

# **Strategic Assessment**

Inland Revenue  
Business Transformation Programme

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# 1 Executive Summary

## The Case for Change

A well-functioning tax system is critical to support a well-functioning economy and achieving Government's fiscal, economic and social objectives.

Inland Revenue's ability to continue collecting tax and disburse entitlements is increasingly constrained by problems with its current operating model<sup>1</sup>. The current model is based on processes designed specifically for tax collection and disbursement. These processes are intimately embedded in the design of the FIRST computer system. Neither the processes nor FIRST were designed for social policy or for today's digital world.

In addition, the organisational culture is oriented toward business processes rather than toward providing customer-centric services. System complexity has increased dramatically to accommodate Inland Revenue's expanded role in the administration of social policy. The technology platform (FIRST) now has approximately 40 million lines of highly intertwined software code, which means it is expensive and time-consuming to adapt the system to new customer requirements, such as smartphone access.

For example, the recent GST rate change required changes to a large number of systems and documents, raising a significant risk of error or system failure. Also, approximately half of our 1100 data entry processing staff are engaged full-time on correcting data entries. System improvements could eliminate much of this rework, but because of the system's extraordinary complexity, it is difficult and expensive to solve this problem.

IR's Business Transformation Programme has identified the following core problems:

- **We are unable to satisfy the changing expectations of our customers.**
- **We are unable to rapidly and economically respond to government policy changes including Better Public Services.**
- **We face an increasing risk of a systems failure that would severely damage our ability to collect and disburse money.**
- **We face an increasing risk of deteriorating organisational performance.**

A proposed new operating model (the "Target Operating Model") would overcome the limitations of the current operating model and future-proof Inland Revenue's ability to continue to achieve its strategic priorities.

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<sup>1</sup> The operating model is a comprehensive description of Inland Revenue's operations, including people, capabilities, processes, systems, and technology.

## Proposal

This Strategic Assessment outlines the case for a progressive transition from Inland Revenue's current operating model toward a new business-led and digitally enabled operating model, known as the "Target Operating Model", delivering the capability Inland Revenue needs to continue to effectively run its business. The changes required to implement the Target Operating Model require a major change from Inland Revenue's current business model.

The Target Operating Model would be progressively phased in over a period of approximately ten years. It would establish a sustainable model for the future.

The Target Operating Model would incorporate a proactive, agile, performance-oriented, collaborative corporate culture; revised organisational capabilities; and customer-centric, digital technology-enabled business processes supported by a modular, scalable, technology platform along with the appropriate supporting policy.

The Target Operating Model will eliminate constraints associated with the complexity and age of Inland Revenue's current model, which was based on business processes designed for tax collection, and technology that went live between December 1991 and March 1992. It would maintain and improve Inland Revenue's ability to perform its core roles of collecting tax and disbursing social entitlements such as child support, to support government's fiscal, economic, and social outcomes.

The Target Operating Model will have the following characteristics:

- Customer-centric culture and capabilities.
- Modern, fit for purpose business systems and processes that support our role as a tax administrator and our expanding role in the delivery of social policies.
- Business systems and processes that allow policy changes to be made in a timely and cost-efficient way.
- Business systems and processes that can integrate with other public service systems and channels to achieve a customer-centric service experience at a lower cost for government and customers.
- Systems and processes that make it easier for citizens and businesses to meet their obligations, such as near real-time transaction processing, where appropriate.
- Business systems and processes that make it more difficult for citizens and businesses to evade their obligations, for example, by facilitating collection of more obligations at source.
- Scalable systems and processes that could allow us to deliver other public services to leverage Inland Revenue's core competencies in the collection and disbursement of money. For example, collecting debt on behalf of other agencies.
- Modular systems and processes that can economically and rapidly adapt to new customer expectations or government policies.
- Integrated service delivery with other public services that deliver our contribution to results 9 (one stop online shop for all government advice and

support to businesses), 10 (New Zealanders can complete their transactions with government easily in a digital environment), and 7 (to reduce the rates of total crime, violent crime and youth crime).

