PERFORMANCE AUDIT REPORT

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

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

97-55

Legislative Post Audit Committee

Legislative Division of Post Audit

THE LEGISLATIVE POST Audit Committee and its audit agency, the Legislative Division of Post Audit, are the audit arm of Kansas government. The programs and activities of State government now cost about $8 billion a year. As legislators and administrators try increasingly to allocate tax dollars effectively and make government work more efficiently, they need information to evaluate the work of governmental agencies. The audit work performed by Legislative Post Audit helps provide that information.

We conduct our audit work in accordance with applicable government auditing standards set forth by the U.S. General Accounting Office. These standards pertain to the auditor's professional qualifications, the quality of the audit work, and the characteristics of professional and meaningful reports. The standards also have been endorsed by the American Institute of Certified Public Accountants and adopted by the Legislative Post Audit Committee.

The Legislative Post Audit Committee is a bipartisan committee comprising five senators and five representatives. Of the Senate members, three are appointed by the President of the Senate and two are appointed by the Senate Minority Leader. Of the Representatives, three are appointed by the Speaker of the House and two are appointed by the Minority Leader.

Audits are performed at the direction of the Legislative Post Audit Committee. Legislators or committees should make their requests for performance audits through the Chairman or any other member of the Committee. Copies of all completed performance audits are available from the Division's office.

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LEGISLATURE OF KANSAS
LEGISLATIVE DIVISION OF POST AUDIT

August 4, 1997

To: Members, Legislative Post Audit Committee

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This report contains the findings, conclusions, and recommendations from our completed performance audit, *Reviewing the Progress of the Department of Revenue's Project 2000.*

This report includes several recommendations for the Department to help ensure the Project has adequate oversight. We also recommended steps to help ensure that new computer systems are tested thoroughly, and that communication within the Project is improved.

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.

We would be happy to discuss these recommendations or any other items in the report with any legislative committees, individual legislators, or other State officials.

Barbara J. Hinton
Legislative Post Auditor

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.

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.*

Project 2000 is being funded with the additional taxes the Department receives as a result of Project activities. *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. *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 moneys received through Project 2000 generally is reasonable. *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. *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.*

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.**

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

Initially called Kansas Tax 2000, Project 2000 is the name of a wide-ranging project for reorganizing business operations and developing new software for the Department of Revenue. The Project has several major purposes—to evaluate the Department's business practices, to "re-engineer" those practices to make the agency more efficient and more customer focused, and to automate and integrate all the Department's major tax systems using new software and hardware. Nearly all the Department will be affected by the changes except the Divisions of Property Valuation and Vehicles. The Department awarded the contract for the Project to American Management Systems, Inc. (AMS) in June 1995.

Legislative concerns have been raised about this Project because of the problems the Department historically has had in developing large-scale computer projects. Specific concerns include whether the Project is on schedule and is meeting its objectives, whether the way the contractor is being paid is reasonable, and whether the amount paid to the contractor to date is appropriate.

This performance audit addresses the following questions:

1.   **How well has the Department of Revenue carried out Project 2000 to date?**

2.   **Has the Department established an adequate system to identify the additional tax moneys that would be generated by the Project?**

To answer these questions, we reviewed the controls the Department established to manage the Project, and conducted more thorough tests of the Department's controls over monitoring the Project's progress and reviewing parts of the Project as they are completed. We also interviewed Department and contractor staff involved with the Project, surveyed Department Project staff, and reviewed policy manuals, status reports, invoices, completed products, and other relevant documents. In addition, we interviewed staff who developed the Department's method for identifying additional revenues that would be generated as a result of the Project, checked the reasonableness of the Department's methodology, and examined how it is applied. We also interviewed the Department's internal auditor charged with auditing the Project and reviewed his workpapers. Finally, we talked to officials from other states that are developing similar systems with American Management Systems.

In conducting this audit, we followed all applicable government auditing standards set forth by the U.S. General Accounting Office, except that we didn't test the accuracy of the Department's revenue and cost estimates for the Project. Our findings begin on page six, after a brief overview of the Project.

Overview of Project 2000

In the mid-1980s, the Department of Revenue unsuccessfully tried to develop a computer system that would integrate all its tax systems. After that failure, the Department updated the existing computer systems it uses to process taxes, but these updates were done in a piecemeal fashion. By the early 1990s, the Department was using a system that basically had been patched together, and was complex and costly to operate. Department officials decided they needed to make another attempt at integrating the tax systems, and improve how the Department operated.

The Department Undertook Project 2000
To Become More Efficient and Customer-Oriented

In 1993, the Department requested information from several consultants to obtain information about the services and products available to help the Department meet it goals. Those goals were as follows:

- implement a system that was flexible and customer-oriented
- recognize and act on customer needs
- simplify and improve the tax process
- increase overall tax revenues
- increase the number of taxpayers voluntarily paying their taxes

The Department also requested specific information on approaches to re-engineering the way it does its work internally, and the way it deals with customers. In addition, it requested software and hardware options for updating and integrating its computer systems.

In 1994, using information provided by consultants, the Department issued a request for proposals for Project 2000. The scope of the project was huge. It envisioned a near total reworking of the agency's way of doing business, coupled with the development of major, complex computer systems that would automate the Department's tax processes and systems. There was to be a massive "culture change" as Department employees learned new processes. All work would be done in teams, jobs would be redesigned to make them more efficient and more rewarding for employees, and the new work processes would be designed to meet the needs of Kansas taxpayers. The request for proposals encompassed all these elements. The most unusual element, however, was the requirement that the vendor agree to be paid only from the increases in revenue that could be attributed to the vendor's work.

The Project was designed to be completed in three stages, as described in the graphic at the top of the next page.

The Department received bids from two vendors, and entered into negotiations with both firms—Arthur Andersen, an international accounting and consulting

The Three Stages of Project 2000

Stage One (this stage has been completed)
- Redesign the Department's business processes
- Reorganize the Division of Taxation
- Plan cultural changes
- Plan stages two and three
- Develop "Fast Track" initiatives to bring in revenue to pay for the Project
- Implement "Fast Track" initiatives
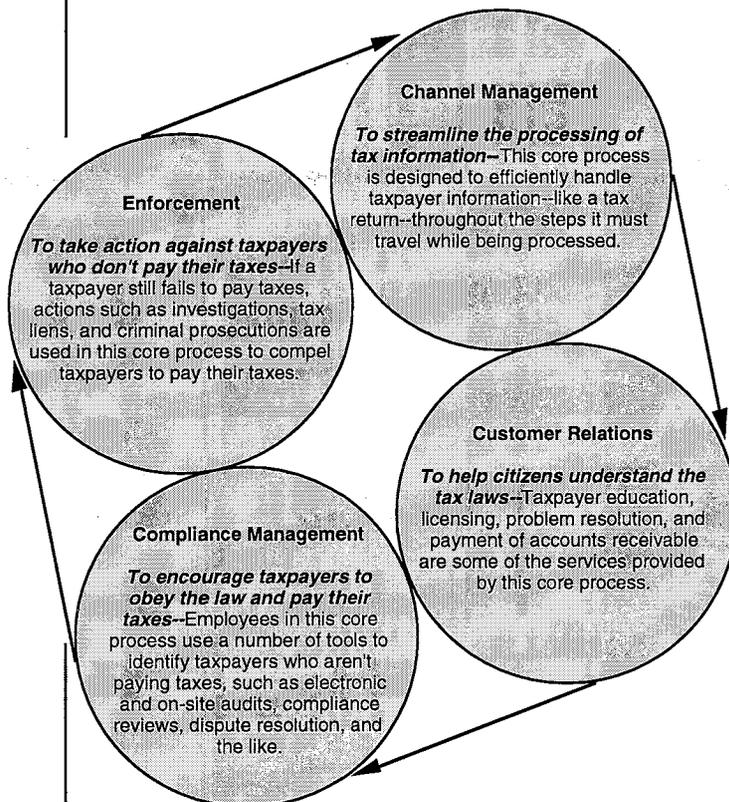- Automate the imaging of tax returns

Stage Two (this stage currently is under way)
- Automate the processing of individual income taxes
- Redesign the jobs in the individual income tax section
- Begin designing the computer programs for automating the other taxes
- Design new software for the department's system for collecting unpaid taxes

Stage Three
- Write software to automate all other taxes, including business, sales and use, motor fuels, corporate income, and liquor enforcement
- Redesign the jobs associated with the other tax systems
- Automate the other tax systems

Under Project 2000, the Department of Revenue Decided To Reorganize Its Taxation Division Around Four Major Functional Areas, Rather Than Specific Tax Types

Channel Management

To streamline the processing of tax information—This core process is designed to efficiently handle taxpayer information—like a tax return—throughout the steps it must travel while being processed.

Enforcement

To take action against taxpayers who don't pay their taxes—If a taxpayer still fails to pay taxes, actions such as investigations, tax liens, and criminal prosecutions are used in this core process to compel taxpayers to pay their taxes.

Customer Relations

To help citizens understand the tax laws—Taxpayer education, licensing, problem resolution, and payment of accounts receivable are some of the services provided by this core process.

