United States General Accounting Office

GAO

Report to the Congress

June 1993

FINANCIAL AUDIT

Examination of IRS' Fiscal Year 1992 Financial Statements

149532

GAO

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

Comptroller General
of the United States

B-250977

June 30, 1993

To the President of the Senate and the
Speaker of the House of Representatives

This report presents the results of our efforts to audit the Principal Financial Statements of the Internal Revenue Service for fiscal year 1992. As part of this effort, we evaluated the IRS' internal controls and its compliance with laws and regulations related to the financial statements. Pursuant to the Chief Financial Officers Act of 1990 (Public Law 101-576), IRS was required to prepare agencywide financial statements for fiscal year 1992 and have them audited. As authorized by the act, we attempted to perform an audit of these statements.

We were unable to express an opinion on the reliability of IRS' 1992 Principal Financial Statements because critical supporting information was not available. Where information was available, we found that it was generally unreliable.

In addition, we found that IRS' internal controls did not effectively safeguard assets, provide a reasonable basis for determining material compliance with relevant laws and regulations, and assure that there were no material misstatements in the Principal Financial Statements. However, we were unable to test all significant controls due to the limitations on data availability mentioned above.

Further, we found no instances of material noncompliance with laws and regulations during fiscal year 1992. However, we could not test compliance with many laws that we considered necessary to test because of the ineffective internal controls and limitations on data availability.

The results of our audit of the IRS are discussed in greater detail in several reports that we have either issued or are planning to issue.

We are sending copies of this report to the Commissioner of the Internal Revenue; the Secretary of the Treasury; the Director of the Office of Management and Budget; the Chairmen and Ranking Minority Members of the Senate Committee on Governmental Affairs, the Senate Committee on Finance, the House Committee on Government Operations, the House Committee on Ways and Means, the Subcommittee on Commerce, Consumer and Monetary Affairs, House Committee on Government Operations, the Subcommittee on Oversight, House Committee on Ways and Means, and the Joint Committee on Taxation; and other interested parties. Copies will be made available to others upon request.

Charles A. Bowsher
Comptroller General
of the United States

Contents

Abbreviations

ADP	automated data processing
CFO	Chief Financial Officer
FMFIA	Federal Managers' Financial Integrity Act
IRS	Internal Revenue Service
OMB	Office of Management and Budget

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To the Commissioner of Internal Revenue

In accordance with the Chief Financial Officers (CFO) Act of 1990, the Internal Revenue Service (IRS) prepared the accompanying Principal Financial Statements for the fiscal year ended September 30, 1992. IRS is the largest revenue collector for the federal government, reporting tax collections of $1.1 trillion for fiscal year 1992. While IRS has historically filed certain unaudited financial information with the Department of the Treasury, this was the first time that IRS prepared a comprehensive set of Principal Financial Statements. Preparation of these statements presented substantial challenges to IRS. This undertaking was made more difficult because existing IRS systems were not designed to provide the meaningful and reliable financial management information needed to effectively manage and report on IRS' operations. In accordance with the CFO Act, we elected to perform an audit of these statements and related internal controls. IRS fully cooperated with us and has made progress towards developing reliable information.

The results of our audit are summarized as follows.

- We are unable to express an opinion on the reliability of the fiscal year 1992 Principal Financial Statements of IRS because critical supporting information was not available. Where supporting information was available, we found that such information generally was unreliable. As a result, internal and external reports that were based on this information may be unreliable.
- In our opinion, internal 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 the Principal Financial Statements. However, we were unable to evaluate and test all significant internal controls due to the limitations on the availability of supporting information mentioned above.
- The ineffective internal controls, lack of supporting information, and unreliable information also affected the reliability of a significant amount of the information contained in the Overview to the Financial Statements and Supplemental Financial and Management Information. Much of this information was either derived from the same sources as the information presented in the Principal Financial Statements or lacked adequate

controls over its reliability. Consequently, this information may be unreliable.

- Our tests for compliance with selected provisions of laws and regulations disclosed no material instances of noncompliance; however, we could not test compliance with many laws that we considered necessary to test because of the ineffective internal controls and limitations on the availability of supporting detail that are discussed above. With respect to laws and regulations that we were able to test, our limited tests would not necessarily detect all material instances of noncompliance. However, our work identified some instances of noncompliance with certain provisions of the Internal Revenue Code relating to distribution of excise taxes.

Although our audit has identified a number of critical financial management problems that demand attention, we believe that there is a high potential return on investment in the financial management function. IRS has made important strides in addressing long-standing financial management problems. But the process of change has just begun. Prior to fiscal year 1989, IRS had put neither substantial effort nor dollars into rectifying the poor state of its financial management operations and no one at IRS was responsible for ensuring the integrity and efficiency of financial management and accounting systems agencywide. IRS established financial leadership through the appointment of a CFO and an Assistant Commissioner (Finance)/Controller in fiscal year 1990. Additionally, IRS has:

- significantly increased its CFO staff to address its long-standing critical shortage of accounting personnel;
- implemented agencywide, in fiscal year 1993, a new integrated accounting and budget system to replace an unreliable system;
- introduced quarterly, rather than annual, budget allocations for its managers for better control over spending;
- begun development of a new cost management system, designed to provide information on the component costs of IRS' operations to support informed financial management decisions; and
- converted to the National Finance Center's payroll system to replace an unreliable payroll system and provide more detailed payroll and benefit cost information.

IRS continues to face major challenges in developing meaningful and reliable financial management information and in providing effective internal controls, as envisioned by the CFO Act. It will take a significant and sustained commitment by IRS management, particularly by the CFO and CFO staff, to build on efforts now underway to develop such information and put proper controls in place. As evidence of this commitment, IRS has already implemented or begun to take steps to correct some of the problems identified in this financial audit. For example, we found that IRS historically reported significantly overstated accounts receivable balances. In response, IRS based its estimate of accounts receivable at September 30, 1992, on the methodology we recommended as a short-term measure until IRS can develop systems and internal controls that will routinely provide reliable information about valid and collectible accounts receivable.

Significant Matters

The significant matters noted in our audit relate to revenue, tax accounts receivable, property and equipment, management of operating funds, computer controls, seized assets, and reports required by the Federal Managers' Financial Integrity Act (FMFIA). We found that IRS had material weaknesses in internal controls over each of these areas that could lead to material losses of assets, noncompliance, or misstatements in the Principal Financial Statements. Also, as noted below, many of the material weaknesses that we identified were not included in IRS' 1992 FMFIA report, which is to identify all such weaknesses. We have issued two reports[1] and plan to issue additional reports that describe these significant matters in detail.

Revenue

We were able to determine that IRS' total reported revenues of about $1.1 trillion were collected and deposited into Treasury accounts. However, we were not able 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, abatements, refunds, and interest, recorded during the year. Without a complete file or listing of transactions supporting these balances, we were not able to perform audit procedures we considered necessary. IRS is developing computer programs to provide this information for the fiscal year 1993 audit. Due to the limitations on the availability of supporting information, we also were unable to adequately evaluate and test revenue-related controls.

A related effect of IRS' inability to retrieve files or listings of transactions is that IRS cannot readily determine, for a given period, the total amount of a

[1] Federal Tax Deposit System: IRS Can Improve the Federal Tax Deposit System (GAO/AFMD-93-40, April 28, 1993) and Financial Audit: IRS Significantly Overstated Its Accounts Receivable Balance (GAO/AFMD-93-42, May 6, 1993).

specific type of transaction, such as penalties or interest, or analyze its components. Such information would be useful to IRS in managing its collection and enforcement activities.

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. Over the past several years, such subsidies may have totalled several billions of dollars.

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 information on the subsidy to congressional committees and others who may be interested in monitoring the financial condition of the social security program.[2]

Also, the agencies who manage programs that depend on trust fund revenues have little ability to (1) verify that the distributions their funds receive are correct and (2) assist in tax enforcement efforts because most receive virtually no related information from IRS, some of which IRS is currently precluded by law from providing.

Further, GAO 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 either (1) routinely to the Office of Management and Budget (OMB), Treasury, and in the President's annual budget submission to the Congress or (2) on an ad hoc basis to

[2]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.

congressional committees, the media, and others. Examples of these problems are listed below.

- 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.
- IRS' current paper-based Federal Tax Deposit system for collecting payment data from businesses allows numerous errors, primarily because the payment data and the related tax data are collected separately. Resolving such errors is both time-consuming and costly to IRS and taxpayers.
- The lack of prompt reconciliations between employee and employer wage records has delayed the recording of revenue adjustments and detection of taxpayer fraud.
- Interest on certain types of accounts receivable was calculated incorrectly, primarily because IRS had not implemented computer programs to routinely perform the required complex calculations and the resulting manual calculations were often erroneous.
- Adjustments to summary-level revenue records were not subject to consistent supervisory review, which increased the risk that erroneous entries may be posted.

To address these problems in revenue accounting, IRS is expanding the role of its CFO and is either studying, planning, or implementing various improvements to its systems and processes. However, many of these improvement efforts have either not yet been defined or are not expected to be complete until well past the year 2000 because they are part of IRS' long-term Tax Systems Modernization effort.

Our audit for fiscal year 1992 was not designed to address IRS' information on (1) the impact of tax policies on revenue, often referred to as "tax expenditures," and the process used by IRS to determine this information or (2) potential tax revenues, often referred to as the "tax gap." We have previously issued many reports on the individual components of tax expenditures and the tax gap.[3]

[3]Recent reports and testimony include Tax Administration: IRS' Efforts to Improve Corporate Compliance (GAO/GGD-92-81BR, April 17, 1992); Tax Policy: Puerto Rico and the Section 936 Tax Credit (GAO/GGD-93-109, June 8, 1993); and Earned Income Tax Credit: Effectiveness of Design and Administration (GAO/T-GGD-93-20, March 30, 1993).

Tax Accounts Receivable

Based upon the methods that we recommended in our May 1993 report on accounts receivable, IRS developed and reported an estimate of $21.6 billion for collectible receivables as of September 30, 1992. However, we were unable to audit this information because IRS only recently completed its analysis.

Historically, IRS reports have significantly overstated both its gross and net collectible accounts receivable. As of June 30, 1991, we estimated that gross receivables of $104.7 billion, representing about 96 percent of the reported balance, included $39.4 billion of invalid accounts, and that only $18.7 billion of the $65.3 billion of valid accounts were collectible. IRS had reported net receivables of $66.4 billion as of June 30, 1991, and, using a new methodology to estimate collectible accounts, $28.4 billion as of September 30, 1991. However, we found that the new methodology overstated collectible accounts receivable. This unreliable information on IRS' accounts receivable has affected decisions about the (1) impact of increased collections on the deficit, (2) evaluation of enforcement and collection performance, (3) determination of staffing levels, and (4) allocation of resources.

IRS gross receivables were overstated primarily because IRS included duplicate and insufficiently supported assessments that it had recorded as part of its efforts to identify and collect taxes due. These and many erroneous assessments were not valid receivables for financial reporting purposes and should not have been included in the reported balances. IRS' estimates of the collectibility of its receivables as of September 30, 1991, were unreliable because, in addition to including invalid receivables, IRS relied solely on collection experience and did not group assessments according to their collection risk or consider the taxpayer's current ability to pay.

Property and Equipment

Computer equipment and software, often referred to as automated data processing (ADP) assets, represent a significant portion of the cost of IRS' property and equipment. Because the information in its ADP inventory system could not be relied upon, IRS did not report a balance for property and equipment in its Principal Financial Statements. Instead, IRS reported, in the notes, a balance of $282 million, which included only a portion of its ADP assets based on a manually compiled listing of selected large-dollar ADP assets. In comparison, for the last three fiscal years, IRS had budgeted acquisitions of property and equipment totalling $453 million. IRS plans to continue to compile information about the cost of the remaining ADP assets. Planned expenditures for ADP assets, approaching $9 billion under IRS' Tax Systems Modernization effort, increase the importance of accurate ADP asset records to IRS.

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 information in its ADP inventory system was current and accurate. Specifically, IRS (1) had not developed procedures to ensure that ADP acquisitions and disposals were accurately recorded on a timely basis, (2) did not effectively perform physical inventories, and (3) did not properly value ADP resources, primarily because, for many items, IRS used unrealistic estimates instead of actual costs. As a result of unreliable and incomplete records, IRS did not readily have the information it needed to effectively manage maintenance contracts, make ADP support staffing decisions, or support development of budget requests, procurement decisions, and performance measurement information related to the use of ADP assets. Further, IRS did not maintain records of the costs of in-house software development which, when combined with ADP inventory information, would provide more complete accountability for ADP costs and assist in planning decisions.

Management of Operating Funds

For years, IRS' systems used to process and account for spending of operating funds could not provide accurate and timely information needed to manage these funds. We were unable to audit approximately $4.3 billion or 64 percent of the reported spending of $6.7 billion from IRS' operating appropriations because IRS could not reconcile the total of detailed spending information in its outdated systems with summary amounts reported by such systems. Due to this limitation, we also were unable to adequately evaluate and test controls relating to these operating expenditures and the majority of operating accounts. The remaining $2.4 billion of reported spending in fiscal year 1992, which we audited, was processed by a new system installed in fiscal year 1992 in IRS' National Office and one region. This new system was implemented throughout IRS on October 1, 1992.

For the spending that we were able to audit, we found that 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. To resolve some of these weaknesses, on October 1, 1992, IRS initiated additional functions in its new system which (1) provide up-to-date information needed to monitor available appropriations, including the introduction of quarterly spending limits, and (2) determine whether funds are available before they are obligated. We did not review the effectiveness of these changes during our audit. However, these changes were not designed to address weaknesses in other areas, which are described below.

There were significant delays in recording certain types of expenditures and adjustments against 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. IRS recently established a task force to resolve these cash differences. We also noted unliquidated obligations that were not being reviewed for appropriateness.

Also, transactions were inappropriately processed due to nonintegrated systems, inadequate review of supporting documents, and inadequate related processing guidance. Specifically, we found (1) duplicate, unsupported, and improperly timed disbursements 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 totalling $0.5 million, 4 of which were part of our sample and 28 that were discovered in related documentation;
- 112 payments totalling $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.

Because IRS did not have reliable information on the use of operating funds, its reports on operating appropriations, used by its managers, Treasury, OMB, and the Congress, also were unreliable. The reliability of historical data included in the President's annual budget submission to the Congress was further diminished because IRS used inappropriate assumptions in converting this data to categories prescribed by OMB.

Further, IRS' Statement of Budget and Actual Obligations, one of its Principal Financial Statements, included amounts that were based on categories used for internal management, rather than those categories reported in its budget submission and as required by OMB.

Computer Controls

To process and account for its revenues, IRS relies on extensive data processing operations, which should include overall or general controls to ensure that data are processed as authorized and are adequately protected from unauthorized change or disclosure. IRS did not adequately control access authority given to computer support personnel or adequately monitor employee accesses to taxpayer data. Further, controls did not provide reasonable assurance that only approved program versions were implemented. Weaknesses in computer controls, according to IRS, permitted employees to make unauthorized accesses and modifications to taxpayer information, resulting in unauthorized refunds. Such weaknesses also increased the risk of unintentional errors. Also, the computer capacity at the backup site for IRS' primary computing center is not adequate to run all of the primary and backup sites' critical applications at the same time, and IRS has not tested the effectiveness of its recently revised disaster recovery plan for the primary computing center.

