United States General Accounting Office

GAO

Report to the Commissioner
Internal Revenue Service

October 1993

FINANCIAL MANAGEMENT

IRS' Self-Assessment of Its Internal Control and Accounting Systems Is Inadequate

GAO/AIMD-94-2

GAO

United States
General Accounting Office
Washington, D.C. 20548

Accounting and Information
Management Division

B-254130

October 13, 1993

The Honorable Margaret Milner Richardson
Commissioner of Internal Revenue

Dear Ms. Richardson:

This report presents the results of our review of the Internal Revenue Service's (IRS) efforts in fiscal year 1992 to identify, report, and correct material weaknesses as required by the Federal Managers' Financial Integrity Act (FMFIA) of 1982. Under FMFIA, agencies are required to disclose the condition of their internal control and accounting systems.

We performed our review as part of our audit of IRS' fiscal year 1992 financial statements pursuant to the Chief Financial Officers (CFO) Act of 1990 (Public Law 101-576). Under the CFO Act, IRS is 1 of 10 pilot agencies required to prepare financial statements and have them audited by June 30, 1993. As authorized in the CFO Act, we elected to perform the financial audit of IRS for the fiscal year ending September 30, 1992. This is one of a series of reports resulting from our audit. Appendix I lists the previously issued reports.

Results in Brief

Although IRS reported nine material weaknesses in its fiscal year 1992 assurance statement to the Secretary of the Treasury, it did not disclose the severity of its internal control and accounting system weaknesses. IRS' assertion that, except for those nine weaknesses, its internal control and accounting systems provide reasonable assurance that the objectives of FMFIA have been achieved is inconsistent with what we found. Specifically, we found weaknesses in three major areas, which relate to (1) revenue accounting and reporting, (2) management of operating funds, and (3) reporting and safeguarding of seized assets. We considered these weaknessess to be material, but they were not included in IRS' fiscal year 1992 assurance statement. We also found weaknesses that either were reported so broadly that they did not focus on all the related issues or did not disclose the full extent of the weaknesses in IRS' assurance statement. Because of material weaknesses we identified and the nine that IRS reported, we disagree with IRS' fiscal year 1992 assurance statement to the Secretary of the Treasury regarding the effectiveness of its internal control and accounting systems. Further, as previously reported in our opinion on

IRS' internal controls,[1] such controls were not properly designed and implemented to effectively safeguard assets, provide a reasonable basis for determining material compliance with laws governing the use of budget authority and other relevant laws and regulations, and assure that there were no material misstatements in IRS' Principal Financial Statements.

Also, IRS' self-assessment process has not achieved the intended benefits of FMFIA because (1) it did not adequately identify internal control and accounting system weaknesses and (2) staff who performed the review were not provided with adequate guidance and training. In addition, some previously identified material weaknesses that IRS reported as corrected still existed because IRS did not address the fundamental causes of those weaknesses or ensure that corrective actions were effectively implemented.

IRS' assurance statement should provide top management a comprehensive assessment of its internal control and accounting system weaknesses. However, in IRS, this report has not served top management effectively. Without a comprehensive and candid assessment of its internal control and accounting systems, IRS management cannot provide the necessary attention needed to ensure that serious weaknesses are corrected. Also, without adequate disclosure, the President, the Congress, and the public will not be aware of the extent of IRS' weaknesses and the efforts needed to correct them.

Background

The Congress enacted the Federal Managers' Financial Integrity Act of 1982 (Public Law 97-255) to reduce fraud, waste, and abuse, and improve management of federal operations by strengthening internal control[2] and accounting systems. The act's application is very broad and covers the programs, activities, operations, and functions of executive agencies. The act addresses the entire range of policies and procedures that management employs to perform its mission efficiently and effectively and to provide full accountability to the taxpayer.

The act requires that agency internal control systems comply with standards prescribed by the Comptroller General and provide reasonable assurance that (1) obligations and costs comply with applicable laws,

[1]Financial Audit: Examination of IRS' Fiscal Year 1992 Financial Statements (GAO/AIMD-93-2, June 30, 1993).

[2]For purposes of the act, the terms internal controls, internal accounting and administrative controls, and management controls are synonymous.

(2) assets are safeguarded against waste, loss, unauthorized use, or misappropriation, and (3) revenues and expenditures are properly recorded and accounted for to permit the preparation of accounts and reliable financial management reports, and to maintain accountability over assets.

