ADMINISTRATION HISTORY APPENDIX
CHAPTER EIGHT: COIN AND CURRENCY, THE IRS, AND THE TREASURY BUILDING

TAX SYSTEMS MODERNIZATION

33

RP/FN 95-145318

THE DEPUTY SECRETARY OF THE TREASURY
WASHINGTON, D.C. 20220

April 13, 1995

NOTE TO THE SECRETARY

Tax Systems Modernization (TSM) requires direct involvement at the Departmental level. Accordingly, I have met with Peggy Richardson and George Muñoz, and together, we have agreed on the charter, membership, and funding for a new Modernization Management Partnership (MMP) to provide departmental support for TSM, as outlined in the attached memorandum. This is an internal agreement with outside consulting support and full-time staffing.

The MMP should satisfy our oversight committees and GAO, as well as our own requirements for proper guidance of TSM.

I'll meet with this group on a monthly basis and keep you informed of our progress.

Frank

Frank N. Newman

Attachment

EXECUTIVE SECRETARIAT

95-144973 34

DEPARTMENT OF THE TREASURY
WASHINGTON

ASSISTANT SECRETARY

APR 10 1995

ACTION

MEMORANDUM FOR DEPUTY SECRETARY NEWMAN

FROM: George Muñoz
Assistant Secretary (Management) & CFO

SUBJECT: Treasury/IRS Modernization Management Partnership

ACTION FORCING EVENT:

When the General Accounting Office (GAO) and the Congressional Appropriations Committees expressed concerns over the management of Internal Revenue Service (IRS) Modernization, budgetary pressures led Congress to reduce the Administration's FY 1995 budget request for IRS Modernization by $367 million (37%). Unless these management concerns are resolved quickly, budget requests of $1.03 billion for FY 1996, and $6.7 billion through FY 2000, could be similarly threatened.

RECOMMENDATION:

In concert with our own efforts to improve financial management, project management, and technical oversight, Departmental Management must assume an active role in policy and management decisions affecting IRS modernization. Recommend that you approve the proposed charter (Tab A) and staffing (Tab B) for a Treasury/IRS Modernization Management Partnership (MMP).

✓ M Agree _____ Disagree _____ Let's Discuss

Also attached are the Interagency Agreements to be signed by Mrs. Richardson and me (Tab C).

BACKGROUND ANALYSIS:

Since its inception in 1987, the IRS modernization effort has evolved from a relatively simple automation upgrade to a complete business process re-engineering. The evolution of organizational structures, priorities, and system development strategies has led oversight bodies such as GAO to conclude that IRS may need to improve its technical and management skills. Appropriations Committee Reports likewise have called for IRS to improve program management, technical expertise, and performance measurement.

ATTACHMENTS: Tab A: MMP Charter
Tab B: MMP Staffing
TAB C: Interagency Agreements

EXECUTIVE SECRETARIAT

CHARTER

Treasury/IRS Modernization Management Partnership

Purpose:

The Treasury/Internal Revenue Service (IRS) Modernization Management Partnership (MMP) is established to foster Treasury Department participation in and support for strategic policy and management decisions affecting modernization of the IRS.

The partnership is being formed specifically to address management concerns identified by oversight bodies such as the General Accounting Office (GAO), ~~and to ensure that~~ core business processes of the IRS are realigned to efficiently meet the needs of U.S. taxpayers in the 21st century. To accomplish this, the MMP will:

- Participate in and approve strategic decisions affecting policies for and management of IRS Modernization;
- Foster effective program management by overseeing priorities, resource allocations, staffing levels and implementation schedules;
- Monitor the progress of IRS Modernization toward specific program milestones and strategic decision points, initiating corrective actions when necessary;
- Ensure that oversight recommendations are responded to in an appropriate manner and that follow-up actions are documented; and
- Ensure that the IRS Modernization planning process includes performance measures and oversee the achievement of management goals.

Context:

IRS Modernization is introducing a new concept of operations to IRS. It is intended to overcome the challenge of exploding workload caused by statutory changes and demographic shifts, permit innovative solutions to a new generation of compliance problems, and exploit continuing advances in information technology. But much of the progress to date is not yet visible to the taxpayer. This circumstance may have led to GAO's recent assertion that "after 8 years and an investment of almost $2 billion, progress ... has been minimal."

TREASURY/IRS MODERNIZATION MANAGEMENT PARTNERSHIP
Staffing and Costs -- FY 1996

SALARIES AND BENEFITS

TITLE	GRADE	ANNUAL SALARY	DAILY SALARY	DAYS ON BOARD	BASE SALARY	3.3% PAY RAISE	20% BENEFITS	TOTAL ESTIMATE
Executive	GS15/05	$81,221	$312	260	$81,221	$2,010	$16,646	$99,877
Senior Analyst	GS14/05	69,047	266	260	69,047	1,709	14,151	84,907
Secretary*	GS07/05	27,698	107	260	13,849	343	2,838	17,030
TOTAL					$164,117		$33,635	$201,814

TOTAL COSTS:

Personnel Costs	$201,814
Consultant**	108,000
Travel	30,000
Supplies	1,000
Total Agreement Costs	340,814
Administrative Overhead @11%	31,330
AGREEMENT TOTAL	$372,144

** Employee devotes 50% time to MMP.*

*** Contractor will work 2 days a week for 26 weeks and 1 day a week for 26 weeks. Daily rate is $1,000. Consultant travel expenses are included in the estimate.*

40

41

DEPARTMENT OF THE TREASURY
DEPARTMENTAL OFFICES
INTERAGENCY AGREEMENT #95-R-194

OFFICE RECEIVING SERVICES: INTERNAL REVENUE SERVICE

BILLING ADDRESS: 1111 Constitution Avenue, N.W.
Washington, D.C. 20224

PURPOSE: The Internal Revenue Service (IRS) agrees to reimburse the Department of the Treasury, Departmental Office, for the services provided by the Departmental Offices to the Treasury/IRS Modernization Management Partnership (MMP), as described in more detail in the attached charter, in an amount not to exceed $235,687 for the period April 20, 1995 through September 30, 1995. Estimated breakdown of costs are as follows:

Personnel Costs	$98,514
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Supplies	1,000
Panasonic Fax Machine UF-755 Inc. installation and one year warranty	2,200
3 PC 486DX266 and 1 Printer HP4 Not inc. installation and support	12,400
Sub-total	214,114
Administrative Overhead @11%	21,573
AGREEMENT TOTAL	$235,687

AUTHORITY: This agreement is entered into under the authority of Section 601 of the Economy Act of June 30, 1932, as amended, 31 U.S.C., 1535 and 1536, and the authorizing legislation of the agencies involved.

