

The Strategic Management Process at the Internal Revenue Service

CONTEXT AND HISTORY

Context

The Internal Revenue Service (IRS) is the largest Bureau of the United States Department of the Treasury. The IRS's Fiscal Year (FY) 1996 budget is approximately \$7.35 billion; it has 106,000 employees. The IRS has conducted long-range planning activities for almost 40 years, although it is only within the last 12 years that the IRS has used a *strategic* management process as its management and planning method. The IRS considers all activities included in planning and budgeting, developing measures, implementing the plans, and evaluating the results as part of its strategic management process. Its current efforts to refine the process are bringing the IRS closer to fulfilling all the requirements of the Government Performance and Results Act of 1993.

History of Planning, Budgeting and Performance Measurement at the IRS

The IRS's first plans served as multi-year budgeting exercises that considered long-term investments and accommodated foreseeable growth. Developed by high-level staff with program area expertise, the plans did not include a vision, objectives, goals, or performance measures associated with a budget.

In 1984, in response to Office of Management and Budget and Department of the Treasury requirements, the IRS developed its first Strategic Business Plan. This was the IRS's first attempt at developing a strategic plan in advance of the related, annual budget request. The planning process now included an assessment of the external operating environment.

THE STRATEGIC MANAGEMENT PROCESS

Early Process: The Strategic Business Plan

From 1989 through 1993, the IRS described its strategic management process as shown in

Figure 1.

Figure 1
IRS Strategic Management Process
1989 - 1993

The IRS's mission, which evolved during the mid- to late 1980s, was the starting point for the entire process. The mission drove the content of the Strategic Business Plan, which was actually a combined strategic-annual performance plan that contained the IRS's objectives, strategies, and one-year actions (see Attachment 1 for information on Strategic Business Plan development). Many of the "themes" from the early plans (e.g., market segment research into the causes of compliance and noncompliance; reengineering the IRS's business processes; and use of technology to increase efficiency and improve customer service) are still found in the IRS's present plans. Initially, plan developers also attempted to estimate the costs and benefits of the one-year actions. However, their success was limited. This was discontinued as a plan element although the IRS continued to look for ways to create closer ties between the Strategic Business Plan and the budget.

Performance Measurement and Assessment Under the Early Process

For many years, the IRS used its internal audit program to evaluate its work methods and results. It supplemented this program by using a huge number of traditional input and output measures as the basis for a centrally coordinated performance assessment program. The assessments compared an individual region's performance over a given period to the prior period, but did not compare any region's performance to that of other regions. There also was no assessment of IRS-wide effectiveness. By the late 1980s, the IRS stopped conducting this assessment program.

But it was beginning to examine how it could use measures to improve quality as well as productivity. At this point, the IRS focused on establishing baselines and setting targets for percentage improvements in the traditional measures, rather than on determining whether its measures effectively evaluated performance or developing new measures.

A 1988 General Accounting Office study suggested that IRS headquarters supplement its ongoing guidance and assistance efforts with a strong end-of-year analysis to determine whether the field offices had achieved their goals. As a result, the IRS put its Business Review program into operation in FY 1989. Business Reviews assessed the field's accomplishments based on the previous year's regional and service center annual operating plans and other areas of concern to headquarters' operational units, but did not include an evaluation of IRS-wide effectiveness. The results of the Business Reviews were supposed to be considered in formulating the following year's Strategic Business Plan annual actions. However, lacking an analysis of the IRS's prior year performance, this was not possible.

One result of using the above process was that the substance of the Strategic Business Plan could change substantially from each year. In addition, formulation of the budget occurred separately from development of the Strategic Business Plan. Using two processes resulted in timing inconsistencies and gaps in understanding between the planning and budget staffs. Staff in the IRS's operations areas used both the Strategic Business Plan and the annual budget to prepare their work plans for the year. Because the budget primarily supported current ways of doing business, it tended to reinforce using tried and true methods for responding to challenges rather than supporting new, strategic solutions to emerging issues. The IRS has only recently realized that it tended to rely on its ability to obtain additional appropriated funding for carrying out Strategic Business Plan actions rather than considering the plan and budget together and redirecting funds from the budgetary base to pay for them. As a result, strategic management did not have the desired impact, and IRS operations changed very little over time.