The act also requires that agencies report whether their accounting systems conform to accounting principles, standards, and related requirements prescribed by the Comptroller General. Specifically, agency systems should provide for (1) complete disclosure of the financial results of the activities of the agency, (2) adequate financial information for agency management and for formulation and execution of the budget, and (3) effective control over revenue, expenditures, funds, property, and other assets.

Under FMFIA, the Secretary of the Treasury is required to provide an annual statement to the President and the Congress on whether the Department's internal control and accounting systems, as a whole, comply with the act's requirements. The Secretary of the Treasury requires each of the Treasury's bureaus—of which IRS is one—to submit an annual assurance statement which (1) states whether their respective internal control and accounting systems conform to the Comptroller General's accounting principles, standards, and related requirements, (2) identifies new weaknesses and agency plans for correcting them, and (3) describes the progress made in correcting previously reported weaknesses.

Objectives, Scope, and Methodology

As part of our audit of IRS' fiscal year 1992 financial statements, we evaluated IRS' efforts to assess and report on its internal control and accounting systems as required by FMFIA. Our specific objectives were to (1) assess IRS' process for evaluating its internal control and accounting systems, with emphasis on whether material weaknesses we noted in our audit were reported, and (2) evaluate IRS' plans for correcting reported material weaknesses.

To assess IRS' process for evaluating and reporting on its internal control and accounting systems, we examined IRS' written policies and procedures for (1) selecting staff to perform the FMFIA review, (2) providing guidance and training to the staff, (3) documenting and testing internal control and accounting systems, and (4) reporting material weaknesses. We interviewed IRS staff responsible for managing and conducting the internal control and accounting system reviews. We also reviewed the documentation maintained by the review staff to determine the nature and scope of the reviews.

In addition, we reviewed the IRS fiscal year 1992 assurance statement, which identified material weaknesses, and compared the reported material weaknesses to those that we found during our audit. We discussed with IRS officials any weaknesses that we identified in our audit, which were not reported in the IRS annual assurance statement, to determine why they were not included.

To assess IRS' corrective action plans, we examined the plans included in the IRS fiscal year 1992 assurance statement. We evaluated the corrective action plans for reasonableness and whether they addressed the fundamental causes of weaknesses. In addition, we interviewed IRS staff to determine how corrective actions were developed for the material weaknesses identified. Further, we evaluated IRS' process for (1) implementing the corrective action plans and (2) removing the weaknesses from its assurance statement. For any weakness reported by IRS as corrected between fiscal years 1985 and 1992, and identified through our audit as recurring, we investigated why the weakness was removed.

We performed our work at the IRS headquarters in Washington, D.C., Southeast Regional Office, Southwest Regional Office, Midwest Regional Office, Mid-Atlantic Regional Office, Andover Service Center, Atlanta Service Center, Kansas City Service Center, and Philadelphia Service Center. Our work was performed from November 1991 through May 1993 in accordance with generally accepted government auditing standards.

IRS provided comments on a draft of this report. These comments are discussed in the Agency Comments section and are included in appendix II.

Fiscal Year 1992 Assurance Statement Overstates the Effectiveness of IRS' Internal Control and Accounting Systems

For fiscal year 1992, the Commissioner of Internal Revenue reported nine material weaknesses to the Secretary of the Treasury and concluded that, except for such weaknesses, IRS' internal control and accounting systems conform to the Comptroller General's internal control standards, and accounting principles, standards, and related requirements. Appendix III summarizes the material weaknesses that IRS reported to the Secretary of the Treasury, which Treasury then included in its annual report to the President and the Congress. Appendix IV provides the criteria for materiality as defined by the Office of Management and Budget (OMB). In three major areas, we found weaknesses that we considered to be material, but which were not included in IRS' fiscal year 1992 assurance statement to the Secretary of the Treasury. We also found weaknesses that were reported so broadly that they either did not focus on all the related issues or did not disclose the full extent of the weaknesses in IRS' assurance statement. Because of the material weaknesses we identified and the nine that IRS reported, we disagree with IRS' fiscal year 1992 assurance statement regarding the effectiveness of its internal control and accounting systems.