PAYMENT: Payment will be quarterly, at the end of each quarter.

APPROVALS: DEPARTMENTAL OFFICES

George Muñoz
Assistant Secretary (Management) and CFO

Date

Financial Manager

42

APPROVALS: INTERNAL REVENUE SERVICE

Margaret Milner Richardson
Commissioner, Internal Revenue Service

Date

Financial Manager

Agency Locator Code (ALC) or Accounting Classification

43

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Date

Financial Manager

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APPROVALS: INTERNAL REVENUE SERVICE

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Margaret Milner Richardson Date
Commissioner, Internal Revenue Service

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95-144973

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ASSISTANT SECRETARY

APR 10 1995

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ATTACHMENTS: Tab A: MMP Charter
Tab B: MMP Staffing
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EXECUTIVE SECRETARIAT

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Treasury/IRS Modernization Management Partnership

Purpose:

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- Participate in and approve strategic decisions affecting policies for and management of IRS Modernization;
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Over the next 10 years, spending on IRS Modernization is projected to exceed $12.6 billion. If successful the project will yield an estimated $32 billion in additional revenue over the same period, while vastly improving service to the taxpayer. Principal risks to successful completion include:

- The need for an additional $12.6 billion not yet appropriated by Congress, and
- Organizational and labor-management issues associated with transition to a new concept of operations.

Responsibilities:

The MMP shall serve as the primary review body for strategic decisions affecting policies for and management of IRS modernization, and as principal point-of-contact for presenting IRS modernization initiatives to Departmental Management and communicating Departmental decisions to IRS. Guidance will be provided to IRS on activities and issues that are critical to the success of IRS modernization, entail significant resource expenditures, or may engender significant Congressional interest. In exercising its responsibilities, the MMP will serve as a vehicle for integrating long-term strategic concerns with day-to-day management decisions, and for building upon existing Departmental review processes without duplicating their functions. To accomplish this, it will:

- Encourage implementation of improved management processes, including adoption of GAO's "Best Practices" for strategic information management;
- Coordinate the efforts of blue-ribbon panels and outside experts retained to review plans for and progress of IRS modernization;
- Coordinate and expedite Departmental review of planning, budget (plans and expenditures), procurement, information systems, human resource and management issues related to IRS Modernization, including the development and oversight of all performance goals, measures, and results and integrate these into a coherent Treasury Department position.
- Facilitate Treasury Department support of IRS Modernization efforts with external oversight bodies, including the Office of Management and Budget (OMB), the General Services Administration (GSA), the General Accounting Office (GAO), and the Congress.

Executive Steering Group:

The MMP shall be directed by an Executive Steering Group, co-chaired by the Assistant Secretary (Management)/CFO and the Commissioner of the IRS. Membership of the group shall include the:

- Deputy Assistant Secretary (Departmental Finance and Management)
- Deputy Assistant Secretary (Information Systems)
- Deputy Chief Financial Officer
- IRS Deputy Commissioner
- IRS Modernization Executive
- IRS Chief Information Officer
- IRS Chief Financial Officer

The Executive Steering Group also includes the following advisory members:

- Assistant Secretary (Tax Policy)
- Assistant Secretary (Legislative Affairs)
- General Counsel
- Inspector General
- Director of Security
- IRS Chief Management and Administration
- IRS Chief Inspector

Subcommittees of the Executive Steering Group may be established by the Co-chairs to undertake specific projects or address particular concerns of the Steering Group. Subcommittee members may include full-time and advisory members of the Executive Steering Group, and other members designated by the Co-chairs.

The Executive Steering Group shall convene at intervals determined by the Co-Chairs. In addition, bimonthly meetings may be held with the Deputy Secretary to review progress on issues related to IRS Modernization.

Staff Support:

The Deputy Assistant Secretary for Departmental Finance and Management (DAS/DFM) will provide support to the Executive Steering Group. Staff support for the Executive Steering Group will consist of an Executive Director, a senior analyst, and a secretary. The Executive Director will serve as a senior staff advisor to the Executive Steering Group Co-Chairs. For purposes of administrative and managerial control, the staff will report to the Director of the Office of Organizational Improvement under DAS/DFM.

Funding:

The Executive Director shall prepare an annual budget for the MMP for approval by the Co-chairs. The budget will include costs of staff salaries and benefits, travel expenses for the Executive Steering Group and MMP staff, consulting fees for outside technical experts, and other expenses of the MMP. Funding for the MMP will be provided by the IRS to Departmental Offices on a reimbursable basis, subject to availability of funds, through an Interagency Agency Agreement to be executed each fiscal year.

Amendments to the Charter:

The charter may be amended as necessary by consent of the Executive Steering Group, with the approval of the Deputy Secretary.

I hereby approve this charter.

Frank Newman 4-13-95

Frank Newman (date)
Deputy Secretary

TREASURY/IRS MODERNIZATION MANAGEMENT PARTNERSHIP
Staffing and Funding -- FY 1995 (April 1 - September 30)

SALARIES AND BENEFITS

TITLE	GRADE	ANNUAL SALARY	DAILY SALARY	DAYS ON BOARD	TOTAL SALARY	20% BENEFITS	TOTAL ESTIMATE
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Senior Analyst	GS14/05	69,047	266	130	34,580	6,916	41,496
Secretary*	GS07/05	27,698	107	130	6,955	1,391	8,346
TOTAL					$82,095	$16,419	$98,514

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TREASURY/IRS MODERNIZATION MANAGEMENT PARTNERSHIP
Staffing and Costs -- FY 1996

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APPROVALS: DEPARTMENTAL OFFICES

_______________________________ _________
George Muñoz Date
Assistant Secretary (Management) and CFO

_______________________ Financial Manager

APPROVALS: INTERNAL REVENUE SERVICE

____ ________

Margaret Milner Richardson Date
Commissioner, Internal Revenue Service

______________________________ Financial Manager

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Agency Locator Code (ALC) or Accounting Classification

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DEPARTMENTAL OFFICES
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George Muñoz Date
Assistant Secretary (Management) and CFO

____________________ Financial Manager

APPROVALS: INTERNAL REVENUE SERVICE

______________________________________ ____________

Margaret Milner Richardson Date
Commissioner, Internal Revenue Service

__________________________ Financial Manager

____

Agency Locator Code (ALC) or Accounting Classification

95-149072

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C.

ASSISTANT SECRETARY

INFORMATION

AUG 0 9 1995

To: George Muñoz

cc: Summers
Newman
Mathur

From: Bob Rubin

What should be done - if anything - not currently being done I'd like to see this week [illegible].