## Benefits

Migrating toward the proposed Target Operating Model would lead to the following benefits:

- Enable Inland Revenue to more easily and quickly implement changes required by government to achieve their fiscal, social and economic outcomes.
- Reduce compliance costs for businesses and individuals.
- Enable Inland Revenue to support better public services to deliver customer-centric services, such as smartphone transactions, at lower cost for the customer and government.
- Improve compliance and enable Inland Revenue to collect a larger percentage of the collectable tax base.
- Enable Inland Revenue to leverage our infrastructure and capabilities in the collection and disbursement of money to support government in a more effective delivery of public services.
- Enable Inland Revenue to maintain and increase organisational performance.
- Minimise the risk of protracted systems outages and intermittent systems failures.

## 2 Strategic Context

A well-functioning tax system is critical to support a well-functioning economy and achieving Government's fiscal, economic and social objectives.

Inland Revenue is responsible for administering New Zealand's tax system. Inland Revenue also manages or shares the administration of several social policy programmes.

Inland Revenue has evolved from *being a department that just collected taxes to a department that does a whole range of things* (Minister of Revenue's Introduction in *IR for the Future*, March 2012). The Minister of Revenue has said that Inland Revenue's challenge now is how we make the organisation, *even smarter and more responsive in the future*.

Inland Revenue's strategic objectives have been defined by an analysis of the organisation's mission, vision, and societal role, in the context of Government policies and priorities.

We have identified limitations with our current operating model that will restrict our ability to fulfil these strategic objectives. In particular, any interruption of our operations puts a large part of the Crown's revenue at risk.

### 2.1 Our Role

On behalf of the Government, Inland Revenue handles a very large volume of interaction with citizens and businesses. We collect more than 80% of core Crown Revenue. Most of this comes from income tax and GST. Inland Revenue also manages or shares the administration of: KiwiSaver, Student Loans, Child Support, Working for Families Tax Credits, and Paid Parental Leave.

In 2011-2012, Inland Revenue:

- Collected \$XX in tax
- Answered XX customer service contacts
- Received XX self-help service contacts
- Collected \$XX in over-due debt
- Identified \$XX in discrepancies through audit activity
- Distributed \$XX in KiwiSaver funds to scheme providers
- Distributed \$XX in Working for Families Tax credits
- Collected \$XX in Child Support payments
- Received \$XX in Student Loan payments

In line with the Government's Policies and Priorities and our vision of being a *world-class revenue organisation, recognised for service and excellence*, Inland Revenue's Business Transformation Programme aims to improve the organisation's ability to adapt to policy changes and changing customer requirements, and to improve robustness and performance, and minimise risk.

## 2.2 Strategic Map

The following diagram illustrates how the proposed transformation programme links with Government priorities and Inland Revenue’s mission, outcomes, and vision.

What IR ultimately exists to do	We contribute to the economic and social wellbeing of New Zealand by collecting and distributing money. Our success is reflected through: <ul style="list-style-type: none"> <li>Revenue is available to fund government programmes through people meeting payment obligations of their own accord.</li> <li>People receive payments they are entitled to, enabling them to participate in society.</li> </ul>	Inland Revenue’s Mission and Outcomes
What IR needs to be so we can best deliver what NZ needs	A world-class revenue organisation recognised for service and excellence. We work with customers and other organisations to make compliance easy and to give New Zealanders confidence that everyone pays and receives the right amount. To be recognised for service and excellence we aim to achieve the performance goals that define a world-class revenue organisation. These are: Speed; Certainty; Compliance; Value.	Inland Revenue’s Vision
What the Government has prioritised	<ul style="list-style-type: none"> <li>Responsibly manage the Government’s finances</li> <li>Build a more competitive and productive economy</li> <li>Deliver better public services within tight financial constraints</li> <li>Rebuild Canterbury</li> </ul>	Government Priorities
Why we need to transform	<ul style="list-style-type: none"> <li>To be a world class revenue organisation recognised for service and excellence, IR must keep up with the pace of change.</li> <li>If IR does not transform, the department will be unable to continue to deliver what New Zealand needs.</li> <li>Transformation will allow IR to overcome the obstacles constraining the achievement of its strategic objectives.</li> </ul>	Inland Revenue Business Transformation Programme
What we want our transformation to achieve	<ul style="list-style-type: none"> <li>Increase Crown revenue</li> <li>Reduce Crown cost of debt</li> <li>Reduce Crown expenditure</li> <li>Reduce State Sector cost</li> <li>Increase the ability to implement policy changes</li> <li>Increase customer satisfaction and minimise compliance burden</li> <li>Improve social policy outcomes</li> </ul>	Inland Revenue’s Strategic Objectives
What transformation aims to achieve via our contribution to better public services	<p><i>Result 9:</i> New Zealand businesses have a one-stop online shop for all government advice and support they need to run and grow their business</p> <p><i>Result 10:</i> New Zealanders can complete their transactions with government easily in a digital environmentf</p> <p><i>Result 7:</i> To reduce the rates of total crime, violent crime and youth crime</p>	Government Results
What it is important to ensure in a transformed state	In designing and delivering a future state organisation, IR will: <ul style="list-style-type: none"> <li>Enhance and sustain the integrity of the tax and social policy system</li> <li>Ensure our understanding of the customer informs the design of services</li> <li>Transform our ability to anticipate a changing environment and respond in a quick and agile way</li> <li>Agree and adhere to an enterprise architecture for our people, process, policy and platform</li> <li>Enhance the integrity of the information that we collect, hold and share with others</li> <li>Develop a culture that actively achieves transformation and an agile organisation. Our values will support a culture based on clear accountability, good relationships, continuous improvement, and collaboration, so that we achieve what New Zealand needs</li> <li>Ensure that working with other organisations is central to delivering better services and value for New Zealanders</li> </ul>	Inland Revenue’s Design Principles