IRS is in the process of implementing new systems to monitor employee activities relating to computerized taxpayer information, and it plans to obtain needed computer capacity at its backup site in 1994 and test its disaster recovery plan in 1993.

Seized Assets

We were unable to audit amounts reported for IRS' seized assets because IRS has not completed compiling its physical inventory of these assets as of September 30, 1992, and, therefore, could not provide us with detailed records that supported its reported balance of $797 million. However, we found that IRS had not instituted basic systems and controls to provide reasonable assurance that asset seizures and disposals were accurately recorded on a timely basis and that seized assets converted to IRS' use were properly controlled and reported. Other deficiencies related to seized assets are discussed in our testimony entitled Tax Administration: IRS' Management of Seized Assets (GAO/T-GGD-92-65, September 24, 1992).

FMFIA

IRS did not disclose the overall severity of its internal control and accounting system weaknesses in its fiscal year 1992 FMFIA report to

Treasury. Without adequate disclosure, users of the FMFIA report will not be aware of the extent of IRS' weaknesses and the efforts needed to correct them. We found material weaknesses that IRS either did not include or did not adequately disclose in its fiscal year 1992 FMFIA report. The severity of the weaknesses seriously impaired IRS' ability to safeguard, manage, and control its tax revenues and operating expenditures.

The review procedures used by IRS to conduct the FMFIA reviews were insufficient and the guidance and training provided FMFIA review staff were inadequate. In addition, some previously identified material weaknesses that IRS reported as corrected, including the above described weaknesses related to seized assets and manually computed interest on accounts receivable, still exist because IRS did not address the fundamental causes of those weaknesses or ensure that corrective actions were effective.

IRS reported its inability to accurately account for its ADP assets as a material weakness. However, other weaknesses were reported so broadly that they did not focus on all of the related issues. For example, while IRS broadly reported in its FMFIA report that the management of its delinquent debt needs to be improved, it did not disclose that its gross receivable balance was overstated. Further, in some instances, IRS did not disclose the full extent of the weaknesses. For example, IRS reported that vendors were not paid on time, but did not disclose the extent of the weaknesses in controls over payments that we identified. Also, IRS' reported weaknesses in ADP controls did not address all of the weaknesses we noted during our audit.

Financial Management at IRS

IRS' CFO, although responsible for compiling the Principal Financial Statements, did not have the authority needed to ensure that the financial management information and supporting data contained in IRS' computer systems was properly maintained and reported. While the CFO assumed an advisory role in system development efforts during 1992, the CFO's approval of related plans and implementation efforts was not required. Additionally, the CFO did not have authority over the operation of certain functions, such as accounting for revenue and for property and equipment, which are necessary for proper performance of the CFO's duties. IRS plans to restructure the duties of the CFO to be more consistent with these responsibilities.

Objectives, Scope, and Methodology

Management has the responsibility for

- preparing the Principal Financial Statements in conformity with applicable accounting principles,
- establishing and maintaining internal controls and systems to provide reasonable assurance that the broad control objectives of FMFIA are met, and
- complying with applicable laws and regulations.

In undertaking our audit of IRS, we planned to conduct an audit of its Principal Financial Statements and of internal controls over safeguarding of assets, assuring material compliance with budget authority and with laws and regulations we considered relevant, and assuring that there were no material misstatements in the Principal Financial Statements. We also planned to test IRS' compliance with laws and regulations we considered relevant. But we did not plan to evaluate all internal controls relevant to operating objectives as broadly defined in FMFIA. For the reasons set forth earlier in this report, we were unable to complete the planned audit work.

As noted above, we were unable to obtain reasonable assurance about whether the Principal Financial Statements are reliable (free of material misstatement and presented fairly in conformity with applicable accounting principles). We were able to evaluate certain internal controls in the following areas; however, due to limitations on the scope of our work, all material weaknesses may not have been detected in these areas:

- cash receipts,
- refund payments,
- tax accounts receivable,
- property and equipment,
- Treasury funds,
- computer general controls, and
- seized assets.

We also obtained an understanding of internal controls over the reliability of performance measures reported in the Overview and Supplemental sections of IRS' report and assessed whether information in the Overview and Supplemental sections was materially consistent with the information in the Principal Financial Statements.

We tested compliance with selected provisions of the following laws and regulations:

- Chief Financial Officers Act of 1990 (Public Law 101-576);
- Federal Managers' Financial Integrity Act of 1982 (Public Law 97-255);
- National Defense Authorization Act for Fiscal Year 1991 (Public Law 101-510); and
- certain laws relating to distribution of excise taxes (26 U.S.C. 9501-9510).

We could not adequately test compliance with the Prompt Payment Act (31 U.S.C. 3901-3907) or with many laws we considered necessary to test because of the previously noted ineffective internal controls and limitations on the scope of our audit. As noted above, the limited tests we were able to perform would not necessarily detect material instances of noncompliance had they occurred.

Except for the limitations on the scope of our work described in this report, our work was done in accordance with generally accepted government auditing standards and OMB Bulletin 93-06, "Audit Requirements for Federal Financial Statements."

Charles A. Bowsher

Charles A. Bowsher
Comptroller General
of the United States

May 28, 1993

Financial Statements

The Department of the Treasury

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Internal Revenue Service

Chief Financial Officer
Annual Report

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Fiscal Year 1992

Overview to the Financial Statements

Internal Revenue Service

Overview to the Financial Statements for the Fiscal Year Ended September 30, 1992

INTRODUCTION

Size and Scope of Operations

In many respects the Internal Revenue Service can be thought of as a multi-billion dollar, highly decentralized and complex corporation. Many people are unaware of the size and scope of the Service's operations as the nation's tax collector, but the numbers are impressive. In FY 1992, IRS operations --

- processed **204 million** tax returns, of which approximately **115 million** (56%) were filed by individual taxpayers,
- processed over **1 billion** information documents (primarily Forms W-2 and 1099),
- received **11 million** returns filed electronically,
- handled **1.7 billion** pieces of paper,
- collected **$1.12 trillion**,
- issued **89 million** refunds totalling **$113 billion**,
- assisted more than **79 million** taxpayers, and
- maintained over **600** offices to serve taxpayers.

To handle operations of this magnitude, the Service managed a budget of $6.7 billion, of which $4.8 billion was spent on salaries and benefits for our employees. We employed nearly 115,000 people worldwide; however, during the peak filing season, that figure jumped to over 130,000. In addition, we continued to invest in our information systems, as evidenced by expenditures of $974 million, including $282 million for initiatives related to our Tax Systems Modernization effort.

These numbers all add up to BIG! Compared to the Fortune 500 companies, in 1991 (the most recent year for which statistics are available) we would have ranked first in total sales (revenue), ahead of General Motors, and twelfth in number of employees, ahead of such industry giants as Westinghouse, Xerox and McDonnell Douglas.

INTERNAL REVENUE SERVICE
Overview to Financial Statements
for the Fiscal Year Ended September 30, 1992

Historical note:

The first IRS Commissioner's Annual Report in 1863 listed 4,000 employees and $41 million in revenue receipts collected from September 1, 1862 to June 30, 1863. In fiscal year 1992, revenue receipts totaled $1.12 trillion and IRS had nearly 115,000 employees.

Highlights of 1992 Operations

The numbers alone don't tell the whole story. Our 1992 operations showed significant progress in many areas. We are very proud that the Ogden Service Center became the first civilian agency to receive the Presidential Award for Quality. This award, the public sector equivalent of the Malcolm Baldridge Award, is given in recognition of outstanding work quality and customer service.

We streamlined our procedures for installment agreements and offers in compromise of tax debts to make these collection tools more accessible and truly viable alternatives for taxpayers who need assistance in meeting their tax obligations. We prepared to bring millions of nonfilers back into the tax system using our nonfiler program strategy which involves all parts of the Service. This strategy combines outreach and assistance for those who need help and reserves enforcement for those who will comply in no other way.

We successfully built momentum for a reduction in the burden of tax administration through efforts such as revamping complex rules for the payroll tax deposit system. Additionally, the telephone tax filing program, Telefile, was such a success during its testing that we are offering this method of filing taxes to a larger taxpayer population.

We began development of a Cost Management System that will enable managers to support their decisions on how best to use resources and improve operations with knowledge and awareness of what it costs them to do business. Our Tax Systems Modernization effort--a fundamental strategy for redesigning tax administration--made major strides with several successful contract awards.

Sometimes developments like these are not easily communicated in financial statements and performance indicators and their importance may be overlooked. But these and other initiatives should be noted because they demonstrate how we are striving toward our Strategic Objectives of Increasing Voluntary Compliance, Reducing Taxpayer Burden, and Improving Customer Satisfaction and Quality-Driven Productivity.

INTERNAL REVENUE SERVICE
Overview to Financial Statements
for the Fiscal Year Ended September 30, 1992

The CFO Act of 1990

We also made significant gains in enhancing financial management in the Internal Revenue Service with the implementation of the Chief Financial Officers (CFO) Act of 1990. The CFO Act represents the most far-reaching financial legislation in nearly 40 years. The IRS is one of the agencies designated by the Act as a pilot for preparing comprehensive financial statements on all funds and having them audited. We fully realize the need for greater management attention to financial management and recognize the extent of our problems, which we have begun to address.

In recognition of the need to be held accountable to our stakeholders and the requirements of the CFO Act, we have prepared the accompanying comprehensive financial statements, with notes, covering fiscal year 1992. The financial statements are intended to be of value to users in making economic, social and political decisions, and in assessing our accountability. They are being audited by the U.S. General Accounting Office. In preparing the formats and note content, professional guidance was obtained from a variety of sources.

The Government Accounting Standards Board (Concept Statement No. 1) states that: "Governmental accountability is based on the belief that the taxpayer has a right to know, a right to receive openly declared facts that may lead to public debate by taxpayers and their elected representatives." Accountability includes a requirement to render an account or explain one's actions to someone else who has the authority to assess performance and to make judgement and take action.

The impact of the audit on our organization, however, goes beyond the finance function. We have begun to look carefully at the underlying financial support throughout the organization. Using audit findings to complement already existing cost-benefit analyses, we are now starting to integrate financial management decisions with decisions regarding our operations (processing tax returns).

Limitations of the Financial Statements

The financial statements have been prepared to report the financial position and results of operations of the Internal Revenue Service, pursuant to the requirements of the CFO Act.

While the statements generally have been prepared from the books and records of the IRS in accordance with the formats prescribed by OMB, they are different from the financial reports used to monitor and control budgetary resources which are prepared from the same books and records.

The statements should be read with the realization that they are for a component of a sovereign entity (the United States Government), that unfunded liabilities reported in the financial statements cannot be liquidated without the enactment of an appropriation, and that the payment of all liabilities other than for contracts can be abrogated by the sovereign entity.

INTERNAL REVENUE SERVICE
Overview to Financial Statements
for the Fiscal Year Ended September 30, 1992

DESCRIPTION OF THE ORGANIZATION

The operations, organization, and locations of the Internal Revenue Service are all organized around the most efficient and effective structure to accomplish our Mission.

MISSION STATEMENT

The purpose of the Internal Revenue Service is to collect the proper amount of tax revenue at the least cost; serve the public by continually improving the quality of our products and services; and perform in a manner warranting the highest degree of public confidence in our integrity, efficiency and fairness.

Who Are We?

The Office of Commissioner of the Internal Revenue was established by act of Congress on July 1, 1862 to assess, levy and collect taxes and to enforce the tax laws through seizure and prosecution. At that time, the revenue was derived primarily from customs duties and taxes on shipping and importations. Congress first received authority to levy taxes on income in 1913 with the passage of the 16th amendment to the U.S. Constitution. Since that time, the nation has depended on the employees of the IRS to collect the necessary monies so that the Federal government can continue to defend, maintain and improve the well-being of our citizens.

In 1952, the Bureau of Internal Revenue was reorganized by Congress and subsequently became known as it is currently titled, the Internal Revenue Service. We are responsible for administering the Internal Revenue Code and related statutes and ensuring compliance with the tax laws, except those relating to alcohol, tobacco, firearms and explosives.

Our Structure

The Internal Revenue Service is headed by the Commissioner who reports to the Secretary of the Treasury. It is the largest bureau of the Department of the Treasury, employing nearly 115,000 people worldwide. We have offices in every major city in the U.S., in U.S. territories, and in 13 international cities. Our organization is designed to allow for maximum decentralization, while providing for uniform interpretation and enforcement of the tax laws and efficient utilization of resources. There are three organizational levels: the National Office, the Regional Offices, and the District Offices and Service Centers.

The National Office, located in Washington, D.C., is the headquarters for IRS. It is responsible for developing nationwide policies and programs for the

INTERNAL REVENUE SERVICE
Overview to Financial Statements
for the Fiscal Year Ended September 30, 1992

administration of the Internal Revenue Code and provides direction to the field organization. The National Office includes the offices of the Commissioner, Deputy Commissioner, Chief Financial Officer, Chief Information Officer, Chief Operations Officer, and the Assistant Commissioners, who are the functional heads for our collection, criminal investigation, employee plans and exempt organizations, examination, finance, human resources, information systems development, information systems management, international, planning and research, procurement, returns processing, and taxpayer services activities. It also includes the offices of the Chief Counsel and Chief Inspector.

The Martinsburg Computing Center, located in Martinsburg, West Virginia, maintains the master files of individual and business tax accounts. The Detroit Computing Center, in Detroit, Michigan, provides various data processing services for the IRS and other Federal agencies.

There are seven Regional Offices, each headed by a Regional Commissioner who is responsible for supervising and evaluating the operations of the District Offices and Service Centers within his/her region. Regional Offices are located in Atlanta, Chicago, Cincinnati, Dallas, New York City, Philadelphia, and San Francisco.

There are 63 District Offices, at least one in each state, that are responsible for providing assistance and service to taxpayers, determining tax liability by examination of tax returns, determining pension plan qualifications, collecting delinquent returns and taxes, and investigating criminal and civil violations of the tax laws.

There are 10 Service Centers which process the millions of tax returns, refunds and related documents through highly automated data processing systems. In addition, the Service Centers maintain accountability records for taxes collected and provide support to the District Offices in the areas of compliance and taxpayer services.

INTERNAL REVENUE SERVICE
Overview to Financial Statements
for the Fiscal Year Ended September 30, 1992

RESULTS OF OPERATIONS

To improve our overall accountability, facilitate making decisions that cut across organizational lines, and provide stronger emphasis to customer service, the Service constantly looks for better ways of doing business. A major challenge confronting us is how to focus our energy and limited resources on the most important opportunities. If we are to focus properly, it is critical to understand that "important" is determined by our customers, the taxpayers.

Core Business Systems

During FY 1992, we embarked on a systems approach to managing which we believe holds great promise: Core Business Systems. Managing within a systems approach will provide the focus for our efforts that we have been seeking. The concept of "Core Business Systems" aids us in creating this focus and in aligning our improvement efforts toward taxpayers. It helps us to break down the walls between functions and look at the Service from a process, rather than a functional or task, perspective. This is an effective business approach which has proven successful in private industry. It will also help us better evaluate the results of our operations.

