United States General Accounting Office

GAO

Report to Congressional Requesters

February 2001

# IRS MODERNIZATION

# IRS Should Enhance Its Performance Management System

GAO

Accountability * Integrity * Reliability

GAO-01-234

# Contents

United States General Accounting Office
Washington, DC 20548

February 23, 2001

The Honorable Bill Thomas
Chairman, Committee on Ways and Means
House of Representatives

The Honorable Amo Houghton
Chairman, Subcommittee on Oversight
Committee on Ways and Means
House of Representatives

In response to congressional and public criticism that it was emphasizing revenue collection over taxpayer service, the Internal Revenue Service (IRS) initiated a major modernization effort to make it more responsive to taxpayers' needs. A key part of this modernization effort is developing a new performance management system that lays out the agency's goals, objectives, and performance measures and is intended to balance taxpayer service and enforcement activities while fostering a productive work environment. The Commissioner of Internal Revenue considers holding managers in IRS' operating divisions[1] accountable for achieving these goals and objectives critical to accomplishing IRS' mission. To an important extent, the performance management system is expected to create the incentives that influence the behavior of IRS employees and determine whether IRS' day-to-day activities support the goals of modernization.

Recognizing that revamping a performance management system is a difficult, long-term effort, you asked us to provide information on how IRS measures its performance. Specifically, as agreed with your office, our objectives were to (1) describe the status of IRS' efforts to develop agencywide and operating division goals, objectives, and performance measures that support IRS' mission and (2) assess these efforts and identify actions, if any, IRS could take to enhance its performance management system.

[1]The operating divisions are (1) Wage and Investment, serving individual taxpayers; (2) Small Business and Self-Employed, serving fully or partially self-employed individuals and small businesses with assets under $5 million; (3) Large and Mid-Size Business, serving businesses with assets over $5 million; and (4) Tax Exempt and Government Entities, serving pension plans, exempt organizations, and governments.

Our assessment is not a review of IRS' compliance with the requirements of the Government Performance and Results Act (GPRA) of 1993.[2] Although IRS expects to use certain features of its performance management system to satisfy GPRA requirements, IRS developed the system primarily to meet its internal management needs. As a result, our assessment focused on whether the system met IRS' unique management needs. Our assessment is based on characteristics that we found associated with goals, objectives, and performance measures in the performance management literature, including GPRA.[3] In particular,

- *goals*, which are broad statements of desired outcomes, should
  - reflect the agency's priorities,
  - provide a clear direction for future agency action,
  - identify what impact or outcome will result from an agency's work, and
  - form the basis for formulating clear objectives;
- *objectives*, which are targets that describe the end results a service or program is expected to accomplish in a given period of time to meet goals, generally should be
  - clearly stated,
  - specific,
  - measurable,
  - outcome or output oriented, and
  - consistent with the agency's mission and goals; and
- *performance measures or indicators*, which are often selected after goals and objectives are developed, should be
  - logically and directly related to the goals and objectives,
  - focus on expected outcomes or outputs, and
  - capture information relevant to the goals and objectives.

[2]P.L. 103-62. GPRA requires agencies to set goals, measure performance, and report on their accomplishments in their annual performance plans and annual program performance reports.

[3]The publications we reviewed included: OMB Circular A-11, Part 2, *Preparation and Submission of Strategic Plans, Annual Performance Plans, and Annual Program Performance Reports* (July 2000); *Agencies' Strategic Plans Under GPRA: Key Questions to Facilitate Congressional Review* (GAO/GGD-10.1.16, May 1997); *The Results Act: An Evaluators Guide to Assessing Agency Annual Performance Plans* (GAO/GGD-10.1.20, April 1998); Center for Accountability and Performance, *Performance Management: Concepts and Techniques*, 2nd ed. (1999); Robert S. Kaplan and David P. Norton, *The Balanced Scorecard: Translating Strategy Into Action* (Boston, Mass.: Harvard Business School Press, 1996); and National Partnership for Reinventing Government, *Balancing Measures: Best Practices in Performance Management* (August 1999).

Our work was done between August 1999 and December 2000 in accordance with generally accepted government auditing standards. See appendix I for a detailed description of our scope and methodology.

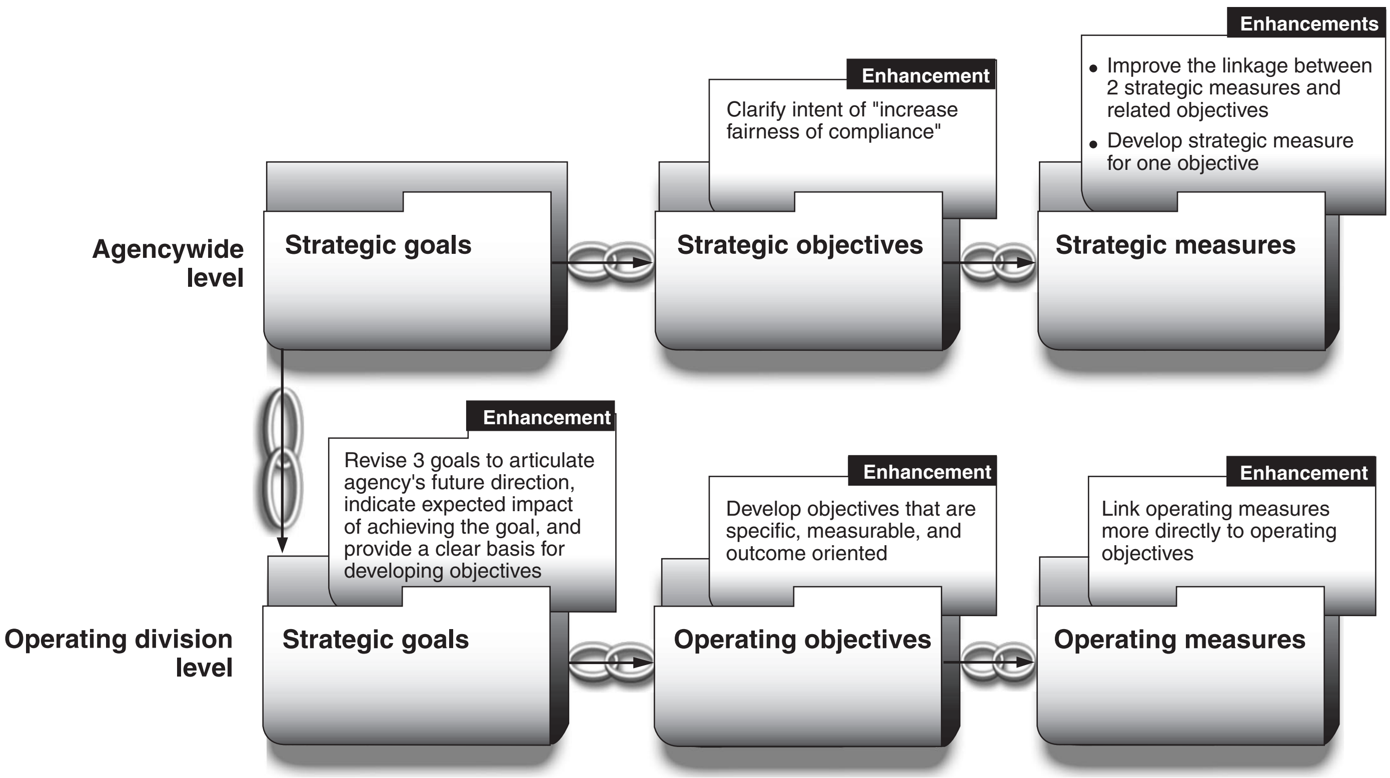
## Results in Brief

IRS has established three agencywide strategic goals and the corresponding strategic objectives and has identified the strategic measures it plans to use for measuring progress toward meeting the strategic objectives. Below the agencywide level, the operating divisions developed their own strategic goals that were to align with the agencywide goals. The operating divisions also developed operational objectives to meet the division-level strategic goals and operating measures to measure progress toward some of those objectives. In addition, managers developed action items that detailed the steps they planned to take to achieve operational objectives.