Compliance Management

To encourage taxpayers to obey the law and pay their taxes—Employees in this core process use a number of tools to identify taxpayers who aren't paying taxes, such as electronic and on-site audits, compliance reviews, dispute resolution, and the like.

Before Project 2000, the Taxation Division was organized by the various types of taxes, such as income tax and withholding tax. In re-engineering its business practices, however, the Department decided to reorganize the Division around its major functional activities. These "core business processes," which are described in the accompanying graphic, are called "channel management," customer relations, compliance management, and enforcement.

Department officials told us they think this organizational structure will create an environment that makes it much easier for customers to deal with the Department. For example, taxpayers will have a single contact within the Department that can handle all their tax needs. This is especially useful for businesses that pay several different types of taxes. In addition, because this organizational structure is centered around the Department's basic tax-related functions, Department officials say they expect it to result in a more efficient and effective use of staff resources.

firm, and American Management Systems, Inc., an international business and information technology consulting firm that offers custom computer development consulting services. The Department evaluated these proposals and conducted extensive negotiations with both firms over a nine-month period.

In June 1995, the Department entered into a fixed-price contract with American Management Systems, Inc. The Project is a partnership between AMS and the Department; staff from the agency and from AMS are working together to develop and integrate the various aspects of the Project. The original contract was to complete Phase I of the Project. In December 1996, after the first stage was completed, the Department signed a second contract with AMS for stages two and three.

Under Project 2000, the Department has completely reorganized its Taxation Division, put in place a new computer system that was designed to speed up the pro-

Project 2000 Combines the Development of a Computer System with a Complete Reorganization of the Department's Business Processes and Jobs	Other States Have Had AMS Develop Computerized Tax Systems
The trend in the information technology industry is moving away from simply replacing outworn computer programs with new ones. In testimony before the National Commission on Restructuring the Internal Revenue Service in January 1997, the Director of Information Resources Management for the General Accounting Office (GAO) said:	AMS began developing the prototype for an automated tax system in Mississippi in January 1994. The system is comparable to the one AMS is developing for Kansas; in fact, parts of the Mississippi system will be modified and used in Kansas. Officials of the Mississippi State Tax Commission told us the system will take about 5 years to complete, and will be finished in late 1998 or early 1999.
Our reviews of major modernization efforts have shown that the introduction of newer, faster, cheaper technology is not a panacea for flawed management practices or poorly designed business processes. Business needs must dictate the requirements and justification for the type of technology to be used. To ensure this occurs, program units in agencies must carefully analyze the process or procedures that are being modernized. When processes are re-engineered in concert with the power of information technology, significant results can be achieved. Information technology projects must then become focused on improving the way work is done rather than simply automating existing, outmoded processes.	Mississippi has a fixed-rate contract with AMS, and are using general fund moneys to pay for the tax system. Mississippi officials estimate they will be able to collect $10 million to $35 million in uncollected taxes annually with the new system. Kansas' contract with AMS is also a fixed-rate contract. Unlike Mississippi, Kansas' contract is being paid for from the additional taxes collected because of the Project, rather than through General Fund appropriations.
	In 1995, AMS completed two computer systems for California's Franchise Tax Board to collect bank and corporate taxes. One was an automated collection system, the other was a system that helps identify which tax returns to audit in order to maximize the returns and minimize the number of pointless audits. AMS' contract with the Board was a fixed-price, performance-based contract funded from the additional taxes, interest, and penalties the state wouldn't have been able to collect without the system. Both systems were completed on time and within budget.
That is exactly what Project 2000 was designed to do, and it's more all-encompassing than any computer development project in Kansas government that we're aware of.	A Board official told us the additional taxes collected were expected to total $7.5 million, but have exceeded $42.6 million so far. The estimated benefits were achieved within the first two months after the system was implemented. AMS was paid in full during the first three months of the project.

cessing of income tax returns, and implemented a number of new tax-collection procedures and processes that are designed to collect more of the moneys taxpayers owed but weren't paying. Additional information about the reorganized Taxation Division is provided in the graphic on page three; the other areas will be discussed in more detail later in this report.

In All, Project 2000 Will Cost About $71 Million, but Those Costs
Are Expected To Be More Than Offset by the Additional Taxes Collected
Because of the Collection Procedures Initiated as Part of the Project

Of the $71 million in costs, $49.9 million will be paid to AMS. The following table shows a breakdown of those costs.

Estimated Costs of Project 2000 (in millions)		
Fees Paid to AMS from Increased Revenues		
Base cost of the contracts	$39.9	
Contract costs include hardware, software, training classes, subcontractor negotiations, and the like.		
Bonus	$10.0	
AMS gets the full bonus only if the Department collects $189.9 million in additional revenues that can be attributable to changes made by the Project within two years of the completion of the Project. This will be discussed in more detail in Question Two.		
Total contractor fees are capped at:		$49.9
Amounts Paid to Other Vendors From Increased Revenues		
Project-related costs, such as fees paid for DISC computer time, charges for facilities renovation, and payments to other vendors for things like microcomputers		$11.2
Costs Paid for Department staff salaries and wages from the State General Fund		
Salaries & Wages for Department staff		$ 9.7
Total estimated Project costs		$ 70.8

The Department estimates that, because of changes made through the Project, it will receive more than $225 million over a seven-year period in taxes owed to the State that it otherwise wouldn't have collected. These additional revenues will result from new collection methods and improvements to the Department's current collections computer system instituted by AMS in the first stage of the Project. This will be discussed further in Question One.

As the table above shows, these additional revenues would more than cover the Project's costs. Complete information about the estimated cost of the Project can be found in Appendix A.

How Well Has the Department of Revenue
Carried Out Project 2000 To Date?

Our reviews showed that the Department of Revenue generally has established good practices for carrying out Project 2000. The major exception is the lack of a full-time Project Director, who can devote sufficient time and attention to the Project to ensure its success. The Department has mitigated this risk to some extent by adding other management personnel to the Project to relieve her of less critical management responsibilities. We identified two additional areas where the Department's practices could work more effectively—testing of products and communications within the Project. Problems in these areas may have contributed to processing delays experienced by the Department while implementing its first major computer system. Those processing problems resulted in many income tax refunds being delayed. Project officials have recognized some of these problems, and have made changes to minimize such problems during the next two stages of the Project. These and other findings are described in the sections that follow.

The Department Generally Has Established
Good Practices for Managing Project 2000

During the past 10 years, Legislative Post Audit has completed a number of performance audits reviewing State agencies' acquisition or development of major computer systems. As described in the profile box on page 8, several of these major computer-development projects were never completed or were only partially completed, even though the State paid for them. Those systems that were developed generally had significant cost overruns and delays. However, Kansas' experience with these kinds of projects isn't out of the ordinary. The profile box also summarizes a recent study that showed nearly one-third of the public-sector and private-sector computer projects reviewed were never completed.

A number of common weaknesses have contributed to the problems we identified in our audits, almost all of which relate to poor management of the projects. In part, we've found that agencies:

- don't adequately plan or manage their projects
- prepare unclear and unenforceable contracts with vendors
- don't assign a high priority to their projects
- underestimate how much work will be involved
- make frequent changes to vendor contracts, inflating costs and delaying completion
- assign people with other full-time jobs to carry out important tasks
- move on to other phases of their projects before fixing problems with the previous phases
- lack the knowledge to realistically assess the adequacy of consultants' work
- pay consultants before the agency identifies all the problems with the system

By analyzing past computer-development projects and reviewing appropriate literature, we identified a set of practices that an organization should have in place for carrying out a project such as Project 2000. This listing is shown at the top of the next page.

Best Practices for Carrying Out a Project Like Project 2000

The organization should make a significant commitment to the project. This ensures that needed resources are available, the project has a high priority, and all members of the organization are on board. Specific practices in this area include:

•providing strong executive support
•designating a full-time project director
•assigning competent staff
•involving users of the project's end product throughout the project

The organization should use a systematic process in carrying out the project. This ensures that the project's results will be appropriate and timely. Specific practices in this area include:

•adopting clear goals and objectives
•laying out the needed work in detail
•doing the work in phases, completing one before beginning the next
•adopting milestones and deadlines
•providing for reviews and tests of the project's "products"
•requiring formal acceptance of the project's "products"
•training users of the project's "products"

The organization should effectively manage the project. This ensures that problems will be identified and addressed, needed changes will be made, and unneeded changes won't be made. Specific practices in this area include:

•monitoring the project's progress on a regular basis
•communicating concerns about the project
•reacting appropriately to problems encountered
•making changes as needed after reasonable consideration
•paying vendors only after reviewing or testing, and accepting products

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Although organizations always will encounter some problems in carrying out any large re-engineering and system development project, having good practices in place should help minimize the chances the project will fail, and maximize the chances for success.