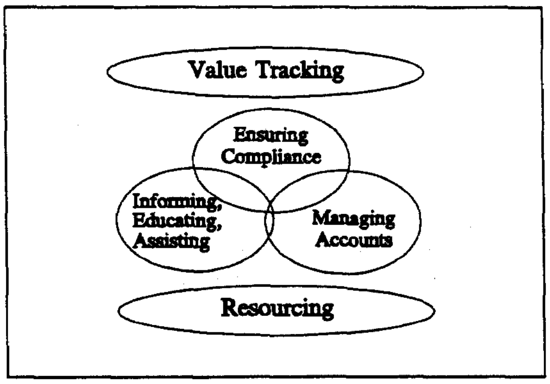
A core system is a series of steps and processes which, when viewed through a horizontal slice across the many functions of IRS, are all integrally important to providing products or services to customers who value them. Core Business Systems uses a top-down approach for identifying, analyzing, and improving major cross-functional Servicewide business systems.

We identified five Core Business Systems that encompass all the activities of the IRS. These core systems support, and are defined by, the Mission Statement:

- **Value Tracking** -- finding out what taxpayers value in the tax administration system.
- **Ensuring Compliance** -- ensuring that taxpayers are complying with requirements of the tax administration system.
- **Informing, Educating and Assisting** -- providing information and assistance to taxpayers to facilitate voluntary compliance with the law and understanding of the tax administration system.
- **Managing Accounts** -- processing routine transactions and providing account and revenue information which is accessible to all authorized customers.
- **Resourcing** -- providing the human, technological, physical, and financial resources to support the tax administration system.

INTERNAL REVENUE SERVICE
Overview to Financial Statements
for the Fiscal Year Ended September 30, 1992

The graphic below depicts the interrelationships of these Core Business Systems:



Performance Measurement

Performance measurement is the hallmark in evaluating the results of operations in a non-profit environment. The "bottom line" for a government organization is, obviously, not profit or loss, but rather the success or failure in accomplishing a mission or delivering a program. Performance measurement, then, is geared to the functions, activities and programs that an organization uses to accomplish its mission or purpose.

The Service measures its performance against the objectives set forth for each of the functions or activities contained in the Core Business Systems. We have used output-related performance measures and other statistics as management tools for many years, mostly to measure the flow of tax returns and related actions (refunds, corrections, assessments, etc.) through the organization. In recent years, we have started adding other factors--qualitative, productivity, and financial--to these measures to produce outcome indicators. These new indicators give us a more complete picture of our performance and help us to better assess our progress in meeting the corporate objectives of increasing voluntary compliance, reducing the burden on taxpayers, and improving customer satisfaction and productivity.

Following are representative performance indicators for each of the Core Business Systems and a discussion of the progress made on each. It is important to note that these 15 indicators are part of a larger body of over 100 used within the Service on a regular basis.

INTERNAL REVENUE SERVICE
Overview to Financial Statements
for the Fiscal Year Ended September 30, 1992

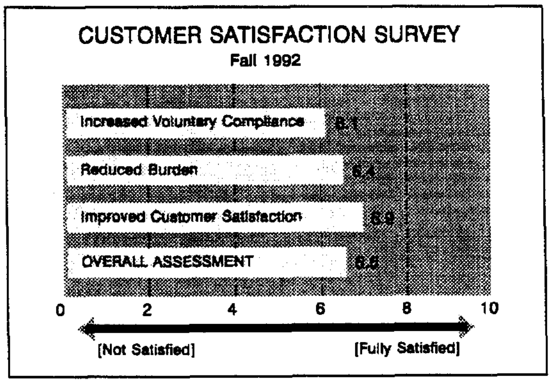
Value Tracking

The objective of the Value Tracking Core Business System is to determine, communicate, and track the extent to which taxpayers value our products and services and to discover new product and service opportunities that will further the IRS Mission. This system applies the concept of net customer value to IRS Core Business Systems. It encompasses the Service's activity related to obtaining information and feedback from taxpayers and building customer value concepts into IRS operating systems and measurements. IRS organizations are the primary internal customer of this Core Business System, with taxpayers and stakeholders regarded as external customers.

Performance Indicator

The performance indicators for the Value Tracking Core Business System are the results of surveys of the U.S. adult population conducted in the spring and fall of 1992. We contracted with a private sector company to conduct these surveys in order to determine how well we are meeting our customers' needs and to aid us in planning future improvements.

Customers were asked to rate the IRS on a scale from one to ten in the following areas: (1) Increased Voluntary Compliance; (2) Reduced Burden; (3) Improved Customer Satisfaction; and (4) Overall Assessment. Through these surveys we determined that the public rates the IRS 6.5, on a 10-point scale, on overall performance. One-third of the respondents gave us an 8, 9, or 10 rating. The results of the survey are shown in the next graphic. There was no statistical difference between the two reporting periods, therefore only the results of the Fall 1992 survey are displayed.



INTERNAL REVENUE SERVICE
Overview to Financial Statements
for the Fiscal Year Ended September 30, 1992

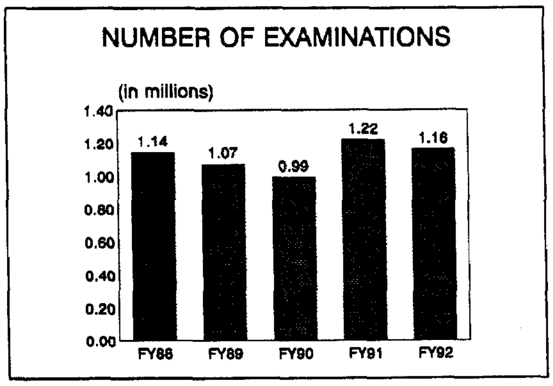
Ensuring Compliance

The objective of the Ensuring Compliance Core Business System is to preserve the integrity of the voluntary tax system by continually measuring compliance behavior, identifying and determining root causes of non-compliance, and taking actions to improve compliance. The system begins with measuring compliance and ends when compliance is confirmed. The programs for this Core Business System are heavily impacted by the philosophies contained in our corporate objectives to increase voluntary compliance and to reduce taxpayer burden.

Performance Indicators

1. *Number of Examinations and Contacts*

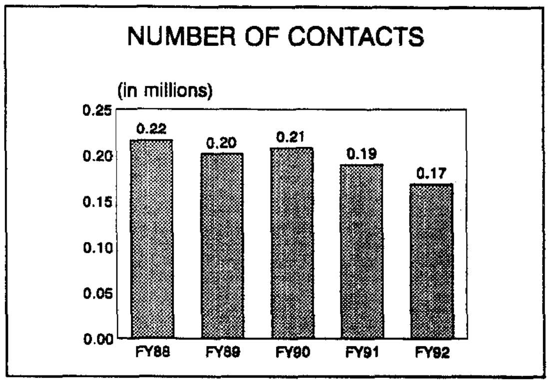
The number of examinations and contacts is an output measure which demonstrates the level of civil enforcement we use in ensuring compliance and is focused primarily on the rate of success we experience in increasing voluntary compliance. The number of examinations and contacts includes the sum of all completed examinations of taxpayer returns and all completed contacts, excluding international examinations, Information Return Program (IRP) notices, excise, employment, and Windfall Profit examinations. Examinations include individual, corporate, fiduciary, partnership, estate, and gift tax return examinations conducted by tax auditors and revenue agents at District Offices and tax examiners in the Service Centers. Contacts are generally made to handle corrections and non-IRP matching investigations conducted by tax examiners in the Service Centers.



During FY 1992, we completed 1.16 million examinations, representing a decrease of 4.9% from FY 1991. The number of contacts during FY 1992 represents a decrease of 10.5% from FY 1991 and 23% from FY 1988. The

INTERNAL REVENUE SERVICE
Overview to Financial Statements
for the Fiscal Year Ended September 30, 1992

reduction in examinations and contacts was largely caused by a reduction of some 250 tax examiner staff years in our Service Centers. This is an indication of our cost effective allocation of resources to ensure compliance.

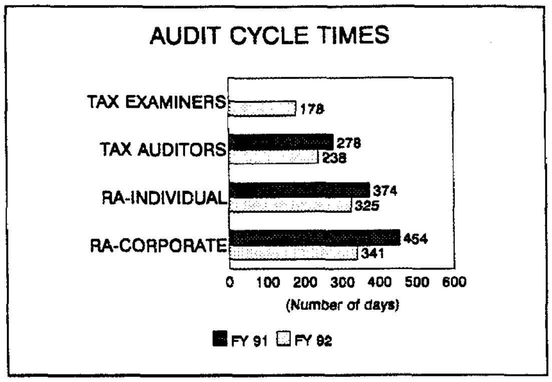


Examinations and contacts continue to be an IRS enforcement mainstay, and a reduction in these would seem to be alarming; however, the tax world has changed dramatically in recent years. We receive from third parties--employers, state tax agencies, and financial institutions--information documents that report income earned, mortgage interest, other interest and dividends, capital gains, and contract fees. There has been a steady increase in the number of information reporting documents we receive and a steady improvement in our ability to match this information electronically against tax returns filed by individuals. This automated information reporting program now covers 90 percent of all income reported by individuals and between 40 and 50 percent of the deductions claimed. It is a critically important supplement to traditional, one-on-one examinations and contacts, and helps to explain how examinations and contacts can decrease while overall audit coverage actually increases.

2. Audit Cycle Time

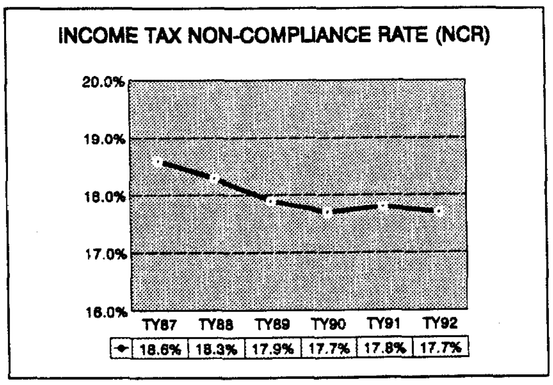
Audit Cycle Time is defined by the average time elapsed between the start of an audit and when the case is closed by the Examination Division. It includes the average days to complete audits and contacts in the Service Centers by tax examiners, audits of individual returns by tax auditors, and audits of individual and corporate returns by revenue agents in the District Offices. Audit Cycle Time is an efficiency measure of our efforts to ensure compliance and an effectiveness measure of taxpayer burden reduction because the period of time a taxpayer is under audit is burdensome and stressful to the taxpayer.

INTERNAL REVENUE SERVICE
Overview to Financial Statements
for the Fiscal Year Ended September 30, 1992



Except for tax examiners, this indicator has been tracked and reported for the last two fiscal years. We have successfully reduced the burden we place on the taxpayer in this area. We report performance in the following categories: Tax Examiners; Tax Auditors; Revenue Agents-Individual; and Revenue Agents-Corporate.

3. Income Tax Non-Compliance Rate



The Income Tax Non-Compliance Rate (NCR) is defined as the percentage of total tax liability for a tax year that is not paid voluntarily. The NCR is one indicator used in the Core Business System "Ensuring Compliance", and is a key

INTERNAL REVENUE SERVICE
Overview to Financial Statements
for the Fiscal Year Ended September 30, 1992

element in measuring the effectiveness of some of our compliance initiatives. Other applications of this rate will allow the IRS to identify and target noncompliant market segments, thereby ensuring the effective allocation of resources and highest rate of return. We are working toward reducing the level of noncompliance by ten percentage points by the year 2000.

INTERNAL REVENUE SERVICE
Overview to Financial Statements
for the Fiscal Year Ended September 30, 1992

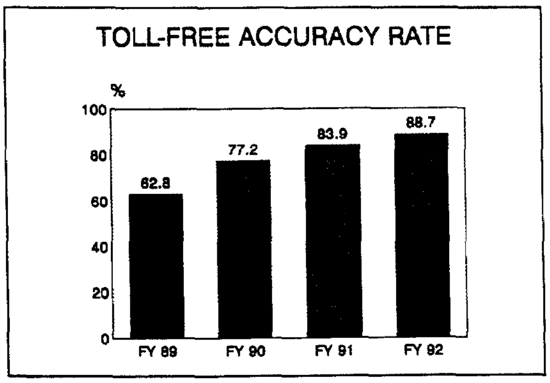
Informing, Educating and Assisting

The objective of the Informing, Educating, and Assisting Core Business System is to enable taxpayers to comply with the tax laws by providing correct, timely and useable information and assistance to all who need it to facilitate not only compliance with the appropriate tax law, but an understanding of the tax system as well. The system begins with the formulation of tax law and/or policy and ends when taxpayers/customers know how, when, why and where to meet the requirements of the tax system. How the IRS implements the initiatives under this Core Business System will have a direct impact on reducing taxpayer burden, increasing voluntary compliance and improving productivity.

Performance Indicators

1. Toll-Free Accuracy Rate

The Toll-Free Accuracy Rate is the percentage of correct responses by Taxpayer Service staff to test inquiries on technical tax law and procedural matters, as measured by the Integrated Test Call Survey System (ITCSS). This indicator measures the efficiency of a major service for customers that contributes to reducing burden and increasing voluntary compliance.



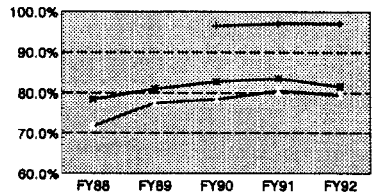
In 1992, the cumulative accuracy rate for toll-free telephone responses regarding tax law, as measured by the ITCSS, was 88.7%, which exceeded our goal of 85%. Questions regarding IRS procedures are also answered, but the accuracy of that information will not be tracked by the ITCSS until FY 1993. In addition to toll-free telephone assistance, we also provided pre-recorded information over toll-free lines on 140 topics. This information is available 7 days a week, 24 hours a day. Almost 68 million calls came in through the two systems in 1992.

INTERNAL REVENUE SERVICE
Overview to Financial Statements
for the Fiscal Year Ended September 30, 1992

2. Processing Accuracy Rate

How accurately we process the tax return data that the customer supplies to us impacts primarily on our objective of reducing the taxpayer's burden. Due to varying levels of complexity, we track and report accuracy rates for two types of returns: "other than full paid" and "full paid". "Other than full paid" include returns where the taxpayer is either due a refund from the IRS or the taxpayer has not paid 100% of their tax liability. In addition, "other than full paid" consist of 1040EZ's, 1040A's, or 1040's with no additional schedules attached, and are thus easier to process. "Full paid" are those returns where the taxpayer is not due a refund and/or has paid 100% of their tax liability.

PROCESSING ACCURACY RATE



	FY88	FY89	FY90	FY91	FY92
ELECTRONIC			96.7%	97.2%	97.2%
OTHER	78.5%	81.0%	82.8%	83.6%	81.6%
FULL PAID	71.8%	77.8%	78.5%	80.8%	79.5%

+ ELECTRONIC * OTHER -- FULL PAID

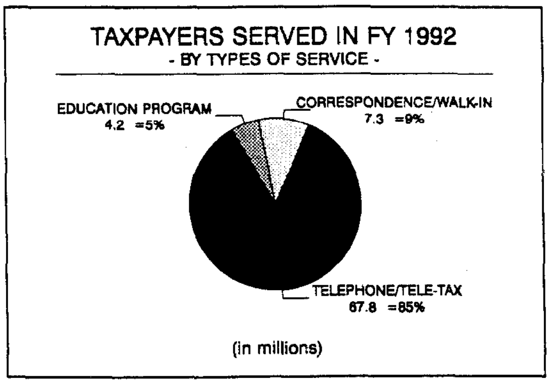
For the last five years, our processing accuracy rate for "other than full paid" returns has been consistently higher than the accuracy rate for "full paid" returns. The accuracy rate of processing "other than full paid" returns has improved from 78.5% in FY 1988 to 81.6% during FY 1992. Our accuracy rate for "full paid" returns has improved by almost eight percentage points over the same time period (71.8% in FY 1988 to 79.5% in FY 1992). Because "full paid" returns are typically more complex (e.g., additional schedules attached to the 1040), there is a higher error rate.