## 2.3 Key Stakeholders

In the development of this Strategic Assessment we have engaged extensively within Inland Revenue about the case for change, and with the Ministers of Finance and Revenue. We have also engaged with the [Information redacted] and will maintain on-going engagement to ensure that they are informed on progress and (for the two last-mentioned) that our operating models are aligned.

In addition to gaining wide support, this approach allows us to present the case for change with confidence about the risks identified with the current operating model and the strategic opportunities that exist. Inland Revenue's senior management team is committed to the Business Transformation Programme. The Commissioner chairs the Transformation Programme Board; A Deputy Commissioner has been assigned the role of Senior Responsible Owner.

We recognise our role in contributing to results 9 (one stop online shop for all government advice and support to businesses), and 10 (New Zealanders can complete their transactions with government easily in a digital environment), and 7 (to reduce the rates of total crime, violent crime and youth crime). We have engaged lead agencies about results 9 and 10. We will also engage with the [Information redacted] about result 7.

The Business Transformation Programme maintains on-going engagement with [Information redacted]. The programme board includes representatives of these agencies.

A stakeholder management plan is being developed to engage key stakeholders including other agencies such as the [Information redacted], third party intermediaries (including the accountancy profession and the IT/software industry), the tax and business community, and customers about the transformation of our operating model. This plan will identify the level of engagement appropriate to each stakeholder group.

Some groups will be asked to provide direct input into the transformation programme; others will be invited to provide advice or comments; and some groups will simply be informed of progress.

## 3 The Case for Change

An Investment Logic Map was developed with key stakeholders in a workshop on 16 July and is attached at Appendix 1.

Several important problems with the current operating model constrain Inland Revenue's ability to continue collecting tax and disburse entitlements. The Business Transformation Programme has identified a comprehensive strategic intervention to address these constraints. This involves an approximately ten-year transition to a new service-oriented operating model known as the "Target Operating Model." The proposed transition represents a major transformation of Inland Revenue's operations, including culture, capability, processes, systems, and technology.

### 3.1 Problems with Existing Model

The Target Operating Model will address the following problems:

- **We are unable to satisfy the changing expectations of our customers.**
- **We are unable to rapidly and economically respond to government policy changes including Better Public Services.**
- **We face an increasing risk of a systems failure that would severely damage our ability to collect and disburse money.**
- **We face an increasing risk of deteriorating organisational performance.**

#### 3.1.1 Changing Expectations of Customers

Globally tax and social welfare agencies operate in a rapidly changing environment. The changing nature of doing business internationally and over the Internet has changed customers' expectations of service delivery.

Technological developments in the private sector have increased service level expectations, with customers wanting a similar experience interacting with their tax agency as they do with banks, airlines and online retailers. Customers now expect to provide information once, and then act in a fast and intuitive online environment when dealing with government.