Recent Process: The Business Master Plan

In 1994, the business planning process changed. During FY 1994, the IRS realized that it needed detailed, integrated plans for its organizational restructuring, human resources programs, and operational programs, including systems modernization. However, these planning efforts were proceeding independently of each other and of the overall strategic management process. To improve that situation, the IRS created a new Business Master Plan (see Attachment 1 for information on Business Master Plan development). The Business Master Plan was intended to

Figure 2
IRS Strategic Management Process
1994-1996

accomplish the desired plan integration and to incorporate and expand on successful elements of the Strategic Business Plan (Figure 2). The Business Master Plan appeared merely to replace the Strategic Business Plan on the overall strategic management process chart. But it also attempted to achieve several improvements over prior plans. Thus, the Plan:

- Incorporated the IRS's vision for future operations. The mission and business vision now formed the basis for the content of the plan.
- Contained long-range objectives and three years of one-year actions, meant to encourage "next step" thinking.
- Identified which officials and organizational segments were responsible for

accomplishing the actions.

- Substituted quantifiable FY 2001 performance goals for the previously used strategies and included performance measures for every Business Master Plan action.
- Considered IRS managers as its primary audience. The IRS revised performance plans for its executives, managers, and management officials to focus on the three strategic objectives and to support Business Master Plan actions (for a sample Executive/Managerial Performance Plan, see Attachment 2). The performance plans listed standards that generally described how the individual should perform to support each objective. Individualized standards could be added. This IRS included a self-training package with the new performance plans when they were first distributed.

The resulting plan contained a great deal of both detail and jargon. At 140 pages, it also was very long. The IRS viewed its first attempt at setting performance measures within the context of the plan (there were 42 pages of measures) as a reasonable, if not entirely successful, effort. But the plan still lacked priorities and did not have the strong links to the budget that the IRS desired.

Although work began almost immediately to refine the FY 1996 and FY 1997 Business Master Plan actions and to incorporate actions for FY 1998, it proceeded more slowly than originally anticipated. When it became apparent that IRS would suffer major budget cuts for FY 1996, work on the Business Master Plan came to a halt while the IRS examined and set operational and funding priorities. When the IRS realized it only would be able to issue an FY 1996 *Preliminary* Edition of the Business Master Plan, it quickly began to re-evaluate its strategic management process once again.

THE REDESIGNED STRATEGIC MANAGEMENT PROCESS

Current Process: Strategic Plan and Budget

As a result, the IRS is changing its strategic management methods so that planning, budgeting, performance measurement, and performance assessment will be integrated into one process beginning with FY 1997 and FY 1998. The IRS studied processes in other organizations to help it formulate its new planning model. Some of the organizations the IRS benchmarked included the Bank of Chicago, Student Loan Marketing Association (Sallie Mae), Federal Home Loan Mortgage Corporation (Freddie Mac), the Patent and Trademark Office, the City of Dayton, the City of Milwaukee, and the Departments of Inland Revenue of the United Kingdom, New Zealand, and Australia. The IRS learned that a strategic management process should incorporate planning, budgeting, performance measurement, and review for all parts of the organization. The IRS's efforts also include a venture with the Private Sector Council to assist in integrating the planning, budgeting, and assessment processes. The Council is composed of representatives from

the Aluminum Company of America, the J.C. Penney Company, Inc., and The Boeing Company.

By creating a single strategic management process, the IRS hopes to stabilize strategic plans from year to year; create more complete, usable, and focused guidance to the field; and fulfill multiple reporting requirements with a single document. An Executive Planning Board oversees strategic planning and strategic budgeting, including investment alternatives, and manages the development, preparation, and presentation of a prioritized, funded business plan, with measurable business and financial outcomes. The Board is chaired by the National Director, Strategic Planning Division and the National Director for Budget. Its members include Acting Deputy Chief Information Officer; National Directors from various line and staff areas; the Director, Analysis and Studies Division; District Director, Hartford District (field representative and liaison to the Measures Advisory Group discussed further in the section entitled Business and Financial Review); and the Executive Vice President of the National Treasury Employee's Union. The Board's purpose is to create a single process to make long-range, strategic decisions for both programs and budgeting.