CLOSE HOLD - NOT FOR DISTRIBUTION

MEMORANDUM FOR SECRETARY RUBIN

THROUGH: Frank N. Newman FNN
Deputy Secretary

FROM: George Muñoz GM
Assistant Secretary for Management & CFO

SUBJECT: Departmental Response to GAO Report, ***"Tax Systems Modernization (TSM): Management and Technical Weaknesses Must Be Corrected if Modernization is to Succeed"***

This provides a Departmental perspective on the findings and recommendations in GAO's July 26 report on IRS modernization, Tax Systems Modernization: Management and Technical Weaknesses Must Be Corrected if Modernization is to Succeed.

As the title of the report indicates, TSM has serious technical and management problems, and an important program with great promise is in danger of losing credibility and support. Of the five main areas GAO addressed in the report, two key issues are central to the business direction and technical success of the program. These are ineffective strategic management of investments, and inadequate systems architecture, testing and integration. The report also criticizes a weak software development process and points out that the current IRS business strategy will not maximize electronic filing and may impair the IRS's future ability to process paper returns. On a positive note, the report does give credit to the IRS for bringing TSM organizational management and control under one Modernization Executive.

The attachment briefly describes GAO's principal findings and recommendations, the IRS's response, and the Departmental Management perspective. The issues GAO presents are serious, but the report findings did not come as a surprise. We were aware of most of these problems, which were raised in previous reports by GAO and the National Research Council and by OMB and Congressional oversight committees. To increase Departmental involvement in responding to these issues, in April we established the Modernization Management Partnership (MMP), which I co-chair with Commissioner Richardson. The MMP was formed to promote an aggressive response to the need for proper guidance and enhanced management of IRS modernization. In their reports accompanying the FY 1996 Appropriations bills, the House and Senate Appropriations Committees commended this effort. They also require our action to implement GAO's recommendations.

EXECUTIVE SECRETARIAT

The Department fully agrees with the direction of GAO's recommendations, although we have reservations that the short deadlines set out in the report may not provide adequate time for implementing the recommendations so as to achieve their full value. More importantly, we are concerned about the IRS's capability of making the substantive changes needed in this costly and critical undertaking, particularly with the recent or imminent departures of several key IRS executives who play major roles in TSM. The stakes are sufficiently high that we need to assure that the best people are brought in to fill these positions. The IRS should not proceed unilaterally on the selection of replacements or in reorganizing without the Department's contributing to these key decisions.

It is important that we assert the vital interests of the Treasury in assuring that TSM is appropriately led, planned, directed, and managed and that the substance of the recommendations is achieved in a suitable time frame. We want to ensure practicality and value; we do not want to respond to GAO merely as an exercise. The IRS and the Department must work together through the Modernization Management Partnership to ensure that the substance and intent of the GAO recommendations become a reality.

The IRS is now developing a plan of action for implementing the GAO recommendations and has 60 days to respond to the final GAO report. In its response to the draft report, the IRS agreed with the report's major recommendations and pointed out areas in which improvements were already underway. The IRS will make every effort to implement the recommended changes within the suggested time frames, but indicated that resource shortages and operational priorities such as implementing tax law changes may impact its plans.

Attachment

REVIEW OF SPECIFIC GAO FINDINGS AND RECOMMENDATIONS

I. STRATEGIC INFORMATION MANAGEMENT PRACTICES ARE INEFFECTIVE

Background: The GAO found that the IRS had not sufficiently established practices and procedures for selecting, prioritizing, controlling, and evaluating progress and performance of major information system investments. For example, a plan detailing the concept of future operations, and other key plans and documents were incomplete. GAO said that the IRS would have difficulty identifying and focusing on the completion of priority TSM projects. The IRS needs to identify higher-risk projects that have little potential of providing significant mission benefits. Other examples of best practices not being followed include: process reengineering <u>preceding</u> TSM design, <u>reliable</u> cost-benefit data, and <u>complete</u> identification of the skills needed for TSM.

GAO Recommendation: <u>Immediately</u> improve strategic information management by implementing a process for selecting, prioritizing, controlling, and evaluating progress and performance, using criteria such as risk, costs and benefits to review all planned and ongoing systems for FY 1996.

IRS Response: The IRS has developed an initial set of investment criteria and will continue to refine the criteria and institutionalize a formal process using the criteria. The IRS is using an information technology investment model which will assist in selecting, prioritizing, controlling and managing information technology investments to achieve reengineered program missions.

Departmental Perspective: This is one of the most critical areas for assuring that TSM contributes to achieving IRS's business mission. The Department is focusing strongly on economic modeling as the key to ongoing and recurring planning and prioritization. We want to assure that there is an effective tool and a reliable basis for evaluating individual projects and determining what investments are worthwhile. To be effective, these vital processes need to become an ongoing management tool, since many of the plans as they exist today will be changed. We also want to ensure an effective tradeoff between reworking architectures and plans to incorporate reengineering results and maintaining useful forward momentum.

II. SYSTEMS ARCHITECTURES, TESTING AND INTEGRATION ARE NOT ADEQUATELY ADDRESSED

Background: The Integrated Systems Architecture reflects the target architecture and the system design of TSM. The GAO found that while this key document was incomplete (missing components such as security, telecommunications and data), projects were proceeding to develop systems. Other plans are needed for major systems, such as a concept of operations for security, and plans for disaster recovery, contingency, and telecommunications security. Also, system development was proceeding even though standard software interfaces were still being defined. A facility to integrate and test systems has not yet been established, and there is no process to manage system changes.

GAO Recommendations: By December 1995 improve key technical infrastructure by:

- Completing architectures for systems, security, and data.
- Institutionalizing configuration management for all new projects and upgrades and develop plans for moving ongoing projects to it.
- Developing a security concept of operations and plans for disaster recovery and contingencies.
- Developing a testing and evaluation master plan.
- Establishing an integration testing and control facility.
- Completing the TSM integration plan.
- Monitoring projects to ensure compliance with modernization architectures.

IRS Response: The Integrated Systems Architecture and the transitional architecture are being combined into a planned 1996 IRS information systems architecture that will reflect a total systems view. A series of plans has been developed to address these weaknesses.

Departmental Perspective: Of all the criticisms, this is one of the most difficult and challenging, and one of the most critical. Without stronger and more disciplined technical management, TSM may develop systems that do not meet mission objectives or that require significant redesign or costly replacement. It is vital that the IRS have a complete information systems architecture that is consistent, realistic, and thorough, and that the architecture drives TSM development and is actually used in implementing TSM projects. This blueprint is not an end in inself, but a tool that directs the builders of TSM on what to build, including the general principles, standards and methods to use. We are primarily concerned with quality and completeness, how effectively the architecture integrates overall IRS business goals and reengineering programs, and most important, how it is actually used to drive development.