Material Weaknesses Not Reported

In three major areas, we found weaknesses that we considered to be material, but which were not included in IRS' fiscal year 1992 assurance statement. The material weaknesses we identified and included in our report on the IRS financial statements, but which were not included in IRS' 1992 assurance statement, are summarized under the following headings: revenue, management of operating funds, and seized assets.

Revenue

IRS reported collections of federal tax revenues totaling $1.1 trillion in fiscal year 1992, which were deposited into Treasury accounts. However, we were unable to audit the components of revenue and most of the revenue-related balances reported in IRS' Principal Financial Statements because IRS' revenue accounting system had not been programmed to generate a computer file or listing of the detailed transactions, such as assessments, collections, and refunds, recorded during the year. Due to these limitations on the availability of detailed information, we were unable to adequately evaluate and test revenue-related controls.

Also, we found that IRS' systems do not maintain and, thus, cannot report the amounts of specific excise taxes collected. As a result, IRS cannot provide Treasury the information needed to distribute these taxes among the general revenue fund and the various excise tax trust funds based on collections, as required by law. Instead, IRS reports to Treasury the amounts of excise taxes assessed, and Treasury distributes revenue based on these amounts. Since total assessments exceed total collections, this practice, in effect, results in subsidies to the excise tax trust funds from general tax revenues.

Similarly, IRS cannot determine the general revenue fund's subsidy to the social security trust fund. This subsidy occurs because amounts distributed, which by law are to be based on wages earned, generally exceed social security taxes collected. However, IRS cannot precisely determine the subsidy amount because it does not account for the specific amounts of social security taxes collected. As a result, IRS cannot provide subsidy information to congressional committees and others who may be interested in monitoring the financial condition of the social security program.[3]

Further, we identified fundamental deficiencies in IRS' analysis and summarization of its revenue-related records and in controls over the reliability of certain supporting transactions. These deficiencies affect the reliability of historical information reported (1) routinely to OMB, Treasury, and in the President's annual budget submission to the Congress and (2) on an ad hoc basis to congressional committees, the media, and others. For example, IRS' reports did not include transactions that were in process at the end of reported periods in its accounts receivable, refunds payable, and other noncash accounts, because IRS did not analyze such transactions to determine which needed to be reported. As of September 30, 1992, such transactions exceeded $150 billion.

Management of Operating Funds

IRS' systems and controls did not provide (1) a reasonable basis for determining compliance with laws governing the use of budget authority and (2) reasonable assurance that its disbursements were appropriate. Specifically, there were significant delays in recording certain types of expenditures and adjustments against operating appropriation accounts. For example, we noted reconciling items and transactions in suspense accounts that were not being effectively investigated and resolved. These included several billions of dollars in cumulative gross differences between IRS' and Treasury's cash records, some of which may partially or wholly offset each other, that would result in adjustments to either Treasury's or IRS' records or both. We also noted unliquidated obligations that were not being consistently reviewed and adjusted. As a result of these weaknesses, IRS' reports on operating appropriations, used by its managers, Treasury, OMB, and the Congress, were unreliable.

Seized Assets

To collect delinquent taxes owed the federal government, IRS seizes assets such as cars, real estate, furniture, and machinery. IRS could not provide us with detailed records that supported its reported balance of $797 million because IRS has not completed its physical inventory of these assets. We also found that IRS had not instituted basic systems and controls to provide reasonable assurance that asset seizures and disposal were accurately and

[3] In our report entitled Social Security: Reconciliation Improved SSA Earnings Records, but Efforts Were Incomplete (GAO/HRD-92-81, September 1, 1992), we suggested that the Congress consider amending the Social Security Act to require that revenues credited to the social security trust funds be based on social security taxes collected.

promptly recorded, and that seized assets converted to IRS' use were properly controlled and reported. The lack of adequate records and safeguarding controls can result in theft or mismanagement of seized assets.

Other Material Weaknesses Not Adequately Disclosed

In addition to material weaknesses that were not reported, we found weaknesses that were reported so broadly that they either did not focus on all the related issues or did not disclose the full extent of the weaknesses in IRS' assurance statement. By not adequately describing the nature and extent of known material weaknesses, management's ability to effectively correct them is significantly weakened.