Strategic Plan and Budget Formulation for FY 1997 and FY 1998

The new strategic management process moves from the mission, business vision, and strategic thinking to simultaneous plan and budget formulation, resulting in one IRS-wide document on which the various operating and field plans may be based (Figure 3).

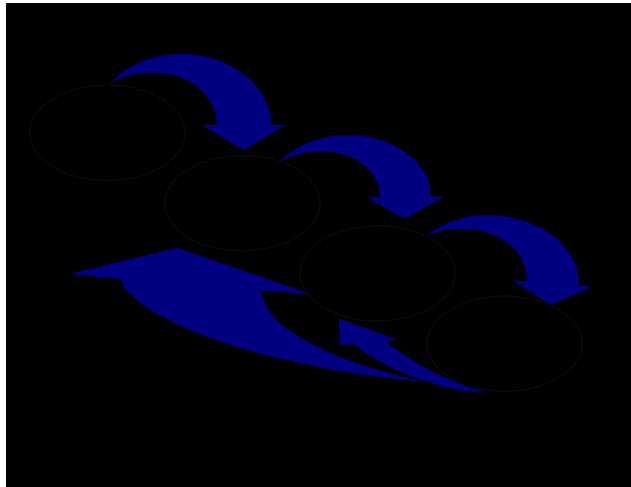


Figure 3
IRS Strategic Management Process
Beginning 1997

The Executive Planning Board is responsible for formulating both the plan and the budget for FY 1997 and FY 1998. A key part of the Board's efforts will be to cost and prioritize IRS business operations to support achievement of the mission, objectives, and business vision. The Board will draw on input from IRS functional areas and stakeholders, examine continuing elements of past plans, and consider information from a budget forecasting model. The forecasting model largely centers on the 70% of the IRS budget that is made up of staffing related costs.

One of the Executive Planning Board's goals is to have a strategic plan and budget that presents information usefully for different audiences. The complete strategic plan and budget will have four portions: the IRS's strategic direction; the prior year's performance report; the current year's performance plan and budget; and the subsequent year's performance plan and budget. The four portions will be integrated to a certain extent, but portions may be extracted for different audiences. A comprehensive version will be distributed to IRS executives, middle managers and National Treasury Employee's Union officers throughout the country. A shorter version will be produced for external audiences and the IRS's lower-level managers. Employees will receive a brief overview of the strategic plan and budget and their regional and service center operating plans. Eventually, the Executive Planning Board would like to see the entire plan entered into a database so that different layers of information could be provided, depending on the audience's needs.

Business and Financial Review

The IRS realized the benefits of reviewing the organization's performance long before the National Performance Review and Government Performance and Results Act made it a central focus for the federal government. However, the financial and Business Review processes remained separate annual processes until FY 1996.

Headquarters is continuing to conduct Business Reviews, individual operational area reviews, and internal audits to judge field office performance. Prior to FY 1996, Business Reviews were conducted only once a year. These annual reviews measured field offices against performance

targets established in their annual operating plans. Because measures and performance targets could vary by plan, prior Business Reviews focused more on whether field offices met their targets than on overall office performance or on identifying best performers.

In FY 1996, the Service began conducting less formal and more interactive Business Reviews during monthly Executive Committee meetings. The reviews were modeled after best practices in private industry, from organizations such as the Bank of Chicago. The IRS believes that the more frequent reviews allow it to identify concerns during the fiscal year and provide offices the opportunity to improve performance before the year-end Business Review. The IRS now provides its field offices with monthly performance data through an online information system. This allows the field offices to track their own performance and identify opportunities for improvement.