To determine whether the Department had put into place appropriate practices for Project 2000, we compared the Department's practices to our list of good practices. We also conducted more in-depth reviews of the most critical areas, including the way the Department monitors the Project's progress, and the way it reviews and accepts work completed by AMS.
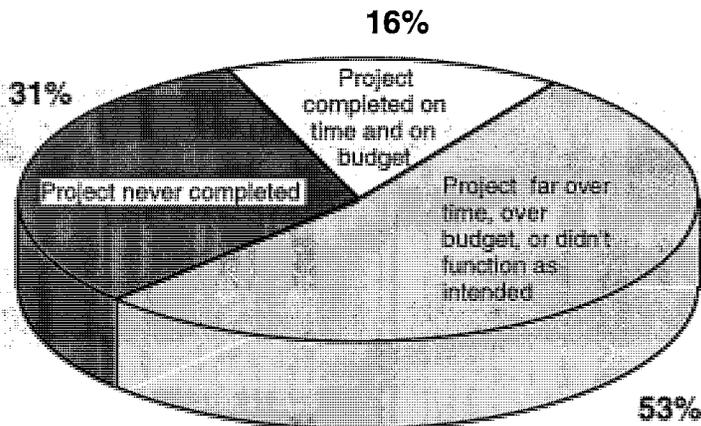
With one exception, we found that the Department had put appropriate practices in place that would help ensure the success of Project 2000, and minimize the likelihood of failure.

The Department no longer has a full-time director assigned to the Project, which increases the risk that the Department won't be able to keep the Project on track. A large re-engineering and system development project such as Project 2000 is extremely complex, and it's essential that the Department be able to monitor it's progress, make needed changes, and react to problems in an appropriate and timely fashion. Until January 1997, the Department's director for Project 2000

worked full-time on the Project, in conjunction with AMS' project director. After the Department re-engineered its business processes, however, the Secretary of Revenue also made the project director responsible for the day-to-day operations of the Division of Taxation. (The previous Director of Taxation had resigned. The Secretary assigned some of the non-managerial duties of the Director of Taxation to another employee.) We raised our concerns about the project director's duties with the project director, the Secretary of Revenue, and other Department officials.

The project director told us she thought the change in her job didn't take away from her ability to manage the Project for two reasons:

- The operations aspects of the Division of Taxation are so closely aligned with the Project that there isn't any real separation between the duties of the Project and the operations of the Division.

- There used to be a lot of friction between Division of Taxation officials and Project 2000 officials. The project director told us she spent a lot of time dealing with these problems in the past. Now that she's in charge of both operations, she actually has more time to devote to Project activities.

The Secretary of Revenue told us it was essential for the changes arising from Project 2000 to be implemented smoothly, without conflict or the need for negotiation. He viewed the formal Project 2000 staff as the development staff of the Project, and the Division of Taxation staff as the implementation staff of the Project. In his view, by placing the project director in charge of both staffs, the Department keeps one full-time director in charge of the

Project, rather than having two individuals, each in charge of different aspects of the Project.

Other Project officials said the Department had created a position of project manager to work directly under the project director, which freed up some of the time the project director used to spend on such issues as project staffing and individual project team activities.

These arguments appear to be reasonable, and the addition of a full-time project manager goes a long way toward mitigating the risks associated with the project director having two jobs. Nonetheless, with a project of this magnitude, we think there is a risk that the project director won't be able to devote the time and attention needed to manage Project 2000 adequately.

Although Most Staff Think the Department's Practices Are Being Appropriately Carried Out, They Reported Concerns About Inadequate Product Testing and Poor Communications

In attempting to find out how well the established practices were working, we surveyed all 93 Department staff who are working or have worked on the Project to obtain their opinions about the Department's practices. In all, 56 employees returned our surveys, for a response rate of 60%. The responses we received generally indicated that the Department's practices are appropriate and working. Key survey items are summarized in the following table:

	Percentage Saying...	
	Yes	No
Responses indicating practices generally are working well:		
Is top-level support for the project adequate?	83	17
Do assigned staff have the necessary skills?	83	17
Have the needs been clearly defined?	76	24
Has there been adequate review of the final products?	70	30
Is management receptive to opinions and suggestions of users?	66	34
Have users been adequately trained?	63	37
Mixed responses as to whether practices are working well:		
Have staff been adequately assisted in transition to new system?	51	49
Responses indicating practices generally may not be working well:		
Has testing of final products been adequate?	39	61
Has communication within the Project been adequate?	27	73

As the table shows, both inadequate product testing and poor communication were seen by many staff as significant concerns. In fact, one respondent commented that, "communication of the Project is almost nonexistent. To get information about the Project, you must have a contact with someone not on the Project." Both areas appeared to contribute to problems bringing the new computer system on-line.

Inadequate practices in these areas contributed to the problems that occurred when the first new computer system was implemented. Essentially, this new system was designed to automate the front-end processing of individual tax returns by taking a picture, or "image," of the information on the returns, and automatically entering that information into the computer. The goal was to speed up the processing of tax returns with their related receipts and refunds, and eliminate the need to hire so many temporary workers to manually process those documents. This new system initially was scheduled to come on-line October 1997, but in December 1995, the Department decided to move its completion date up to December 1996.

Problems with the new system became apparent almost immediately after it was brought on-line. Within a week, there was a large backlog of unprocessed tax returns, delaying refunds and deposit of tax moneys received. From mid-February through the end of April, the Department processed far fewer refunds than it did the previous year. In response, Project staff worked extra hours to deal with the backlog. In addition, using its own funds, AMS hired more than 100 temporary data entry workers to help clear this backlog. It also brought in additional high-level staff from its main office to help solve the software problems. By the end of the first week of May, the system's problems had been addressed, and the backlog had been eliminated.

How the Department Is Trying to Address Employees' Fear of Change Under Project 2000

Project 2000 will mean a drastic change for most employees after it's implemented completely. All the Department's processes and jobs will change, which can be very threatening to Department employees. Most employees will be doing different jobs in the future, and the way they do their jobs will be different, because everybody will be working in teams.

We asked Project officials what they are doing to address these concerns. They cited the following:

- The Secretary has promised no layoffs because of the Project.
- Project officials are trying to involve as many Department staff as possible in the Project, even if they aren't assigned to the Project. The whole Project is set up with Department and AMS people on the same teams, with the same duties, responsibilities, and goals. They consult with employees who are subject-matter experts, and ask users for their input on the work products being developed. They heavily involve managers in the details of these work products. Also, the Department has initiated ongoing team-building efforts, in which different teams are brought together for their input into the Project.

- As jobs are being redesigned, anybody from the Department can come in and listen to the work going on. The job-design teams hold weekly meetings with various groups from the Department, at which they explain what they are doing and answer questions. Two open committee meetings are held each week. The question-and answer portion of the meetings are written up and distributed.
- Employees will receive training in such areas as working in teams, creating change within the system, and doing their new jobs. Supervisors will receive training in new management styles, and in how to help employees improve.

Despite these efforts, many of the people who responded to our survey didn't think the Department had done an adequate job of helping staff in the transition from the old way of doing business to the new. When asked that question, 49% of the people who had an opinion said the Department hadn't done an adequate job.

To identify the reasons for the delays in processing, we interviewed several Department and AMS staff involved in implementing the new system. Those we interviewed didn't always agree about the reasons, but some issues were mentioned by at least several staff members. Those common issues are summarized below:

- *The testing performed on the new imaging equipment wasn't adequate to identify all the types of problems that could occur.* Although Department staff tested the imaging system extensively before it was brought on-line, those tests didn't address all the areas where the problems eventually occurred. For example, the new system couldn't handle W-2 forms that had been printed on different types and weights of paper. Trying to process these documents slowed down the new system. In addition, although the Department knew the system couldn't handle such things as copies made of original tax forms, and returns completed in red ink, it didn't realize how many of these documents would be submitted and have to be processed manually.

  Several staff members told us the Department hadn't tested the new technology using a large volume of taxpayer-prepared documents. Rather, the tests were done using Department-generated test documents. Some people we talked to said that the testing didn't give the Department a representative picture of what it would have to deal with during an actual filing season.

- *The Department had designed "front-end" edits to identify certain inaccuracies before further processing, but those edits didn't get put in place.* As a result, when the Department manually processed documents that couldn't be handled by the new system, there was nothing to catch their errors. Thus, other staff had to reprocess a significant number of those documents. That slowed down the manual processing.

  The project director told us she didn't realize these edits weren't in place until problems began to arise. Apparently, there was some misunderstanding about where in the process those edits should have taken place because project team members told us they always assumed the edits would take place after scanning, not before.

- *Because the extent and significance of problems with the imaging system weren't adequately communicated, those problems weren't addressed promptly.* The minutes of January 1997 status report meetings indicated that outside vendors hadn't fixed all hardware and software problems identified with the new technology, some identified as early as the previous November. Project staff told us the equipment vendor did address some of the problems, but in a piecemeal fashion. And, as one problem was resolved, others became apparent.