III. SOFTWARE DEVELOPMENT PROCESS IS WEAK

Background: In August 1993, the IRS's software capability was rated level 1 using the model developed by the Software Engineering Institute at Carnegie Mellon University. (There are five levels in the model, with level 5 representing the greatest capability and maturity.) The GAO found that the level had not improved significantly since 1993. GAO also found there were no procedures for assuring software quality, that measurements of process quality (referred to as metrics) were not adequately defined, and that the management of requirements and configurations for TSM was not instituted.

GAO Recommendations: Immediately improve software development capability by requiring development contractors to be certified at level 2 of the software capability maturity model developed at Carnegie Mellon University. By December 1995, take measures to improve IRS's software development capabilities to move the IRS toward level 2, including implementation of consistent procedures for managing software requirements, quality assurance, configuration management, and project planning and tracking.

IRS Response: The IRS is taking the necessary steps to improve its software develop ment capabilities and will require contractors to be at level 2 . However, IRS points out that a substantial majority of software organizations are still operating at level 1. In a major contract that is ready to be let now, rather than delay the contract, the IRS will accept level 1, but will work with the contractor to achieve level 2 maturity.

Departmental Perspective: We agree that progress along the maturity scale is necessary, but the Department is primarily interested in the results of continuous process improvement--greater predictability, quality and productivity. Experience has shown it is much easier to create and promulgate new processes, methodologies, and metrics, than to instill them into everyday activity. We need to assure that improved processes are effectively used.

IV. BUSINESS STRATEGY WILL NOT MAXIMIZE ELECTRONIC FILING

Background: The IRS's goal for electronic returns is 80 million in the year 2001. That would represent about 35 percent of all returns filed. In 1994, about 16 million electronic returns were filed, or 7.8 percent of all returns. The GAO projected that at the current rate, in 2001, the IRS will only achieve a level of 39 million electronic returns filed, or 17 percent of all returns. This would result in a greater than anticipated level of paper returns and exceed the capacity currently planned for its document processing system (a major TSM component).

GAO Recommendation: Focus the IRS's electronic filing strategy to cover a wider population of taxpayers.

IRS Response: The IRS has appointed an electronic filing executive to develop a detailed, comprehensive strategy to broaden public access to electronic filing. The IRS will provide more incentives for practitioners and the public to file electronically.

Departmental Perspective: The electronic filing strategy must incorporate a strong and believable marketing emphasis reflecting the reality that we are trying to get the consumer (taxpayer) to do something different without the force of law behind us. Intermediate-term filing levels need to be set forth so that mid-course corrections can be identified in time to make a difference. Decisions about key components of TSM which depend on electronic filing success must be "future-proofed"as much as possible to avoid the worst impacts of failure to achieve desired penetration.

V. TSM ACCOUNTABILITY AND AUTHORITY WERE FRAGMENTED

Background: The GAO acknowledged that the IRS had addressed its major concerns regarding fragmented accountability and authority for IRS information systems by moving to create an Associate Commissioner. Prior to this, the IRS's Modernization Executive was responsible for developing TSM systems, while the CIO was responsible for developing non-TSM systems. The GAO also found that several development projects were being managed and controlled by the IRS's Research Division.

GAO Recommendation: Assign the Associate Commissioner responsibility for managing and controlling all systems development, including the system development efforts of the Research division.

IRS Response: In May 1995 the Modernization Executive position was reestablished as the Associate Commissioner to provide leadership and organizational structure to deliver TSM.

Departmental Perspective: The Department recognizes the value of focused accountability for overall success. Beyond this, the Department is also concerned that this accountability is made effective and operational by being ratcheted down into specific milestones within relatively short time-frames.

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C.

SECRETARY OF THE TREASURY

September 5, 1995

NOTE TO GEORGE MUÑOZ

FROM: Bob Rubin

What should be done -- if anything -- not currently being done to see this work right.

cc: Larry Summers
Frank Newman
Sylvia Mathews

95-149077

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C.

ASSISTANT SECRETARY

AUG 0 9 1995

CLOSE HOLD - NOT FOR DISTRIBUTION

MEMORANDUM FOR SECRETARY RUBIN

THROUGH: Frank N. Newman
Deputy Secretary

FROM: George Muñoz
Assistant Secretary for Management & CFO

SUBJECT: Departmental Response to GAO Report, *"Tax Systems Modernization (TSM): Management and Technical Weaknesses Must Be Corrected if Modernization is to Succeed"*

This provides a Departmental perspective on the findings and recommendations in GAO's July 26 report on IRS modernization, Tax Systems Modernization: Management and Technical Weaknesses Must Be Corrected if Modernization is to Succeed.

As the title of the report indicates, TSM has serious technical and management problems, and an important program with great promise is in danger of losing credibility and support. Of the five main areas GAO addressed in the report, two key issues are central to the business direction and technical success of the program. These are ineffective strategic management of investments, and inadequate systems architecture, testing and integration. The report also criticizes a weak software development process and points out that the current IRS business strategy will not maximize electronic filing and may impair the IRS's future ability to process paper returns. On a positive note, the report does give credit to the IRS for bringing TSM organizational management and control under one Modernization Executive.

The attachment briefly describes GAO's principal findings and recommendations, the IRS's response, and the Departmental Management perspective. The issues GAO presents are serious, but the report findings did not come as a surprise. We were aware of most of these problems, which were raised in previous reports by GAO and the National Research Council and by OMB and Congressional oversight committees. To increase Departmental involvement in responding to these issues, in April we established the Modernization Management Partnership (MMP), which I co-chair with Commissioner Richardson. The MMP was formed to promote an aggressive response to the need for proper guidance and enhanced management of IRS modernization. In their reports accompanying the FY 1996 Appropriations bills, the House and Senate Appropriations Committees commended this effort. They also require our action to implement GAO's recommendations.

The Department fully agrees with the direction of GAO's recommendations, although we have reservations that the short deadlines set out in the report may not provide adequate time for implementing the recommendations so as to achieve their full value. More importantly, we are concerned about the IRS's capability of making the substantive changes needed in this costly and critical undertaking, particularly with the recent or imminent departures of several key IRS executives who play major roles in TSM. The stakes are sufficiently high that we need to assure that the best people are brought in to fill these positions. The IRS should not proceed unilaterally on the selection of replacements or in reorganizing without the Department's contributing to these key decisions.

It is important that we assert the vital interests of the Treasury in assuring that TSM is appropriately led, planned, directed, and managed and that the substance of the recommendations is achieved in a suitable time frame. We want to ensure practicality and value; we do not want to respond to GAO merely as an exercise. The IRS and the Department must work together through the Modernization Management Partnership to ensure that the substance and intent of the GAO recommendations become a reality.