IRS has made progress in the challenging task of revamping its performance management system. In addition to developing goals, objectives, and performance measures, IRS has implemented a new strategic planning and budgeting process intended to integrate the use of performance measures into agency management.

However, as shown in figure 1, we identified several issues that IRS could address at both the agencywide and division levels to enhance its performance management system.

Figure 1: Recommended Enhancements to IRS' Performance Management System




Source: GAO.

At the agencywide level, the intent of the objective of "increase fairness of compliance" is not clear, and performance measures do not capture key information needed to gauge progress toward achieving three strategic objectives. At the division level, three of 15 goals do not (1) clearly articulate the divisions' future direction, (2) indicate the expected impact of achieving the goal, or (3) provide a clear basis for establishing objectives. Also, operating objectives are not specific, measurable, or in all but two cases, outcome or output oriented; and a large number of operating measures and indicators are not directly linked to objectives. In addition, because IRS was introducing its new performance management concepts, many of the action items developed by managers to meet the fiscal year 2000 operating objectives were not specific, measurable, and outcome or output oriented.

IRS recognizes that revamping its performance management system will be an ongoing process because the inherent difficulties in implementing such a major change will require continuing adjustments. We are making recommendations to the Commissioner of Internal Revenue on how IRS can enhance its performance management system at both the agencywide and division levels. In commenting on a draft of this report, the Commissioner agreed with our recommendations at the division level. However, the Commissioner raised some concerns with our recommendations to clarify one strategic objective and add a measure for the strategic objectives concerning customer service.

## Background

In response to congressional concerns that IRS was overemphasizing revenue collection at the expense of fairness to taxpayers, the Commissioner of Internal Revenue is seeking to refocus the agency toward an approach that promotes voluntary compliance with the tax laws through better taxpayer service while concentrating enforcement resources on those taxpayers who are deliberately and willfully noncompliant.

IRS realized it needed to revamp its performance management system to reflect this new focus within the constraints of two legislative requirements on how it sets goals and measures performance. First, the Government Performance and Results Act of 1993 requires federal agencies to establish a hierarchy of goals, objectives, and performance measures applicable to various organizational units within their agencies. Second, the IRS Restructuring and Reform Act of 1998[4] directed IRS to establish individual, group, and organizational goals and objectives, but prohibited IRS from using tax enforcement results[5] to evaluate any IRS employee or to impose or suggest production quotas or goals.

According to the performance management literature we reviewed, the purpose of organizational goals, objectives, and measures is to enable an organization to monitor how well it is achieving its mission. Strategic goals provide direction to an organization's work, services, programs, and activities and generally describe a desired outcome for the organization and its programs. To achieve goals, organizations develop objectives. Objectives are more specific than goals and are measurable targets that

[4]P.L. 105-206.

[5]Tax enforcement results are outcomes produced when IRS employees exercise their judgment in recommending or determining whether or how IRS should pursue enforcement of the tax laws. Examples of tax enforcement results are the number of liens, levies, and seizures issued; the dollar amount assessed; the dollar amount collected; and the number of fraud referrals.

describe the end results a service or program is expected to accomplish in a given time period. Finally, organizations develop performance measures to monitor progress toward their objectives and ultimately their goals. Performance measures should be quantifiable measures, such as outcomes, outputs, efficiency, or cost-effectiveness, and should be useful in determining whether the organization is achieving its goals.

One framework for developing performance measures is the "balanced measures approach," which was adopted by IRS. This approach originated in the private sector when companies concluded that overemphasizing short-term financial objectives could actually be detrimental to their long-term success. Instead, these companies began focusing on both financial and nonfinancial aspects of performance, including areas such as product convenience and quality, that engender the kind of customer satisfaction and loyalty necessary for success in the long run.

## IRS Has Developed Goals, Objectives, and Performance Measures

At both the agencywide and operating division levels, IRS has established goals and the corresponding objectives and has identified the performance measures it plans to use for measuring progress toward meeting the goals and objectives.

### IRS Established New Agencywide Strategic Goals, Objectives, and Measures to Reflect Its New Mission Statement

In 1998, the Commissioner of Internal Revenue replaced IRS' old mission statement with a new one: "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."

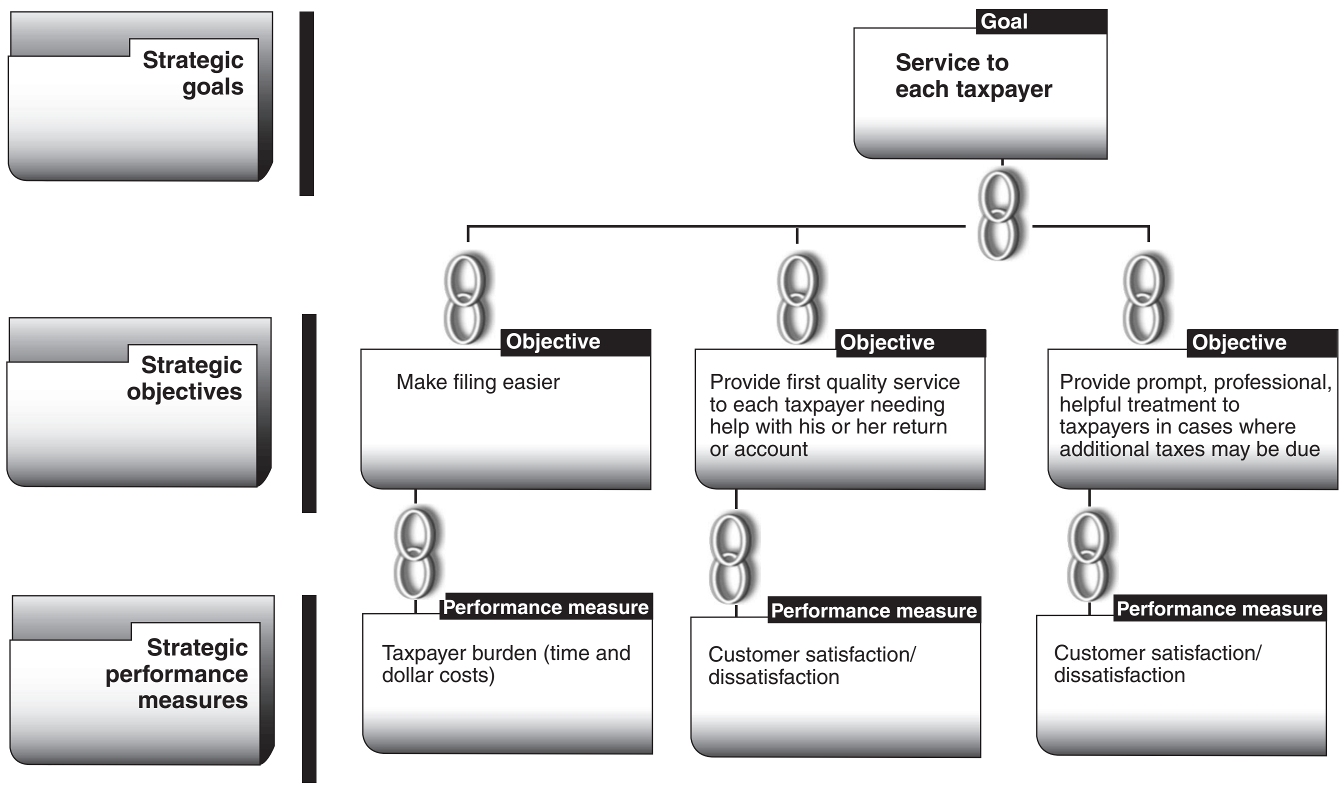
Using the balanced measures approach of emphasizing multiple goals, IRS established three agencywide strategic goals in 1999 to reflect its new approach to tax administration. The goals are