Our current operating model constrains our ability to satisfy these expectations. The model is based on business processes that were designed for tax collection but not for social product delivery, and for delivery through traditional, not digital channels. The organisational culture is oriented toward business processes rather than toward providing customer-centric services. The technology platform (FIRST) is extraordinarily complex, with approximately 40 million lines of highly intertwined software code, which means it is expensive and time-consuming to adapt the system to new customer requirements, such as smartphone access.

As an example, approximately half of our 1100 data entry processing staff are engaged full-time on correcting data entries. System improvements could eliminate much of this

rework, but because of the system's extraordinary complexity, it is difficult and expensive to solve this problem.

Delivery channels, such as the call centre and website, are specifically designed around products and processes rather than customer requirements. These constraints make it very difficult to deliver a citizen-centric service that combines customer information across products to deliver a single experience through the customer's chosen channel. They also make it difficult for Inland Revenue to integrate with other public services to achieve an all-of-government service experience, or to add new delivery channels.

### **3.1.2 Responding to Government Needs and Expectations**

It is becoming more expensive and time-consuming to implement policy changes. The technology platform is already complex, and it is becoming more complex as time goes on.

Two factors constrain Inland Revenue's ability to implement Government policy changes, if the change requires a modification of Inland Revenue's technological platform:

- The number of areas in the system that are affected by a particular change, and
- The number of programmers that can work on any particular section of our systems without loss of productivity, and
- The availability of software specialists qualified in the underlying software language, which is obsolescent.

The growing complexity of Inland Revenue's technology platform constrains the organisation's ability to implement fundamental changes to tax policy or social programmes. Because the system is not modular, changing one part can affect any other part of the system. Each new policy or programme further increases the system's complexity. Changing such a complex system is costly, time-consuming, and risky.

These constraints also undermine our ability to make operational changes. Operational changes are required to respond to our day to day demands, and adjust policy settings in line with government requirements.

For example, the recent change of GST rate, from 12.5% to 15%, required changes in a large number of peripheral systems and documents including forms, brochures, letters, and web pages. The system's complexity makes it difficult to co-ordinate all these individual changes, and opens the possibility of errors that could bring down the system. Also, because of the system's complexity, implementing such a simple change involves a significant amount of work.

Delivering Inland Revenue's contribution to results 9 (one stop online shop for all government advice and support to businesses), 10 (New Zealanders can complete their transactions with government easily in a digital environment), and 7 (to reduce the rates of total crime, violent crime and youth crime), is particularly challenging (and perhaps even impossible) without significant changes to Inland Revenue's business systems and processes.

### 3.1.3 Risk of Systems Failure

The age and complexity of Inland Revenue's technological platform lead to a risk of serious system failure.

Inland Revenue's primary technology platform, FIRST, went live 1991-1992. Over the past twenty years, other systems to support our social products have been added and upgraded. Inland Revenue's technological platform now includes the FIRST mainframe system, along with a range of satellite systems.

As the system has evolved, it has become extraordinarily complex.

*Inland Revenue's FIRST system, originally intended for the efficient administration of tax, has over recent years, also been used to administer a great many non-tax programmes such as student loans, Child Support and KiwiSaver. This has resulted in greater systems complexity, loss of agility and efficiency, and increased administration costs.*

*(Minister of Revenue's Speech to Tax Agents' Institute of New Zealand, 9 March 2012.)*

Several reviews of Inland Revenue's systems have been undertaken recently. These reviews reached the following conclusions (among others):

- As major legislative changes continue to be made, complexity within our technology platforms increase. The result is that the system's ability to continue to respond to major policy changes and the changing business needs is declining while the cost of system support and maintenance is growing.
- Demand for new customer channels (Internet, smartphone) is growing, together with a desire to move to near real time transactions. The complexity and highly intertwined nature of FIRST's core mainframe design makes it increasingly difficult for Inland Revenue to respond to these changing needs, including changes to support the Government's more collaborative cross-government approach.
- It is becoming increasingly difficult to recruit appropriately skilled staff, and access to knowledge to resolve system problems, because of the age of our systems and in particular, the underlying, now outdated, technology. This particularly affects the core mainframe system (FIRST), because appropriately qualified specialists are approaching retirement. Students at New Zealand tertiary institutions apparently see no future in studying the relevant technical material.

Inland Revenue's situation has some similarities with that of the Royal Bank of Scotland in June 2012. A system failure in late June 2012 left millions of Royal Bank of Scotland customers unable to access their accounts over the weekend. Although the problem was corrected within a few days, several thousand customers were still reporting problems a month later. Some customers said they were keeping their accounts open only in the hope of receiving compensation.

