John Ashcroft from 1991 to 1993. He is the first individual to have been appointed Director of Revenue by Governors of two different states. Since 1993, he has been an Adjunct Professor of Law at Washington University School of Law. He served as Law Clerk for then-Chief Justice Andrew Jackson Higgins of the Missouri Supreme Court. He received his Master of Business Administration and undergraduate degrees from St. Louis University, and his law degree from University of Missouri-Kansas City School of Law. He also holds a Master of Laws-Taxation degree from Washington University School of Law. *Confirmed April 3, 2003.*

Karen Hastie Williams
Partner, Crowell & Moring

Karen Hastie Williams is a partner in the law firm of Crowell & Moring in Washington, DC, where she specializes in public contract law, legislation, and Federal budget practices. Prior to joining Crowell & Moring, she was the administrator of the Office of Federal Procurement Policy at the Office of Management and Budget during the Carter Administration, and also served as Chief Counsel to the Senate Committee on the Budget. Ms. Williams clerked for US Supreme Court Associate Justice Thurgood Marshall and Judge Spottswood Robinson, III at the US Court of Appeals for the District of Columbia circuit. She was the first black female to serve as a law clerk to a Supreme Court Justice. Ms. Williams is a member of several corporate boards, including SunTrust Bank, Inc., Gannett, Inc., Continental Airlines, Chubb Corporation, and Washington Gas Light Company. In 1994, she was Chair of the National Race for the Cure. Ms. Williams is a graduate of Bates College, the Fletcher School of Law and Diplomacy at Tufts University, and the Columbus Law School at Catholic University.

Appendix C: IRS Oversight Board Operations, FY2002

The IRS Oversight Board has completed its second year of operation. During this period the Board has engaged in a variety of activities, meeting six times as a full Board, and more times at the committee level. The Board met on the following dates in FY2002:

- December 4-5, 2001
- January 29-30, 2002
- April 2-3, 2002
- June 3-4, 2002
- July 29-30, 2002
- September 19-20, 2002

The January 29-30, 2002 meeting included a pubic meeting at which the Board received public presentations from 15 customer and stakeholder organizations on four topics of strategic interest to the Board—enforcing compliance, reducing taxpayer burden, improving operations, and workforce issues. Major organizations representing tax practitioners for individuals, small business, large business, payroll associations, state tax administrators, tax software companies, electronic services industry representatives, low income taxpayers, and IRS workers were represented at the meeting. The meeting provided the Board with an excellent opportunity to learn about the IRS' performance from a customer perspective, and the information obtained from this meeting was used throughout the year.

Because of the cyclic nature of the budget process, the Board spent a significant part of each meeting on one or more aspects of the IRS budget, and reviewed and approved the IRS budget for FY2004. In addition, the Board participated in a series of strategic assessment meetings conducted by the IRS as part of its strategic planning and budget formulation process, and had a representative at each meeting. This early participation provided the Board with a deeper understanding of the strategic analysis necessary to begin the budget formulation process and the strategic decision-making process.

During FY2002 the Board developed three reports to Congress: the Board's Annual Report to Congress, its report on Electronic Filing, and a review of the Office of the Taxpayer Advocate. The first two reports are statutorily required; the report on the Taxpayer Advocate was discretionary on the part of the Oversight Board.

The Board also invested time in several other topics of strategic importance. The IRS Business System Modernization (BSM) program was on the agenda at virtually every Board meeting, and the Board was deeply involved in discussions with IRS executives and the Prime Contractor on progress made, problems encountered, and appropriate corrective action for this critical program, both at full Board meetings and at Modernization committee meetings.

Another major activity for the Oversight Board in FY2002 was the succession planning for the IRS Commissioner. After former Commissioner Rossotti informed the Board that he would not serve another five-year term, the Board worked with the Treasury Department to develop a position specification that described the qualities the Board and Department of Treasury believed were important in the next Commissioner. Using this specification, the Board hired an executive search firm experienced in filling Chief Executive Officer (CEO) positions to find candidates meeting this specification. The Board cannot overstate how difficult it is to find CEO-caliber candidates who are willing to serve a five-year term as IRS Commissioner. Ultimately, the Board was able to find two candidates possessing the requisite experience who would consider serving, and forwarded the names of those candidates and their qualifications to the White House for its consideration.

The Board decided to have representation at all six Nationwide Tax Forums the IRS conducted during the summer months. At these meetings, each attended by over 2,000 tax professionals, the Board sought out the opinions of attendees on IRS operations, and conducted small group meetings with both tax professionals and employees to discuss IRS issues with each group.

Other strategic issues the Board evaluated during the year included the IRS employee survey conducted by Gallup, electronic filing program, K-1 matching, the closing of the Brookhaven pipeline for processing paper tax returns, and the re-engineering of compliance strategies in both LMSB and SB/SE.

During the year, the Board provided speakers to a number of organizations that were interested in the Board's operations, including tax practitioner and payroll reporting groups, as well as several internal IRS management meetings.

The three committees of the Board also met periodically in person or by telephone. The Modernization Committee met several times to review in-depth progress of the IRS' Business Systems Modernization program, including such topics as management capability, schedule progress, and needed improvements to the program. The committee also reviewed the IRS' efforts to provide a more detailed view of its overall information technology needs and the funding required to support its current systems environment.

The Performance Management Committee met four times during the year with IRS executives to review progress in meeting performance goals for major IRS operational divisions, in addition to several planning meetings it conducted. The Board focused on customer and employee satisfaction, quality, and selected productivity goals. These reviews with IRS division executives proved to be very effective in understanding the progress each division was making, and provided the Board with valuable data to use in its year-end review of executive evaluation and compensation.

In keeping with the Board's statutory responsibility to review the selection, evaluation, and compensation of senior IRS executives, the Committee on Personnel and Organization conducted a thorough review of the performance evaluations and proposed bonuses of 13 top IRS executives. This review was coordinated with the Performance Management Committee to ensure that executive evaluations were consistent with operating division performance. The Committee also performed a complete review of the operations of the Office of the Taxpayer Advocate, and produced a report that was adopted by the full Board and released to the public. The committee also launched a review of training at the IRS, which is still underway.

In keeping with the RRA 98 requirement to report Oversight Board travel expenses to Congress, the Board incurred $58,735 in travel expenses for Board members and staff in FY2002, primarily for travel to and from Board committee meetings.

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