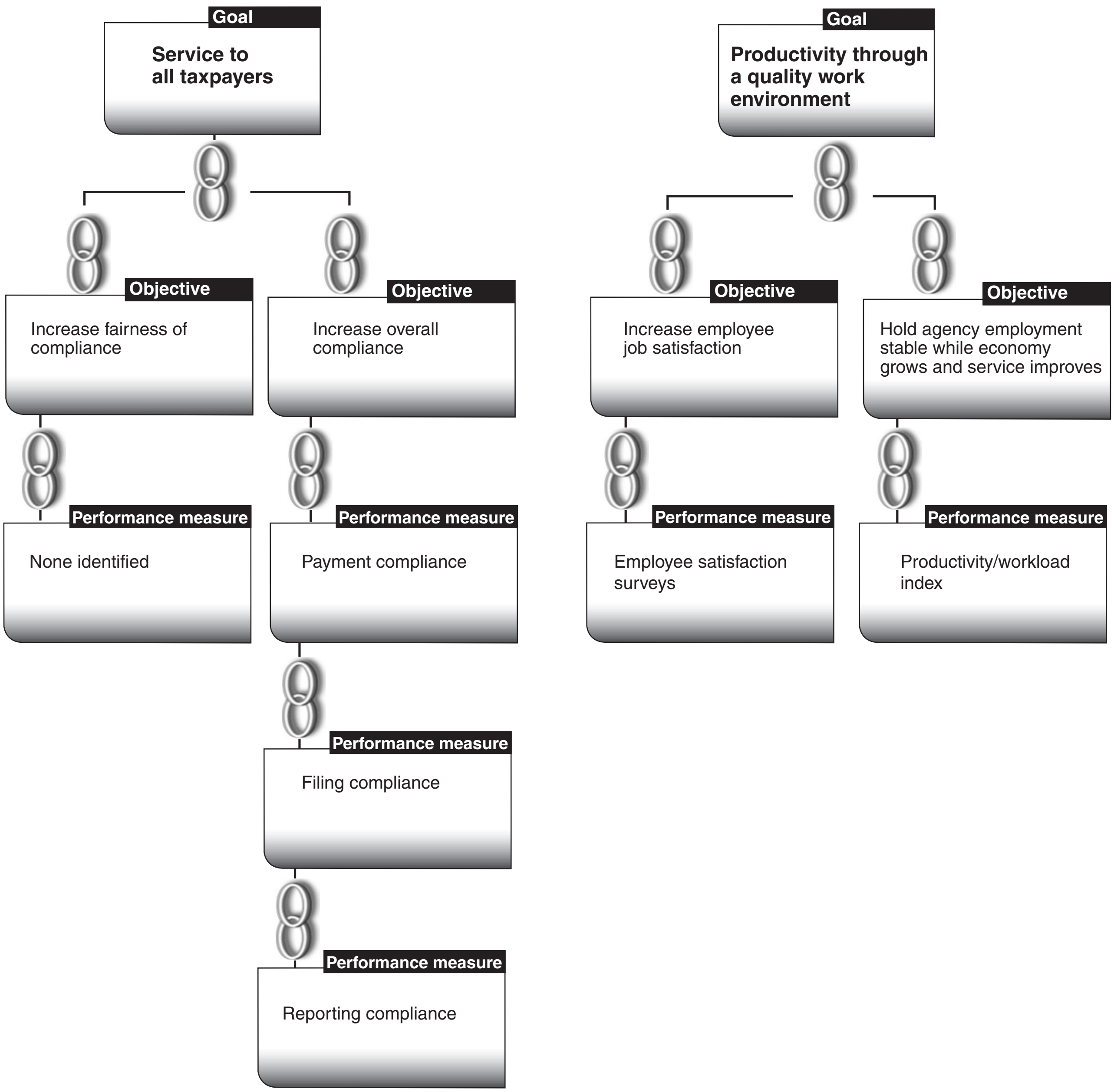
- "service to each taxpayer,"
- "service to all taxpayers," and
- "productivity through a quality work environment."

IRS chose the balanced measures framework for its new performance management system because senior executives wanted to ensure that managers and employees considered taxpayer needs in addition to revenue collection when making decisions. IRS also established two or more strategic objectives for each goal.

In 1999, IRS developed and began using the results of its employee satisfaction survey as a strategic measure for the objective of “increase employee job satisfaction.” In 2000, IRS identified and began developing other strategic measures, such as taxpayer burden as a measure for “making filing easier.” These measures are in various stages of development. For example, IRS expects to have taxpayer burden estimates for the Wage and Investment Division in fiscal year 2001 and anticipates developing estimates for the Small Business and Self-Employed Division in fiscal year 2002. IRS is not sure when data on productivity and workload will be available. The strategic goals, objectives, and performance measures are shown in figure 2.

**Figure 2: IRS' Agencywide Strategic Goals, Objectives, and Performance Measures**




Goal
Service to all taxpayers
Objective
Increase fairness of compliance
Performance measure
None identified
Objective
Increase overall compliance
Performance measure
Payment compliance
Performance measure
Filing compliance
Performance measure
Reporting compliance
Goal
Productivity through a quality work environment
Objective
Increase employee job satisfaction
Performance measure
Employee satisfaction surveys
Objective
Hold agency employment stable while economy grows and service improves
Performance measure
Productivity/workload index

Source: IRS.

## IRS' Strategic Planning and Budgeting Process Provides the Framework for Operating Divisions' Goals, Objectives, and Measures

In 2000, IRS implemented a new strategic planning and budgeting process that provides the framework for developing goals, objectives, and measures at the operating division level. Under this process, the operating divisions developed program plans that identified the division's strategic goals, which were to correspond to each of the agencywide strategic goals. Such division-level strategic goals were to be tailored to the specific characteristics and needs of individual taxpayer segments served by the division. The program plans also identified the operating objectives, which IRS calls operating priorities, intended to accomplish the division's strategic goals.

For example, the Wage and Investment Division (W&I) concluded that most of the taxpayers it deals with

- prepare their own tax returns;
- are highly compliant, with noncompliance often resulting from taxpayer confusion;
- contact IRS only once a year; and
- receive refunds.