Although the annual Business Reviews will still be held at the end of the fiscal year and will incorporate three quarters of performance data, it will differ from prior Business Reviews. First, future Business Reviews will answer five key questions about field office performance:

- How did a region perform compared to its maximum potential performance?
- How did a region's performance level and improvement compare to other regions?
- How did a region's performance improve between last year and this year?
- How did a region perform compared to the principle Business Master Plan quantitative goals?
- Does a region collect more total revenue than other regions given the size of its budget, the incomes of its taxpayers, and other economic conditions in the region?

Second, Business Reviews will focus primarily on the mission, objective, and goal level measures. FY 1994 was first year that field office performance data was converted into point scores and performance across offices was compared in a written report. Statistical comparisons will be part of future Business Reviews and will be the basis of the annual Business Review used to fulfill Government Performance and Results Act requirements. As with other Treasury bureaus, the IRS will present its performance report in the President's budget.

Furthermore, the IRS's Business Reviews will now include outcome measures (e.g., customer satisfaction) as well as output measures (e.g., taxpayer phone calls answered). In the past, the IRS used quantitative output measures to evaluate office performance on corporate goals and objectives. To discourage measures "gaming" and to eliminate inappropriate incentives, the IRS

is developing measures that focus more on results and less on outputs. With better outcome measures, the IRS expects to better understand the link between the level of resources it invests and the outcomes these resources produce. To aid in the development of better outcome measures, the IRS has established a Measures Advisory Group comprised primarily of field executives. The Measures Advisory Group will provide recommendations on new performance measures, as well as revisions to existing measures, to the Executive Planning Board.

Until now, the strategic management process was based on a yearly cycle. The IRS is in the process of altering the timing of its planning cycle. Under the new cycle, the Executive Planning Board will conduct programmatic and budgetary planning between January and June, two years prior to the target fiscal year. The budget will be submitted to the Treasury Department in June and to the Office of Management and Budget in September. Congress will typically receive the budget in January. Congress will act upon it by sometime late the following year. Finally, performance will be measured throughout the next fiscal year and formally evaluated at the end of that year. In all, including evaluation, the process will be a three-year cycle. For example, the FY 1999 plan and budget will be formulated throughout 1997. It will be approved by Congress in late 1998, and put into effect, based on the enacted level, for the start of FY 1999. The annual performance report for FY 1999 will be submitted in FY 2000.

This year, the process has been delayed because budget cuts have created difficulties in determining FY 1996's plan and budget. Currently, the IRS is planning for both FY 1997 and FY 1998, although its focus is on the latter. For FY 1998, the Executive Planning Board expects to integrate its strategic plan and budget into one document, revise the performance measures and targets from FY 1997, and continue to prioritize its list of business investments.

Internal and External Stakeholder Involvement

Currently, strategic plan and budget development is a "top-down" process. Its purpose is to encourage decision-makers to discuss and come to a consensus on the short- and long-term goals and objectives of the organization. The Executive Planning Board meets frequently on-site at the IRS, and briefs the Executive Committee at least quarterly. Off-site planning sessions, used formerly, have not been conducted in recent years due to an increase in costs, and scheduling conflicts.

The IRS incorporated input from external stakeholders, such as the American Institute of Certified Public Accountants, American Bar Association, Tax Executives Institute, taxpayer advocacy groups, and the National Treasury Employee's Union, as it developed the former Strategic Business Plans. It solicited input on critical issues prior to the development of any straw proposal, and asked stakeholders to review a later draft plan. The IRS also sought input on critical issues before producing the first Business Master Plan. Although external stakeholder input was not sought for the FY 1996 Business Master Plan, National Treasury Employee's Union representatives were included on the development team. The IRS is currently developing plans to include stakeholders in the development of the FY 1998 strategic plan and budget.

