United States General Accounting Office

GAO

Report to the Commissioner of Internal Revenue

June 2002

INTERNAL REVENUE SERVICE

Improving Adequacy of Information Systems Budget Justification

G A O

Accountability ★ Integrity ★ Reliability

GAO-02-704

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Abbreviations

IRS	Internal Revenue Service
IS	information systems
IT	information technology

G A O
Accountability * Integrity * Reliability

United States General Accounting Office
Washington, D.C. 20548

June 28, 2002

The Honorable Charles O. Rossotti
Commissioner of Internal Revenue

Dear Mr. Rossotti:

On April 9, 2002, we testified before the Subcommittee on Oversight, House Committee on Ways and Means, on the Internal Revenue Service's (IRS) fiscal year 2003 budget request.[1] In brief, we reported that although IRS had adequately justified its $450 million Business Systems Modernization request, it did not develop its $1.63 billion information systems (IS) operations and maintenance request in accordance with the best practices of leading private- and public-sector information technology (IT) organizations. This report officially transmits both the results we reported and the recommendation we made to you in our testimony. Before our testimony, we discussed the results of our work with IRS officials, and they agreed with our findings and recommendation. We performed our work from February through April 2002, in accordance with generally accepted government auditing standards.

IRS's Information Systems Request for Operations and Maintenance Is Not Adequately Justified

Leading private- and public-sector organizations have taken a project- or system-centric approach to managing not only new investments but also operations and maintenance of existing systems. As such, these organizations

- identify operations and maintenance projects and systems for inclusion in budget requests;
- assess these projects or systems on the basis of expected costs, benefits, and risks to the organization;
- analyze these projects as a portfolio of competing funding options; and
- use this information to develop and support budget requests.

[1]U.S. General Accounting Office, *Internal Revenue Service: Assessment of Budget Request for Fiscal Year 2003 and Interim Results of 2002 Tax Filing Season*, GAO-02-580T (Washington, D.C.: Apr. 9, 2002).

This focus on projects, their outcomes, and risks as the basic elements of analysis and decision-making is incorporated in the IT investment management approach that is recommended by the Office of Management and Budget and us.[2] By using these proven investment management approaches for budget formulation, agencies have a systematic method, on the basis of risk and return on investment, to justify what are typically very substantial operations and maintenance budget requests. These approaches also provide a way to hold IT managers accountable for operations and maintenance spending and the ongoing efficiency and efficacy of existing systems.

IRS did not develop its IS request in accordance with these best practices of leading organizations. In particular, the largest elements of IRS's budget request are not projects or systems. Rather, they are requests for staffing levels or other services. For example, IRS is requesting $240 million for staff and equipment supporting operations and maintenance of desktop computers agencywide, as well as $111 million for staff and equipment supporting its major computing centers' operations. Further, the agency is requesting $266 million for telecommunications services contracts. Taken together, these three initiatives constitute about 38 percent of the total $1.63 billion being requested for operations and maintenance, but the budget request gives no indication regarding how these initiatives are allocated to systems. In addition, in developing these requests, IRS did not identify and assess the relative costs, benefits, and risks of specific projects or systems in these areas. Instead, according to IRS officials responsible for developing the IT operations and maintenance budget, they simply took what was spent last year in these categories and added the money to fund cost-of-living and salary increases.

These IRS officials attributed the gap between IRS's practices and those followed by leading organizations to the lack of an adequate cost accounting system, cultural resistance to change, and a previous lack of management priority. To better justify future budget requests, these officials said that they have assessed the strengths and weaknesses of IRS's budgeting and investment management processes against our IT investment management framework[3] and found significant weaknesses in

[2]See, for example, U.S. General Accounting Office, *Information Technology Investment Management: A Framework for Assessing and Improving Process Maturity*, Exposure Draft, GAO/AIMD-10.1.23 (Washington, D.C.: May 2000, Version 1).

[3]GAO/AIMD-10.1.23.

15 critical areas. To address the weaknesses, IRS is currently developing capital planning guidance that is based on our IT investment management framework. This guidance is to be issued by late summer 2002, but a schedule for implementing it had yet to be determined. In addition, IRS had adopted and was in the process of implementing a cost model that is to enable it to account for the full costs of operations and maintenance projects and determine how effectively IRS projects are achieving program goals and mission needs. IRS plans to have the cost model in place and operational by June 30 of this year so that it can validate its fiscal year 2003 IS appropriation request and begin using the cost model to develop the fiscal year 2004 request.