The IRS is now developing a plan of action for implementing the GAO recommendations and has 60 days to respond to the final GAO report. In its response to the draft report, the IRS agreed with the report's major recommendations and pointed out areas in which improvements were already underway. The IRS will make every effort to implement the recommended changes within the suggested time frames, but indicated that resource shortages and operational priorities such as implementing tax law changes may impact its plans.

Attachment

REVIEW OF SPECIFIC GAO FINDINGS AND RECOMMENDATIONS

I. STRATEGIC INFORMATION MANAGEMENT PRACTICES ARE INEFFECTIVE

Background: The GAO found that the IRS had not sufficiently established practices and procedures for selecting, prioritizing, controlling, and evaluating progress and performance of major information system investments. For example, a plan detailing the concept of future operations, and other key plans and documents were incomplete. GAO said that the IRS would have difficulty identifying and focusing on the completion of priority TSM projects. The IRS needs to identify higher-risk projects that have little potential of providing significant mission benefits. Other examples of best practices not being followed include: process reengineering preceding TSM design, reliable cost-benefit data, and complete identification of the skills needed for TSM.

GAO Recommendation: Immediately improve strategic information management by implementing a process for selecting, prioritizing, controlling, and evaluating progress and performance, using criteria such as risk, costs and benefits to review all planned and ongoing systems for FY 1996.

IRS Response: The IRS has developed an initial set of investment criteria and will continue to refine the criteria and institutionalize a formal process using the criteria. The IRS is using an information technology investment model which will assist in selecting, prioritizing, controlling and managing information technology investments to achieve reengineered program missions.

Departmental Perspective: This is one of the most critical areas for assuring that TSM contributes to achieving IRS's business mission. The Department is focusing strongly on economic modeling as the key to ongoing and recurring planning and prioritization. We want to assure that there is an effective tool and a reliable basis for evaluating individual projects and determining what investments are worthwhile. To be effective, these vital processes need to become an ongoing management tool, since many of the plans as they exist today will be changed. We also want to ensure an effective tradeoff between reworking architectures and plans to incorporate reengineering results and maintaining useful forward momentum.

II. SYSTEMS ARCHITECTURES, TESTING AND INTEGRATION ARE NOT ADEQUATELY ADDRESSED

Background: The Integrated Systems Architecture reflects the target architecture and the system design of TSM. The GAO found that while this key document was incomplete (missing components such as security, telecommunications and data), projects were proceeding to develop systems. Other plans are needed for major systems, such as a concept of operations for security, and plans for disaster recovery, contingency, and telecommunications security. Also, system development was proceeding even though standard software interfaces were still being defined. A facility to integrate and test systems has not yet been established, and there is no process to manage system changes.

GAO Recommendations: By December 1995 improve key technical infrastructure by:

- Completing architectures for systems, security, and data.
- Institutionalizing configuration management for all new projects and upgrades and develop plans for moving ongoing projects to it.
- Developing a security concept of operations and plans for disaster recovery and contingencies.
- Developing a testing and evaluation master plan.
- Establishing an integration testing and control facility.
- Completing the TSM integration plan.
- Monitoring projects to ensure compliance with modernization architectures.

IRS Response: The Integrated Systems Architecture and the transitional architecture are being combined into a planned 1996 IRS information systems architecture that will reflect a total systems view. A series of plans has been developed to address these weaknesses.

Departmental Perspective: Of all the criticisms, this is one of the most difficult and challenging, and one of the most critical. Without stronger and more disciplined technical management, TSM may develop systems that do not meet mission objectives or that require significant redesign or costly replacement. It is vital that the IRS have a complete information systems architecture that is consistent, realistic, and thorough, and that the architecture drives TSM development and is actually used in implementing TSM projects. This blueprint is not an end in inself, but a tool that directs the builders of TSM on what to build, including the general principles, standards and methods to use. We are primarily concerned with quality and completeness, how effectively the architecture integrates overall IRS business goals and reengineering programs, and most important, how it is actually used to drive development.

III. SOFTWARE DEVELOPMENT PROCESS IS WEAK

Background: In August 1993, the IRS's software capability was rated level 1 using the model developed by the Software Engineering Institute at Carnegie Mellon University. (There are five levels in the model, with level 5 representing the greatest capability and maturity.) The GAO found that the level had not improved significantly since 1993. GAO also found there were no procedures for assuring software quality, that measurements of process quality (referred to as metrics) were not adequately defined, and that the management of requirements and configurations for TSM was not instituted.

GAO Recommendations: Immediately improve software development capability by requiring development contractors to be certified at level 2 of the software capability maturity model developed at Carnegie Mellon University. By December 1995, take measures to improve IRS's software development capabilities to move the IRS toward level 2, including implementation of consistent procedures for managing software requirements, quality assurance, configuration management, and project planning and tracking.

IRS Response: The IRS is taking the necessary steps to improve its software develop ment capabilities and will require contractors to be at level 2 . However, IRS points out that a substantial majority of software organizations are still operating at level 1. In a major contract that is ready to be let now, rather than delay the contract, the IRS will accept level 1, but will work with the contractor to achieve level 2 maturity.

Departmental Perspective: We agree that progress along the maturity scale is necessary, but the Department is primarily interested in the results of continuous process improvement--greater predictability, quality and productivity. Experience has shown it is much easier to create and promulgate new processes, methodologies, and metrics, than to instill them into everyday activity. We need to assure that improved processes are effectively used.

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TREASURY CLEARANCE SHEET NO. 95-149072
Date 8/8/95

MEMORANDUM FOR: xx☐ SECRETARY ☐ DEPUTY SECRETARY ☐ EXECUTIVE SECRETARY
☐ ACTION xx☐ BRIEFING ☐ INFORMATION ☐ LEGISLATION
☐ PRESS RELEASE ☐ PUBLICATION ☐ REGULATION ☐ SPEECH
☐ TESTIMONY ☐ OTHER

FROM: Assistant Secretary for Management and CFO
THROUGH: Deputy Secretary
SUBJECT: GAO Report on IRS Tax Systems Modernization

☐ Under Secretary for Finance
- ☐ Domestic Finance
- ☐ Economic Policy
- ☐ Fiscal
  - ☐ FMS
  - ☐ Public Debt

☐ Under Secretary for Int'l Affairs
- ☐ International Affairs

☐ Enforcement
- ☐ ATF
- ☐ Customs
- ☐ FLETC
- ☐ Secret Service

☐ General Counsel
☐ Inspector General
☐ IRS
☐ Legislative Affairs
☐ Management
☐ OCC

☐ Policy Management
- ☐ Scheduling

☐ Public Affairs/Liaison
☐ Tax Policy
☐ Treasurer
- ☐ E & P
- ☐ Mint
- ☐ Savings Bonds

