



PERFORMANCE AUDIT REPORT

**Reviewing the Progress of the
Department of Revenue's Project 2000**

Executive Summary *with Conclusions and Recommendations*

**A Report to the Legislative Post Audit Committee
By the Legislative Division of Post Audit
State of Kansas
August 1997**

Legislative Post Audit Committee

Legislative Division of Post Audit

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To: Members of the Kansas Legislature

This executive summary contains the findings and conclusions, together with a summary of our recommendations and the agency response, from our completed performance audit, *Reviewing the Progress of the Department of Revenue's Project 2000*.

The report includes several recommendations for the Department to help ensure the Project has adequate oversight, more thorough testing, and better communication. The report also contains appendices showing the estimated costs of Project 2000, and the results of a survey we did of all Department staff who have worked on the Project.

If you would like a copy of the full audit report, please call our office and we will send you one right away. We would be happy to discuss these recommendations or any other items in the report with you at your convenience.

A handwritten signature in cursive script that reads "Barbara J. Hinton". The signature is fluid and elegant, with a large initial 'B'.

Barbara J. Hinton
Legislative Post Auditor

**Reviewing the Progress of the
Department of Revenue's Project 2000**

**EXECUTIVE SUMMARY
LEGISLATIVE DIVISION OF POST AUDIT**

**Question 1: How Well Has the Department of Revenue
Carried Out Project 2000?**

**Project 2000 combines the development of a computer system page 5
with a complete reorganization of the Department's operations, pro-
cesses, and jobs.** *This project will cost about \$71 million, but the Depart-
ment expects those costs to be more than offset by the additional taxes
collected because of the improved collection procedures implemented
through the Project. The Project is a partnership between American Manage-
ment Systems, Inc. (AMS) and the Department; staff from the agency and
AMS are working together to develop and integrate the various aspects of the
Project.*

**The Department generally has established good practices for page 6
managing Project 2000.** *We compared the Department's management
practices to practices that an organization should have in place for carrying
out such a project. With one exception, we found the Department had put
appropriate practices in place. The Department no longer has a full-time
director assigned to the Project. The Secretary recently gave the project
director the additional responsibility for day-to-day operations of the Taxation
Division. This increases the risk that the Department won't be able to keep
the Project on track. However, the Department also took efforts to minimize
this risk by adding a full-time project manager to work directly with the project
director to relieve her of some duties, such as dealing with staffing issues.*

**Although most staff think the Department's practices are being page 9
appropriately carried out, they reported concerns about inadequate
product testing and poor communications.** *Inadequate testing and
communications could result in unanticipated problems cropping up, and an
inadequate response to those problems. In fact, both of these situations
occurred when the Department implemented the Project's first major comput-
er system in 1997, resulting in significant delays in processing income tax
returns, and related delays in making refunds to taxpayers. Department
officials we interviewed reported the following:*

- *testing on the new equipment wasn't adequate to identify all the types
of problems that could occur.*
- *the Department designed "front-end" edits to identify certain inaccura-
cies or data processing errors before further processing, but those
edits weren't put in place.*
- *because the extent and significance of problems with the new
"imaging" system weren't adequately communicated to the project
director, those problems weren't addressed promptly.*
- *the Department decided to implement the system during the peak tax
season, rather than phasing this system in or waiting until the peak
season was passed, to keep from having to hire so many temporary
workers, and to process taxpayer's refunds more quickly.*

In response to the problems, the Department has added additional testing time for future parts of the Project, and has improved its monitoring process to help ensure that problems get communicated to management.

Project 2000 generally is on schedule, but its final completion date has been extended by about six months. *Under the original plan, the Department estimated the Project would be completed by June 1999. That date has now been moved forward to December 1999. The Department has made several decisions that extended this estimated completion date. Part way into the Project, AMS and the Department decided to implement the individual income tax computer system first, instead of the withhold tax computer system. Because of this change, design and implementation plans had to be developed for both computer systems in Stage One, instead of just one. In negotiating with AMS for Stage Two, the Department added two pieces to the Project—an “imaging” system for withholding tax returns for the Department of Human Resources, and a set of modules that would help the computer make more complex decisions. Also, in response to the problems the Department experienced implementing the first computer system, additional testing time for future parts of the Project was built into the schedule.*

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Question 1 Conclusion: *Because of its size, complexity, and length, Project 2000 has a high risk of failure. While the risk is high, so are the potential rewards. If all the benefits of the Project are realized, the Department will be more efficient, more accessible to customers, less bureaucratic, and a better place to work. Its business processes and computer systems also would be much closer to cutting edge, and the Department would be collecting a higher percentage of the taxes owed but not paid. The Department has done a good job of managing many aspects of the Project. Clearly, there were problems when the imaging system was brought on-line, and some of those may have been avoidable. It appears, however, that Department officials have learned from their experience with the income tax return imaging system, and have acted to improve their practices as problems are identified.*

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As State resources grow ever tighter, maintaining such a level of commitment can't be easy. For example, the Department currently is using about 60 employees on the Project. A high level of commitment will need to be maintained for nearly three more years to continue the chances of the Project succeeding.