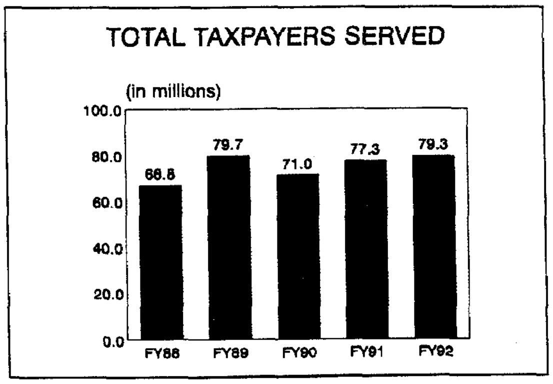
Errors are caused by both the taxpayer and by our employees. However, there is currently no method available for distinguishing the two for reporting purposes. We will attempt to eliminate taxpayer errors by providing additional education and assistance before they file their respective returns, and eliminate employee errors through improved training, technology, and quality programming. Tax form simplification is another initiative on which we are continuously working.

INTERNAL REVENUE SERVICE
Overview to Financial Statements
for the Fiscal Year Ended September 30, 1992

3. Total Taxpayers Served

Taxpayer service is provided in three areas: (1) telephone calls answered (toll-free, non toll-free, and tele-tax calls answered); (2) walk-ins and correspondence (taxpayers visiting IRS offices and correspondence written in response to taxpayer's letters); and (3) taxpayers assisted through IRS education programs, as shown in the following graphic.





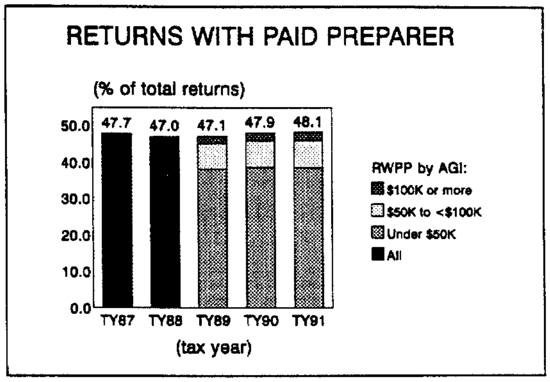
Every year we make special outreach efforts to provide taxpayers with information and training to help them file their returns. We served over 79 million taxpayers in FY 1992, as shown in the above graphic, clearly

INTERNAL REVENUE SERVICE
Overview to Financial Statements
for the Fiscal Year Ended September 30, 1992

demonstrating our commitment in becoming a customer service organization. During the 1992 filing season, we gave presentations on the Earned Income Credit and other topics, and also conducted Small Business Education Workshops to inform businesses of their tax responsibilities, particularly as they pertained to federal tax deposits, record keeping, and employment taxes. Additionally, during the 1992 filing season, more than three million low income, elderly and non-English speaking taxpayers received help filing their tax returns from 79,000 volunteers in the Volunteer Income Tax Assistance (VITA) Program and Tax Counseling for the Elderly (TCE) Program.

4. Returns with Paid Preparer

The percentage of individual returns filed (Form 1040 series) with paid preparer is a good indication of the complexity of tax laws, tax forms, and the instructions we give to the 'average' taxpayer. This performance indicator is a good measure of the amount of burden we place on the taxpayer.



The trend from 1987 to 1991 shows that slightly more taxpayers are turning to paid preparers for assistance in completing their tax returns. In 1991, over 48% of individual returns were filed with a paid preparer, or some 55.7 million individual tax returns. Analysis of the composition of the data can indicate what income levels are being most affected and what factors contributed to the cause. For example, in 1989, 1990 and 1991 (the only years for which data is currently available) slightly more than 80% of the returns filed with paid preparers were for taxpayers with less than $50,000 of Adjusted Gross Income. Knowing how different groups of taxpayers are burdened helps us direct outreach and assistance efforts, design tax forms (the 1040EZ form was designed to reduce the burden on a specific group of taxpayer) and develop appropriate regulations.

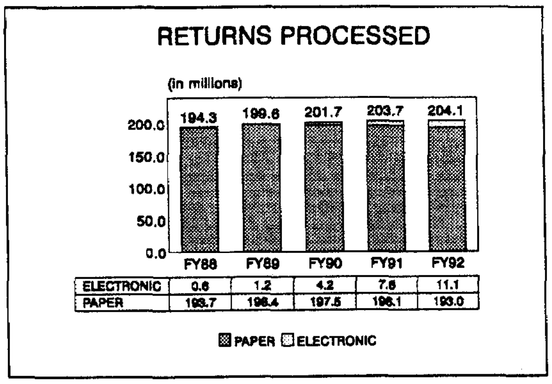
INTERNAL REVENUE SERVICE
Overview to Financial Statements
for the Fiscal Year Ended September 30, 1992

Managing Accounts The objective of the Managing Accounts Core Business System is to process routine transactions and provide for the creation, maintenance and security of accurate account and revenue information which is accessible to all authorized customers. The system begins with customers supplying tax returns, information documents and payments, and ends when customers no longer have use for the information. The programs for this Core Business System are largely Service Center oriented, dealing mainly with the processing of tax returns through the "pipeline" of the Service Center.

Performance Indicators

1. Returns Processed

The number of tax returns filed with our Service Centers is a measure of a major process relative to the accomplishment of our mission. "Returns processed" includes both paper and electronic returns, and "paper returns" includes supplemental returns (amended returns and extensions for both 1040's and 1120's). During FY 1992, we processed 204.1 million tax returns, an increase of .2% over FY 1991 and an increase of 5% or 9.8 million returns over the last five years. Of the total tax returns processed in FY 1992, 56% or 115 million were individual returns and the remaining 44% were corporate, partnership, excise tax, employee plans and exempt organizations, various types of employment tax, and estate and gift tax returns.



	FY88	FY89	FY90	FY91	FY92
ELECTRONIC	0.6	1.2	4.2	7.6	11.1
PAPER	193.7	198.4	197.5	196.1	193.0

Currently, five of the ten Service Centers process electronically filed tax returns (ELF), while all Service Centers process a wide variety of paper returns. The ELF program allows taxpayers to provide tax return information to a third party processor, usually a tax return preparer, who transmits the information to the IRS

INTERNAL REVENUE SERVICE
Overview to Financial Statements
for the Fiscal Year Ended September 30, 1992

through a computer linkage. During FY 1992, 11.1 million or 5.3% of all returns filed with the IRS were ELF returns. The chart also shows that we have turned the corner on processing of paper tax returns. Since 1989, the second year of the ELF program, the number of paper returns filed has decreased while total returns have increased due to the increase in ELF returns.

The error rate for ELF returns is 2% (compared to 15% for paper returns), and refunds are received within 2-3 weeks (compared to 6 or more weeks for paper returns). This means less burden on taxpayers because they have fewer problems caused by errors on their return and greater customer satisfaction because they get their refunds faster. It also means cost savings for IRS because of the lower error rate. For the 1992 filing season, we accepted ELF balance-due returns for the first time in a fully operational mode. We project that over 20 million taxpayers will file electronically by 1994.

2. Processing Cycle Time (Refunds and Adjustments)

The amount of elapsed time between the receipt of the return and the refund issue date defines processing cycle time for refund timeliness. The amount of elapsed time between the initiation of the adjustment and the closing of the case by the tax examiner defines processing cycle time for adjustment timeliness.

Because the length of the processing cycle time has an impact on reducing the burden on the taxpayer, the IRS strives to keep the processing cycle time to a minimum. During FY 1992, the average days from receipt of a return (both individual and business) in the mail room to the date a refund check was issued was 37 days. The refund baseline is 40 days. The average time from initiation of an adjustment to the time the case was closed by the tax examiner was 31 days for FY 1992.

We are also improving the timeliness, quality and consistency of correspondence processing. Our goal is to close 65% of all correspondence cases within 30 days from the date the case is initiated, and if a final response is not sent to a taxpayer within 30 days, an interim letter explains the reason for the delay. This letter also provides an expected final response date and an IRS contact person and telephone number so the taxpayer can call for additional information. Accurate and timely handling of correspondence will reduce case rework and repeats, thereby reducing the burden of taxpayers having to make additional inquiries, and will reduce the burden on taxpayers of dealing with additional notices.

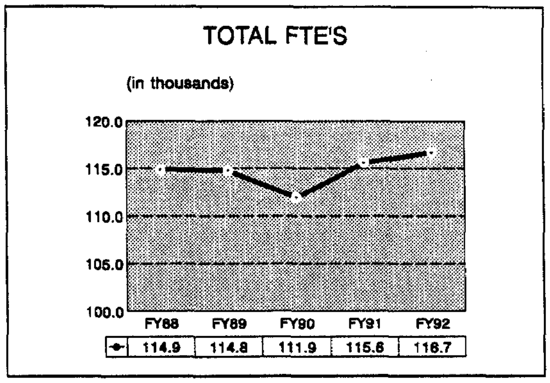
INTERNAL REVENUE SERVICE
Overview to Financial Statements
for the Fiscal Year Ended September 30, 1992

Resourcing

The objective of the Resourcing Core Business System is to timely obtain, develop and maintain quality human, technological, physical, and financial resources which enables the Service to provide the best customer value. The focus of this core system begins with the identification of current and future customer needs and ends when the customer is satisfied with the value provided.

Performance Indicators

1. Total Full Time Equivalents (FTE's)

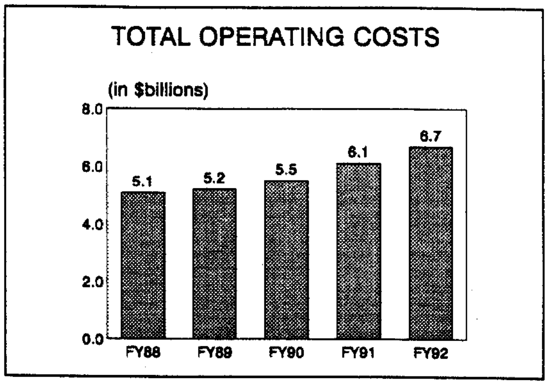


Total FTE's, or staff years, indicates the level of staffing that goes along with total budgeted operating costs shown below. When considered with other performance indicators, it is a good macro-level indicator of the level of productivity the Service is achieving in accomplishing its mission. These are direct FTE's and do not include any reimbursables or overtime. Over the past five years, the level of staffing has been relatively constant. For FY 1992, we realized 116,673 direct FTE's, an increase of 0.90% over FY 1991. From FY 1988 to FY 1992, the increase is 1.6% or 1,800 FTE's.

2. Total Operating Costs

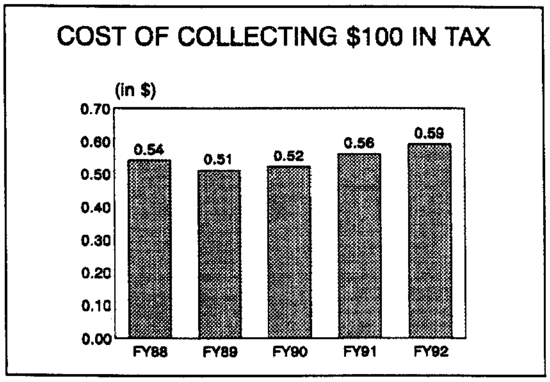
Total budgeted operating costs are the current year appropriations available to expend on the salaries, goods and services necessary to accomplish our activities for the current year. Our operating costs have increased by 30.6% ($1.6 billion) from FY 1988 to FY 1992; however, much of this increase is attributable to mandatory pay increases and to investments in modernization (Tax Systems Modernization alone accounts for approximately 31% of the $1.6 billion increase).

INTERNAL REVENUE SERVICE
Overview to Financial Statements
for the Fiscal Year Ended September 30, 1992



3. Total Tax Collected Compared to Total Operating Costs

This is a traditional macro-level indicator we use to measure our overall mission accomplishment. While budgeted operating costs have increased since FY 1988 by some 30.6%, collections have increased by only 20.5% ($191.8 billion) over the same period of time. This has increased our cost of collecting $100 from $0.54 in FY 1988 to $0.59 in FY 1992, an increase of 9.3%. We believe that this increase is exacerbated by the recent recession and difficult economic times. We are also building for the future through capital investments in Tax Systems Modernization that will benefit the Service and taxpayers into the next century.



INTERNAL REVENUE SERVICE
Overview to Financial Statements
for the Fiscal Year Ended September 30, 1992

RESULTS OF FINANCIAL MANAGEMENT

FY 1992 Budget

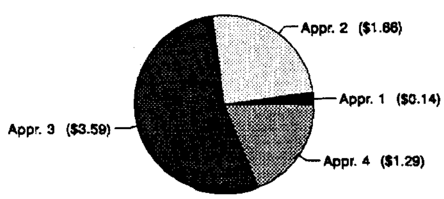
The Service received an operating budget of $6.68 billion for FY 1992, which includes the *Hurricane Andrew Relief Fund* authorized by Congress late in the fiscal year. In addition, funding for other purposes (non-operating) was provided, as explained later in the Overview.

The Service's operating budget consists of the following four Congressional appropriations:

#1 - Administrative and Management Appropriation,
#2 - Processing Tax Returns and Assistance Appropriation,
#3 - Tax Law Enforcement Appropriation,
#4 - Information Systems Appropriation.

The dollars associated with these appropriations are shown in following graphic. The funds allocated for the Tax Systems Modernization effort, $296.8 million, are included in Appropriation 4.

FY 1992 BUDGET
By Appropriation
(in $billions)



Tax Systems Modernization (TSM)

Tax Systems Modernization is not just a matter of automating manual processes, but rather embracing technology to leverage change throughout the organization. TSM involves changing the way we do business, changing the way we interact with our customers, and improving the efficiency of our operations. Restructuring the business of IRS with the support of technology will allow us to significantly reduce taxpayer burden, improve voluntary compliance, achieve quality-driven productivity gains and increase revenue.

INTERNAL REVENUE SERVICE
Overview to Financial Statements
for the Fiscal Year Ended September 30, 1992

TSM is well under way and already producing measurable benefits. Taxpayers are receiving faster and more accurate service, tax account issues are resolved more efficiently, and IRS case workers have improved access to information needed to perform daily tasks. Electronic filing and TeleFile provide alternative ways to file tax returns. We can now control and associate taxpayer correspondence so that timely IRS responses address all issues raised by the taxpayer and IRS. New business concepts like Compliance 2000 and one-stop service enable us to tailor up-front education and assistance to market segments and provide better service on the back-end as well. The section on Supplemental Financial and Management Information in this report includes a detailed discussion of TSM initiatives and associated expenditures during fiscal year 1992.