External expert advice confirms that migrating to a new platform will take approximately eight to ten years. If we do not begin the transition soon, the growing complexity of our

systems coupled with the increased demand over this period will place an unsustainable load on our systems. At some point we will pass a threshold where we will lose confidence in the on-going stability of our platform. The prospect of intermittent system failures becomes a real possibility. We already experience periodic system outages. However, we expect these to be more frequent in the future causing disruptions to service delivery.

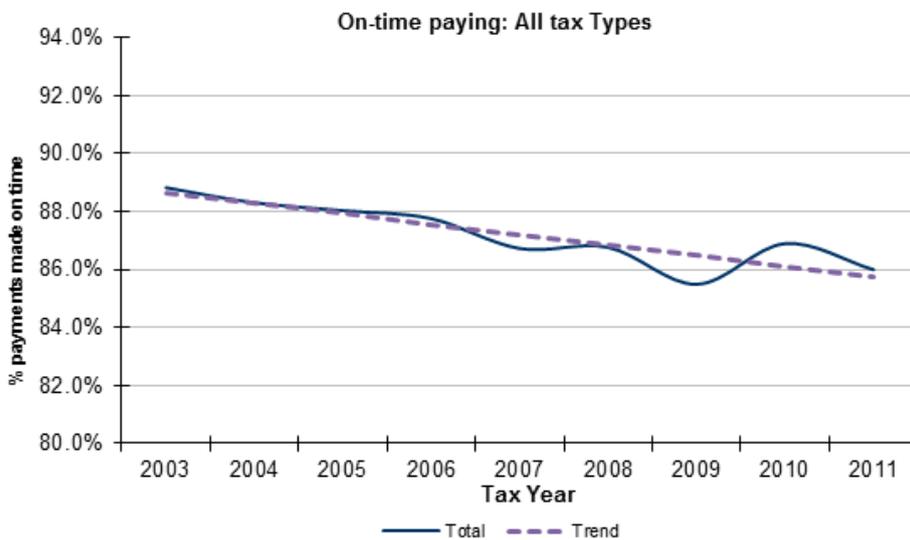
Of more concern is the prospect of protracted systems outages or a catastrophic system failure. In this event we will have limited capability to be able to deliver our core functions of collecting tax and disbursing entitlements, leading to (among other things) unexpected "dips" in revenue, and people not receiving their entitlements.

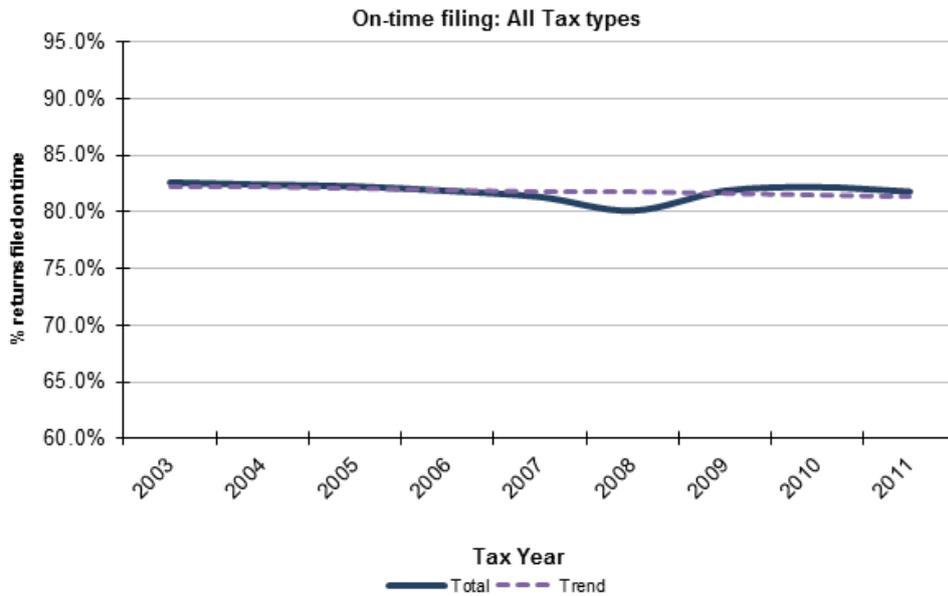
Over time, negative customer experiences caused by system outages and failures may impact customer behaviour, leading to normally compliant customers becoming non-compliant and reinforcing the behaviour of non-compliant customers. This leads to a reputational risk for Inland Revenue.