For example, a material weakness that IRS has broadly reported since 1988 is the management of its delinquent debt. However, such a broad description does not disclose that its systems are outdated, inefficient, unintegrated, and error prone, which hampered its ability to analyze and properly report on its receivable balance. As we reported in May 1993,[4] we estimated that as much as $39.4 billion of the reported $104.7 billion, which represented 96 percent of the gross receivable balance as of June 30, 1991, was overstated due to (1) duplicate and insufficiently supported assessments that IRS had included as part of its efforts to identify and collect taxes owed, and (2) erroneous assessments. These amounts were not valid receivables for financial reporting purposes. Further, the inaccurate information provided Members of Congress and the public with an exaggerated idea of the potential for increasing collections to reduce the deficit.

In some areas, reported material weaknesses were narrowly described and thus, did not adequately disclose the full extent of the weakness. For example, in its fiscal year 1992 assurance statement, IRS reported a material weakness in its payment systems. This weakness related to vendor invoices not being paid by due dates calculated in accordance with the Prompt Payment Act. However, we found (1) duplicate, unsupported, and improperly timed payments to vendors and (2) inaccurate or no interest paid on late payments. For example, in a random sample of 280 payments, we found

- 32 duplicate and overpayments totaling $500,000, 4 of which were part of our sample and 28 of which were discovered in related documentation;

[4] Financial Audit: IRS Significantly Overstated Its Accounts Receivable Balance (GAO/AFMD-93-42, May 6, 1993).

- 112 payments totaling $17.2 million, for which complete supporting documentation could not be provided;
- 83 early payments, resulting in interest cost to the federal government, which did not have evidence of approval for early payment;
- 81 payments made after the due date, for which IRS was required to pay interest; and
- 56 of the late payments for which interest was not properly calculated or paid.

Also, in its fiscal year 1992 assurance statement, IRS narrowly described an automated data processing (ADP) control material weakness in which Integrated Data Retrieval System users had access to various command codes that allowed them to adjust taxpayers' records to generate refunds. However, we found that IRS also did not adequately control access authority given to computer support personnel or adequately monitor their accesses to taxpayer data. Further, controls did not provide reasonable assurance that only approved program revisions were implemented.

Overall, by not reporting or fully disclosing material weaknesses (1) IRS is not in a position to provide the proper management attention to those weaknesses or to ensure that effective corrective actions are completed, (2) the Secretary of the Treasury is not able to accurately determine if the Department's internal control and accounting systems conform to the Comptroller General's accounting principles, standards, and related requirements, and (3) the President, the Congress, and public will not be advised of the significance of IRS' material weaknesses.

IRS' Self-Assessment Process for Identifying Material Weaknesses Is Only Partially Effective

Although IRS has established a self-assessment process for its annual FMFIA review, we found that the process has not achieved the intended benefits of FMFIA because (1) it did not adequately identify serious internal control and accounting system weaknesses and (2) staff who performed the review were not provided with adequate guidance and training.

An effective FMFIA process should include a (1) comprehensive evaluation of the risks associated with the entire internal control system of the agency, program, or function being reviewed, and (2) determination of whether controls and systems are effective in achieving the objectives of FMFIA. As part of this process, management should provide

- adequate training for review staff;
- clear and concise instructions for performing FMFIA reviews;

- active managerial oversight and guidance;
- adequate tools to perform FMFIA reviews,[5] including tools for data gathering, risk assessments, testing, and documenting results; and
- follow-up procedures to ascertain whether corrections of past weaknesses are effective.

FMFIA Prescribed Review Procedures Not Sufficient

We found that IRS staff relied extensively on audit reports and internal and external studies to evaluate internal control and accounting systems. Of the 21 material weaknesses reported between 1990 and 1992, IRS identified 14 through audit reports and other studies. While audit reports should be a key source for identifying material weaknesses, they should not be the primary source used by an agency. Audit coverage of an agency's operations, by its very nature, encompasses only a small portion of those operations during any fiscal year. Consequently, audit coverage should not be relied on to identify most of an agency's material internal control weaknesses. Because relatively few of IRS' reported material weaknesses were identified as part of the FMFIA evaluations, and because of the additional unreported weaknesses and those weaknesses that were not adequately described, we believe that IRS' evaluations were insufficient and have not achieved the intended benefits of FMFIA.