☐ Other

NAME (Please Type)	INITIAL	DATE	OFFICE	TEL. NO.
INITIATOR(S)				
J.Ochs, T. Forte, P. Clermont	JSO	8/8/95	Modernization Mgmt. Partnership/ Ofc. Organizational Improvement	622-2136
REVIEWERS				
W. Scott Gould	WSG	8/9/95	Deputy Assistant Secretary (Departmental Finance and Management)	622-2400
George Muñoz	GM	8/9/95	Assistant Secretary for Management & CFO	622-0410

SPECIAL INSTRUCTIONS: Due to the sensitive nature of some of our comments,

PLEASE HOLD CLOSE -- DO NOT DISTRIBUTE

☐ Review Officer Date: ☐ Executive Secretary Date

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95-150220

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

COMMISSIONER

September 14, 1995

MEMORANDUM FOR LAWRENCE H. SUMMERS
DEPUTY SECRETARY OF THE TREASURY

FROM: Margaret Milner Richardson
Commissioner of Internal Revenue

SUBJECT: Economic Justification for Tax Systems Modernization

Attached for your information is a copy of the Executive Summary of our Tax Systems Modernization (TSM) Economic Analysis Report that was submitted to Congress on September 1, 1995. Also included are copies of the transmittal letters to the chairmen of our House and Senate Appropriations Subcommittees.

I believe that the report is a strong endorsement of our continued investment in TSM. A fully funded program will provide a payoff of at least 7 to 1; will save taxpayers an estimated 2.3 billion hours of work, which is valued at $68.0 billion; will completely recoup its cost in FY 2000; and, eliminate several thousand IRS positions.

While full funding of the $20.7 billion program cost does not appear likely, even reduced investment will produce a significant return on investment.

If you would like to discuss this further, please call me.

M.M.R.

Attachment

To Peggy

Thanks for the TSM report. What is methodology? ~~what is yield in ...~~ ~~[illegible]~~ We should discuss this[illegible]

Larry

The Deputy Secretary of the Treasury

Sept. 20, 1995

TO: PEGGY RICHARDSON

FROM: LARRY SUMMERS LS

Thanks for the TSM Report. What is methodology? We should discuss further.

Room 3326 622-1080

CHAPTER 1: SUMMARY

This analysis shows that Tax Systems Modernization is a bold investment that will pay big dividends in the years ahead. It projects seven dollars in benefits for each dollar invested in the system. Benefits could be significantly greater. But even a worst case analysis shows that benefits will exceed costs while reducing taxpayer burden.

1.1 INTRODUCTION - WHY THIS REPORT?

In September 1994, the Congress required the Internal Revenue Service (IRS) to develop a comprehensive Economic Analysis to evaluate continued investment in Tax Systems Modernization (TSM). This is the first formal report on investment in Tax Systems Modernization.

Tax Systems Modernization is the vehicle for the organizational and technological transformation of the IRS. The Tax Systems Modernization Economic Analysis Report details the benefits, costs and the corresponding risks associated with Tax Systems Modernization and the IRS Business Vision.

The estimates in the Tax Systems Modernization Economic Analysis Report are presented in *then year* (inflation adjusted) dollars. The report also includes risk adjusted estimates and present value estimates, which are expressed in 1995 dollars.

The report is based on the implementation of the entire Tax Systems Modernization Program from FY 1990 through FY 2008 as originally planned. A major assumption of the report is the reinvestment of Full-Time Equivalent position *productivity savings* into processing and assistance workload growth and to further enhance compliance activities. An alternative scenario based on *no* reinvestment of productivity savings other than those required to meet workload growth in processing, assistance and compliance activities is also provided.

1.2 THE BENEFITS ARE SIGNIFICANT

Tax Systems Modernization provides $160.5 billion in benefits over its economic life. The report assumes the reinvestment of some of the productivity savings derived from Tax Systems Modernization. With this reinvestment of productivity savings, the TSM Program would provide $160.5 billion in benefits over its 19 year economic life at a cost of $20.7 billion. This represents a return of 7.8 to 1. Even when these estimates are adjusted for risk, the Return on Investment would be 7.0 to 1. TSM would provide productivity savings of 23,823 positions, of which 15,099 would be reinvested (3,619 to handle workload growth in processing and assistance activities and 11,480 to enhance compliance). The other 8,724 would be eliminated which include the 5,077 positions already eliminated.

Labor Savings of $7.8 billion and Labor Cost Avoidance of $8.9 billion (22,844 positions) account for $16.7 billion in labor-related benefits. As Figure 1-1 illustrates, Labor Savings focus on the difference between labor required in the base year FY 1990 and the labor required with Tax Systems Modernization. Labor Cost Avoidance focuses on the labor costs required to maintain the FY 1990 level of IRS performance if Tax Systems Modernization were not implemented.

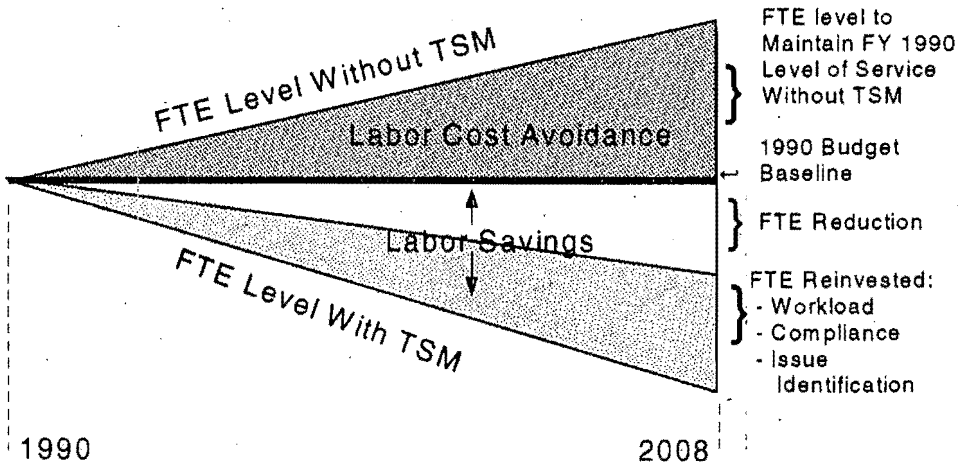

Figure 1-1 Full-Time Equivalent Savings and Avoidance

Replacing existing systems with more efficient Tax Systems Modernization processes will save $4.8 billion.

Improved Compliance, estimated at $134.7 billion, results from: the reinvestment of Labor Savings in improved compliance activities; acceleration of contacts with potentially non-compliant taxpayers; improved issue identification; and, market segment analysis.