### 3.1.4 Risk of Performance Deterioration

Some key indicators are already under pressure, and are likely to progressively deteriorate without significant investment that addresses our system and process weaknesses and risks.

In particular, the timeliness of customer payment and return filing has been gradually but consistently declining for several years. This trend predates the 2008 economic downturn.

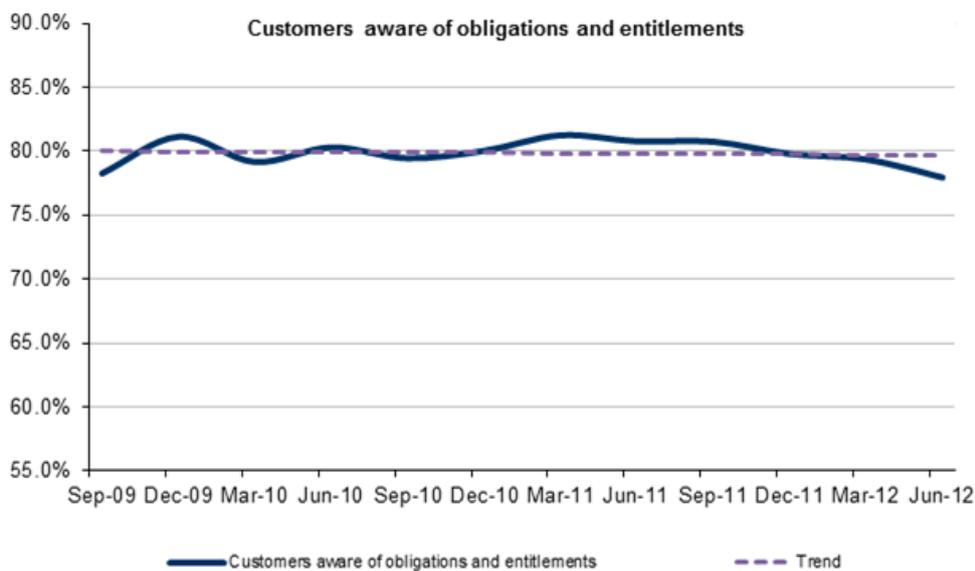


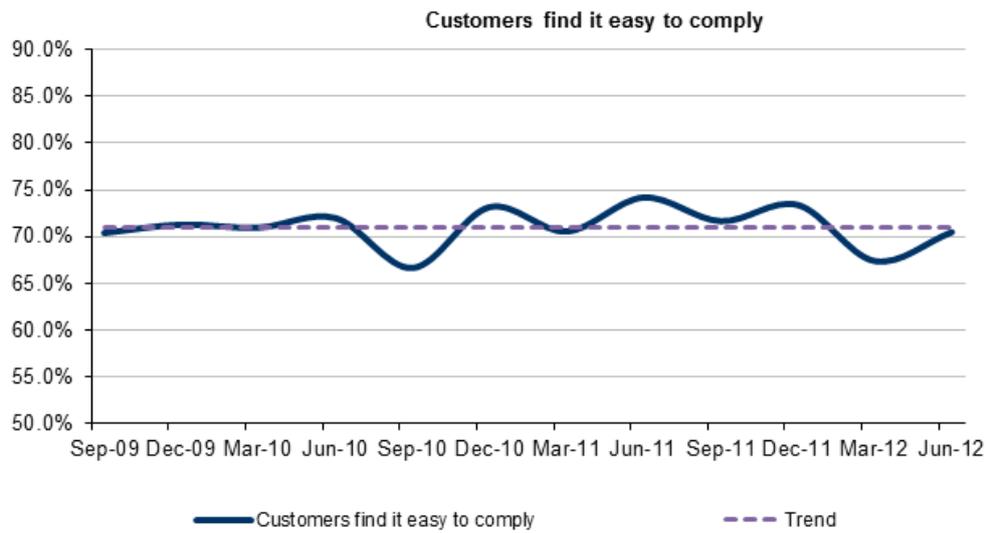


Inland Revenue has put in place a range of interventions including system/ process improvement initiatives to enhance the performance in this and other areas of compliance. At best, these have reduced the rate of decline. The historical evidence suggests that a step change is required to get significant lift in our effectiveness in the future, as well as to prevent the anticipated decline of the same over time.