  The project director told us she'd been aware there were problems, but had always been told they would be resolved soon. Because staff didn't make her aware of how severe the problems were, she said, she delayed stepping in to

11.

help resolve them. Weekly status reports always included a discussion of issues and problems, but they often were buried among other items. Major problems weren't finally resolved until top Department and AMS management finally got in touch with the vendors' top management.
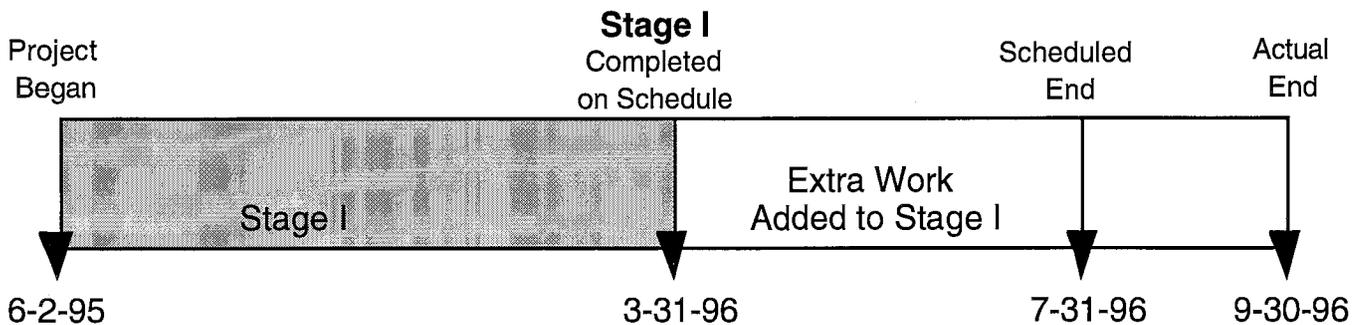
- *The Department decided to implement the system during the peak tax season, rather than phasing this system in or waiting until the peak season was passed.* Department officials told us they decided to implement the new imaging system when they did to keep from having to hire so many temporary workers, and to help process taxpayers' refunds more quickly. When problems occurred, neither goal was achieved. If the system had been phased in, or started when the number of tax returns being filed was at a minimum, the problems that occurred would have affected taxpayers less severely.

We also noted that the Department has significantly reduced the amount of time it allows Project staff to review new products that have been developed by AMS. Reviewers used to get 10 days to complete their final reviews. Project officials recently reduced the time allowed to three days to try to keep the Project on schedule. The project manager told us a three-day review should be adequate because the reviewers already are familiar with the products, and in many cases have reviewed interim versions of those products.

Reviewers we talked to said they've been able to meet the time limits so far without sacrificing the quality of their reviews, but some would like more time to review the larger, more complex, and more technical work products, such as technical manuals. In fact, some reported that for those larger products, the review time wasn't adequate. Further, in our survey, although two of every three respondents said they had enough review time, one of three said they didn't. However, the project director indicated she may reinstate the 10-day review period later in the Project.

To address the problems discussed above, Department officials told us they plan to change the way new Project 2000 computer systems are brought on-line to try to avoid these types of problems in the future. In addition, the project director indicated that more time would be allowed for testing new computer systems, and that

Estimated Schedule for Completing Stage One

Project Began		Stage I Completed on Schedule		Scheduled End	Actual End
	Stage I		Extra Work Added to Stage I		
6-2-95		3-31-96		7-31-96	9-30-96

12.

future systems would be phased in more gradually. She also indicated that clearer lines of authority would be identified, and that more attention would be paid to the risks of installing a new system at a peak production time. In addition, weekly status reports already have been modified to highlight more clearly important issues and problems.

Project 2000 Generally Is on Schedule, But Its Final Completion Date Has Been Extended by About Six Months

At the start of this Project, the original estimates called for the Project to be completed by June 1999. Currently, the Department estimates the Project will be completed about December 1999. The timeline below shows the current schedule for completing the Project.

Stage One was completed on-time. At the end of Stage One, AMS didn't have its proposal for Stage Two completed, so AMS and the Department agreed to do a contract modification to the Stage One contract. They chose some of the tasks that were originally intended to be done in Stage Two and moved them up so that the Project wouldn't have any down time. As the timeline on the facing page shows, on average, the work called for in the contract modification was completed about two months late. Because Stage Two didn't start until about December 1996, there haven't been any major pieces due to be completed yet. We were able to look at a few minor pieces of the work for Stage Two that have come due, and those pieces were about a month late, on average.

The Department has made several decisions that have extended the Project's estimated completion date. These are as follows:

- Initially, Project plans called for the withholding tax computer system to be the tax system implemented in Stage Two. The purpose of some of the work done in Stage One was to prepare for the development of that tax system. However, in getting ready for Stage Two, AMS and the Department jointly agreed to implement the individual income tax computer system instead.

Estimated Schedule for Completing Stages Two and Three

Stage II	**Stage II**	**Stage III**
Start of Contract	Scheduled	Scheduled
Work Signed	End	End

Stage III

9-30-96   4-98   12-99
12-6-96

13.
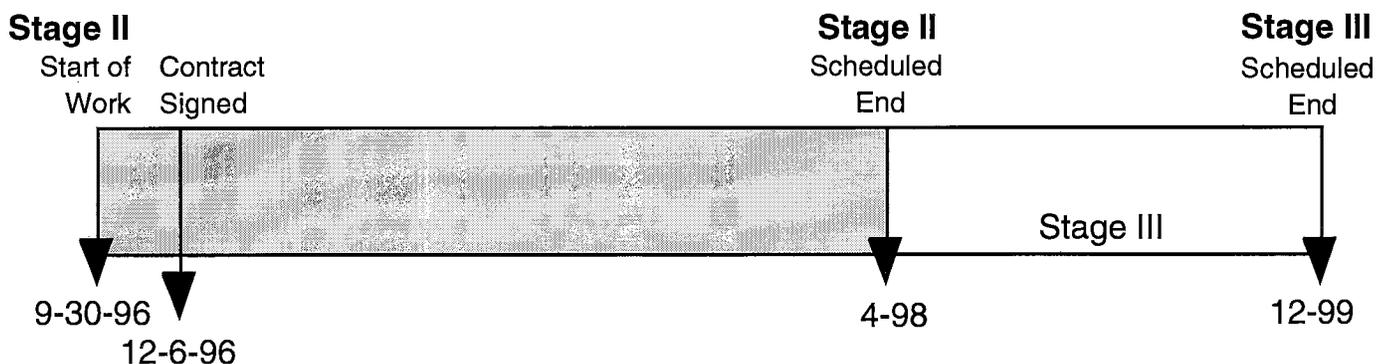
Therefore, some additional work had to be done to prepare for the individual income tax system. For example, work plans for writing the software had to be developed, and jobs associated with operating the tax system had to be designed. Part of the reason the Department decided to move the income tax system ahead of the withholding tax system was that Mississippi's withholding tax system the Department was going to use wasn't completed in time.

- The Department added two pieces to the Project that weren't in the original contract. One was an "imaging" system for withholding tax returns for the Department of Human Resources, and the other was a set of modules that would help the computer make more complex decisions.

- Because of the problems with the imaging system for income taxes, in May 1997, AMS and the Department decided to build-in additional testing time for the new automated computer systems that will become part of the integrated system. This makes future implementation efforts less risky, but adds time.

Timeliness is somewhat less important for this Project than for other computer-acquisition projects we've reviewed because the contract is a fixed-price contract, and because the Project is being funded with the additional tax moneys being collected through Project initiatives. In addition, the majority of the changes that were designed to increase tax collections already have been made, so any delays in the Project won't significantly affect its revenue-producing aspects. Delays will increase the personnel costs associated with the Project, because the Department currently has about 60 employees working full-time on it. All the Department's personnel costs come from State General Fund money.

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.

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.

Recommendations

1.   To ensure that Project 2000 has adequate direction and oversight, and to minimize the risk of failure, the Department of Revenue should do the following:

a.   review the workload of the project director. This review should conclude whether the director has time to do both jobs, whether the Department needs to hire another person to handle operations, or whether it needs to add more management resources to ensure the project director has time to keep up with Project developments, and to make the most important decisions.

b.   design additional tests for the new computer systems that will be brought on-line in the future to ensure that test documents are more representative of what the Department is likely to see from taxpayers. In addition, the Department should ensure that it provides clear and concise instructions to taxpayers filling out their forms, including letting them know that they should submit original documents, not copies.

c.   further improve communications within the Project. Because a significant majority of respondents to our survey thought communications within the Department were insufficient, and because adequate communications are vital to a successful project and a workforce committed to make the Project work, the project director should talk to Project employees about what they think the problems are, and what steps need to be taken to address problems in this area.

d.   use more flexibility in setting time limits for the review of final work products being delivered by Project staff. For example, the time allowed for Project management to review specific work products should be based on the size and complexity of the work being reviewed, and not on an across-the-board rule for all products.

Has the Department Established an Adequate System
To Identify the Additional Tax Moneys
That Would Be Generated by Project 2000?