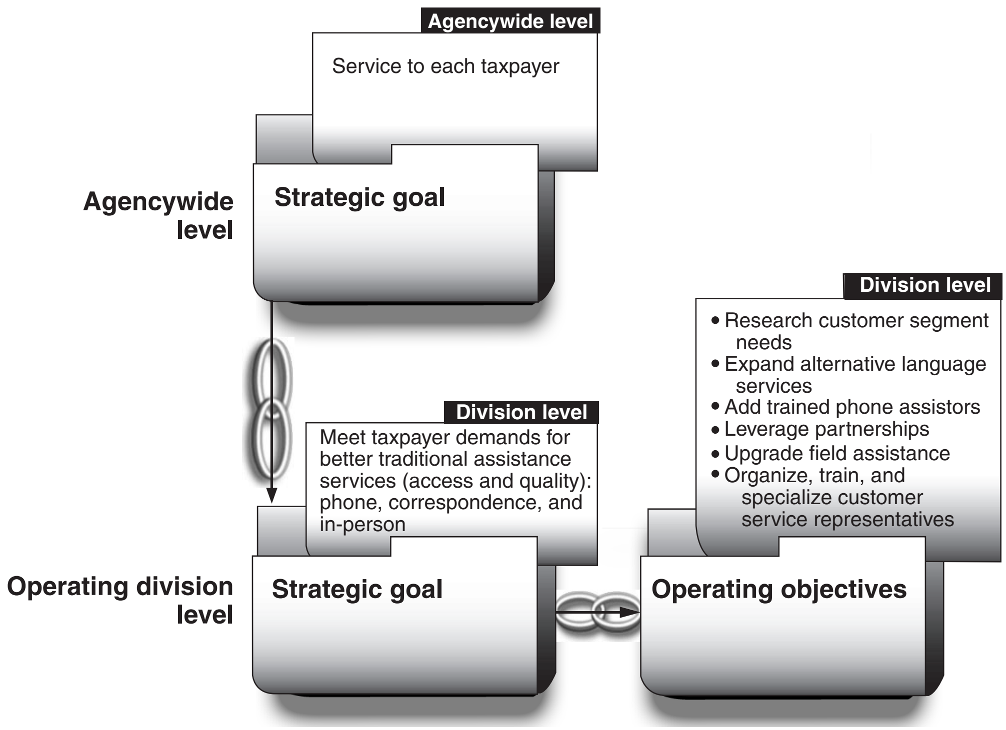
W&I considered these characteristics when developing its strategic goals and operational objectives. Figure 3 illustrates the linkage between the agencywide goal of "service to each taxpayer" and one of W&I's strategic goals and associated operating objectives, which addresses improving taxpayer convenience and communication.

The program plans also identify three types of operating measures or indicators that the operating divisions will use to measure their performance. They are

- balanced measures, which includes customer satisfaction to align with "service to each taxpayer," business results (quality and quantity) to align with "service to all taxpayers," and employee satisfaction to align with "productivity through a quality work environment," to measure the overall health of the organizational unit;
- workload indicators, such as the number of returns processed, to project the expected level of activity for the organizational unit, identify resource needs, and justify resource requests; and
- performance indicators, such as the percentage of individual refunds issued within 40 days of the date of the signed tax return, to measure how well the organizational units are achieving program objectives.

At the time of our review, each division had developed these measures for at least some of their organizational units.

**Figure 3: W&I Strategic Goal and Operating Objectives Corresponding to the Agencywide Goal of "Service to Each Taxpayer"**




Source: IRS.

As the final step in this process, IRS requires managers to develop action items that detail the steps they will take to implement the operational objectives. IRS' fiscal year 2000 Operations Plan established six agencywide priorities to promote consistency among action items. The six priorities were to (1) implement balanced measures, (2) improve customer satisfaction, (3) improve employee satisfaction, (4) improve the quality of work, (5) identify and work with taxpayer segments likely to become noncompliant, and (6) improve compliance by emphasizing non-enforcement activities.

At each organizational level down to the group level, managers and their work groups developed action items that addressed each of these six priorities.

## IRS Has Made Progress But Could Further Enhance Its Performance Management System

IRS has made progress in the challenging task of revamping its performance management system from one focused on revenue collection to one that better balances taxpayer satisfaction, tax law compliance, and employee satisfaction. However, IRS could make enhancements to its performance management system by revising some goals, objectives, and measures at both the agencywide and operating division level.

### IRS' Efforts to Integrate Performance Measures Into Management Represent Progress in Supporting Its Mission

IRS intends to make its new performance management system the routine way the agency is managed, which IRS believes will put it in a better position to manage toward its strategic goals and objectives. Specifically, IRS intends to use its performance measures to monitor and evaluate its performance as part of its new planning and budgeting process and then use the results of this review to reassess and revise its objectives and goals. In addition, IRS considers the action items developed to implement operational objectives a primary mechanism for getting employees at all levels of the agency actively engaged in carrying out IRS' goals and mission. Managers and their work groups are expected to develop action items in response to problems they define and the causes and possible solutions they identify from their analysis of the operating data. In this way, IRS hopes to establish a "clear line of sight" between employees' day-to-day activities and IRS' overall mission and strategic goals.

Because IRS has not yet completed a full cycle of its new planning and budgeting process, it is too soon to evaluate the impact of this results-oriented process on performance. Nevertheless, the effort IRS is making to integrate the use of performance measures into its day-to-day management represents progress in using performance management to support the new mission of the agency.

### Issues to Be Addressed at the Agencywide Level

At the agencywide level, we identified three issues that IRS could address to enhance the usefulness of its performance management system. The issues include the (1) clarity of one strategic goal, (2) clarity of one strategic objective, and (3) linkage between certain strategic measures and strategic objectives.

With respect to the first issue, two of IRS' three strategic goals—"service to each taxpayer" and "productivity through a quality work environment"—give a relatively clear indication of IRS' priorities, direction, and the potential impact its policies can be expected to have on individual taxpayers and agency employees. However, IRS' goal of "service to all taxpayers" did not clearly convey its intent, which is to apply the tax law with integrity and fairness so that taxpayers that do not comply with the tax laws are not allowed to place a burden on those that do. During the course of our review, we brought this matter to the attention of top IRS executives, including the Commissioner of Internal Revenue. IRS agreed that the goal did not clearly convey its intent. In February 2001, just before we issued this report, IRS released its strategic plan for fiscal years 2000-05, which showed the goal statement was modified to read "service to all taxpayers through fair and uniform application of the law." This modification of the goal statement makes clearer that this goal covers how IRS applies the tax laws to all taxpayers.

With respect to the second issue, IRS' strategic objectives are consistent with its mission and with one exception—the objective of "increasing fairness of compliance"—are clearly stated, specific, measurable, and outcome or output oriented. As IRS recognizes, this fairness objective could be subject to various interpretations and difficult to measure. For example, fairness could mean each individual taxpayer is equally likely to be audited regardless of such characteristics as occupation or income. Fairness could also mean that IRS would target enforcement activities toward pockets of noncompliance so that compliant taxpayers are less likely to be burdened by audit activities. Rewording this objective to more clearly express the desired result could help managers better focus their efforts to achieve this objective.