Evidence from some of our other measures corroborates this. Measures of the ease with which customers are able to self-manage their tax affairs are especially sensitive to IR interventions and the indicators looking at the impact made in these areas are therefore also an indirect measure of how fit-for-purpose our systems and processes are.

The two relevant indicators show respectively a downward and static trend, despite IR’s sustained investment in improving the current systems and processes. The proportion of customers who are aware of aware of their obligations and entitlements is trending downwards (albeit slowly), while the percentage of customers who find it easy to comply is static as shown in the two diagrams below.





Maintaining or improving organisational performance will require either an increase in baseline funding for additional resources to improve performance, or allocation of funding to transform the way we deliver our business to ensure a sustainable increase in our performance across all areas.

## 3.2 Strategic Intervention

The Service Logic & Investment Prioritisation (SLIP) process identified the need to migrate toward a new operating model, known as the "Target Operating Model". This model would overcome limitations with the current model and establish a sustainable model for the future.

The changes required to implement the Target Operating Model require a major change from Inland Revenue's current business model. The Target Operating Model is a comprehensive description of how Inland Revenue will operate in the future. The work environment will be proactive, agile, and performance-oriented. It will value and encourage internal and external collaboration. The new model represents a major change from the current operating model. It will demand new organisational capabilities.

Business processes in the Target Operating Model will be focussed on the needs of citizens, businesses, and government, and they will integrate seamlessly with digital communication channels.

The Target Operating Model demands a new technology platform. This will consist of discrete, independent, modules, so that any module can be modified without affecting other parts of the system. It will be scalable, so that it can be easily expanded to support new products.

Changes to government policy may be required to support Inland Revenue's migration from the current model to the Target Operating Model.

The scalable and modular nature of the proposed model allows for a phased transition away from the current model. The new model would be phased in by prioritising most-needed business capabilities and processes, according to Government and organisational priorities. Modules that support the highest priority processes would be implemented first. The prioritisation would be based on risks and opportunities, and associated costs and benefits.

The Target Operating Model will have the following characteristics:

- Customer-centric culture and capabilities.
- Modern, fit for purpose business systems and processes that support our role as a tax administrator and our expanding role in the delivery of social policies.
- Business systems and processes that allow policy changes to be made in a timely and cost-efficient way.
- Business systems and processes that can integrate with other public service systems and channels to achieve a customer-centric service experience at a lower cost for government and customers.
- Systems and processes that make it easier for citizens and businesses to meet their obligations, such as near real-time transaction processing, where appropriate.
- Business systems and processes that make it more difficult for citizens and businesses to evade their obligations, for example, by facilitating collection of more obligations at source.
- Scalable systems and processes that could allow us to deliver other public services to leverage Inland Revenue's core competencies in the collection and

disbursement of money. For example, collecting debt on behalf of other agencies.

- Modular systems and processes that can economically and rapidly adapt to new customer expectations or government policies.
- Integrated service delivery with other public services that deliver our contribution to results 9 (one stop online shop for all government advice and support to businesses), 10 (New Zealanders can complete their transactions with government easily in a digital environment), and 7 (to reduce the rates of total crime, violent crime and youth crime)

### 3.3 Benefits

Implementing the proposed new operating model would:

- Enable Inland Revenue to more easily and quickly implement changes required by government to achieve their fiscal, social and economic outcomes.
- Reduce compliance costs for businesses and individuals.
- Enable Inland Revenue to support better public services to deliver customer-centric services, such as smartphone transactions, at lower cost for the customer and government.
- Improve compliance and enable Inland Revenue to collect a larger percentage of the collectable tax base.
- Enable Inland Revenue to leverage our infrastructure and capabilities in the collection and disbursement of money to support government in a more effective delivery of public services.
- Enable Inland Revenue to improve organisational performance.
- Minimise the risk of protracted systems outages and intermittent systems failures.
- Make it easier for people to meet their obligations, and harder for them not to.

## 4 Appendix I

# Inland Revenue - Business Transformation

## INVESTMENT LOGIC MAP Programme