The Department has established a reasonable method for determining the amount of additional tax revenues it's receiving because of Project 2000. Those additional tax collections, which totaled $17.6 million through May 1997, primarily will come from the "fast-track" initiatives developed or instituted under the Project. These include referring delinquent tax accounts to a private collections agency, identifying registered taxpayers who haven't filed State tax returns for all the time periods they should have, identifying people who should be paying Kansas taxes but have never registered, and improving productivity through a new telephone "autodialer" function and a screening tool to focus tax collection efforts on taxpayers most likely to pay. The "extra" taxes collected because of these initiatives are transferred to the Automated Tax System Fund to pay American Management Systems and other Project-related expenses. Through May 1997, a little more than $9 million had been paid to AMS out of these additional tax receipts, and $3.7 million had been spent for other Project-related expenses, including microcomputers and telecommunications fees. The Department has taken reasonable steps to ensure that the amount of additional taxes collected and deposited into the Fund are accurate. These and other findings are discussed in the sections that follow.

Project 2000 Is Being Funded With the Additional Taxes Collected Because of the Project

The 1993 Legislature gave the Department the statutory authority to pay for an automated tax system out of the <u>increase</u> in the amount of taxes collected <u>because of</u> the Project. These additional moneys represent taxes already owed that the State hasn't been able to collect. In some cases, these additional taxes are delinquent amounts owed by taxpayers who haven't filed timely returns. In other cases, these additional taxes are owed by taxpayers who haven't registered with the Department, such as a newly opened business.

By contract, American Management Systems will be paid a maximum of $49.9 million for its work on Project 2000. Under the terms of this fixed-price benefits-funded contract, AMS will be paid $39.9 million for the three stages of the Project. Those payments will be made on a pre-determined schedule as work products are completed and approved by the Secretary. Before any scheduled payments can be made, however, enough additional tax moneys have to have been collected and deposited into a special fund (the Automated Tax Systems Fund) to cover those payments.

AMS also is eligible for a $10 million bonus. After the Department has collected about $90 million in additional tax revenues, AMS will receive 10% of the next $100 million in additional tax revenues, up to the $10 million maximum. AMS

The original contract for Project 2000 set a fixed price for Stage One of the Project, and set a potential bonus of $2 million for the end of the Project. Although AMS gave estimates of the price of Stages Two and Three, the actual fixed price for those stages was to be negotiated at the end of Stage One.

When we read the contract for Stages Two and Three, we noticed that the bonus had increased to $10 million. Project officials told us that when they were negotiating the contract for Stages Two and Three, AMS wanted to increase its <u>base</u> fee by $10 million over what it had estimated for those stages. The primary reason was that the Department had added two additional activities to Stage Two that hadn't been included in the original Request for Proposal. Those involved developing an imaging system for the Department of Human Resources' unemployment insurance remittances, and providing additional decision-making models for the software.

Department officials told us they wanted the additional work to be done, but didn't want to add to AMS' base fee. As a compromise, they negotiated a new bonus structure with AMS. AMS will receive a bonus after the State takes in enough additional taxes to pay $39.9 million for AMS' base fee and an additional $50 million for the State, which will be used in part to pay Project-related costs for other vendors. The bonus is 10% of the next $100 million taken in, up to a maximum of $10 million. In order for AMS to receive its base fee and the entire bonus of $10 million, the new system must generate $189 million in additional tax collections within two years after the project is completed.

can continue to collect bonus payments until that $100 million mark is reached, or until two years after the Secretary signs off that the Project is completed. If the Project is competed on-schedule, that will be about January 2002.

The additional tax revenues the Department collects also will be used to pay for about $11.2 million of other Project-related expenses. Those expenses are for such items as microcomputers, facility renovations, and telecommunication fees.

The net monetary benefit to the State because of Project 2000 is estimated to be $153 million in additional revenues through the year 2002. Project staff estimate the Department will collect about $225 million in tax revenues through fiscal year 2002 that it otherwise wouldn't have collected. After all expenses are paid, including about $10 million in Department staff salaries and wages, the State will have an additional $153 million in tax collections through fiscal year 2002 that it otherwise wouldn't have received. Tax collections are expected to continue at this higher level indefinitely. As the accompanying graph shows, those additional tax collections are estimated to reach about $50 million a year by 2002.

Estimated Annual Revenues and Costs Associated with Project 2000

in Millions
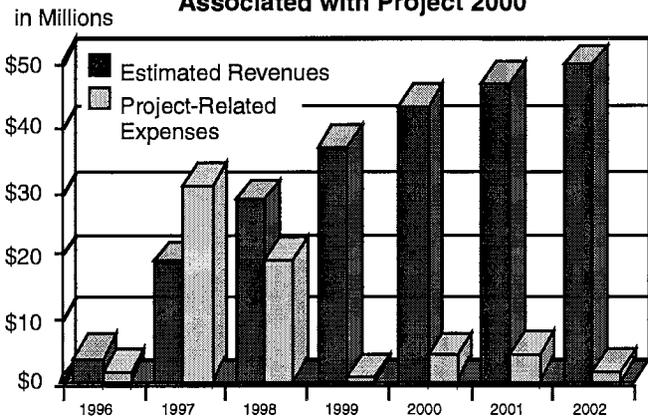
Project 2000 costs are expected to rise in FY 1997 and 1998 when much of the work is being done. Many of the changes designed to increase tax collections already have been implemented; they're estimated to bring in more additional taxes each year through FY 2002, when they're expected to reach $50 million.

Through May 1997, the Department collected an additional $17.6 million in taxes because of the Project's "fast-track" initiatives. The following table describes each of these initiatives, indicates how much additional tax money the Department has received from each, and shows how much of the money received can be attributed to the Project. The initiatives are grouped in two categories: those that provide the Department with additional capacity to collect taxes that are owed (the Department wasn't doing these before), and those that increase the productivity of the delinquent tax collections staff.

Project 2000 "Fast-Track" Initiative	Department's Term For This Initiative	Amount Received (through 5-97)	% Attributed to Project 2000
Additional Capacity To Collect Taxes Owed			
Cleaning up existing delinquent taxpayer files to ensure all the information is accurate and up-to-date	Data Purification	$ 597,378	100%
Identifying taxpayers who are registered with the Department, but who haven't filed tax returns for all the periods they should have	Non-Filer Resolution	203,812	100%
Giving delinquent tax accounts that haven't had any activity for three or more years to a private collections agency	Outsourcing Old Accounts	697,531	100%
Identifying individuals or businesses who should be paying taxes in Kansas, but who aren't registered with the Department	Tax Discovery	1,487,701	100% (a)
Improvements in Productivity			
Upgrading the existing system for collecting delinquent taxes owed to the State to include a telephone number autodialer function and a screening tool to direct tax collectors to those taxpayers most likely to pay the taxes they owe.	KICS (Kansas Integrated Collections System)	14,639,065	all moneys above a pre-established baseline of "normal" collections activity
Total		**$17,625,487**	

(a) After two years, the amount of taxes from these taxpayers that gets credited to the Project is reduced by 1% each month.

As of the date of this audit, a total of $16.5 million had been transferred from the State General Fund (where tax collections are deposited) to the Automated Tax Systems Fund to pay AMS and other Project-related expenses. The following table shows how much has been spent from the Automated Tax Systems Fund through May 1997.
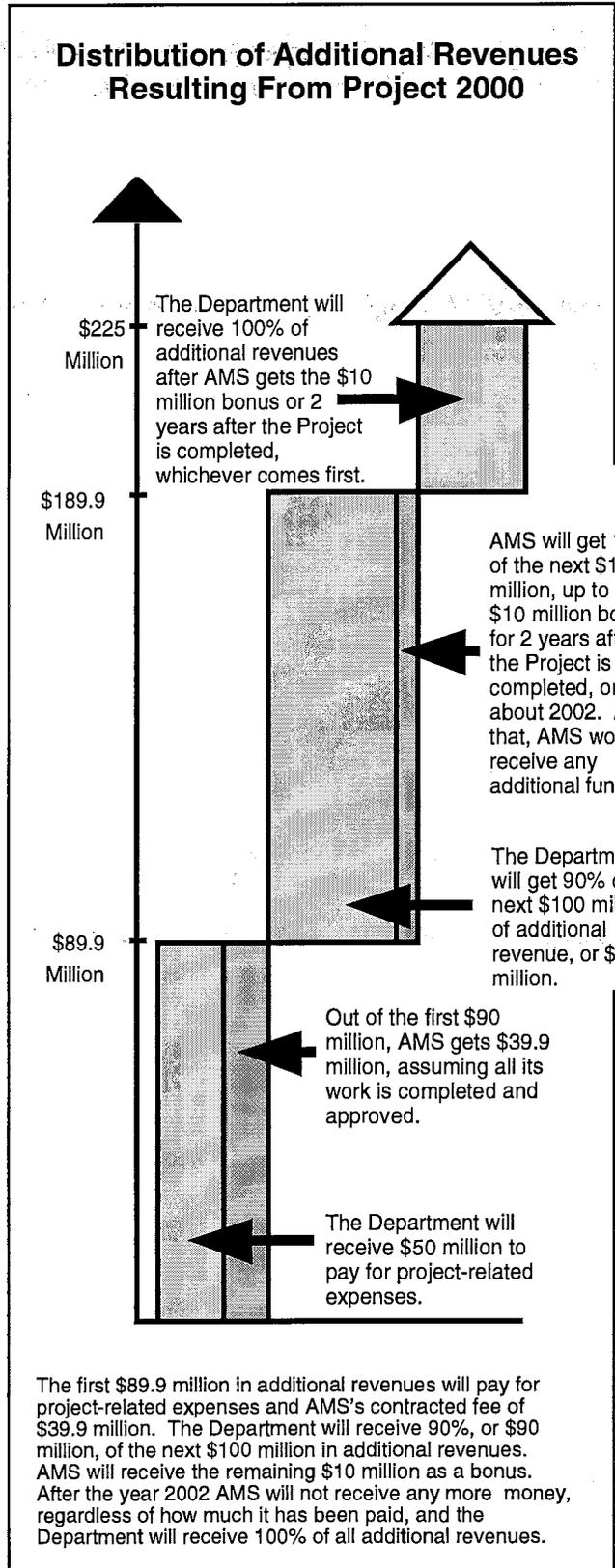
**Expenditures From the
Automated Tax Systems Fund**