With respect to the third issue, for six of its seven strategic objectives, IRS has developed performance measures that are directly related to the objectives, focus on expected outcomes or outputs, and capture relevant information. However, for two of these six objectives, IRS' performance measures do not capture all the information that is relevant to gauging progress toward achieving the objectives. IRS has relied strictly on taxpayer perceptions as measured by customer satisfaction surveys or complaints to measure how well it is meeting its two strategic objectives of "providing quality service to taxpayers who need help with their returns or accounts" and "providing quality service to those who may owe additional taxes." Although customer satisfaction surveys and complaints provide relevant information, they do not address an important component of IRS' service—whether the taxpayer's problem was properly handled within the context of the tax law. Elements of IRS' existing quality management systems might provide the basis for developing such a measure. The quality management systems currently include assessments such as whether IRS employees properly computed tax liabilities or selected the most appropriate payment method for collecting past-due taxes. In addition, IRS did not have a performance measure for its strategic objective of “increase fairness of compliance.” Without a performance measure that is logically and directly related to this objective, IRS cannot determine its progress toward meeting the objective.

## Issues to Be Addressed at the Division Level

At the operating division level, we identified three issues that IRS could address to enhance the usefulness of its performance management system. The issues include (1) the clarity with which goals articulate the divisions’ future direction, indicate the expected impact of achieving the goal, and provide a clear basis for establishing objectives; (2) whether objectives, which IRS calls operating priorities, are specific, measurable, and outcome or output oriented; and (3) the linkage between operating measures and operational objectives.

With respect to the first issue, our review of 15 division-level strategic goals for three of four divisions[6] found that they reflected IRS’ agencywide goals and priorities. However, three of the goals did not

- articulate the divisions’ future direction,
- indicate the expected impact of achieving the goal, or
- provide a clear basis for establishing objectives.

These goals are (1) “address underreporting, nonfiling, and abuse of trusts and pass-throughs,” (2)”build a tax administration to effectively deal with globalization,” and (3) “implement comprehensive issue management strategy.” For example, the strategic goal to “address underreporting, nonfiling, and abuse of trusts and pass-throughs” is set within the broad context of increasing overall compliance. However, it is vague and does not articulate the division’s future direction or a desired impact. And since the expected impact is not indicated, the goal does not provide a good basis for formulating objectives. In contrast, the strategic goal “achieve early, accurate resolution of taxpayer accounts” focuses managers’ attention on the impact that is expected and provides a basis for setting objectives to accomplish the goal. Appendix II provides a more detailed analysis of the shortcomings of these the three goals.

With respect to the second issue, our review of division-level operational objectives found that they were clearly stated and consistent with division-level goals and IRS’ overall goals. However, none of the 72 objectives were

[6]We reviewed the strategic goals for three of IRS’ four operating divisions—Wage and Investment, Small Business and Self-Employed, and Large and Mid-Size Business.

stated in terms that were specific and measurable—that is, they did not include a time period, a numeric target, or a means to measure the objective. Also, 70 of 72 were not outcome or output statements because they did not include an expected result, a program impact, or a time period.

We recognize that formulating objectives that describe the desired end result can be a challenging undertaking; however, objectives that are not clearly articulated are less useful to managers responsible for accomplishing division objectives. For instance, the objective "consider targeted notices and guidance" provides no indication of

- which notices or guidance are of interest,
- what is to be done with them,
- how to measure whether the objective has been met, or
- the expected impact of accomplishing this objective.

In contrast, the objective "centralize processing of OICs [offers-in-compromise] to improve quality, timeliness, and efficiency" indicates what is to be done and the expected impact of meeting this objective.

With respect to the third issue, our review of the operating division's program plans found that the operating divisions have identified balanced measures, workload indicators, and performance indicators for many of their functional programs.[7] However, for 63 of the 72 objectives, the operating divisions had not linked operating measures and indicators directly to the objective. Without such direct linkages, operating divisions will not be able to measure the extent to which they are meeting their objectives.

For example, the W&I program plan identified expanding Spanish and second-language services as an operational objective. However, W&I has not developed measures specifically directed toward measuring the impact of its actions, such as the customer satisfaction level of Spanish-speaking taxpayers, or the extent to which they achieved this objective, such as whether W&I increased the number of Spanish-speaking tax auditors. In contrast, W&I did identify specific performance measures for its objective of leveraging partnerships with volunteer and other organizations to

[7] The work of each operating division is performed through functional programs aligned with one of three general service areas: prefiling services, filing and account services, and compliance services. W&I's Taxpayer Assistance program, for example, is a prefiling service.

deliver return preparation services. As measures of its success in meeting this objective, W&I will look to (1) reducing the number of compliance personnel supporting field assistance, (2) increasing the number of hours volunteers provide walk-in assistance, and (3) increasing return preparation services provided by partnering organizations.

## In the First Year of Implementation, IRS' Managers Lacked Adequate Guidance for Developing Action Items

In fiscal year 2000, IRS began requiring managers to develop plans each year that identify the actions they intend to take to support their operating objectives. We evaluated the action items contained in the plans using the same characteristics we used to evaluate objectives. We found that, while clearly stated and consistent with IRS' mission, few action items were specific, measurable, and outcome or output oriented. In addition, the large number of action items reduced the likelihood that they would be tracked and assessed. IRS recently issued guidance for developing individual performance commitments that could be a model for better guidance on action plans.

We received and reviewed 268 action plans from 32 of IRS' 33 district offices. Although the 6,398 fiscal year 2000 action items we reviewed were clearly stated and consistent with IRS' mission, we found that 91 percent of them (5,847) were not specific, measurable, and outcome or output oriented. As a result, IRS could find it difficult to hold managers accountable for achieving their action items. The following examples illustrate how the quality of the action items varied:

- "Use reports to identify improvement areas and develop actions to address them."
- "Branch will establish a quarterly review of 5 cases from each of four pure general program groups. The five cases will be reviewed by a manager from another group for adherence to the EQMS [Examination Quality Management System] standards."

The second action item is more specific, measurable, and outcome or output oriented because it includes such information as who is responsible for taking action, the frequency of the action, the number of actions, and the anticipated outcome (adherence to quality standards). Appendix III provides additional examples of action items.

IRS National Office officials were not surprised by our results. In fiscal year 2000, their guidance steered managers away from developing specific and measurable action items for at least two reasons. First, IRS lacked statistically valid performance data, and therefore, IRS' training course on balanced performance measures instructed managers not to establish quantitative measures for their action items. Second, IRS felt the need to introduce the balanced measures concept to managers as quickly as possible, even though operating divisions did not develop specific goals and objectives until after the action plans were due. As a result, the action items that divisions provided to their organizational units as a framework to follow were vague and nonspecific. For example, the Examination operations plan included the following action items:

- "Ensure the cultural change and philosophy supporting the protection of taxpayer rights has been embraced by the organization,"
- "Support the transition to the new operating divisions," and
- "Revise the Quality Review Program to emphasize uniformity and consistency."

In addition, although IRS guidance instructed managers to prepare brief, focused plans with a few areas of emphasis, we found that each manager's plan contained an average of 24 action items. This multitude of action items could reduce the likelihood that managers would be focusing on those activities that are critical to achieving the operating division's goals and objectives. Furthermore, such a large number of action items might increase the difficulty of holding managers accountable for achieving their action items.