Question 1 Recommendations: *A brief summary of the report's recommendations, together with a summary of applicable comments from the agency, is presented below.*

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We made several recommendations to the Department of Revenue to ensure that Project 2000 has adequate direction and oversight, and to minimize the risk of failure. They include:

- *reviewing the workload of the project director*
- *designing additional tests for the new computer systems that will come on-line in the future to ensure the tests are more representative of what the Department is likely to expect to receive from taxpayers*
- *improving communications within the Project*

- allowing more flexibility in assigning time limits for the review of final products

The Department disagreed with two of our recommendations. Department officials disagreed with our finding that the project director's additional responsibilities for operations of the Taxation Division presents a risk. They point out that as the project moves to implementation, the line between the Project and operations blurs, and that it's critical for one person to be in charge of the transition. They also think that the Department's current procedures for reviewing products allows adequate flexibility for appropriate reviews.

Question 2: Has the Department Established an Adequate System To Identify the Additional Tax Moneys That Would Be Generated by the Project?

Project 2000 is being funded with the additional taxes the Department receives as a result of Project activities. page 16
These moneys represent additional taxes already owed to the State, but that the State hasn't been able to collect. The Department has entered into a fixed-price contract with American Management Systems, Inc. for Project 2000. AMS will be paid \$39.9 million for its work on the Project, and can also earn a bonus of up to \$10 million. The contractor is paid on a pre-determined schedule as work products are completed and signed-off on by the Secretary. However, payments are made only if there have been enough additional taxes collected to cover the payments.

The additional tax revenues also will be used to pay for about \$12 million of other Project-related expenses, such as microcomputers and facility renovations. The Department's salary costs for its employees working on the Project will be an additional \$10 million over the life of the Project. These salary costs will come out of the State General Fund.

Project staff estimate that the State will collect about \$225 million in additional tax revenues that it wouldn't have collected otherwise through fiscal year 2002. These additional tax revenues come from the initiatives that were developed during Stage One of the Project to improve the Department's collections. If the full amount is realized, the Department will net about \$153 million through fiscal year 2002 after all expenses have been paid.

The Department has collected about \$17.6 million in additional tax revenues through May 1997 as a result of the Project. page 18
The additional revenues result from two types of changes begun early in the Project. The first change gives the Department additional "capacity" to collect taxes. This includes such activities as identifying taxpayers who should be paying Kansas taxes but who aren't registered with the Department, and identifying taxpayers who are registered with the Department, but who haven't filed tax returns for all the periods they should have. The other change involved upgrading the existing computer system for collecting delinquent taxes in order to improve the Department's tax collection efforts.

**The Department's method for identifying additional tax mon-
eys received through Project 2000 generally is reasonable.** page 19
This method was developed jointly by a team of Department and AMS staff. The Directors of the Budget and Legislative Research Department also provided input. The methodology has two parts. First, all taxes collected from the initiatives that gave the Department additional "capacity" to collect taxes are credited to the Project because they represent new sources of tax collections. Second, taxes collected because of improvements in the Department's collections productivity are measured against a monthly benchmark, based on the Department's past collections performance. Only those amounts above the benchmark are credited to the Project. Amounts below the benchmark are subtracted from the additional revenues.

**The amount of additional revenue attributed to Project 2000
appears to be accurate.** page 22
Computer programs calculate the amount of additional tax revenue to credit to Project 2000 each month. After the revenue is calculated, the Department's internal auditor assigned to the Project audits a sample of payments from newly identified taxpayers to ensure that the payments resulted from collection activities. He does the same with a sample of payments from delinquent taxpayers. He subtracts all amounts he can't link directly to Project activities. After the revenues are audited, the Secretary sends a report of the revenues to the Directors of the Budget and Legislative Research. They review the amounts for reasonableness. In general, we concluded the steps taken to verify the additional tax revenues were reasonable.

Conclusion: Funding a large project with revenues generated by page 23
the project itself is an imaginative and useful idea. However, it is only useful if the method used to measure the increased revenue is balanced and fair to both the vendor and the State. Developing such a methodology is very difficult, and in many ways is very subjective. Although different methods could be used to measure the additional taxes being collected because of Project 2000, the methodology that was developed appears to be reasonable and fair. Moreover, the internal auditor who checks the revenues each month appears to be thorough and conservative in his reviews, giving the Department and the Legislature greater assurance that tax revenues aren't being inappropriately attributed to the Project.

APPENDIX A: Estimated Costs of Project 2000 page 25

APPENDIX B: Survey of Department of Revenue Staff page 27
Working on Project 2000

APPENDIX C: Agency Response..... page 31

This audit was conducted by Allan Foster, Ellyn Sipp, and Cindy Crawley. If you need any additional information about the audit's findings, please contact Mr. Foster at the Division's offices. Our address is: Legislative Division of Post Audit, 800 SW Jackson Street, Suite 1200, Topeka, Kansas 66612. You also may call (785) 296-3792, or contact us via the Internet at: **LPA@mail.ksleg.state.ks.us**.