Deposits into Fund:	$16,496,498
Payments to AMS:	$9,019,516
Payments to Other Vendors:	$3,678,382
Fund Balance:	$3,798,600

The Department's Method for Identifying Additional Tax Moneys Generated from Project 2000 Appears To Be Reasonable

Project management assigned a working group to develop a "revenue-tracking" methodology. This working group included staff from the Department's research and revenue analysis and internal audit divisions, as well as from AMS. The Director of the Budget and the Director of the Legislative Research Department provided input as well. Additional technical assistance was provided by Dr. John Wong, a professor from Wichita State University, who also serves on the State's Consensus Revenue Estimating Group.

The basic decisions about which additional tax collections will be attributable to the Project are described on the following page.

Distribution of Additional Revenues Resulting From Project 2000

$225 Million — The Department will receive 100% of additional revenues after AMS gets the $10 million bonus or 2 years after the Project is completed, whichever comes first.

$189.9 Million

AMS will get 10% of the next $100 million, up to the $10 million bonus, for 2 years after the Project is completed, or about 2002. After that, AMS won't receive any additional funds.

The Department will get 90% of the next $100 million of additional revenue, or $90 million.

$89.9 Million

Out of the first $90 million, AMS gets $39.9 million, assuming all its work is completed and approved.

The Department will receive $50 million to pay for project-related expenses.

The first $89.9 million in additional revenues will pay for project-related expenses and AMS's contracted fee of $39.9 million. The Department will receive 90%, or $90 million, of the next $100 million in additional revenues. AMS will receive the remaining $10 million as a bonus. After the year 2002 AMS will not receive any more money, regardless of how much it has been paid, and the Department will receive 100% of all additional revenues.

19.

Additional capacity to collect taxes owed to the State:

- *Cleaning up existing delinquent taxpayer files.* For instance, the Department had a large backlog of delinquent taxpayers it couldn't find because of old or incorrect addresses. Updating addresses allows the Department to begin collection activities. <u>Any past-due taxes collected from these delinquent taxpayers will be attributed to the Project.</u>

- *Referring delinquent tax accounts to a private collection agency.* The Department hadn't been making such referrals. <u>As a result, any past-due taxes collected from these delinquent taxpayers will be attributed to the Project.</u>

- *Identifying registered taxpayers who haven't filed State tax returns for all the time periods they should have.* The Department used to do this, but had stopped several years ago because of a lack of resources. <u>Any past-due taxes collected from these taxpayers for the period(s) they should have filed returns will be attributed to the Project.</u>

- *Identifying people who should be paying Kansas taxes but have never registered.* Using new computer-matching strategies and capabilities, for example, the Department can now match people who have drivers licenses with people who paid income taxes. Department staff also might target industry groups— such as the restaurant industry—to try to identify all restaurants that should have been paying sales taxes. <u>When new taxpayers are identified through such efforts, all delinquent and future taxes they pay will be attributed to the Project.</u>

Because these initiatives represented new sources of tax collections, the revenue-tracking group decided that 100% of the taxes they generated should be credited to the Project. To address the Budget Director's concern that some of these taxpayers may have been identified through the Department's regular tax collection activities, the final methodology was changed so that the Project got full credit for tax revenues from these sources for only two years. After that, the amount of taxes collected from these taxpayers that will be credited to the Project is reduced by 1% each month.

Improvements in productivity:

The contractor upgraded the Department's existing automated delinquent tax collection system. The primary benefits provided to-date by this upgrade include a telephone number autodialer function, which frees-up collectors' time, and a screening tool to direct tax collectors to those taxpayers who are most likely to pay the taxes they owe.

Because the Department was collecting delinquent taxes before the automated collections system was upgraded, the revenue-tracking group had to figure out

a way to determine how much of the taxes collected after the upgrade were the result of the improved collections system, and how much would have been collected anyway. The group decided it had to establish a baseline of collections. Any amount over this baseline would be credited to the Project.

The revenue-tracking group tried a number of different methods to calculate the baseline. It couldn't use historical delinquent tax collections data for its projections because those data were of such poor quality. For example, if a delinquent taxpayer sent in a payment that covered his or her delinquent tax <u>and</u> the tax owed in the current period, that entire payment had been counted as a delinquent tax collection, even though only a portion of it was for delinquent taxes.

> **The Department Made a $4 Million Contract Modification Just 6 Months After Signing The Original Stage One Contract**
>
> We had a concern that the work called for in the 1st contract modification was really work that should have been completed as part of the original contract. Based on our review, it appears that the work outlined and paid for in the contract modification (certain general systems design work) was originally planned to be done in Stage Two.
>
> Officials told us that, at the end of Stage One, AMS' proposal for Stage Two was not quite ready. Department and AMS officials agreed to move up some of the work intended for Stage Two in order to keep team members busy until the next contract could be negotiated.
>
> The Project Director also stated such a move would give the Department a "discrete" product in case it contracted the rest of the Project to another vendor. In addition, by moving the work up to Stage One, the Department avoided the 5% salary increase for AMS built into Stage Two.

To address this problem, the revenue-tracking group "cleaned up" the historical files to arrive at a truer picture of the amount of delinquent taxes the Department actually collected. During the clean-up process, only revenues associated with specific collections activities—such as calling or writing a taxpayer—were counted.

Because only two years' worth of cleaned-up data were available, and because these two years had erratic collections activity, the group needed a way to project the baseline into the future. With the assistance of Dr. John Wong, a starting baseline collections point was determined. This starting point was projected forward using a "moving average" of changes in the State General Fund. This technique allows the baseline to reflect changes in economic factors and tax laws.

The baseline amount of collections is compared with actual tax collections for each month. <u>If the Department collects more than the baseline amount, the difference is credited to the Project and deposited in the Automated Tax Systems Fund. If the Department collects less than the baseline amount, the difference is subtracted from the balance in the Fund.</u>

In general, the system established by the revenue-tracking group for determining which additional tax collections should be credited to the Project appeared to us to

be reasonable. As additional computer systems are brought on-line and begin generating additional revenue, the methodology group will add new components to the methodology to identify the moneys generated by the new pieces of the Project.

The Amount of Additional Tax Collections
Attributed to Project 2000 Appears To Be Accurate

To determine how accurately these additional taxes have been credited to the Project, we interviewed the Department's internal auditor, and reviewed the working papers he prepares each month in verifying the credited amounts.

We also observed the actual steps taken to identify the additional tax collections that should have been credited to the Project for March 1997. Those steps are described below:

- Each month, computer programs calculate the amount of additional taxes collected because of Project 2000. The internal auditor has reviewed the computer programs used to calculate tax collections or identify new taxpayers. When the methodology first was being applied, he identified a number of errors in the programs. These were corrected, and the revenues credited to the Project were appropriately adjusted.

- Each month, the internal auditor also reviews the amount of delinquent taxes collected. He audits a sample of payments from newly identified taxpayers, including all accounts of $7,000 or more. Such audits are done to ensure there was a specific collections action—a letter, a telephone call, or the like—that caused the taxpayer to send money to the Department. The internal auditor also compares tax payments of $10,000 or more from delinquent taxpayers to a listing of accounts that had some Department audit activity. This comparison is done to ensure that the collection was because of a Project activity, and not because of a Department audit activity. The internal auditor subtracts those delinquent tax collections that can't be reasonably linked to Project activities.

- The Secretary sends a report that indicates the amount of additional tax collections attributable to the Project to the Directors of the Budget and Legislative Research. They review the information for reasonableness. If the numbers appear to be reasonable, they certify the amount and send a letter to the Director of Accounts and Reports, who transfers the money from the State General Fund to the Automated Tax System Fund. At that point, money is available to pay AMS or other Project-related expenses.

In general, we concluded that the steps taken to verify the additional tax revenues were reasonable, and provided adequate assurance that the amount of money credited to the Project was accurate.