FACTORS INFLUENCING CHANGE

Both internal and external factors have influenced the strategic planning process at the IRS. The General Accounting Office's 1988 report helped the IRS improve its oversight and performance evaluation process. In 1990, the U.S. Congress passed the Chief Financial Officers Act, mandating that agencies create five-year financial systems development plans that were consistent with Office of Management and Budget guidance. The Chief Financial Officers Act also moved federal agencies and departments towards producing audited financial statements and annual management reports with performance measures. The Government Performance and Results Act's passage in 1993 mandated that all federal agencies move towards conducting strategic planning linked to budgeting and measured by performance measures for FY 1999. But as a Government Performance and Results Act pilot agency, the IRS is already working to comply with that law. Additional legal requirements affecting the IRS's Information Resources Management Strategic Plan also indirectly impact the strategic plan and budget. The IRS would like to use a six-year plan to meet all legal requirements although it will be unable to include budget figures for all years.

Since the budget was adjusted downward for FY 1996, the IRS has devoted enormous resources to trying to set consistent operating and fiscal priorities. As a result, the IRS wants to hone its strategic management process so that funding priorities are clearer, and adjustments may be easily made. The IRS also receives pressure from Congress to increase revenues by becoming more efficient and increasing enforcement and voluntary compliance efforts. The IRS wants to use its strategic management process to help it respond to these external forces.

USE AND IMPACT OF STRATEGIC PLANNING

Budgeting and Planning

As explained in Pages 4 - 7, the IRS realized that its planning efforts would be more successful if budget were a part of the effort. The IRS considered whether it would be possible to make changes to the budget format and approach based on the Strategic Business Plan and Business Master Plan formats, but concluded that it would not work. For FY 1998, the IRS has begun a process of reformatting its strategic and annual performance plans and performance reports to work in closer harmony to its standard budget format and approach, and intends to fully integrate them by 1999.

Personnel Evaluations

Performance plans for executives, managers, and management officials have also been affected by the strategic management process. Beginning in FY 1995, their performance plans were centered on the three objectives (for additional information on the objectives, see Attachment 1).

COSTS

The costs associated with the strategic management process have not been quantified. However, the IRS estimates that they are significant. The IRS's Strategic Planning Division currently has ten staff members working directly on the strategic management process; however, it is not the only part of the organization that participates in the process. Directors and some staff members of the Budget Division and Analysis and Studies Division are also heavily involved. Executives representing each major organizational segment, and some of their staff members, have varying levels of involvement. This also holds true for the field offices. In addition, subordinate organizational levels contribute to the assessment and budgeting activities. For several years, costs also included holding an annual one to three day off-site meeting for 30-40 executives, 10-15 staff members, and an outside consultant. The high level of staff involvement exemplifies the significant costs estimated, but not quantified, by the IRS. However, because the IRS's plan and strategic management process are in transition, the number of resources currently committed to this effort will be reduced in the future.

NEXT STEPS

As noted earlier, the IRS's goal for the immediate future is to fully integrate planning with budgeting, measures development, and the performance assessment process, and make the entire process responsive to feedback from performance measures. A new FY 1998 strategic plan and budget is being prepared and will be available for review later in FY 1996. Executives throughout the IRS are working to achieve consensus on which performance measures are the most useful for

determining how to best improve organizational performance. They will then use the resulting performance measurement system as the basis on which their offices and own performance are judged.

Once a more comprehensive consensus on performance measures is reached among executives, plans and budgets for the future will be based on steps necessary to achieve the key performance measures. The IRS believes the stage will thus be set to use the strategic management process to guide operations and make performance improvements.

Lessons Learned

The IRS has learned many lessons that they plan to incorporate into their planning process. The lessons are presented below:

- Integrate the plans and the budget to provide the incentive and means to achieve the agency's goals.
- Ensure that the agency's plans drive its budget requests but prepare contingency plans so that plans may be adjusted to conform to actual appropriations.
- For contingency planning, provide detailed information on how potential budget cuts might affect programs and offices.
- To facilitate use by most audiences, issue plans in versions of several lengths and levels of complexity.
- Include key internal and external stakeholders in the planning process.
- Ensure field offices create supporting plans that focus on agencywide annual performance plan actions, including outcome measures.
- Reduce the number of performance measures to a critical few.
- Involve senior management, including field executives, in determining measures, their use, and their assessment to facilitate their buy-in.