IRS officials told us they are taking steps to improve the quality of the action items. These steps include

- developing training on the balanced measures system that is to include a module covering the skills needed to analyze data to better identify action items,
- developing a handbook on action planning intended to help managers analyze customer satisfaction data,
- issuing a four-page brochure intended to help familiarize both IRS employees and other interested parties with the purpose of the customer satisfaction survey and how the data should be used to improve IRS operations, and
- ensuring that the District Offices of Research and Analysis provide the operating divisions with more research assistance.

Although these initiatives may help managers identify the areas that should be targeted by action items, they do not cover how to formulate action items in specific, measurable, and outcome or output oriented terms or how to limit the number of action items to the critical few. Such guidance would have to be provided by the operating divisions since, under the new strategic planning and budgeting process, they will be responsible for implementing the strategic plans.

Recently issued guidance on developing individual performance commitments, a component of the employee evaluation process, could serve as a model for guidance on developing action items. Performance commitments are intended to better link IRS' performance appraisal process to the balanced measures and set forth specific expected goals and results tied directly to the organization's strategic objectives. The guidance identifies the key features of a well-constructed commitment as

- spelling out specifically what is to be accomplished, not general tasks, duties, or responsibilities of an ongoing job,
- describing realistically the actions to be taken and the expected outcomes,
- maintaining a "line of sight" to the goals of the Service,
- including a clear timeframe for accomplishment,
- being achievable and capable of being monitored and assessed, and
- outlining required organizational resources or support.

The key features of a well-constructed commitment are similar to those that would be key features of a good action item. Guidance laying out similar features, along with examples of specific, measurable, and outcome- or output-oriented action items, could help managers develop action items that would in turn help employees carrying out IRS' day-to-day operations to better link their activities to IRS' goals and objectives.

## Conclusions

IRS has made progress in the challenging task of revamping its performance management system. The goals, objectives, and measures that IRS has developed along with its new strategic planning and budgeting process are intended to integrate results-oriented management into IRS' daily decision-making. However, as IRS officials acknowledge, extensively revamping a performance management system is a complex task that takes years to complete. We identified several opportunities to enhance IRS' performance management system, including clarifying goals and objectives, improving the linkages between measures, objectives, and goals, and developing fewer but more specific action items. Such enhancements could increase managerial accountability and create stronger incentives for frontline employees to achieve IRS' goals and objectives.

## Recommendations for Executive Action

As IRS continues to refine its performance management system, we recommend that the Commissioner of Internal Revenue take steps at both the agencywide and division levels to enhance the system. At the agencywide level, these steps are to

- clarify the strategic objective, “increase fairness of compliance,” to more precisely express the desired result in ways that can be measured, and
- add a measure of quality—that is, whether the taxpayers’ problems are correctly handled within the context of the law—to the agencywide performance measures for the strategic objectives of providing quality service to taxpayers who need help or who may owe additional taxes, and provide a performance measure for the objective, “increase fairness of compliance.”

At the division level, these steps are to

- clarify three strategic goals to better articulate IRS’ future direction, indicate the expected impact of achieving the goal, and provide a clear basis for establishing objectives;
- revise or develop operating objectives to ensure that they are specific, measurable, and outcome or output oriented; and
- revise or develop operational performance measures to ensure that the measures are directly linked to operational objectives.

In addition, we recommend that IRS provide better guidance to unit managers on how to develop action items that are few enough to focus employees’ attention and are specific, measurable, and outcome or output oriented.

## Agency Comments and Our Evaluation

We requested comments on a draft of this report from IRS. We obtained written comments in a February 13, 2001, letter from the Commissioner of Internal Revenue (see app. IV). In his letter, the Commissioner characterized our assessment of IRS’ implementation of its revamped performance management system as fair and balanced. He said that he believes IRS has made significant progress, but recognizes that IRS still faces many challenges in establishing a lasting and effective system for measuring agency performance. The Commissioner agreed with our recommendations at the division level. However, the Commissioner raised some concerns with our recommendations to clarify one strategic objective and add a measure for the strategic objectives concerning customer service.

In commenting on our recommendation that IRS clarify its strategic objective of "increasing fairness of compliance," the Commissioner agreed that it was ideal for objectives to be completely self-explanatory. However, he said that he believed it was important to communicate to the public that IRS valued fairness in conjunction with its compliance role. He said that IRS intends to continue to elaborate on the intent of this objective in its ongoing communications with taxpayers and IRS employees. Further, the Commissioner stated that an aspect of IRS' current work on the balanced measures system is to better understand the taxpayers' concept of fairness and to develop suitable measures of fairness. We agree that communicating to the public that IRS values fairness is important. However, since IRS' new performance management system is intended to increase accountability, we continue to believe that IRS needs to clarify this objective statement so that taxpayers know specifically what to expect from IRS in the area of fairness, IRS managers can better focus their efforts on achieving this objective, and Congress can gauge IRS' progress in meeting this objective.

In commenting on our recommendation that IRS use a quality measure in addition to a customer satisfaction measure for the strategic goal of providing quality customer service, the Commissioner agreed conceptually that it is relevant to determine whether taxpayers' problems are properly handled within the context of the law. The Commissioner focused his comments on measuring customer satisfaction and expressed concern that weighting the customer satisfaction score or otherwise combining it with a quality score would diminish the customer view and devalue the importance of taxpayers' opinions. We agree that a customer satisfaction score measures one very important component of providing quality service to taxpayers. However, taxpayers may not know whether their case was handled properly within the context of the law. Therefore, we continue to believe that IRS needs to have a separate score to measure the component of quality service that deals with whether IRS handles taxpayer problems properly. It is not our intent that IRS attempt to combine these two measures into one overall score of customer service, and we have modified our recommendation to make this clearer.

The Commissioner agreed with our recommendations on improving IRS' performance management system at the division level regarding the clarity of goals, the specificity and measurability of objectives, and the linkage between measures and objectives. He said that while the operating divisions have already taken some steps in line with our report recommendations, IRS will be addressing these issues on an ongoing basis and that refinements will occur as IRS develops more experience with the strategic planning and budgeting process. The Commissioner also agreed with our recommendation to provide better guidance to unit managers on how to develop action items and said IRS had already undertaken corrective action in this area.

As agreed with your office, unless you publicly announce its contents earlier, we plan no further distribution of this report until 30 days from the date of this letter. At that time, we will send copies to the Ranking Minority Member of the Subcommittee on Oversight; the Ranking Minority Member of the Committee on Ways and Means; the Secretary of the Treasury; and the Commissioner of Internal Revenue. We will also make copies available to others on request.

Please contact me at (202) 512-9110 or Ralph Block at (415) 904-2150 if you or your staff have any questions. Key contributors to this report are acknowledged in appendix V.

Sincerely yours,

James R. White

James R. White
Director, Tax Issues

# Appendix I: Objectives, Scope, and Methodology

## Objectives

Our objectives were to (1) describe the status of IRS' efforts to develop agencywide and operating division goals, objectives, and performance measures that support IRS' mission and (2) assess these efforts and identify actions, if any, IRS could take to enhance its performance management system.