Although IRS has initiated actions to address the previously noted weaknesses, we are concerned about whether these actions will be implemented in time to have meaningful impact on formulation of the fiscal year 2004 budget request. For example, IRS had not yet developed a plan and schedule for implementing its IT capital planning guidance. In addition, IRS officials told us they are already beginning the process to develop the fiscal year 2004 budget. Consequently, until IRS overcomes its obstacles, the agency's future IS appropriation requests, like its fiscal year 2003 request, will not be adequately justified.

Recommendation for Executive Action

We recommend that the Commissioner of Internal Revenue direct the Budget Director, Modernization, Information Systems, and Security Services, to prepare IRS's fiscal year 2004 IS budget request in accordance with leading organizations' best practices. At a minimum, this should include (1) adopting these best practices as an explicit priority and (2) employing these practices in time for use in developing the fiscal year 2004 budget request.

Agency Comments

In commenting on a draft of this report, the Commissioner of Internal Revenue agreed with our recommendation, adding that IRS understands its importance and is taking actions to fully implement it. The Commissioner described IRS's ongoing and planned efforts relating to implementing best practices and addressing our recommendation, including specifying milestones for when these initiatives will be fully implemented. The Commissioner's written comments are reprinted in appendix I.

As you know, 31 U.S.C. 720 requires the head of a federal agency to submit a written statement of the action taken on our recommendation to the Senate Committee on Governmental Affairs and the House Committee on Government Reform not later than 60 days from the date of this report. A written statement must also be submitted to the House and Senate Committees on Appropriations with the agency's first request for appropriations made more than 60 days after the date of this report.

We are sending copies of this report to the Chairmen and Ranking Minority Members of Senate and House committees and subcommittees that have appropriations, authorization, and oversight responsibilities for IRS. We are also sending copies to the Secretary of the Treasury, the Chairman of the IRS Oversight Board, and the Director of the Office of Management and Budget. In addition, this report will be available at no charge on the GAO Web site at http://www.gao.gov.

Should you or your staff have questions on matters discussed in this report, please contact me at (202) 512-3439. I can also be reached by e-mail at hiter@gao.gov. A GAO contact and key contributors to this report are listed in appendix II.

Sincerely yours,

Randolph C. Hite
Director, Information Technology Architecture
and Systems Issues

Comments from the Internal Revenue Service

COMMISSIONER

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

June 13, 2002

Mr. Joel C. Willemssen
Managing Director, Information
Technology Issues
U.S. General Accounting Office
441 G Street, N.W.
Washington, D.C. 20548

Dear Mr. Willemssen:

I am writing to comment on the General Accounting Office (GAO) Draft Report, "Internal Revenue Service: Improving Adequacy of Information Systems Budget Justification (Job Code 310237)." The GAO's report recommending improvement to the analysis and justification of our information systems budget is accurate and timely. The Modernization Information Technology and Security (MITS) Services organization is reorganizing and realigning people, operations, and service delivery to IRS customers, which will help us apply financial best practices to improve:

- Budget development
- Investment decisions
- Information technology resources management

During the past six months, MITS Services has fundamentally improved the financial management and budgeting processes for IT funding by aligning the budget for FY 2002 - FY 2004 with:

- Responsible organizations and executives
- Specific operational activities
- Specific projects for investments

We included in this process consistent budget planning and forecasting for all IT resources and performance measures for each program area.

We also realigned the MITS Services budgetary resources to meet the IRS business priorities within essentially flat budgets from FY 2002 – FY 2004. We prioritized

significant investment projects through an agency-wide portfolio management process that included Tiers A, B, and a significant portion of C. For the first time, we included infrastructure investments in the portfolio prioritization that resulted in aggressive targets and significant savings in operational and maintenance activities and funding increases to modernization support, high-speed remote access for revenue agents, and improvement projects for operating division to provide enhancements of installed systems.

Over the last six months, we have aggressively used best practices in developing our FY 2004 budget request. We also used best practices to analyze and allocate our FY 2004 plan and budget. We will continue to fully implement the best practices for operating and maintaining existing systems and improving our planning and budgeting procedures.