Interest Savings, estimated at $4.3 billion, is the difference between interest saved through improved tax processing due to Tax Systems Modernization and the loss of interest float to the federal government.

Reduction of taxpayer burden will be accomplished through the redesign of forms and modernization of the IRS Customer Service and District Offices. Redesigning forms will reduce burden by decreasing the number of entries on each form, simplifying the instructions, and enabling taxpayers to file less complex forms. Modernizing IRS operations will enable taxpayers to spend less time interacting with the IRS since the accuracy of our processing and compliance activities will increase as a result of TSM. TSM will reduce taxpayer burden by 2.3 billion hours valued at more than $68.0 billion.

1.3 COSTS

Costs reflect the methodology, assumptions, and range of cost estimates contained in the independent cost analysis for the Tax Systems Modernization Program conducted by the Federally Funded Research and Development Center -- Tax Systems Modernization Institute. The Tax Systems Modernization Institute's task was to independently estimate and validate the IRS cost estimates for TSM. The independent cost analysis fulfills the following two objectives: (1) provides an independent cost analysis of the TSM Program in response to the Congressional Appropriations Conference Report; and, (2) provides input to the cost portion of the Tax Systems Modernization Economic Analysis Report. The estimates in the independent cost analysis were used for the cost portion of this report.

The total cost estimate of TSM from FY 1990 through FY 2008 is $20.7 billion presented in *then year* (inflation adjusted) dollars. If this report's cost analysis were expressed as in past analyses (in constant dollar terms), that figure would be $17.5 billion (FY 1995 base year). In this report all costs will be reflected in *then year* (inflation adjusted) terms.

Consistent with an independent cost analysis, costs for FY 1995 and FY 1996 reflect funding required to accomplish tasks that the projects stated were planned for those years. Thus, the independent cost analysis funding levels may not correspond to IRS budget figures.

The March 1992 Economic Analysis estimate for the Tax Systems Modernization Program was $22.3 billion (constant 1992 dollars) compared with the $20.7 billion estimate (inflation adjusted dollars) in the independent cost analysis. The current independent cost analysis accounts for significant decreases in hardware costs over the past few years; more fully addresses telecommunications costs, and includes Management and Administration costs in support of the Tax Systems Modernization Program.

1.4 RISK ANALYSIS -- SAVINGS ARE SIGNIFICANT IN ANY SCENARIO

Economic analysis and estimates such as those contained in the Tax Systems Modernization Economic Analysis Report depend on the quality of the data as well as the underlying technical and business assumptions.

Using a "best case/worst case" risk analysis process, risks were assessed in areas including system sizing, software development and new technology costs. Risks were assessed on benefit categories such as meeting forecasted compliance rates, productivity rates and workload growth rates. The resulting risk adjusted estimates for Tax Systems Modernization were $145.1 billion for benefits and ranged from a worst case of $35.4 billion to a best case of $193.2 billion, while the associated costs were estimated at $20.7 billion and ranged from a low of $16.1 billion to a high of $25.7 billion.

1.5 THE RETURN ON INVESTMENT FOR TSM IS SUBSTANTIAL

Based on the information found in the Tax Systems Modernization Economic Analysis Report, Tax Systems Modernization provides an excellent Return on Investment for the Report Estimate and the Risk Adjusted Estimate.

Table 1.5-1 TSM RETURN ON INVESTMENT ($ billion)

	Report Estimate	Risk Adjusted Estimate
Benefits	$160.5	$145.1
Costs	$20.7	$20.7*
Return on Investment	7.8 to 1	7.0 to 1

* The risk adjusted estimate is approximately $77 million dollars more than the report estimate, which is not readily apparent here due to rounding to the nearest $100 million. Based on the Risk Analysis, the possible cost increases roughly balance possible decreases.

Based on the Office of Management and Budget's Circular A-94 discount rate, the Tax Systems Modernization Program yields an estimated net present value (1995 dollars) of $69.6 billion over the 19 year period. The discounted estimate for benefits is $83.8 billion and for costs is $14.2 billion resulting in a present value benefit/cost ratio of 5.9:1 (see Table A1-1 in the Appendix for more information).

1.6 ALTERNATIVE SCENARIO

An alternative scenario based on *no* reinvestment of productivity savings other than those required to meet workload growth in processing, assistance and compliance activities is also provided in this report. This alternative approach was discussed and agreed to by the Office of Management and Budget. Under this alternative scenario, Tax Systems Modernization would provide $83.3 billion in benefits over its economic life at a cost of $20.4 billion for a Return on Investment of 4.1 to 1. Under this scenario, 17,750 positions would be eliminated including the 5,077 positions already eliminated through FY 1996.

* * * *

Through Tax Systems Modernization, the IRS can generate significant cost savings and revenues -- good news for America's tax system.