## Scope and Methodology

To describe IRS' efforts to develop goals, objectives, and performance measures, we interviewed officials responsible for developing and implementing IRS' new strategic planning and budgeting process. We reviewed IRS' draft strategic plan for fiscal years 2000-05. Because IRS' new performance management system is intended to balance taxpayer service and enforcement activities, we focused on the goals, objectives and performance measures affecting enforcement employees. Therefore, we reviewed the strategic and program plans prepared by the Wage and Investment, Small Business and Self-Employed, and Large and Mid-Size Business Divisions because examination and collection employees were generally reassigned to one of these divisions during IRS' reorganization. In addition, we requested the fiscal year 2000 action plans prepared by the district and each of the examination and collection divisions and branches from IRS' 33 district offices. We received 15 district plans, 56 division plans, and 197 plans from 60 branch and 32 district offices.

To assess IRS' efforts in developing the components of its performance management system, we conducted a literature search on performance measures in general and balanced measures in particular; identified characteristics associated with goals, objectives, and performance measures for use in evaluating IRS' performance management system; and discussed IRS' approach and methodology with IRS contractors involved in developing the performance measures and analyzing the resulting data. We also interviewed IRS headquarters officials and supervisors in the Northern California and Kansas-Missouri District Offices to discuss their use of performance measurement data and the action plans they developed. We selected these two offices because of their proximity to the members of the audit team.

## Characteristics Used to Assess IRS' Performance Management System

The following provides more information on the characteristics associated with goals, objectives, and performance measures that we used to assess IRS' performance management system and how we determined if those characteristics were present.

### Characteristics Associated With Goals

Characteristics associated with strategic goals are that they should (1) reflect the agency's priorities, (2) provide clear direction for future agency action, (3) identify what impact or outcome will result from an agency's work, and (4) form the basis for formulating clear objectives. Basically, we were looking for statements that indicated how and why the goal should be achieved. In assessing IRS' goals, we addressed the following types of questions:

- *Reflect the agency's priorities*: Does the goal contribute toward achieving IRS' mission of helping taxpayers understand and meet their tax responsibilities and applying the tax law with integrity and fairness?
- *Provide clear direction for future action*: Does the goal establish a trend for IRS' programs and activities?
- *Identify impact or outcome*: Does the goal indicate what effect achieving the goal will have on taxpayers, overall compliance, or employees?
- *Form the basis for formulating clear objectives*: Does the goal indicate the kinds of activities that managers and employees should focus on?

## Characteristics Associated With Objectives and Action Items

Characteristics associated with objectives and action items are that they should be (1) clearly stated, (2) specific, (3) measurable, (4) outcome or output oriented, and (5) consistent with the agency's mission and goals. We used these characteristics to assess IRS' strategic objectives, operating objectives, and action items. Basically, we were looking for statements that would allow managers to be held accountable for their actions. In assessing IRS' strategic objectives, operating objectives, and action items, we addressed the following types of questions:

- *Clearly stated*: Is the objective or action item easy to understand? Does it contain jargon that would be unfamiliar to IRS managers and employees?
- *Specific*: Does the objective or action item include details such as who is responsible for taking action? Does the objective or action item include a time period, an expected result, or a numeric target?
- *Outcome or output oriented*: Does the objective or action item include an expected result, a program impact, or a time period?
- *Measurable*: Is the objective or action item quantifiable? Does the action item include a time period, an expected result, a numeric target, or a means to measure?
- *Consistent with IRS' mission*: Is the objective or action item consistent with IRS' mission statement and goals?

## Characteristics Associated With Performance Measures

Characteristics associated with performance measures are that they should be (1) logically and directly related to the goals and objectives; (2) focus on expected outcomes or outputs; and (3) capture information relevant to the goals and objectives. In assessing IRS' performance measures, we addressed the following types of questions:

- *Logically and directly related*: Does the measure address the important components of the goals or objectives?
- *Focus on expected outcomes or outputs*: Does the measure address the impact that IRS' activities have on taxpayers and employees or the output of IRS programs?
- *Capture relevant information*: Is the measure providing information useful to managers in assessing the extent to which the objective has been achieved or the impact of IRS activities?

# Appendix II: Assessment of the Characteristics of Operating Division Strategic Goals

We assessed whether all of the 15 strategic goals established by the Wage and Investment, Small Business and Self-Employed, and Large and Mid-size Business Divisions had the characteristics described in appendix I. We found that all 15 reflected IRS' priorities. However, three of the goals did not provide a clear direction for future action, identify the expected impact of achieving the goal, or form the basis for establishing clear objectives. A discussion of how we assessed these three goals follows.

**"Address Underreporting, Nonfiling, and Abuse of Trusts and Pass-Throughs"**

This goal, established by the Small Business and Self-Employed Division, is set within the context of increasing overall compliance. However, the word "address" is vague and does not provide a clear indication of the direction IRS will be taking in the future. For example, "address" could mean increasing taxpayer education, outreach to practitioners, or compliance monitoring. In addition, the goal statement does not articulate what the expected impact will be—presumably, to reduce the amount of unreported income that results from taxpayers' underreporting income, failing to file tax returns, or using questionable trusts and pass-throughs. The goal also does not provide a good basis for formulating objectives for accomplishing it because it does not indicate how IRS will deal with underreporting, nonfiling, and abuse of trusts and pass-throughs. As a result, the goal statement does not communicate the activities IRS will focus on in both the short term and the long term and the accomplishments IRS is striving to achieve.

**"Build a Tax Administration to Effectively Deal With Globalization"**

This statement, established by the Large and Mid-Size Business Division, is attempting to articulate a goal for administering the tax laws in a global economic environment where such factors as transnational operations, rapidly changing technology, and changing business practices must be recognized. However, the goal is broad and nonspecific. As with the prior example, the phrase "build a tax administration" does not articulate the direction IRS intends to take in the future. In addition, the goal does not indicate the expected impact on taxpayers or overall compliance. For example, the phrase "effectively deal with globalization" could refer to identifying and responding to emerging trends quickly or to developing technical competence and sophistication in interacting with multinational corporations. The goal statement also does not indicate what type of activities will be undertaken or the areas that should be improved and so does not provide the basis for formulating objectives to accomplish the goal.

**"Implement Comprehensive Issue Management Strategy"**

With this goal statement, IRS' Large and Mid-Size Business Division is attempting to address the dissatisfaction of taxpayers related to the examination of large corporate returns. However, as with the other goals, the phrase "implement a comprehensive issue management strategy" is too vague to indicate the future direction of IRS' programs and activities. The statement also does not provide an indication of how achieving this goal will impact taxpayers and overall compliance, focusing instead on IRS' internal processes. In addition, the vagueness and generality of the goal statement provide little basis for formulating objectives. For example, if IRS has identified the factors contributing to taxpayer dissatisfaction, the goal statement should articulate how IRS will deal with those factors.

# Appendix III: Examples of Action Items Developed by IRS Organizational Units

This appendix provides examples of action items developed by IRS managers in the examination and collection functions. The action items are grouped in two categories, those that were specific, measurable, and outcome or output oriented, and those that were not.

## Specific, Measurable, and Outcome- or Output-Oriented Action Items

The following action items were determined to be specific, measurable, or outcome or output oriented.