Automated Financial System (AFS)

For several years, IRS has been working towards a single integrated financial management system as required by OMB Circular A-127. The new system, called the Automated Financial System (AFS), is an off-the-shelf software product called Federal Financial System and includes modifications specified by the Service. AFS will provide a fully integrated budget and accounting process, including general ledger (the Standard General Ledger is incorporated), budget execution, planning, accounts receivable, disbursements, accounts payable, document tracking, purchasing, travel, and project cost accounting. Features include daily updates of accounting and budget information, commitment accounting, increased online query, online status of funds, and funds control. The system will also interface with the payroll system, Travel Reimbursement and Accounting System (TRAS), Program for Relocation Information and Moving Expenses (PRIME), and the Procurement Network (PRONET). The integration of AFS is planned to be completed by December 1996.

The AFS software is installed on computers in the Detroit Computing Center. The accounting module was implemented in Central Region during FY 1991, in the National Office in FY 1992, and in all remaining offices on October 1, 1992. The budget execution module was implemented in all offices on October 1, 1992. Full implementation of this system is a major step toward improving financial management within the Service because it will enhance the Service's ability to provide timely and accurate financial data for both internal and external users.

Cost Management

The IRS is developing a Cost Management System that will enable managers to support their decisions on how to best use resources and improve operations with knowledge and awareness of what it costs to do business. This system is centered on the principles of activity-based management (ABM), and will be integrated with the existing AFS accounting/budgeting system, TIMIS-PC TARE timekeeping system, and existing operational workload management systems. In the private sector, this method is used to help businesses focus internally and determine whether their methods of doing business are the "best" ways. ABM concentrates on managing activities without organizational boundaries, versus the

INTERNAL REVENUE SERVICE
Overview to Financial Statements
for the Fiscal Year Ended September 30, 1992

traditional vertical approach of managing by function and organization. An activity-based (horizontal) view focuses on a product/process orientation as the method to improve the value of the services provided to customers by maximizing operational efficiency and effectiveness.

The Cost Management System being developed builds on historical cost data by integrating workload, performance measurement, and financial data to improve products and processes. This ultimately provides value-added quality, and cycle time analysis that external and internal customers demand. The framework of the system represents an exciting change to the traditional finance paradigm.

The Cost Management System prototype is being conducted in the Cincinnati Service Center and will be expanded to the Seattle, Baltimore and Boston offices during FY 1993. The design is scheduled for completion in September 1994, with a two-year Servicewide implementation beginning in December 1994. Implementation of the system will help drive changes within IRS needed to meet the three Strategic Objectives: increasing voluntary compliance, reducing taxpayer burden, and improving quality-driven productivity and customer satisfaction.

Accounts Receivable

The growth of accounts receivable has been a concern since the mid-1980s. Reasons for the continued growth include growth in returns filed, the economy and inflation, increases in bankruptcy and litigation cases, improved examination document matching and substitute for return programs, the extended collection statute and declining enforcement staffing levels. Collections against receivables, however, have remained relatively constant over the last five years.

The Office of Management and Budget indicated in the FY 1992 President's Budget that the IRS accounts receivable collection program was a high risk area and expressed reservation about the adequacy of the program's progress and plans. Because of the enormous size and complexity of tax receivables, this area has been the focus of efforts to introduce new accounting principles, practices and systems wherever appropriate.

There are several major issues with tax receivables and the allowance for doubtful accounts that the Service is working to resolve. These were recently highlighted in the GAO report on their audit of tax receivables at June 30, 1991. At the date of their audit work, GAO found systems deficiencies and other inherent problems that overstated net tax receivables at June 30, 1991, and would adversely impact the FY 1992 statements if left uncorrected. At GAO's suggestion, IRS valued the reported collectibility of receivables by examining a sample of 2,600 accounts. We have also made progress in correcting the other deficiencies noted in the report.

INTERNAL REVENUE SERVICE
Overview to Financial Statements
for the Fiscal Year Ended September 30, 1992

We will continue to aggressively address accounts receivable. Our projections, however, indicate accounts receivable will continue to grow, albeit at a reduced rate. We believe that our present initiatives, coupled with significant growth in resources dedicated to the prevention and collection of delinquent accounts receivable, are essential components of an effective strategy for collecting monies owed to the Federal government.

Prompt Payment

The Prompt Payment Act is a legislative directive for sound financial management. It directs federal agencies to pay invoices on time, to pay interest penalties when payments are late and to take discounts only when payments are made within the discount period. In FY 1992, we paid $673,000 in interest on 17,000 late payments (5%) out of 350,000 subject to the Prompt Payment Act.

We have taken several steps to improve on our payment processes and greatly reduce late payments. Conversion to AFS will improve the Service's performance by warehousing invoices to ensure timely payment. Also, the accuracy of this performance measurement will be improved by the inclusion of actual data rather than estimates derived from statistical sampling. The Controller appealed to field and National Office executives to be more diligent in following the guidelines for prompt payment of invoices, and follows up weekly to evaluate progress in this area. He also set up a Prompt Pay Task Force to study the various payment processes used by the Service to identify procedures and mechanisms that need to be added, streamlined, or eliminated. Correction of our prompt payment problems is a high priority for senior level managers in IRS.

Interpretation of Financial Statements

The following analysis seeks to impart to the reader a high level understanding of the reporting environment of the Service. In addition, this discussion seeks to assist the reader in interpreting the financial statements and footnotes.

Assets

Asset classes should be viewed as falling into one of two broad asset categories. The first category of assets relates to resources which are managed on behalf of the government. These resources are not available for use in internal operations of the Service. Essentially, these resources relate directly to the collection aspect of the Service. Currently, this category is comprised of Federal tax receivables, funds with the Treasury available for the payment of tax refunds, seized property and monies and revolving fund assets. These assets are designated as *Custodial Assets* in the Statement of Financial Position. The fiscal year 1992 financial statements report approximately $23.2 billion of custodial assets, composed primarily of federal tax receivables.

The second broad category of assets relates to those resources more commonly appearing in the statements of other federal entities. These resources do not relate directly to the collection effort as do Custodial Assets. These assets are referred to as *Operating Assets*. As of September 30, 1992 approximately $1.4 billion of

INTERNAL REVENUE SERVICE
Overview to Financial Statements
for the Fiscal Year Ended September 30, 1992

operating assets were reported, comprised primarily of funds with U.S. Treasury, and receivables from other federal entities.

Operating assets are further categorized on the statement of financial position as "financial resources" or "non-financial resources". All operating assets, with the exception of inventory are classified as financial resources.

Liabilities

As with assets, liabilities are also divided into custodial and operating categories on the statement of financial position. It is easy to conceptualize custodial liabilities if one thinks of these liabilities as offsetting many of the custodial assets. For example, the tax receivable asset is offset by a liability (due to U.S. Treasury, tax receivables) thus designating that the receivable is "due to" the Treasury upon collection. Seized properties and monies are also offset by a corresponding custodial liability.

As with operating assets, operating liabilities relate to the non-collection aspect of the Service. Operating liabilities are comprised of payables, accrued payroll and benefits and liabilities for deposit funds. In addition, unfunded liabilities for annual leave and contingencies are included.

Net Position

Net Position sections on the Statement of Financial Position reflect the difference between assets and liabilities. This section corresponds roughly to the equity section of conventional balance sheets, as it portrays the "equity" that federal stakeholders (taxpayers, elected officials, etc.) have in the entity. However, unlike conventional balance sheets, this "equity" is comprised of unexpended appropriations i.e. budget authority available at fiscal year end which has not yet been expended for goods and services or future funding requirements.

As with the assets and liabilities described above, a net position section is separately presented for custodial and operating categories. In this manner, the custodial and operating categories are self-balancing, essentially producing separate statements of financial position for the custodial and operating aspects of the Service.

The custodial net position is comprised of unexpended appropriations relating to funds with the Treasury available for the payment of refunds and revolving fund disbursements. In addition, future funding requirements, which represent future appropriations required to meet current accruals, are included. The operating net position is also comprised of unexpended appropriations. Also, the operating net position is comprised of invested capital, which offsets the inventory amounts, and future funding requirements. The fiscal year 1992 future funding requirements are comprised primarily of unfunded annual leave.

INTERNAL REVENUE SERVICE
Overview to Financial Statements
for the Fiscal Year Ended September 30, 1992

Collections and Transfers

The Statement of Collections and Operations presents fiscal year activity relating to both Service collection activity as well as appropriations received and expended for goods and services used in internal operations.

As the nation's tax collector, collection of all revenue and related transfers to the Treasury are presented to sufficiently disclose all financial activity relating to the Service. No portion of Service collections are retained by the Service, but rather, are transferred to the Treasury. Service collections are comprised primarily of individual and business as well as excise, FICA and federal unemployment taxes. Collections are also comprised of reimbursement payments, which represent fees for services to the public and other federal agencies. Such collections are also transferred to the U.S. Treasury.

Financing Sources and Operating Expenditures

Financing sources reflect appropriations received and actually expended on goods and services received by the Service. Operating expenditures reflect all expenses incurred by the Service during the fiscal year, including the purchase of fixed assets and supplies.

Principal Financial Statements

Department of the Treasury

Internal Revenue Service

Principal Financial Statements

Fiscal Year 1992

Statement of Financial Position

Department of the Treasury
Internal Revenue Service
Statement of Financial Position
As of September 30, 1992

Dollars in Millions	
Custodial Assets *(managed on behalf of the federal government, not available for use in internal operations)*	
Federal tax receivables, net (Note 2)	$21,564
Funds with U.S. Treasury (Note 3)	768
Revolving fund assets (Note 4)	10
Other custodial assets (Note 5)	37
Seized property and monies (Note 6)	797
Total Custodial Assets	**$23,176**
Operating Assets *(relating to internal operations, funded by Congressional appropriations)*	
Financial Resources	
Funds with U.S. Treasury and cash (Note 3)	$1,138
Receivables, non-federal	14
Advances and prepayments, non-federal	19
Intragovernmental items:	
Receivables, federal	167
Advances and prepayments, federal	49
Total Financial Resources	**1,387**
Non-Financial Resources	
Property and equipment (Note 7)	
Inventory	8
Total Non-Financial Resources	**8**
Total Operating Assets	**$1,395**

The accompanying notes are an integral part of these statements.

Department of the Treasury
Internal Revenue Service
Statement of Financial Position
As of September 30, 1992

Dollars in Millions	
Custodial Liabilities *(offsets Custodial Assets)*	
Due to U.S. Treasury	$21,601
Other custodial liabilities (Note 8)	2,883
Seized property and monies (Note 6)	797
Commitments and contingencies (Note 9)	
Total Custodial Liabilities	**25,281**
Custodial Net Position *(offsets Custodial Assets)*	
Unexpended appropriations	215
Unexpended appropriations, revolving fund (Note 4)	10
Less: Future funding requirements (Note 10)	(2,330)
Total Custodial Net Position	**(2,105)**
Total Custodial Liabilities and Net Position	**$23,176**
Operating Liabilities *(relating to internal operations)*	
Funded Liabilities	
Accounts payable, non-federal (Note 3)	$349
Deposit funds	12
Accrued payroll and benefits	283
Payables, federal	25
Total Funded Liabilities	**669**
Unfunded accrued annual leave (Note 10)	294
Unfunded commitments and contingencies (Notes 9 and 10)	9
Total Operating Liabilities	**972**
Operating Net Position *(relating to internal operations)*	
Unexpended appropriations (Note 11)	718
Invested capital	8
Less: Future funding requirements (Note 10)	(303)
Total Operating Net Position	**423**
Total Operating Liabilities and Net Position	**$1,395**

The accompanying notes are an integral part of these statements.

Statement of Collections and Operations

Department of the Treasury
Internal Revenue Service
Statement of Collections and Operations
For the Year Ended September 30, 1992

Dollars in Millions		
Collections and Transfers		
Collections of federal revenue (Note 12)		
Income taxes	$665,367	
Estate and gift taxes	11,479	
Excise taxes	33,565	
Employment taxes	398,727	
Penalties and interest	11,662	$1,120,800
Revolving fund sales (Note 4)		6
Other		322
Total Collections		**1,121,128**
Less: Refunds and other payments (Note 12)	113,108	
Revolving fund costs (Note 4)	6	(113,114)
Net Collections		**1,008,014**
Less: Net transfers to Treasury (Note 12)		(1,008,014)
Excess of Net Collections over Net Transfers to Treasury		**$0**

The accompanying notes are an integral part of these statements.

Department of the Treasury
Internal Revenue Service
Statement of Collections and Operations (continued)
For the Year Ended September 30, 1992

Dollars in Millions	
Financing Sources	
Appropriations expended	$6,163
Reimbursements, public	2
Reimbursements, intragovernmental	115
Other receipts	54
Less: Receipts transferred to Treasury	(54)
Total Financing Sources	**6,280**
Operating Expenditures	
Administration and management	119
Processing tax returns and assistance	1,613
Tax law enforcement	3,563
Information systems	974
Total Operating Expenditures	**6,269**
Excess of Financing Sources over Operating Expenditures	**11**
Less: Adjustment for Net Unfunded Expenses	(11)
Excess of Financing Sources Over Funded Expenses	**$0**

The accompanying notes are an integral part of these statements.

Statement of Cash Flows for Appropriated Funds

Department of the Treasury
Internal Revenue Service
Statement of Cash Flows for Appropriated Funds
As of September 30, 1992

Dollars in Millions	
Cash Flows From Financing Activities	
Appropriations received (Note 13)	$6,680
Reimbursements	117
Net Cash Provided by Financing Activities	6,797
Cash Flows Used for Operating Activities	
Funded Expenses	6,280
Adjustments Affecting Cash Flow	
Increase in receivables	78
Decrease in advances and prepayments	(48)
Decrease in funded liabilities	241
Net Cash Used for Operating Activities	6,551
Net Cash Provided by Operating and Financing Activities	246
Funds with U.S. Treasury and Cash, Beginning	892
Funds with U.S. Treasury and Cash, Ending (Note 3)	$1,138

The accompanying notes are an integral part of these statements.

Statement of Budget and Actual Obligations

Department of the Treasury
Internal Revenue Service
Statement of Budget and Actual Obligations
For Fiscal Year Ended September 30, 1992

Dollars in Millions

Program Name	Total Budget Authority	Obligations Incurred
Executive Direction	$13	$13
Procurement	3	3
Planning and Research	13	13
Finance	18	18
Human Resources	9	8
Internal Audit and Internal Security	90	90
Returns Processing	954	949
Statistics of Income	23	23
Taxpayer Services	296	296
Tax Fraud and Financial Investigations	336	333
Examination	1,352	1,351
Employee Plans and Exempt Organizations	120	120
International	45	45
Collection	771	770
Document Matching – Returns Processing/Collections	91	91
Appeals and Legal Services	362	361
Processing and Services	12	12
Compliance and Enforcement	20	20
Tax Systems Modernization	39	39
Information Systems Management	447	438
Information Systems Development	306	203
Training	60	59
Information Systems Support	425	350
Standard Level Users Charge	476	476
Support and Resources Management	578	572
Section 523A Travel Reduction	9	0
Total	$6,868	$6,653

Total Obligations Incurred	$6,653
Add: September 30, 1991 Undelivered Orders	170
Unreconciled Variance	3
Less: September 30, 1992 Undelivered Orders (Notes 9 and 11)	(534)
Adjustment for Net Unfunded Expenses	(11)
Deobligation of Prior Year Funds	(12)
Total Operating Expenditures	$6,269

The accompanying notes are an integral part of these statements.