We understand the importance of correcting the issues you identified. We are taking actions to resolve them. I have enclosed our response to your recommendations. Thank you for your hard work in preparing this comprehensive report, your support of the IRS, and your ongoing counsel.

Sincerely,

Charles O. Rossotti

Enclosure

Response to the GAO Recommendations
Improving Adequacy of Information Systems Budget Justification
(Job Code 310237)

The GAO report contains four recommendations based on the leading private and public sector organizations' systems-centered approach to managing new investments and their operations and maintenance of existing systems. We are taking the following actions in response:

1. **Identifying operations and maintenance projects and systems for inclusion in budget requests.** As part of the MITS Services reorganization, the Directors of Information Technology Services (ITS), Security, and Human Resources and Training are now planning and budgeting all MITS Services resources. The MITS Services Directors identified program activities, operations, and maintenance projects that support daily operations with the goal to reduce costs and align resources to improve service delivery. This included reviewing and realigning current operations and maintenance projects and systems for the FY 2002, FY 2003, and FY 2004 budgets. To improve service delivery and performance, we used a pilot activity-based costing software package called the "IT Cost-of-Services model" to aid in allocating labor and non-labor resources. The MITS Services Directors spent considerable time during the first six months of FY 2002 identifying activities and cost drivers within their respective units. We used this information and performance metrics to analyze and project costs for the FY 2004 budget. The IT Cost-of-Services model (still in development) includes all MITS Services activities, and we are using it to plan, project, and report costs for business tasks/activities funded by the IT budget (labor and non-labor). We plan to complete the model design and pilot during the final quarter of FY 2002.

2. **Assessing these projects or systems based on costs, benefits, and risks to the organization.** The MITS Services organization uses a business case methodology to assess proposed investments in the Business Systems Modernization (BSM) program. In addition, we are developing a capital planning guide to provide capital planning and investment control, budget formulation and execution, and procurement and acquisition processes and procedures. We are applying business case and capital planning methodology to MITS Services' current operations and maintenance activities. For the FY 2004 budget, the MITS Services senior team is using the newly identified IT program activities and projects to assess projected costs for security, web services, end user support (Tier III), business systems development, and enterprise operations. However, because we have not fully developed the process, we are assessing the benefits and risks at a higher level than called for by the GAO. We are designing a capital planning process to address, in detail, prioritization and cost benefit analysis with risk assessments. We anticipate developing a draft capital planning guide by September 2002.

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3. **Analyzing these projects as a portfolio of competing funding options.** The MITS Services organization addressed program activities and competing priorities within a flat budget for FY 2003 and FY 2004. Specifically, we are managing MITS Services program budget as a portfolio. Working within a known funding allocation for the Information Systems Multi-Year (ISY) budget, the MITS Services senior leadership team analyzed all hardware and software operations and maintenance funding as one portfolio. This included comparing requirements for end user support (Tier III), enterprise operations, business systems development, web services, security requirements, and general management. For the Tier B projects, MITS Services led a prioritization process with the business systems staffs of the business units to assess funding needs for Tier B projects. We realize we need to implement a consistent process to manage our portfolio and prioritize business requirements from the IRS business units. The capital planning guide will include requirements for IT portfolio management and the IRS's planning, budgeting, and performance management policies, processes, and practices.

4. **Using this information to develop and support budget requests.** The MITS Services organization used costs, benefits, and risk and performance measures for planning and budgeting IT services at a high level for the FY 2004 budget. For the FY 2004 budget, we believe we have initiated a process to establish a robust portfolio of IT activities for operating and maintaining the ISY $1.5 billion budget. This process includes using the IT Cost-of-Services model to provide a bridge between traditional budget planning and reporting and the MITS Services operations. The model includes:

   - Developing a Capital Planning Guide
   - Developing Business Case processes required for new IT funding requests, patterned after the BSM method
   - Developing an IT project portfolio, patterned after the BSM process

GAO Contact and Staff Acknowledgments

GAO Contact

Gary N. Mountjoy, (202) 512-6367

Staff Acknowledgments

In addition to the individual named above, other key contributors to this report were Bernard R. Anderson, Michael P. Fruitman, Timothy D. Hopkins, and Ona M. Noble.

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