In addition, we noted deficiencies in the process for evaluating IRS' accounting systems. The Department of the Treasury developed a questionnaire as a guide to assist its bureaus in evaluating their accounting systems. The questionnaire, which covers broadly many operations areas and is composed of "yes" or "no" answers, is of limited use in effectively identifying weaknesses. IRS used this questionnaire to perform its accounting system reviews. Thirteen staff—at two service centers, one regional office, and two headquarters offices—who performed the accounting system reviews told us that some of the questions in the questionnaire were not applicable to the systems that were reviewed. They also said that the questionnaire was not specific or flexible enough to fully disclose or identify weaknesses in accounting systems. Although 2 of the 13 staff provided additional explanations when they filled out the questionnaire, such additional information was not required to supplement the questionnaire.

Based on our reviews at the service centers, we found that the questionnaire used to evaluate accounting systems was inadequate for IRS'

[5]OMB has issued guidance for performing FMFIA reviews (Circular A-123, "Internal Control Systems"; Circular A-127, "Financial Management Systems"; and annual memoranda issued to agencies).

purposes. The questionnaire was insufficient to address the size and complexity of IRS' accounting systems, to fully evaluate the risk of errors and irregularities associated with the systems, or to adequately determine whether controls are in place to prevent or detect errors and irregularities. Further, the Treasury questionnaire focuses on traditional accounting activities such as payables and receivables which are very different from IRS' primary financial activity of tax collection.

Guidance and Training Not Always Adequate

Except for the accounting system reviews conducted at the service centers, IRS did not provide adequate guidance or training to staff who performed FMFIA reviews. The Internal Revenue Manual states that the FMFIA coordinators[6] should ensure that adequate guidance and training are provided to staff who conduct the internal control and accounting system reviews. Staff assigned to perform the annual FMFIA review should be trained to determine the risks associated with the entire internal control and accounting systems of the agency, program, or function being reviewed.

Fourteen of the 22 review staff whom we interviewed stated they were not formally trained. At the beginning of the review process, they received (1) a memorandum informing them of the review process, (2) a copy of Treasury's review procedures, and (3) references to the Internal Revenue Manual section related to the FMFIA process. IRS review staff said that this information was inadequate for learning how to properly conduct the FMFIA reviews because some staff were performing the FMFIA review for the first time and the instructions were general. Ten of the 14 staff told us that they were not satisfied with the adequacy of the information provided to implement the FMFIA assessment process of identifying, disclosing, and correcting internal control and accounting system material weaknesses.

On the other hand, the remaining eight review staff who conducted the accounting system reviews at the service centers were trained by FMFIA coordinators before the annual review process began. The training sessions usually lasted a few days, during which the staff examined and discussed Treasury's questionnaire to determine which questions were applicable to the system under review.

The review staff who conducted the accounting system reviews at the service centers and received the training told us that they had a good

[6]FMFIA coordinators are contact points for review staff. The coordinators provide guidance and training to staff and assist in reviewing and reporting the results of IRS' self-assessment efforts.

working relationship with the FMFIA coordinators and could call on them for information. However, these staff also told us that they did not receive adequate instructions for identifying and disclosing internal control and accounting system weaknesses.

Corrective Actions Cited Have Not Fully Resolved Problems

While IRS has reported that it has corrected 156 out of 176 reported material weaknesses since 1985, we found that the corrective actions did not always resolve the weaknesses. OMB Circulars require that an agency design corrective action plans for reported material weaknesses and then effectively and efficiently implement them. Although corrective actions have effectively eliminated material weaknesses, we found a few material weaknesses that were prematurely reported as corrected. Also, we found other material weaknesses where the planned corrective actions do not address the underlying cause of the weaknesses.

Weaknesses Prematurely Reported as Corrected

We found that material weaknesses IRS had previously reported as corrected still exist. This calls into question whether IRS is effectively verifying that the corrective actions resolve weaknesses before removing them from IRS' records. According to IRS policy, reported material weaknesses should be certified as corrected before they are removed from IRS' records. This is also consistent with OMB requirements for validating the corrective action before the weaknesses are removed. However, the FMFIA coordinators told us that there are no written policies requiring them to test corrective actions to determine if they were effective. Instead, the FMFIA coordinators rely on representations from persons responsible for resolving the weaknesses that reported material weaknesses have been resolved; thus, they do not perform any tests themselves.