- “Branch will establish a quarterly review of 5 cases from each of four pure general program groups. The five cases will be reviewed by a manager from another group for adherence to the EQMS standard.”
- “Specialty Group Managers (E & G [Estate and Gift], SEP [Special Enforcement Program], Employment Tax) will ensure attorneys and examiners receive information regarding the recommendations of Business Measures Task Force Study within 60 days of issuance of report.”
- “Ensure all contact employees receive examination customer service training by December 31, 1999.”
- “Train CEP [Coordinated Examination Program] and Specialty agents on recommendations of Business Measures Task Force Study within 60 days of issuance of report.”
- “Compile 9/30/99 data by 12/31/99 for baseline compilations.”
- “Ensure all employees receive Customer Service Examination Specific training by 12/31/99.”
- “CEB-3 [Chief of Examination Branch 3] will attend one group meeting each month to discuss employee feedback and elevate issues when appropriate.”
- “Group manager will conduct field visits with revenue officers at least once during the fiscal year.”
- “Complete balanced measures training 8530(A) by 12/31/99.”
- “Improve manager and employee understanding of auditing standards through consistency reviews and at least one non-evaluative live case review per examiner by 12/31/99.”
- “Managers and secretaries will not use the VMS [Voice Mail System] but will answer the phones personally. R/A [revenue agent], T/A [tax auditor], and ROE [revenue officer examiner] will use VMS system when not in the office, but will leave dated and current messages for callers to receive.”

## Unspecific, Unmeasurable, and Not Outcome- or Output-Oriented Action Items

In contrast to the above action items, the following were determined not to be specific, measurable, and outcome or output oriented.

- “Support on-going Research Strategy Projects.”
- “Ensure employees have necessary tools to perform duties (on-going).”
- “Implement/follow the district’s market segment plan.”
- “Identify improvement areas and implement actions to address them.”
- “Ensure managers are correctly implementing the balanced measures.”
- “Monitor group plans to ensure actions are being taken to improve quality.”
- “Minimize neglected taxpayer groups.”
- “Emphasize one stop service in our examinations.”
- “Dialogue, coach, collaborate, and look forward when planning and making decisions.”
- “Meet District/Division due date or time line.”
- “Identify potential areas for outreach activities.”
- “Strive to understand and solve problems from the taxpayer’s point of view.”
- “Increase available help for those taxpayers who are calling in or writing in for assistance.”
- “Use new IRM [Internal Revenue Manual] standards for operational reviews (when available).”
- “Utilize all forms of communication available to facilitate keeping employees informed.”
- “Use balanced measures as part of the decision making process.”
- “Identify transition issues.”
- “Create a positive environment that encourages open communication (e.g. coaching and mentoring).”
- “Monitor and balance between providing quality customer service support and providing quality customer service to Collection taxpayers across all branches.”

# Appendix IV: Comments From the Internal Revenue Service

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

COMMISSIONER

February 13, 2001

Mr. James R. White
Director, Tax Issues
General Accounting Office
441 G. Street, NW
Washington, DC 20548

Dear Mr. White:

Thank you for the opportunity to comment on the report, "IRS Modernization: IRS Should Enhance Its Performance Management System," which focuses on how the Internal Revenue Service is measuring organizational performance through a revamped performance management system. The report provides a fair and balanced assessment of our implementation strategy. I am gratified it recognizes this is a long-term, complex undertaking that will require continuing adjustments. I believe that we have made significant progress, including implementing our new Strategic Planning and Budgeting Process, which integrates the use of performance measures into the way we manage the agency. I also appreciate the challenges we still face to ensure a lasting and effective organizational performance measurement system. My comments on your recommendations follow:

**Issues We Should Address at the Agency-wide Level**

The report identifies two issues we should address to enhance the usefulness of our performance management system; they involve:

- Clarity of the strategic objective, "Increasing Fairness of Compliance,"
- Link between case quality and customer satisfaction measures.

The first issue raises the concern that the objective of "increasing fairness of compliance" is not clearly stated, specific, and measurable. You have accurately captured one aspect of this objective in the report; to target our "enforcement" programs toward pockets of noncompliance so compliant taxpayers are less likely to be burdened by enforcement activities. While it may be ideal to have an objective stated so that it is completely self-explanatory, we must also communicate, especially to the public, a general message of fairness in conjunction with our compliance role. We want to guard against viewing the statements of our goals and objectives too academically. However, we will continue to elaborate on the intent behind the objective "increase fairness of compliance." Incidentally, an important aspect of our current work on the balanced measures system is to better understand the taxpayers' concept of "fairness" and to establish suitable measures of fairness. What we learn from these efforts will enhance our future communications about fairness of compliance.

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The second issue involves whether we gather and consider sufficient data to accurately gauge progress in customer satisfaction. The report indicates we should use an objective measure of case quality (proper outcome), in addition to direct customer feedback, to determine whether customer satisfaction measures are relevant or accurate. I think we both agree we should determine if the taxpayer's problem was properly handled within the context of the tax law. However, we differ on how we should incorporate and consider the information when arriving at an overall score. Our customer satisfaction measures are strictly based on the experience and perceptions of taxpayers with whom we have interaction. If we weigh customer satisfaction perceptions with case quality results to arrive at a customer satisfaction score, we could diminish the customer view and devalue the importance of their opinion. We believe it is more appropriate to consider the case quality factor, in conjunction with quantity, as components of the Business Results measure. While I appreciate your view, I believe that a pure customer satisfaction result, based solely on the taxpayers' perception, is important for us to capture and understand. As our balanced measures system matures, we will continue to assess the best way to capture and consider all relevant factors.

**Issues We Should Address at the Division Level**

The report identifies three issues that could be addressed at the Division Level to enhance our performance management system. The issues involve:

- Clarity of division goals,
- Specificity and measurability of objectives,
- Link between measures and objectives.

I agree we must address these issues on an ongoing basis. I believe clarity and specificity of goals and the measurability of objectives will improve as our business performance process matures. Many of these goals, objectives, and strategies relate to areas of emphasis that are new to the IRS and represent a change in our approach to our customers. We will refine them as we develop more experience. During the course of this audit our largest divisions "stood up." As part of that stand up, they reviewed their strategic goals and objectives and made changes, which are in line with the report's recommendations. In addition, we regularly refine these elements as appropriate during our business performance review sessions with each division and the strategic planning process. During the planning process for 2002, while developing division specific program plans, we will concentrate on improving the link between specific performance measures and objectives, to the extent we can.

**In the First Year of Implementation, IRS Managers Lacked Adequate Guidance for Developing Action Items**

I agree we had insufficient guidance for managers in our first year of balanced measures implementation. I appreciate your report recognized some of the reasons for this situation, including our need to introduce the concepts behind the balanced

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measures approach as quickly as possible, even if all required elements were not in place. The corrective steps we described to you during the audit have been completed including:

- Specific training and reference materials on developing concrete and measurable action items
- The brochure explaining the role and use of customer satisfaction data to improve performance
- Guidance on developing individual performance commitments, which was effective for the FY 2001 performance plans.

I agree that as we develop managerial plans in the future, the business divisions must ensure their commitments are in line with the goals of the IRS, are relevant to their division's program plans, and are specific and measurable. We will continue to work hard to achieve that.

In closing, I want to thank you for the considerate analysis and helpful observations. I will keep you informed of our progress as we refine our performance management system, which I believe is a critical component of modernizing America's Tax Agency.

Sincerely,

Charles Rossotti

Charles O. Rossotti

cc: Director, Legislative Affairs
Assistant Inspector General for Audit

# Appendix V: GAO Contacts and Staff Acknowledgments

## GAO Contacts

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## Acknowledgments

In addition to those named above, Benjamin Douglas, Suzy Foster, Jonda Van Pelt, and John Zugar made key contributions to this report.

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