Notes to Principal Financial Statements

INTERNAL REVENUE SERVICE
Notes to Principal Financial Statements
for the Fiscal Year Ended September 30, 1992

Note 1. Significant Accounting Policies

A. Reporting Entity

The Internal Revenue Service (the Service) is a bureau of the U.S. Department of the Treasury (Treasury). The Service was created in 1862 when the Congress established the Office of the Commissioner of the Internal Revenue. In 1952 the Bureau was reorganized by the Congress and in 1953 became the Internal Revenue Service.

The mission of the Service is to collect the proper amount of tax revenue at the least cost; serve the public by continually improving the quality of its products and services; and perform in a manner warranting the highest degree of public confidence in Service integrity, efficiency and fairness.

In fulfilling its mission, the Service maintains a variety of appropriated, trust and revolving funds. The accompanying principal financial statements of the Service include the accounts of all funds under Service control. All intra-agency balances and transactions have been eliminated. In addition, amounts relating to the GSA Building Delegation Allocation Account have been excluded from these financial statements.

B. Accounting Standards

Fiscal year 1992 is the first year that the Service has prepared principal financial statements in accordance with the Chief Financial Officers Act of 1990 (CFO Act). This legislation mandated changes in financial management and reporting in federal agencies, including the preparation of principal financial statements with footnotes.

In October 1990, principals of the Joint Financial Management Improvement Program (JFMIP) established the Federal Accounting Standards Advisory Board (FASAB) to consider and recommend accounting standards for the federal government. In March, 1991 the FASAB issued interim guidance on accounting standards, recommending that federal agencies prepare financial statements using applicable standards, including those currently in effect within the agency.

Except as noted below, guidance in the preparation of financial statements and notes was obtained primarily from the Office of Management and Budget (OMB) Bulletin No. 93-02, *Form and Content of Agency Financial Statements*. Additional guidance was obtained from Service policy and procedure manuals. Financial statements prepared in accordance with this guidance are considered to be statements prepared on a comprehensive basis of accounting other than generally accepted accounting principles.

INTERNAL REVENUE SERVICE
Notes to Principal Financial Statements
for the Fiscal Year Ended September 30, 1992

Note 1. Significant Accounting Policies (continued)

C. Basis of Accounting

Federal revenue is reported on the cash basis of accounting, i.e. when remittances are received. Refunds are also reported on the cash basis of accounting. Tax receivables and an offsetting liability to the U.S. Treasury are presented in the Statement of Financial Position to more accurately present the financial position of the Service; however, this treatment has no effect on tax revenues reported in the Statement of Collections and Operations. Liabilities for the refund of tax payments are not accrued until related tax returns are filed.

The current fiscal year acquisition cost of all property, equipment and supplies are reported within operating expenditure categories in the Statement of Collections and Operations. Appropriations are expended in amounts equal to these property and equipment expenditures. Property and equipment are not depreciated. The acquisition cost for property and equipment has not been capitalized and reported in the Statement of Financial Position. Rather, the acquisition cost for selected property and equipment is reported in Note 7 only.

All other transactions are recorded on the accrual basis of accounting. Under this method, revenues and financing sources are recognized when earned and expenses are recognized when incurred, without regard to the receipt or payment of cash. Appropriations are recognized as a financing source upon the incurrence of the related expense, i.e. when the appropriation is expended. Reimbursements are recognized as a financing source as the related reimbursable costs are incurred.

Operating expenditures in the Statement of Collections and Operations are presented by appropriation rather than object class.

D. Custodial Assets and Liabilities

Current guidance recommends that assets be reported in "Financial" or "Non-Financial" categories. However, due to the nature and amount of specific assets, and to more accurately present the financial position of the Service, an additional category was created. This category, entitled "Custodial Assets", presently includes federal tax receivables, funds for the payment of refunds, assessments and other resources. These custodial assets total $23.2 billion. In contrast, the financial and non-financial assets currently reported total approximately $1.4 billion.

The custodial assets are offset by a separate "custodial" net position category to further highlight the effect these resources have on the financial position of the Service. In addition, an unfunded custodial liability for advance payments is offset by a future funding requirement in the custodial net position section.

INTERNAL REVENUE SERVICE
Notes to Principal Financial Statements
for the Fiscal Year Ended September 30, 1992

Note 1. Significant Accounting Policies (continued)

E. Operating Assets and Liabilities

Financial and Non-Financial Resources of the Service are presented on the Statement of Financial Position as "Operating Assets".

Funded and unfunded liabilities of the Service, outside the realm of custodial liabilities, are presented as "Operating Liabilities". A separate "Operating Net Position" section is also provided to further delineate operating and custodial aspects of the Service.

F. Budgets and Budgetary Accounting

Financing sources are provided through congressional appropriations on an annual, multi-year and no-year basis. Appropriations are used to finance operating expenses and purchase property and equipment as specified by law. Appropriations are also received to meet program obligations, including payments on the earned income tax credit and interest on tax refunds.

A permanent, indefinite appropriation, which does not require consideration by Congress during the annual appropriation process, is available for the payment of tax refunds.

G. Federal Tax Receivables

Federal tax receivables are comprised primarily of taxes, penalties and interest assessed under provisions of the Internal Revenue Code which remain uncollected at September 30, 1992. Accrued interest and penalties are also included. The balance reported is net of estimated uncollectible amounts. At GAO's recommendation, IRS valued the reported collectibility of receivables by examining a sample of 2,600 accounts. As a custodial asset, federal tax receivables are offset by a corresponding custodial liability, which represents the amount of receivables transferable to the U.S. Treasury upon collection.

H. Funds With U.S. Treasury - Custodial

This custodial asset is comprised primarily of the undisbursed amount remaining under a warrant received for the payment of tax refunds. The balance is comprised of appropriations received for the payment of interest on tax refunds and earned income credit payments.

The payment of tax refunds is based on a permanent, indefinite appropriation as contained in 31 U.S.C. 1324. However, as with other appropriations, actual authority for payment is contingent upon the execution of a warrant. Consequently, the undisbursed balance remaining under this warrant was deemed to best represent those funds with the U.S. Treasury available for the payment of tax refunds.

INTERNAL REVENUE SERVICE
Notes to Principal Financial Statements
for the Fiscal Year Ended September 30, 1992

Note 1. Significant Accounting Policies (continued)

I. Funds With U.S. Treasury and Cash - Operating

This line item, included within the "Operating Asset" category, is comprised primarily of funds available at the U.S. Treasury to meet authorized operating liabilities and other purchase commitments of the Service.

J. Advances and Prepayments

Payments in advance of the receipt of services are reported as prepaid charges at the time of prepayment and recognized as expenses when the related services are received.

K. Property and Equipment

The land and buildings occupied by the Service are provided by the General Services Administration (GSA). GSA charges the Service a Standard Level Users Charge (SLUC), which approximates commercial rental rates for similar properties. Additions to property and equipment, costs for leasehold improvements, and operating and capital leases are expensed as payments are made.

L. Inventory

The inventory of the Service is comprised of unissued supplies that will be consumed in future operations. The inventories on hand at year end are stated at the lower of cost (using the first-in, first-out method) or market value. The recorded values are adjusted for the results of physical inventories taken at fiscal year end. Expenditures are recorded upon consumption of the inventory by the Service.

M. Leave and Retirement Plans

Annual leave is accrued as it is earned and reduced as it is taken. Each year, the balance in the accrued annual leave account is adjusted to reflect current rates. Funding for accrued annual leave will be expended when the leave is taken in the future. Sick leave and other types of nonvested leave are expended as taken.

Most employees hired before January 1, 1984 participate in the Civil Service Retirement System (CSRS), to which the Service makes matching contributions equal to approximately 7 percent of pay.

The Service does not report CSRS assets, accumulated plan benefits or unfunded liabilities, if any, applicable to its employees. Reporting such amounts is the responsibility of the Office of Personnel Management.

INTERNAL REVENUE SERVICE
Notes to Principal Financial Statements
for the Fiscal Year Ended September 30, 1992

Note 1. Significant Accounting Policies (continued)

On January 1, 1984, the Federal Employees Retirement System (FERS) went into effect pursuant to Public Law 99-335. Most employees hired after December 31, 1983, are automatically covered by FERS and Social Security. Employees hired prior to January 1, 1984, could elect to join FERS and Social Security or remain in CSRS. A primary feature of FERS is that it offers a savings plan to which the Service automatically contributes 1 percent of pay and matches any employee contribution up to an additional 4 percent of pay. For employees covered by FERS, the Service also contributes the employer's matching share for Social Security.

N. Operating Net Position

Operating Net Position is comprised of the following three components:

Unexpended Appropriations - The amount of all unexpended budget authority, both available and unavailable, plus undelivered orders at fiscal year end.

Future Funding Requirements - The amount of future appropriations that will be necessary, beyond the September 30, 1992 fiscal year end, to liquidate September 30, 1992 unfunded liabilities.

Invested Capital - The inventory of supplies, not consumed as of September 30, 1992.

O. Collections

The Service has been given the authority to collect and remit certain revenues to various agencies, including the Treasury. The following are the major revenue sources which fall under Service jurisdiction:

Income Taxes - Federal income taxes paid by individuals, businesses, estates and trusts under Subtitle A of the Internal Revenue Code (IRC).

Estate and Gift Taxes - Taxes paid under Subtitle B of the IRC.

Employment Taxes - The collection of employment taxes under Subtitle C of the IRC is administered by the IRS on behalf of other federal agencies. Pursuant to the Social Security Act, as amended by P.L. 94-202 effective January 1, 1978, Social Security taxes are collected through the Federal Tax Deposit (FTD) system and remitted to the Social Security trust fund. Federal unemployment taxes are also collected through the FTD system and remitted to the Department of Labor.

INTERNAL REVENUE SERVICE
Notes to Principal Financial Statements
for the Fiscal Year Ended September 30, 1992

Note 1. Significant Accounting Policies (continued)

Excise Taxes - Various excise taxes paid under Subtitle D of the IRC. Subtitle E excise taxes on alcohol, tobacco and firearms are not collected by the Service. Rather, these excise taxes are collected by the Bureau of Alcohol, Tobacco and Firearms.

Penalties and Interest - Fines assessed for violations or late charges and interest charged for delinquent payment of taxes.

P. Statement of Budget and Actual Obligations

The Statement of Budget and Actual Obligations is presented by management activity code (MAC) rather than budget activity code (BAC). Management Activities are used in Financial Plan formulation and execution. Some are prorated to more than one appropriation while others are entirely within a single appropriation. Budget Activities are subdivisions of Service appropriations into major programs for purposes of the federal budget.

Q. Comparative Data

Comparative data for the prior year have not been presented as this is the first year for which principal financial statements with notes have been prepared for the Service. Comparative data will be presented in subsequent years.

R. Transactions in Process

Transactions in process at year end are not reflected in the accompanying financial statements. These transactions in process include assessments, collections, adjustments, abatements, and other items. The Service did not analyze such transactions, exceeding $150 billion at September 30, 1992, to determine which should have been reported in fiscal year 1992.

INTERNAL REVENUE SERVICE
Notes to Principal Financial Statements
for the Fiscal Year Ended September 30, 1992

Note 2. Federal Tax Receivables

Federal tax receivables include unpaid taxes, penalties and interest assessed and accrued, reduced by an estimate of uncollectible amounts. Prior to September 30, 1992, the Service used several methods for determining reported accounts receivable which overstated amounts collectible. Based upon the method recommended by GAO, the Service developed and reported an estimate of $21.6 billion for collectible receivables as of September 30, 1992. This estimate was based on a collectibility analysis of a sample of 2,600 separate accounts. An estimate of gross valid accounts receivable as of September 30, 1992 was not determined. The Service is investigating long-term solutions to systematically determine valid and collectible accounts receivable balances.

Accounts receivable result from vigorous tax administration as well as taxpayers failing to meet their obligations. Accounts receivable are resolved when collected, abated (e.g., removed from inventory upon discovery of an error, acceptance of an offer-in-compromise, or discharge due to bankruptcy) or purged from inventory when the collection statute of limitations expires.

Federal tax receivables, combined with other custodial liabilities, are offset by amounts due to U.S. Treasury.

INTERNAL REVENUE SERVICE
Notes to Principal Financial Statements
for the Fiscal Year Ended September 30, 1992

Note 3. Funds with U.S. Treasury

Funds with U.S. Treasury are reported in both the Custodial and Operating sections of the Statement of Financial Position. Funds with U.S. Treasury balances are adjusted to conform with balances reported by the Department of Treasury. Variances are due to unresolved cash differences in transactions between the Service's general ledger and Treasury's Undisbursed Appropriation Account Ledger, TFS 6653. As of September 30, 1992 these unresolved differences were approximately $18 million in the custodial section and $112 million in the operating section. The amount shown for Operating accounts payable, non-federal has been affected by these unresolved differences. The majority of the $183 million difference between the reported accounts payable non-federal and the general ledger is attributed to cash reconciling items. Deposit and clearing funds represent cash held for others and cash items pending investigation and recording into appropriate accounts.

The Custodial portion was comprised of the following at September 30, 1992:

(Dollars in Millions)

Appropriated Funds	$637
Deposit and Clearing Funds	131
Funds with U.S. Treasury - Custodial	$768

Funds with U.S. Treasury, reported in the Operating section, reflect the total of all undisbursed account balances with the U.S. Treasury to meet authorized operating liabilities and purchase commitments of the Service. The restricted portion of these funds is related to expired budget authority.

Funds with U.S. Treasury in the Operating section was comprised of the following at September 30, 1992:

(Dollars in Millions)	Available	Restricted	Total
1992 Appropriations	$ 514	$ 8	$ 522
1991 Appropriations	101	7	108
1990 Appropriations	25	17	42
1989 Appropriations	22	19	41
Merged Appropriations		4	4
Multi-Year funds (Hurricane Andrew Relief Fund)	1		1
No-Year Appropriations, including Tax Systems Modernization	404		404
Deposit and Clearing Funds	12		12
Cash-Imprest Funds	4		4
Funds with U.S. Treasury and Cash - Operating	$1,083	$55	$1,138

INTERNAL REVENUE SERVICE
Notes to Principal Financial Statements
for the Fiscal Year Ended September 30, 1992

Note 4. Revolving Fund

The Federal Tax Lien Act of 1966 authorized the creation of a revolving fund for the redemption of real property on which a tax lien has been filed. The fund was established under permanent authority and is therefore available without fiscal year limitation.

In accordance with Section 7425 of the IRC and Section 2410 of Title 28, the revolving fund can be used to redeem real property foreclosed upon by a holder of a lien which is superior to the tax lien. Real property is redeemed when the Service pays the lienholder the amount bid at sale plus interest and certain post-sale expenses. The Service may then sell the property, reimburse the fund and apply the net proceeds to the outstanding tax obligation.

The revolving fund is reimbursed from the proceeds of the sale in an amount equal to the outlay from the fund for the redemption. The balance of the proceeds is applied against the amount of the tax, interest, penalties and the costs of sale. The remainder, if any, would revert to the parties legally entitled to it.

The revolving fund is comprised of the following at September 30, 1992:

(Dollars in Millions)

Fund Assets:	
Funds with U.S. Treasury	$ 7
Land and Building Inventory	3
Total Fund Assets	$10
Fund Net Position:	
Unexpended Appropriation - revolving fund	$10

Note 5. Other Custodial Assets

The category "Other Custodial Assets" relates to program items of the Service transferable to the Treasury upon their collection. Other Custodial Assets have not been adjusted for an allowance for doubtful accounts. Other Custodial Assets are comprised of manual assessments of $37 million at September 30, 1992.