For example, in 1985, IRS reported a material weakness concerning seizure monies deposited in the wrong service center, which would cause difficulty in reconciling taxpayer and IRS' records. IRS' corrective action plan was to simplify procedures to ensure input of all seizures into IRS' financial records, such as the general ledger, and to issue a memorandum to field staff, emphasizing the importance of controlling all seized monies. This weakness was reported as corrected in 1986. However, we found that deposits of seizures were still, in some instances, sent to the wrong service center for processing because procedures were still unclear.

Also, in 1986, IRS reported, as a material weakness its difficulty in properly calculating interest on certain types of accounts receivable. These complex calculations were being done manually and were prone to errors. In 1989, IRS prematurely reported that this weakness had been corrected. Its corrective action was to develop a computer program and update procedures to calculate the interest. However, the calculation of the interest is still a serious problem primarily because IRS had not implemented computer programs to routinely perform the required complex calculations. We found that the resulting manual calculations were still often erroneous. For example, to assess the accuracy of the interest calculation, IRS' Manhattan District Office reviewed 499 manual interest cases from June 1990 to February 1993 and found that 63 percent contained errors.

Corrective Action Plans Will Not Eliminate Reported Weaknesses

Planned corrective actions are not likely to eliminate some of IRS' reported material weaknesses in its fiscal year 1992 assurance statement, because such plans are not comprehensive enough to address related weaknesses or lack sufficient detail needed to correct specific weaknesses. For example, as we described in our report on IRS' accounts receivable, IRS' corrective actions related to managing delinquent debt will not address the fundamental weaknesses in accounting for and reporting of receivables. IRS' planned corrective action does not specifically address steps needed to account for and report valid and collectible accounts receivable for financial reporting purposes.

Also, IRS reported its property management as a material weakness in 1983. As part of its effort to correct the problem, in 1991, IRS adopted the Computer Resources Management System (CRMS) to maintain detailed records of its ADP assets—computer equipment and software. As we recently reported, IRS' ADP inventory records were unreliable for managing and reporting these assets, because IRS had not instituted basic procedures and related controls to ensure that the information in the system is current and accurate.[7] Specifically, IRS' corrective action plan did not include procedures to (1) ensure that ADP acquisitions and disposal were accurately recorded in CRMS on a timely basis, (2) effectively perform physical inventories, and (3) properly value ADP resources included in CRMS.

Many of the corrective actions that IRS has taken to correct reported material weaknesses involved updating existing policies or issuing new policies; implementing new system procedures, regulations, or

[7] Financial Management: IRS Lacks Accountability Over Its ADP Resources (GAO/AIMD-93-24, August 5, 1993).

requirements, such as assigning organizational responsibility for carrying out a new requirement; or developing new systems without implementing basic controls and procedures. While such improvements in procedural guidance are desirable, if they are not directed at the fundamental causes of the weaknesses and corrective actions are not tested to ascertain that the desired results were achieved, the weaknesses will persist.

Efforts to Increase Involvement of Senior Executives

Recognizing the need to strengthen internal controls, IRS established, in January 1993, a Senior Management Council for management control which consists of the Deputy Commissioner, Chief Financial Officer, Chief Inspector, Chief Information Officer, and Chief Operations Officer. The goal of this council is to provide oversight and strategic review of the FMFIA process.

The council plans to increase senior executive involvement, review critical issues and vulnerabilities, address cross-functional and funding issues, provide oversight and review of IRS' progress in implementing corrective actions, and ensure that corrective actions are effective.

Such direct top level management involvement satisfies a basic goal of FMFIA, and could provide the impetus to direct proper attention to identifying, reporting, and correcting material weaknesses. The establishment of this council is an important step in strengthening IRS' FMFIA process.

Conclusions

Because of widespread material weaknesses in IRS' operations, we do not believe that IRS has reasonable assurance that the objectives of FMFIA have been achieved. IRS' FMFIA process for identifying, disclosing, and correcting material weaknesses must be substantially improved if IRS is to produce reliable information that top management can use to control costs and improve operations. Top management involvement is an essential first step in strengthening IRS' operations and accurately reporting IRS' internal control and accounting system weaknesses to the Secretary of the Treasury.

Recommendations

To ensure accurate reporting to the Secretary of the Treasury on the effectiveness of IRS' internal control and accounting systems, we recommend that the Commissioner of Internal Revenue direct the Senior Management Council to coordinate and oversee activities to (1) establish and implement proper written procedures that provide for the identification, documentation, and correction of material weaknesses, (2) provide classroom training and guidance materials to all review staff, (3) develop effective corrective action plans that address the fundamental causes of the weaknesses, and (4) verify the effectiveness of corrective actions before removing reported weaknesses from IRS' records.