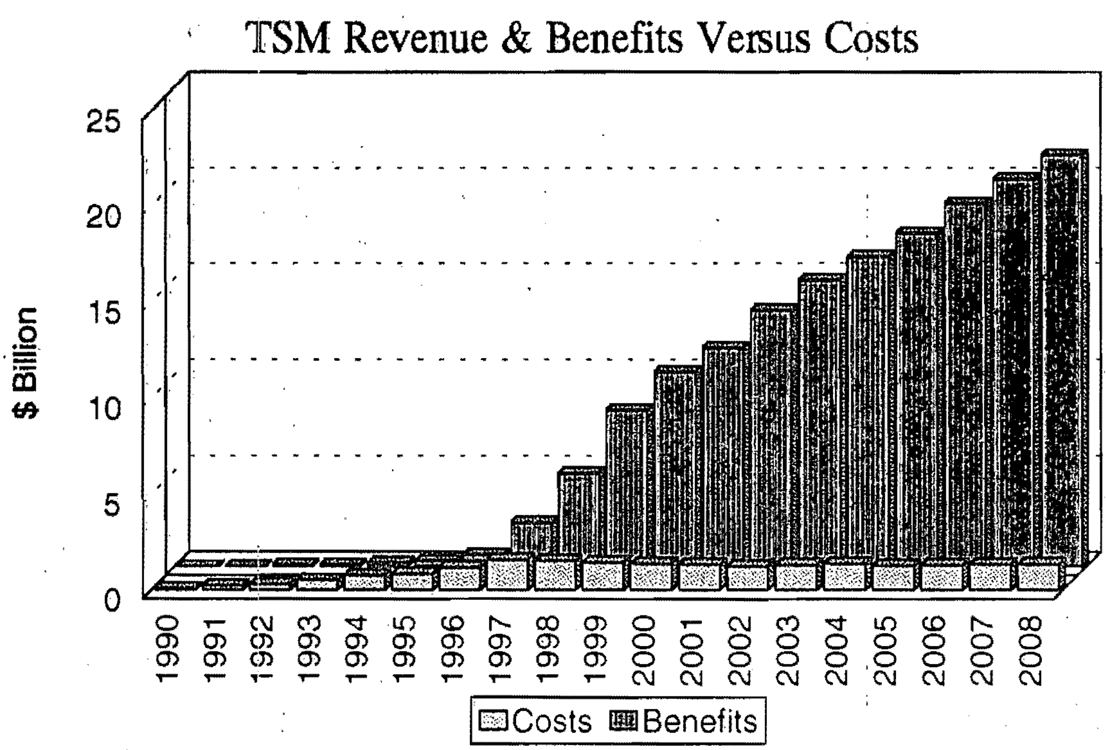

Figure 1-2 TSM Revenue & Benefits Versus Costs

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

COMMISSIONER

September 1, 1995

The Honorable Jim Lightfoot
Chairman, Subcommittee on Treasury,
Postal Service and General Government
Committee on Appropriations
U.S. House of Representatives
Washington, D.C. 20515

Dear Mr. Chairman:

This letter transmits the Tax Systems Modernization (TSM) Economic Analysis Report required by Conference Report 103-741 on the Internal Revenue Service's FY 1995 Appropriation. The Report incorporates the results of the independent cost analysis conducted by the Federally Funded Research and Development Center -- Tax Systems Modernization Institute, a subsidiary of the IIT Research Institute. The Report is based on the TSM Program from FY 1990 through FY 2008 as originally planned and was substantially completed before the impact of the FY 1996 budget realities were known.

I am pleased to share the positive results of the analysis -- the fully implemented TSM Program will provide a payoff of at least 7 to 1; will save the taxpayers an estimated 2.3 billion hours of work, which is valued at $68.0 billion; will completely recoup its cost in FY 2000; and, eliminate several thousand IRS positions.

The TSM Program will improve productivity, reduce taxpayer burden and increase compliance. A major assumption of the Report is the reinvestment of productivity savings from the implementation of TSM to handle future processing and assistance workload growth and further enhance compliance.

With this reinvestment of productivity savings, the TSM Program would provide $160.5 billion in benefits over its 19 year economic life at a cost of $20.7 billion. This represents a return of 7.8 to 1. Even when these estimates are adjusted for risk, the return on investment would be 7.0 to 1.

There is also an analysis of the reduction of taxpayer burden associated with the implementation of the TSM Program -- a key goal of our Business Vision. TSM will reduce burden by 2.3 billion hours, saving taxpayers $68.0 billion. These estimates are based on reducing the burden associated with paperwork and compliance.

The Honorable Jim Lightfoot

The Report includes an alternative scenario based on *no* reinvestment of productivity savings other than those required to meet workload growth. Under this scenario, TSM would provide $83.3 billion in benefits over its economic life for a return on investment of 4.1 to 1.

This analysis is a strong endorsement of the TSM Program. It clearly indicates that the best way to maximize the investment in TSM is to reinvest employees whose positions are eliminated to boost voluntary compliance and generate revenue. Without this reinvestment, the TSM Program produces some $77.2 billion less in benefits to the government -- a significant reduction from the benefits of the fully delivered TSM Program and the reinvestment strategy.

I firmly believe that the continued investment in the full TSM Program and the fulfillment of our Business Vision is the right course of action. The return on investment, productivity savings and reduction of taxpayer burden are predicated on full funding of the $20.7 billion cost of the Program. As I mentioned earlier, the Report was based on an assumption of full funding since it was substantially completed before the impact of FY 1996 budget realities were known.

I recognize the fiscal constraints that the Congress is under and am committed to working with you on a comprehensive plan to fully fund and deliver the Program. Without the commitment for stable funding of the Program, a significant revision of the TSM Program and our Business Vision will be necessary in the near future. Regardless of budget decisions about the Program, the infrastructure replacement components in TSM will be required.

I hope that you find this analysis useful in the continuing budget debate. I appreciate your continued support of our efforts to modernize and would appreciate an opportunity to discuss the TSM Program further with you.

Sincerely,

Peggy Richardson

Margaret Milner Richardson

Enclosure

cc: The Honorable Steny Hoyer

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

COMMISSIONER

September 1, 1995

The Honorable Richard C. Shelby
Chairman, Subcommittee on Treasury,
Postal Service and General Government
Committee on Appropriations
United States Senate
Washington, D.C. 20510

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The TSM Program will improve productivity, reduce taxpayer burden and increase compliance. A major assumption of the Report is the reinvestment of productivity savings from the implementation of TSM to handle future processing and assistance workload growth and further enhance compliance.

With this reinvestment of productivity savings, the TSM Program would provide $160.5 billion in benefits over its 19 year economic life at a cost of $20.7 billion. This represents a return of 7.8 to 1. Even when these estimates are adjusted for risk, the return on investment would be 7.0 to 1.

There is also an analysis of the reduction of taxpayer burden associated with the implementation of the TSM Program -- a key goal of our Business Vision. TSM will reduce burden by 2.3 billion hours, saving taxpayers $68.0 billion. These estimates are based on reducing the burden associated with paperwork and compliance.

The Honorable Richard C. Shelby

The Report includes an alternative scenario based on *no* reinvestment of productivity savings other than those required to meet workload growth. Under this scenario, TSM would provide $83.3 billion in benefits over its economic life for a return on investment of 4.1 to 1.

This analysis is a strong endorsement of the TSM Program. It clearly indicates that the best way to maximize the investment in TSM is to reinvest employees whose positions are eliminated to boost voluntary compliance and generate revenue. Without this reinvestment, the TSM Program produces some $77.2 billion less in benefits to the government -- a significant reduction from the benefits of the fully delivered TSM Program and the reinvestment strategy.

I firmly believe that the continued investment in the full TSM Program and the fulfillment of our Business Vision is the right course of action. The return on investment, productivity savings and reduction of taxpayer burden are predicated on full funding of the $20.7 billion cost of the Program. As I mentioned earlier, the Report was based on an assumption of full funding since it was substantially completed before the impact of FY 1996 budget realities were known.

I recognize the fiscal constraints that the Congress is under and am committed to working with you on a comprehensive plan to fully fund and deliver the Program. Without the commitment for stable funding of the Program, a significant revision of the TSM Program and our Business Vision will be necessary in the near future. Regardless of budget decisions about the Program, the infrastructure replacement components in TSM will be required.

I hope that you find this analysis useful in the continuing budget debate. I appreciate your continued support of our efforts to modernize and would appreciate an opportunity to discuss the TSM Program further with you.

Sincerely,

Peggy Richardson

Margaret Milner Richardson

Enclosure

cc: The Honorable Robert J. Kerrey