Manual assessments encompass jeopardy, prompt and termination assessments not yet recorded to individual and business master files. Manual assessments are made when collection of a tax deficiency is jeopardized due to an impending expiration of a statute. In addition, manual assessments are utilized to expedite collection of taxes relating to criminal activity and bankruptcy.

INTERNAL REVENUE SERVICE
Notes to Principal Financial Statements
for the Fiscal Year Ended September 30, 1992

Note 6. Seized Property and Monies

Seized property and monies of the Service originate from its collection activities and its role in criminal investigations.

The Internal Revenue Code (IRC) authorizes the Service, as part of its collection activities, to seize property and monies in order to compel payment for delinquent tax obligations. The IRC prescribes detailed procedures for the seizure of property and monies, including proper methods for notifying parties and details of sale. Seized property and monies are held and safeguarded by the Service until such time as the taxpayer has exhausted available remedies under the law. Generally, the seized property is sold and the proceeds used to satisfy the delinquent tax obligation.

The IRC also authorizes the seizure of property and monies resulting from investigations conducted by Criminal Investigation personnel of the Service. Property and monies are seized as part of the forfeiture laws pertaining to property used for criminal purposes. These seizures occur primarily from IRS jurisdiction over violations of the IRC or money laundering crimes as provided in Title 18, U.S.C.

The Service temporarily retains custody of seized cash and personal (non-real) property under $500,000 estimated value. After property and monies in IRS custody are forfeited in an administrative hearing, cash is transferred to the general fund of the U.S. Treasury. All property valued over $500,000 and all real property is transferred to the U.S. Marshall Service for disposition. Other property is transferred to the Justice Department's Asset Forfeiture Fund or is placed into official use.

Criminal Investigation personnel may place certain forfeited properties (other than seized monies) into official use. When this occurs, the forfeited property is recorded in the fixed asset accounting system. The Service is performing a reconciliation of seized property and monies recorded in the general ledger to seizure records in the district offices. There may be a significant adjustment to the amounts reported below. Seized property and monies recorded in the general ledger were comprised of the following at September 30, 1992:

(Dollars in Millions)

Collateral	$260
Seized Property	499
Acquired Property	4
Seized Monies	34
Assets, Seized Property and Monies	$797

INTERNAL REVENUE SERVICE
Notes to Principal Financial Statements
for the Fiscal Year Ended September 30, 1992

Note 7. Property and Equipment

The Service's criterion for capitalization of property and equipment is a useful life of more than one year and a unit cost of $5,000 or more. Current fair market value is used for property and equipment transferred at no cost to the Service from other agencies. However, due to systems limitations and control weaknesses, additions to property and equipment are expensed in the current period. Consequently, complete and accurate information on property and equipment was not available for reporting in the financial statements.

Complete acquisition cost data was not available for the following categories: mini and micro computers, peripherals, software, National Office's non-ADP assets, Criminal Investigation's law enforcement vehicles and sensitive investigative equipment, telecommunications equipment purchased with field funds, Communications Replacement System equipment and Automatic Call Distributers/Audio Response Units purchased before October 1, 1987 with National Office funds. Currently, system and procedural enhancements are underway to improve the reporting of property and equipment maintained by the Service.

Physical inventories were used as the basis for reporting the cost of mainframe computers. The Property Assets Tracking System provided the non-ADP assets information. Management information systems were utilized for the telecommunications equipment information. Partial information on property and equipment consisted of the following as of September 30, 1992:

(Dollars in Millions) Classes of Property and Equipment	Service Life	Acquisition Cost
Mainframe CPU's, Computing and Service Centers	15	$107
Furniture	8	10
Non-ADP equipment	10	19
Investigative equipment	10	19
Law enforcement vehicles	3	44
Sensitive investigative equipment	10	6
Telecommunications equipment	15	77
Total		$282

INTERNAL REVENUE SERVICE
Notes to Principal Financial Statements
for the Fiscal Year Ended September 30, 1992

Note 8. Other Custodial Liabilities

The category "Other Custodial Liabilities" relates to current liabilities to taxpayers for tax refunds due on filed returns and voluntary advance payments made in anticipation of additional tax, penalties and interest. It also includes the liability for taxpayer deposits and clearing account liabilities. The category "Other Custodial Liabilities" was comprised of the following at September 30, 1992:

(Dollars in Millions)

Tax Refunds Payable	$ 422
Advance Payments	2,330
Deposit Funds	25
Clearing Funds	106
Total	$2,883

Note 9. Unfunded Commitments and Contingencies

The Service has made obligations for goods and services which have been ordered but not yet received (undelivered orders) at fiscal year end. Aggregate undelivered orders for all Service activities amounted to $534 million as of September 30, 1992.

As of September 30, 1992 the Service recorded contingent liabilities of $9 million for pending and threatened legal matters for which it is probable, in the opinion of Service management and legal counsel, that the Service will incur a liability.

The Service is also involved in various legal actions in connection with which the United States will probably be liable for amounts payable from the Judgement Fund administered by the Justice Department in accordance with 31 U.S.C. 1304 and therefore are not reported in the statements. In the opinion of Service management and legal counsel, it is probable that approximately $46 million will be payable from the Justice Department Judgement Fund for judgements and settlements relating to Service litigation and claims.

Tax examinations often result in proposed additional taxes which may later be assessed and collected. Prior to assessment, proposed adjustments are considered a contingent gain and are not reported in the statements. These proposed adjustment fall into two categories: 1) proposed additional taxes held in suspense pending the statutory period for taxpayer response, and 2) cases for which the taxpayer has requested an administrative appeal. Due to uncertainties concerning the amount which will eventually be realized from proposed tax adjustments, no estimate of contingent gain is set forth in the statements.

INTERNAL REVENUE SERVICE
Notes to Principal Financial Statements
for the Fiscal Year Ended September 30, 1992

Note 10. Future Funding Requirements

Future funding requirements are an offset, in the Net Position Section, to unfunded liabilities. As an offset to unfunded liabilities, they represent expenses incurred and unpaid as of fiscal year-end for which appropriations for their payment have not yet been provided. Future funding requirements were comprised of the following at September 30, 1992:

(Dollars in Millions)

Custodial Items:	
Unfunded liability for advance payments	$2,330
Operating Items:	
Unfunded accrued annual leave	294
Unfunded accrued contingent liability	9
Future Funding Requirements Operating Section	$ 303

Note 11. Unexpended Appropriations

The category "Unexpended Appropriations" within the Operating Net Position section reflects total budget authority available and unavailable for obligations, plus undelivered orders. Unexpended Appropriations were $76 million less than the amount reported on FMS 2108, the year-end closing statement, as a result of cash related adjustments. Unexpended Appropriations were comprised of the following at September 30, 1992:

(Dollars in Millions)

	Appropriated Funds
Unexpended Appropriations:	
Available	$129
Unavailable	55
Undelivered Orders	534
Total Unexpended Appropriations	$718

INTERNAL REVENUE SERVICE
Notes to Principal Financial Statements
for the Fiscal Year Ended September 30, 1992

Note 12. Collections of Federal Revenue, Refunds and Net Transfers

The following amounts comprise revenues collected, refunds and net transfers to Treasury for the year ended September 30, 1992:

(Dollars in Millions)

	Collections	Refunds(2)	Net Transferred
Income Taxes			
Individuals	$ 553,507	90,013	463,494
Corporations	111,860	19,689	92,171
Estate and Gift	11,479	401	11,078
Excise (3)	33,565	1,997	31,568
Employment Taxes			
FICA(1)	364,192	834	363,358
SECA	24,421	---	24,421
Railroad Retirement	4,359	19	4,340
FUTA	5,755	155	5,600
Penalties and Interest	11,662	---	11,662
Total Taxes	$1,120,800	$113,108	$1,007,692

(1) All collections of federal income tax withholding and FICA are first applied to pay FICA liability in full, regardless of the amount paid. The balance is then credited to federal income tax.

(2) Refunds include principal and interest.

(3) Detail of excise taxes is included in Supplemental Financial and Management Information section of this report.

The allocation of federal revenues to the general fund and trust funds is detailed in Supplemental Financial and Management Information.

INTERNAL REVENUE SERVICE
Notes to Principal Financial Statements
for the Fiscal Year Ended September 30, 1992

Note 13. Appropriations Received

Appropriations received for the fiscal year ended September 30, 1992 were comprised of the following:

(Dollars in Millions)

Annual Funds:	
Appropriation 1	$ 141
Appropriation 2	1,657
Appropriation 3	3,584
Appropriation 4	860
No-Year Funds:	
Appropriation 3	2
Appropriation 4	435
Multi-Year Funds:	
Appropriation 3	1
Total	$6,680

Supplemental Financial and Management Information

Department of the Treasury

Internal Revenue Service

Supplemental Financial and Management Information

Fiscal Year 1992

Allocation of Revenue and Excise Taxes

•

Financial Statement and Account Definitions

•

Objectives and Strategies

•

Tax Systems Modernization

INTERNAL REVENUE SERVICE
Supplemental Financial and Management Information
For the Fiscal Year Ended September 30, 1992

ALLOCATION OF REVENUE AND EXCISE TAXES

Allocations of Revenues to Funds

The source of data for Allocations of Revenues to Funds is the Department of Treasury, Financial Management Service.

(Dollars in Millions)

General Fund of the U.S. Treasury	$ 691,285
Social Security Trust Funds (1)	395,258
Unemployment Trust Fund	5,755
Railroad Retirement Board Fund	4,359
Excise Tax Funds:	
Highway Trust Fund (2)	16,733
Airport and Airways	4,645
Environmental Superfund	1,198
Black Lung Disability	626
Leaking Underground Storage Tanks	159
Oil Spill	295
Aquatic Resources-Sport Fish	229
Boat Safety	70
Vaccine Injury Compensation	118
Inland Waterways	70
Total Allocations of Revenue	$1,120,800

(1) Allocation to Social Security trust funds includes FICA of $365 billion, SECA of $24 billion, income tax on Social Security income of $6 billion and tax refund offsets of $40 million.

(2) Net of $194 million reallocated by Treasury: $123 million to Sport Fish, $70 million to Boat Safety and $1 million to Land and Water.

INTERNAL REVENUE SERVICE
Supplemental Financial and Management Information
For the Fiscal Year Ended September 30, 1992

Excise Tax Revenues

(Dollars in millions)

General Fund Excise Taxes:	
Telephone Services	$ 3,173
General Fund Portion of Highway Taxes	3,395
General Fund Portion of Airport/Airways	18
Ozone Depleting Chemicals	568
Luxury Taxes	305
Exempt Organizations/Emp. Pension and Benefits	470
Miscellaneous excise taxes (1)	69
Unclassified excise taxes	492
Trust Fund Excise Taxes:	
Highway Trust Fund (2)	18,051
Airport and Airways	4,762
Environmental Superfund	808
Black Lung Disability	626
Leaking Underground Storage Tanks	230
Oil Spill	277
Aquatic Resources-Sport Fish (2)	85
Boat Safety (2)	-0-
Vaccine Injury Compensation	165
Inland Waterways	71
Total Excise Tax Revenues	33,565
Less: Refunds	1,997
Net Excise Tax Revenues	$31,568

Detailed information in the table above is based on net tax liabilities reported on excise tax returns. The balance of the adjustment needed to report total excise tax revenues is included in Unclassified Excise Taxes.

(1) Miscellaneous excise taxes include foreign insurance, cruise ship passengers, gas guzzler, windfall profits, real estate investment trusts, regulated investment companies, wagering, bows and arrows, foreign transfers of property and greenmail.

(2) Amounts do not reflect a reallocation made by Treasury of $194 million from the Highway Fund: $123 million to Sport Fish, $70 million to Boat Safety, and $1 million to Land and Water.

INTERNAL REVENUE SERVICE
Supplemental Financial and Management Information
For the Fiscal Year Ended September 30, 1992

FINANCIAL STATEMENT AND ACCOUNT DEFINITIONS

A. Statement of Financial Position

The Statement of Financial Position presents Service assets (resources), liabilities and net position (the difference between assets and liabilities). To clarify financial reporting, line items have been divided into two major categories. Statement of Financial Position line items are reported in either "Custodial" or "Operating" categories. Custodial assets are primarily tax receivables, seized property and funds restricted for refunds. These assets are offset by Custodial Liabilities. However, additional custodial liabilities exist which are unfunded and hence do not offset an asset. These custodial liabilities are offset as future funding requirements in the Net Position section.

All remaining financial statement line items are included within the "Operating" category. These line items relate directly to the operating needs of the Service and include such items as Funds with Treasury (for the payment of operating costs), non-tax receivables, and property and equipment.

Custodial Assets

(1) **Custodial Assets** - This heading describes assets which are programmatic rather than operational in nature. An example of Custodial Assets are federal tax receivables. These assets are programmatic as they relate to the broad program mission of the Service and not its internal operating needs.

(2) **Federal Tax Receivables** - The net receivable amount from taxes, including individual, corporate, payroll, etc. The receivables are presented net of an allowance for doubtful collections.

(3) **Funds With U.S. Treasury** - Funds available under a permanent, indefinite appropriation primarily for the payment of tax refunds and interest on tax refunds. These appropriations cannot be used for operating needs of the Service. Consequently, it is classified as a Custodial Asset.

(4) **Revolving Fund Assets** - Funds with U.S. Treasury and inventory which relate to the Federal Tax Lien Revolving Fund.

(5) **Other Custodial Assets** - Comprised primarily of manual assessments in transit.

(6) **Seized Property and Monies** - Primarily relates to seized property and monies held by the Service pending a judicial or administrative proceeding. Also, included on this line is deposit funds, seized monies held with the U.S. Treasury.

INTERNAL REVENUE SERVICE
Supplemental Financial and Management Information
For the Fiscal Year Ended September 30, 1992

Operating Assets

(7) **Operating Assets** - Operating assets are all financial statement line items which relate directly to the operating needs of the Service. These items include funds available to pay operating costs, non-tax receivables and property and equipment.

(8) **Financial Resources** - This heading describes available financial resources to meet current or future operational needs of the Service (as opposed to Custodial Assets, which are used for programmatic purposes).

(9) **Funds with U.S. Treasury and Cash** - Undisbursed appropriations available for Service expenditures. Much of this balance will be used for undelivered orders and payables in existence at fiscal year end. This line item also includes deposit funds, budget clearing accounts and imprest funds.

(10) **Receivables, Non-Federal** - Total receivables due from non-federal sources, including but not limited to vendor and salary overpayments, cost of living adjustments, and travel advances.

(11) **Advances and Prepayments, Non-Federal** - Total payments made in advance of the receipt of goods or services, where the advance or prepayment was made to a non-federal source.

(12) **Intragovernmental Items** - Receivables and Advances/Prepayments relating to activity with other federal agencies, eg. reimbursables and refunds from other government agencies.

(13) **Non-Financial Resources** - Those assets which cannot, either because of existing need or by law, be easily sold or converted into financial resources.

(14) **Property and Equipment** - This line item appears in the Statement of Financial Position to remind the reader of the existence of property and equipment in use by the Service. However, an actual dollar amount is not reported in the statement itself. Rather, selected property and equipment amounts are reported in Note 7.

(15) **Inventory** - Supplies held for future consumption by the Service.