Agency Comments

In commenting on a draft of this report, IRS took no exception to our findings and fully supported the recommendations. To strengthen its self-assessment program, the IRS Commissioner directed the Senior Management Council to hold executives accountable for ensuring that weaknesses are identified and that corrective actions eliminate the weaknesses. Also, IRS is in the process of reorganizing its program to consolidate its dispersed responsibilities into a single Office of Management Controls within the Chief Financial Officer's organization. The Office of Management Controls will develop a servicewide training strategy to present to the senior council. IRS stated that for its fiscal year 1993 review, it has increased headquarters and field managers' awareness of their responsibilities by providing clearer, more specific guidance in the current instructions and by directly involving districts and service centers in the assurance letter process.

IRS' comments indicate that it is addressing the weaknesses described in our report. However, many of the related details have been neither formulated nor implemented. We plan to further review these efforts and assess their effectiveness as part of our audit of IRS' fiscal year 1993 financial statements. IRS' comments are included in appendix II.

This report contains recommendations to you. As you know, 31 U.S.C. 720 requires the head of a federal agency to submit a written statement on actions taken on these recommendations. You should submit the statement to the Senate Committee on Governmental Affairs and the House Committee on Government Operations within 60 days of the date of this report and to the House and Senate Committees on Appropriations with the agency's first request for appropriations made over 60 days after the date of this report.

We are sending copies of this report to the Secretary of the Treasury; Director of the Office of Management and Budget; Chairmen and Ranking Minority Members of the Senate Committee on Governmental Affairs, the

House Committee on Government Operations, the Senate Committee on Finance, the House Committee on Ways and Means, the Subcommittee on Commerce, Consumer and Monetary Affairs of the House Committee on Government Operations, the Subcommittee on Oversight of the House Committee on Ways and Means; the Chairman of the Joint Committee on Taxation; and other interested parties. Copies will be made available to others upon request.

This report was prepared under the direction of Gregory M. Holloway, Associate Director, Civil Audits, who may be reached at (202) 512-9510, if you or your staff have any questions. Other major contributors are listed in appendix V.

Sincerely yours,

Donald H. Chapin

Donald H. Chapin
Assistant Comptroller General

Contents

Abbreviations

ADP	automated data processing
CFO	Chief Financial Officer
CRMS	Computer Resources Management System
FMFIA	Federal Managers' Financial Integrity Act
GAO	General Accounting Office
IRS	Internal Revenue Service
OMB	Office of Management and Budget

Reports Resulting From GAO's Audit of IRS' Fiscal Year 1992 Financial Statements

IRS Information Systems: Weaknesses Increase Risk of Fraud and Impair Reliability of Management Information (GAO/AIMD-93-34, September 22, 1993).

Financial Management: IRS Lacks Accountability Over Its ADP Resources (GAO/AIMD-93-24, August 5, 1993).

Financial Audit: Examination of IRS' Fiscal Year 1992 Financial Statements (GAO/AIMD-93-2, June 30, 1993).

Financial Audit: IRS Significantly Overstated Its Accounts Receivable Balance (GAO/AFMD-93-42, May 6, 1993).

Federal Tax Deposit System: IRS Can Improve the Federal Tax Deposit System (GAO/AFMD-93-40, April 28, 1993).

Comments From the Internal Revenue Service

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

COMMISSIONER

August 25, 1993

Mr. Donald H. Chapin
Assistant Comptroller General
Accounting and Information Management Division
United States General Accounting Office
Washington, D.C. 20548

Dear Don:

Thank you for the opportunity to comment on the draft GAO report entitled IRS' Self-Assessment of Its Internal Control and Accounting Systems is Inadequate. This draft is one of several we expect to receive as a result of GAO's audit of our fiscal year 1992 financial statements. I appreciate your staff's efforts in conducting a comprehensive, thoughtful review of the Service's performance in fulfilling its management control responsibilities under the Federal Managers' Financial Integrity Act (FMFIA).