Conclusion

Funding a large project with revenues generated by 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.
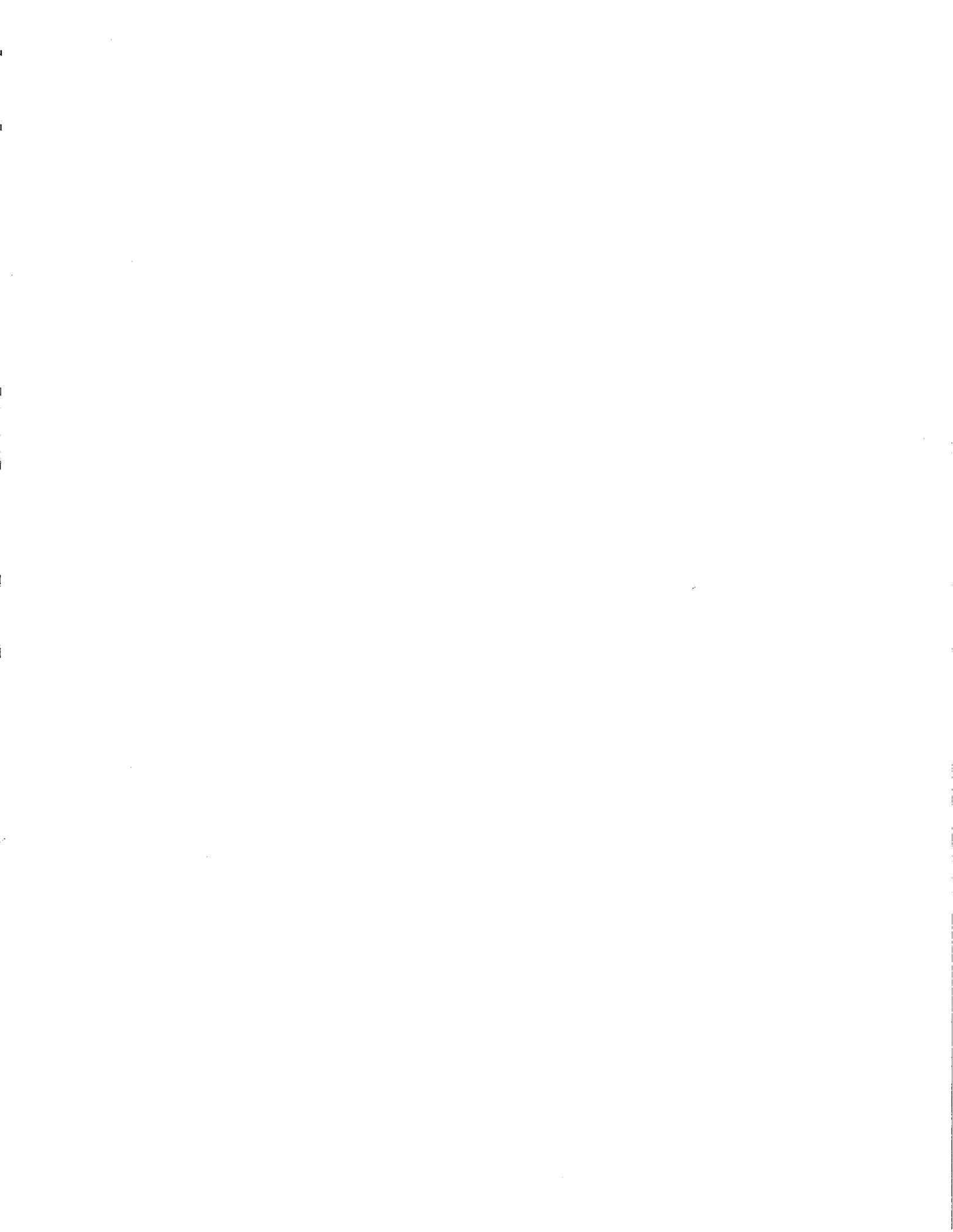
APPENDIX A

Estimated Costs of Project 2000

	Stage 1(a)	Stages 2 and 3	Total Costs
Contractor Costs			
Services	$ 8,980,824	$18,035,384	$ 27,016,208
Bonus		10,000,000	10,000,000
Hardware/Software	2,232,322	4,674,850	6,907,172
Training Courses	228,059	758,879	986,938
Subcontracts	3,941,524	1,053,910	4,995,434
Total by Stage	$15,382,729	$34,523,023	
Total Contractor Costs			**$49,905,752**
Automated Tax System Fund:			
Direct Purchases by the			
Department			
Hardware/Software	$1,839,298	$5,338,242	
Subcontracts	0	1,420,000	
Total by Stage	$1,839,298	$6,758,242	$8,597,540
DISC fees (b)			1,053,000
Facilities Renovations			575,000
Maintenance, Misc.			1,000,000
Total ATS Fund			**$11,225,540**
Department of Revenue			
Staff Salaries, Benefits (b)			**$9,699,753**
Project Total			**$70,831,045**

(a) Includes the cost for the first contract amendment for Stage One.
(b) These figures represent estimated costs from July 1995 through December 1998. If the Project's completion is delayed, these costs likely will be higher.
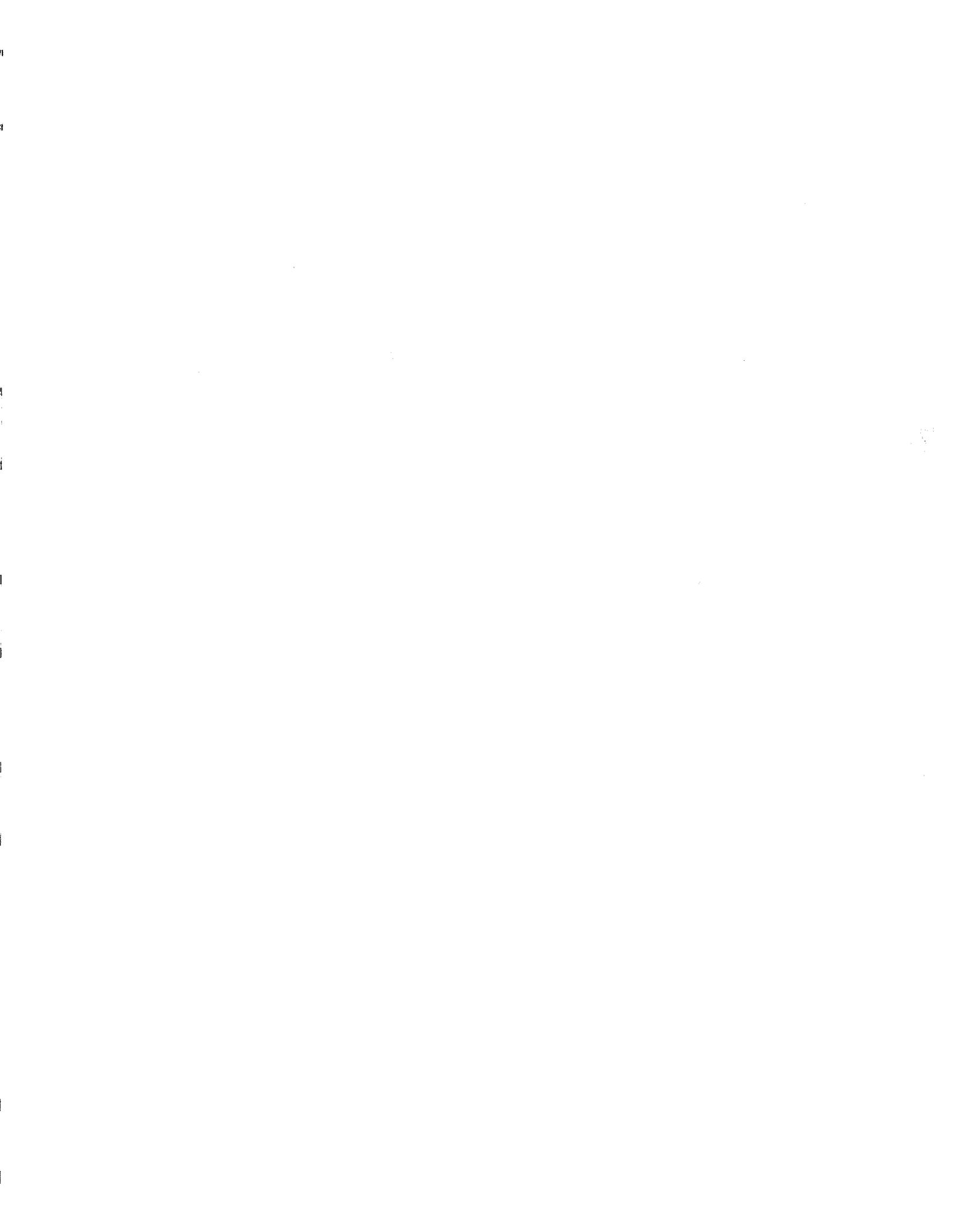
APPENDIX B

Survey of Department of Revenue Staff Working on Project 2000

During this audit, we sent surveys to 93 Department employees to get their opinions and perceptions about how well Project 2000 was being managed. In all, 56 employees returned our surveys, for a response rate of 60%. The results of our survey are summarized below, broken down by the different types of employees who work on the Project—managers, team leaders, and team members. Because three of the survey responses didn't fit into any of these three categories, those responses aren't shown in this Appendix.