Custodial Liabilities and Net Position

(16) **Custodial Liabilities** - Liabilities which offset certain Custodial assets.

(17) **Due to U.S. Treasury** - The offset to the Tax Receivables asset and other custodial assets.

INTERNAL REVENUE SERVICE
Supplemental Financial and Management Information
For the Fiscal Year Ended September 30, 1992

(18) Other Custodial Liabilities - Tax refunds actually approved for payment, advance payments, and deposit and clearing funds.

(19) Seized Property and Monies - The offset to the asset Seized Property and Monies.

(20) Commitments and Contingencies - In the case of the Service, amounts which may be receivable or payable in the future, for which the final outcome is uncertain.

(21) Custodial Net Position - The difference between Custodial Assets and Liabilities, comprised of Unexpended Appropriations and Invested Capital reduced by Future Funding Requirements.

(22) Unexpended Appropriations - Budget authority relating primarily to the payment of tax refunds. The unexpired portion of warrants processed for the payment of these refunds. Unexpended budget authority for the Federal Tax Lien Revolving Fund is also presented.

(23) Future Funding Requirements - The offset to unfunded liabilities.

Operating Liabilities and Net Position

(24) Operating Liabilities - Liabilities relating to the internal operating requirements of the Service.

(25) Funded Liabilities - Liabilities for which budget authority, revenues, or other sources of funds necessary to liquidate the liabilities has been made. These sources of funds are available through appropriations, earnings or other funding sources as of fiscal year end.

(26) Accounts Payable, Non-Federal - Payables to individuals or non-federal entities, recorded on the accrual basis.

(27) Deposit Funds - The offset to the budget clearing accounts and deposit funds which are included within Funds with U.S. Treasury on the asset side.

(28) Accrued Payroll and Benefits - Includes all funded payroll incurred but unpaid as of fiscal year end.

(29) Payables, federal - Payables to federal entities recorded on the accrual basis.

(30) Unfunded Accrued Annual Leave - Vacation leave which is accrued and recorded but which has not yet been funded.

INTERNAL REVENUE SERVICE
Supplemental Financial and Management Information
For the Fiscal Year Ended September 30, 1992

(31) Unfunded Commitments and Contingencies - In the case of the Service, amounts which may be due in the future, as a result of lawsuit settlements and contract dispute settlements, for which the final outcome is uncertain.

(32) Operating Net Position - The difference between Operating Assets and Liabilities, comprised of Unexpended Appropriations and Invested Capital reduced by Future Funding Requirements.

(33) Unexpended Appropriations - Authority which is unobligated plus undelivered orders.

(34) Invested Capital - The offset to the supplies inventory.

(35) Future Funding Requirements - The offset to unfunded liabilities.

B. Statement of Collections and Operations

Presents the collections and related transfers of federal revenue to the U.S. Treasury. Presents appropriations used for Service operations and all expenditures of the Service for the fiscal year.

(1) Collections of Federal Revenue - The aggregate of federal revenue collected by the Service during the fiscal year. Collections include individual and business, excise, FICA and federal unemployment taxes, and related penalties and interest.

(2) Other - Miscellaneous taxes, licenses and services performed for the public, federal and other governmental agencies such as the tax refund offset program, child enforcement program, document duplication, etc.

(3) Revolving Fund Sales - Proceeds from the sale of redeemed real property used to offset related costs to acquire and to satisfy tax obligations.

(4) Less Refunds and Other Payments - The refund of taxes, related interest, and earned income credits.

(5) Revolving Fund Costs - Cost of real property sold and administrative costs of the fund.

(6) Net Transfers to the Treasury - Net Federal tax collections transferred to the Treasury. This amount will equal the "Net Collections" amount.

INTERNAL REVENUE SERVICE
Supplemental Financial and Management Information
For the Fiscal Year Ended September 30, 1992

(7) Appropriations Expended - The amount of appropriations used to fund expenses. This line item includes amounts expended for acquired property and equipment, accrued expenses and unfunded expenses from prior periods that are funded with current period appropriations.

(8) Reimbursements, Public and Intragovernmental - Sums received by the Federal Government as a repayment for commodities sold or services furnished either to the public or to other Government agencies that are authorized by law to be credited directly to specific appropriation and fund accounts.

(9) Other Receipts - Miscellaneous receipts transferred to the Treasury.

(10) Operating Expenditures - These are reported by appropriation on the accrual basis of accounting, which records the expense when it is incurred, without regard to the payment of cash. In addition, property and equipment purchases are included within these expenditure amounts.

(11) Adjustment for Net Unfunded Expenses - Presented as a reduction since the calculated liability for unfunded leave decreased from the prior fiscal year. Unfunded expenses for contingencies are also included.

C. Statement of Cash Flows

Presents increases and decreases to the Operating Fund Balance with Treasury during the fiscal year. Appropriations and reimbursements increase the fund balance while expenditures reduce the fund balance.

D. Statement of Budget and Actual Obligations

Presents total budget authority for current, multi-year and no year appropriations available during the fiscal year. This budget authority is presented by management activity code (MAC). Amounts obligated against this budget authority are also presented by MAC. Data is from ROPE (budget execution) system and is reconciled to General Ledger and SF-133 reports. Reconciling amounts exist because of differences in treatment for certain transactions between ROPE and General Ledger.

INTERNAL REVENUE SERVICE
Supplemental Financial and Management Information
For the Fiscal Year Ended September 30, 1992

OBJECTIVES AND STRATEGIES

Objective #1: Increase Voluntary Compliance

The Internal Revenue Service constantly seeks new ways to more effectively manage its significant resources and diverse programs. The Strategic Management Process was developed as a method for helping us better account for the overall environment in which we operate, the strategic nature of our activities, the interdependence of functions, and our commitment to quality customer service. The Strategic Management Process starts with the Mission Statement. The Strategic Business Plan (SBP) includes three Objectives that describe what we plan to do to fulfill our Mission. To explain how we will meet our Objectives, the SBP is structured along five strategies. The Objectives are equally important and work together toward achieving our Mission; the Strategies are all equally important and support the Objectives.

The public's willingness to meet its tax responsibility is the foundation of our nation's tax system. Ensuring greater voluntary compliance is the most efficient and cost effective approach to collecting the revenues needed to fund our Federal government. Most citizens want to comply with the tax laws. It is our role to assist them in understanding how to meet their tax obligations. We must ensure that the way we administer the tax laws encourages compliance, and that we treat the public with dignity and respect. It is also essential that we enforce the tax laws vigilantly and vigorously against those who intentionally disregard their responsibilities in order to guarantee that all taxpayers pay their fair share.

Objective #2: Reduce Burden on Taxpayers

Taxpayer burden is the time, expense and dissatisfaction experienced by taxpayers, tax professionals and others in complying with the tax laws. To some degree, this burden is an inherent and necessary part of the tax system as taxpayers must keep records, file information and tax returns, and make tax deposits and payments. The challenge to the Service is in improving our system of tax administration so that the number of contacts each taxpayer has with the Service is reduced and the quality of the contacts that take place is improved.

Objective #3: Improve Quality, Productivity, and Customer Satisfaction

Improving the way we do business will reduce the burden on taxpayers and the costs of administering the tax system. We want to satisfy our customers' needs by providing quality products and services which enable and encourage them to meet their obligations. We must reduce the amount of time it takes to answer their questions and resolve their tax filing problems. We must also ensure that the help they request is provided quickly and accurately. To successfully meet these challenges, we are creating new ways of doing our work so that the service we provide is high in quality and satisfies the customer.

INTERNAL REVENUE SERVICE
Supplemental Financial and Management Information
For the Fiscal Year Ended September 30, 1992

Strategy #1: Compliance 2000

The Compliance 2000 Strategy focuses on identifying the causes of noncompliance and addressing them by employing taxpayer assistance, education and outreach; making our regulations and procedures clearer and simpler; identifying and encouraging legislative change; and, when warranted, using more focused and sophisticated enforcement techniques.

The tax system works best when taxpayers understand what is expected of them, when the burden of meeting their tax obligations is minimized and when they are given timely, complete and accurate information and assistance that helps them to comply. Compliance 2000 is a philosophy which recognizes that a good part of noncompliance with the tax laws is caused by taxpayers' lack of understanding of what is required. It means we increase our education and assistance efforts as well as take an active role in pushing for improvements in both the tax law and in our own procedures. However, we also recognize that despite our best efforts, some segments of the population will not voluntarily respond. Compliance 2000 includes a focused use of our enforcement tools and resources against noncompliance.

Strategy #2: Tax Systems Modernization

Current IRS computer systems are old, extremely complex and costly to maintain. We are engaged in a long-term modernization effort, known as Tax Systems Modernization (TSM), which will enable the IRS to change the way it does business for transition into the 21st century. The philosophy and concept of TSM is a key to delivering one-stop service, a service that taxpayers have come to know from dealing with commercial businesses such as banks, airlines, credit card companies, and insurance companies.

The TSM strategy is an integrated approach to the design, development and implementation of information systems. TSM will assist us in making a smooth transition to a new way of doing business using state-of-the-art electronic methods for processing tax data. It is not just a way of automating our current operations; TSM will also enable us to reshape the way we work to meet the needs of all our customers for timely, accurate delivery of information. Restructuring the business of IRS with the support of technology will allow us to significantly reduce taxpayer burden, improve voluntary compliance, achieve quality-driven productivity gains, and increase revenue.

Strategy #3: Diversity

The Diversity Strategy focuses on cultural sensitivity and design of appropriate communication methods as key components to providing quality service to the increasingly diverse groups which make up the U. S. population. Diversity in our workplace is an essential strategy in meeting our Objectives. As America's demographics change, the needs of our customers become more diverse, and in order to meet those needs we must understand the underlying differences in perspectives as well as needs.

INTERNAL REVENUE SERVICE
Supplemental Financial and Management Information
For the Fiscal Year Ended September 30, 1992

In the external realm, we must recognize the makeup of the taxpaying public as well as that of the non-compliant citizen. Aging of the population, changing lifestyles, gender, disabilities, geographical location, and immigration are some of the new factors we must consider in our quest to achieve our mission. For example, we are now printing some of our tax forms and instruction guides in Spanish. We must take the extra step to analyze our customer base and then deliver what is necessary for them to comply with the tax laws.

We also realize that it makes good business sense to retain employees who come from many cultural backgrounds and experiences. We are continuously identifying ways in which a diverse work force can assist in meeting our three Objectives and we are committed to continuing our efforts to become an organization in which Equal Employment Opportunity is a way of doing business. Two ways in which we are striving toward this end are: (1) educating our employees on the ways in which valuing and understanding diversity can help us increase voluntary compliance and better serve taxpayers; and (2) increasing representation of minorities and women in managerial positions. Diversity is an effective way to achieve our Objectives now and is an investment in the future.

Strategy #4: Ethics

Our Ethics Strategy helps increase the taxpayers' trust in our ability to administer the tax system fairly and efficiently. It demonstrates our commitment to treating the taxpayer, the taxpayer's representative, and each other with fairness, honesty and impartiality. To achieve our Objectives, we must pay attention to both the way decisions are made and the way they appear inside and outside the Service. Ensuring that we act with the highest standards of professional conduct will help us meet the demands of ethics legislation, Congressional oversight, aggressive media attention and the expressed concerns of taxpayers and their representatives.

The Internal Revenue Service developed a strict code of ethics before the turn of the century, and that code has evolved into one of the toughest sets of rules in the Federal government. However, our management is convinced that the ethical organization of the future must go beyond simply making rules, it must continuously reinforce those rules. We have developed an ethics training program that is required for all employees. The centerpiece of this training is an Ethics Resource Guide, which sets forth our expectations, requirements and resources available for advice in the ethics field. We believe that consistent and outstanding ethical behavior by our personnel is essential to increasing taxpayer voluntary compliance and building their confidence in the products and services we provide.

INTERNAL REVENUE SERVICE
Supplemental Financial and Management Information
For the Fiscal Year Ended September 30, 1992

Strategy #5: Total Quality

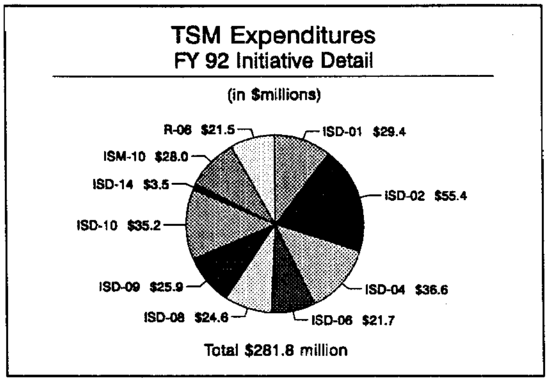
The Total Quality Strategy requires us to view the Service in terms of the systems we use to produce our products and services. This means we must consider the relationships among our functions, identifying how each function is connected to and impacts the others. This cross-functional approach will be used to improve the quality of what we provide to customers in support of our three Objectives.

We are establishing methods to continuously improve our products and services by identifying what our customers need and want from us; applying systems management concepts and analysis techniques to improve the performance of our systems and streamline operations; developing baselines and measures to determine how successful our products are in meeting our Objectives; decreasing errors and eliminating the need for redoing work; and reducing the cost of producing our products and services. We are also working with the National Treasury Employees Union to involve employees in enhancing the quality of our products and improving customer satisfaction, and encouraging risk-taking and innovation by working to revise and improve the systems we use for reward and recognition.

If we are to achieve excellence in carrying out the Mission, we must change some of the fundamental ways in which we deliver tax administration to our customers and in which we manage our organization. The actions we take to implement our Total Quality Strategy will help us make these changes.

INTERNAL REVENUE SERVICE
Supplemental Financial and Management Information
For the Fiscal Year Ended September 30, 1992

TAX SYSTEMS MODERNIZATION



Expenditures for FY 1992 indicate that progress is being made in many different areas. The initiatives listed in the chart above are summarized below:

ISD-01 **Information Systems Development Program Management**: Overall mission support for the TSM effort.

ISD-02 **Departmental Applications**: Various projects, including Automated Underreporter, Case Processing System, Automated Criminal Investigation, Servicewide Electronic Research Project, Integrated Collection System, Business Area Analyses, and others.

ISD-04 **Systems Integration and Long Term Design**: Includes the functions of systems architecture, data standards, requirements architecture, integration support, program support, system engineering, and configuration management.

ISD-06 **Integrated Input Processing System**: Includes projects for Document Processing System, Electronic Management System, and Design Division.

ISD-08 **Service Center Support System**: Includes projects that provide the foundation for other Service Center TSM projects.

INTERNAL REVENUE SERVICE
Supplemental Financial and Management Information
For the Fiscal Year Ended September 30, 1992

ISD-09 — **Corporate Files On-Line**: Includes projects for Corporate Files On-Line, Corporate Accounts Processing System, Workload Management System, Security and Communications System, and Automated Inventory Control System.

ISD-10 — **Corporate Systems Modernization and Transition**: A project to implement TSM-driven changes in the Detroit and Martinsburg Computing Centers.

ISD-14 — **Service Center Recognition/Image Processing**: A project to replace the two existing non-compatible systems at each Service Center with one integrated system.

ISM-10 — **Communications Modernization**: Includes projects to complete installation of the AMA System, cover services received through the Consolidated Data Network, and meet other TSM data communications requirements.

R-06 — **Full Utilization/Electronic Filing System**: Includes projects for the Electronic Filing System and TeleFile.

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