I fully support the recommendations contained in the report. They are compatible with several recent actions the Service has already taken to strengthen its management control program. I have directed IRS's Senior Council for Management Control to hold executives accountable for ensuring that weaknesses are identified and that corrective actions eliminate the weaknesses. In support of this charge, the Council has met with all executives responsible for correcting weaknesses identified as a result of FY 1992 FMFIA reviews to discuss the status of their corrective action plans and the effectiveness of completed corrective actions. Further, the Council will use its active oversight of corrective actions taken in response to Internal Audit, Inspector General and GAO audit recommendations as an independent avenue for verifying the thoroughness of IRS's FY 1993 FMFIA self-assessment process.

To improve the administrative focus and visibility of the management control program, we are reorganizing the program to consolidate its dispersed responsibilities into a single Office of Management Controls within the Chief Financial Officer's organization. Concentrating program resources will ensure development of consistent guidance and orderly administration of the various program elements.

We recognize the need to educate management about its internal control responsibilities and to improve training for review staff. I have asked the new Office of Management Controls to develop a Servicewide training strategy for presentation to the Senior Council for Management Control.

Mr. Donald H. Chapin

We have already taken some initial steps to increase headquarters and field managers' awareness of their responsibilities by providing clearer, more specific guidance in the instructions for this year's assurance letter, and by directly involving Districts and Service Centers in the assurance letter process. The Senior Council conducted a videoconference with Regional Commissioners and FMFIA coordinators to convey its expectations and to solicit support for the FY 1993 assurance process. We also laid the foundation this year, through regular telephone calls and meetings, for improved communication with the headquarters and field staff who coordinate reviews.

Although we have already made significant improvements, with the establishment of the Senior Council and the other steps taken this year, our intent is to continue to strengthen our FMFIA process.

We hope you find these comments useful.

Sincerely,

Peggy Richardson
Margaret Milner Richardson

Material Weaknesses Reported by Treasury and IRS

For fiscal year 1992, the Treasury and IRS reported the following nine material weaknesses in their FMFIA report and assurance statement respectively.

Material weakness	Year initially reported
Insufficient management oversight throughout IRS and a lack of comprehensive procedures have contributed to a large number of instances where proper documentation is lacking and invoices are not paid by the deadline required under the Prompt Payment Act.	1992
Timing of direct deposit of electronic filing refunds and the subsequent submission of supporting documents make it extremely difficult for the criminal investigation unit to identify refund schemes in time to stop refunds.	1992
Daily deposits totaling millions of dollars are delivered to the Federal Reserve Bank by a warehouse worker in a government car.	1992
IRS personnel have access to a wide variety of command codes which allow them to adjust taxpayer accounts to generate refunds.[a]	1991
Adequate documentation for financial transactions related to processing of Form 1042S for withholding of interest paid to foreign taxpayers on income tax refunds is not provided.	1991
Large volumes of "substitute for return" credits are being erroneously refunded after the refund statute expiration date.	1990
Mechanisms for ensuring that IRS meets high standards of integrity need strengthening.	1989
Management of IRS delinquent debt, including tax administration and its collection system, needs to be improved.	1988
Property management procedures and controls over the use and accountability of capitalized property need improvement.	1983

[a]This material weakness was expanded in IRS' fiscal year 1992 FMFIA report to include employee access over command codes.

Office of Management and Budget Criteria for Material Weaknesses

OMB 1992 FMFIA reporting guidance provides that a weakness is material if it meets one or more of the following criteria:

- significantly impairs the fulfillment of an agency or component's mission;
- deprives the public of needed services;
- violates statutory or regulatory requirements;
- significantly weakens safeguards against waste, loss, unauthorized use or misappropriation of funds, property, or other assets;
- results in a conflict of interest;
- merits the attention of the agency head/senior management, the Executive Office of the President, or the relevant Congressional oversight committee;
- is of a nature that omission from the report could reflect adversely on the actual or perceived management integrity of the agency;
- prevents the primary agency financial system from achieving central control over agency financial transactions and resource balances; or
- prevents conformance of financial systems with (1) financial information standards and/or (2) financial system functional standards.

Major Contributors to This Report

Accounting and Information Management Division, Washington, D.C.

Robert F. Dacey, Senior Assistant Director
Hodge A. Herry, Assistant Director
Renu Saini, Audit Manager
Donna M. Daly, Auditor-in-Charge
Anastasia P. Greene, Auditor

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