		Managers	Team Leaders	Team Members
General Control for the Project				
Do you think there is adequate	Yes	8	6	27
top-level agency support for the Project?	No	3	0	5
	Don't know	0	0	3
In terms of influence over the Project,	the right amount	7	4	16
do you think the contractor (AMS) has	too much	3	2	15
	too little	1	0	3
	don't know	0	0	1
Has the Department communicated to you	Yes	9	4	29
a clear vision of what the Project is	No	2	2	4
trying to accomplish?	Don't know	0	0	1
Do you think what the Project	Yes	9	6	20
is trying to accomplish is realistic?	No	2	1	6
	Don't Know	0	0	8
Do you think the Department has	Yes	8	5	19
clearly defined what it needs from the Project?	No	1	1	9
	Don't know	0	1	6
Do you think the cost of the Project	Yes	7	4	3
has been realistically estimated?	No	4	1	14
	Don't know	0	2	18
Controls Related to Project Staffing				
In general, do you think the KDOR staff	Yes	9	6	26
working on the Project have the necessary skills	No	2	1	6
to carry out their responsibilities?	Don't know	0	0	2
In general, do you think the KDOR staff	Yes	8	4	12
working on the Project have adequate authority	No	2	3	17
to carry out their responsibilities?	Don't know	0	0	6
In general, do you think the AMS staff	Yes	10	6	23
working on the Project have the necessary skills	No	0	1	6
to carry out their responsibilities?	Don't know	1	0	6
Do you think enough staff have been assigned	Yes	9	7	22
to the Project?	No	1	0	8
	Don't know	0	0	5

		Managers	Team Leaders	Team Members
Controls Related to Users				
Is Project management receptive to the	Yes	8	5	15
opinions and suggestions of users?	No	1	2	11
	Don't know	1	0	9
Do you think users have been adequately	Yes	8	5	12
trained thus far?	No	3	2	9
	Don't know	0	0	14
Is there sufficient communication about the	Yes	7	5	14
Project to all KDOR staff not working on it?	No	3	2	12
	Don't know	0	0	7
Up to this point, has the Department done in	Yes	7	3	11
an adequate job of assisting staff in the transition	No	4	4	13
from the old way of doing business to the new?	Don't know	0	0	8
Controls Related to Project Planning				
Do you think the Department's current deadlines	Yes	6	4	10
for the Project are reasonable?	No	4	2	20
	Don't know	1	1	4
If the project has gotten behind schedule in the	Yes	8	4	17
past, have appropriate actions been taken to	No	3	2	5
get it back on schedule?	Don't know	0	1	11
Controls Related to Monitoring of Project Progress				
Do you think there's sufficient communication	Yes	5	2	7
among all levels of the Project?	No	6	5	23
	Don't know	0	0	4
Have you been involved in the status report?	Yes	7	6	9
process? *If no, skip to question 22.*	No	4	1	22
If yes, please answer the following questions:				
a. Has the process provided you with the	Yes	6	5	5
information you need?	No	1	1	3
	Don't know	0	0	1
b. Has the process been adequate at	Yes	6	5	7
identifying issues or areas of concern	No	1	1	2
that need to be addressed?	Don't know	0	0	0
c. Have any concerns you've raised or been	Yes	6	4	4
aware of been addressed satisfactorily?	No	1	1	4
	Don't know	0	0	1
Do you have any concerns related to	Yes	2	2	12
monitoring project progress?	No	9	4	19

		Managers	Team Leaders	Team Members
Controls Related to Review of Project Deliverables				
On the pieces of the project you've been involved with, did you think the final products were adequately reviewed?	Yes	8	5	13
	No	2	2	5
	Don't know	0	0	16
On the pieces of the project you've been involved with, did you think the final products were adequately tested?	Yes	4	5	7
	No	7	1	15
	Don't know	0	0	12
Do you have any concerns related to the way project deliverables are reviewed?	Yes	4	3	10
	No	7	3	21
Have you been involved in reviewing any of the project deliverables?	Yes	9	4	11
	No	1	3	22
If no, thanks for helping us with this survey.				
If yes, please answer the following questions:				
a. Has this process worked to ensure that the deliverables are of the necessary quality?	Yes	7	4	9
	No	1	0	1
	Don't know	1	0	1
b. Did you have enough time to do the reviews?	Yes	6	4	5
	No	2	0	6
c. Did you review a deliverable that was within an area you were familiar with?	Yes	7	4	10
	No	1	0	1
d. Were the criteria for accepting deliverables clear?	Yes	7	3	7
	No	1	1	4
e. Did the scope and approach memo provide sufficient detail to guide your review?	Yes	7	3	4
	No	0	1	5
	Don't know	0	0	2
f. Did all the individuals reviewing the deliverables you looked at have sufficient expertise to do the review?	Yes	7	2	6
	No	0	1	4
	Don't know	1	1	1
g. Did you feel free to suggest changes or disapprove deliverables?	Yes	7	4	7
	No	1	0	2
	Don't know	0	0	1
h. Have you requested any changes to any of the deliverables you reviewed?	Yes	5	3	10
	No	3	1	1
If yes, please answer the final question:				
i Were the changes made?	Yes	3	3	6
	No	1	0	1
	Don't know	0	0	3

APPENDIX C

Agency Response

On July 22, 1997, we provided a draft copy of the audit report to the Department of Revenue. The Department's response to the report is included in this Appendix.

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Office of the Secretary

July 30, 1997

Barbara J. Hinton
Legislative Post Auditor
Mercantile Bank Tower
800 SW Jackson
Topeka, KS 66612-2212

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JUL 30 1997
LEGISLATIVE POST AUDIT

Dear Ms. Hinton:

Thank you for the opportunity to respond to the report, "Reviewing the Progress of the Department of Revenue's Project 2000." I appreciate the thoughtful and balanced review your staff has done, and am confident it will further public understanding of this very important undertaking.

The report concludes that the department "...generally has established good practices for carrying out Project 2000." The auditors' conclusion reflects the incredible amount of effort we put into planning and managing the redesign of tax administration in Kansas. While elimination of risk is never possible as major change is implemented, the auditors conclude that the management practices of the department have served to significantly minimize that risk.

Let me respond to the specific recommendations:

1. **Project Director.** The report states that "the Department no longer has a full-time director assigned to the Project" which increases its risk. This statement simply reflects a misunderstanding of the role of the Director of Transition, Karla Pierce. Her assignment is solely related to the successful implementation of Project 2000. Project tasks increasingly entail implementation of new business processes and technology in tax administration. Accordingly, I determined early this year to assign Ms. Pierce to oversee the transition of the design work to tax operations. As projects move to implementation, the line between "project" and operations blurs until finally operations has fully enveloped the project. It

is critical to have one person in charge of this complex transition --
someone who understands tax operations as well as the project plan. Ms.
Pierce fills that role admirably. Accordingly, the present organization, in
my view, helps to assure that tax operations and the innovation team are
working in concert. This structure is clearly the lowest risk alternative
available. Indeed, to create a structure with one person overseeing
implementation and another supervising the design and build efforts
would entail unacceptable risk.

2. Testing Of New Applications. The auditors correctly point to the
need for more thorough testing of new applications. We have concluded
(subsequent to the audit) a detailed examination of the front end
processing changes implemented this year. Important conclusions of that
review include a detailed plan for more comprehensive testing.

3. Improved Communications. Recognizing the importance of adequate
communications, the department has implemented many ways to keep
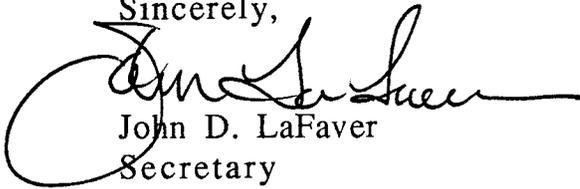associates informed about Project 2000. These include:

- Project bulletins
- All team meetings
- Lotus Notes, which contain comprehensive project data including
     - Minutes
     - Progress reports
     - Communication data bases
     - Issue/risk action logs
     - Staffing needs logs
- Brown bag lunches to discuss the issues of the day for any associates
- IMC Meetings
- PMC meetings
- Memos
- ReveNews (intradepartmental newsletter)
- Electronic mail

I suspect that some of the perceived lack of communication is because
team members are simply too busy with their assigned tasks to keep up
with all that is happening in the project. The Communication Team is
updating our plan to get needed information out in a timely and useful
way. It must be understood, however, that with a project as large,
complex and fast-moving as Project 2000, some frustration in not
understanding all aspects of the Project by every staff member must be
expected.

4. Final Work Product Review. We agree that time needed for appropriate staff reviews of final products are dependent on the complexity of the deliverable. We believe, however, that existing procedures allow adequate flexibility for appropriate reviews.

Again, I appreciate the opportunity to review the audit report. Your report correctly observes that, "A high level of commitment will need to be maintained... to continue the chances of the Project succeeding." I pledge to you my determination to see this effort to a successful conclusion and appreciate the opportunity the report affords legislators and the public to fully understand the importance of this work.

Sincerely,

John D. LaFaver
Secretary