United States General Accounting Office

GAO

Testimony

Before the Committee on Governmental Affairs
United States Senate

For Release on Delivery
Expected at
9:30 a.m.,
Thursday,
July 28, 1994

FINANCIAL AUDITS

CFO Implementation at IRS and Customs

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060637/152259

GAO/T-AIMD-94-164

Mr. Chairman and Members of the Committee:

We are pleased to appear today to discuss the progress of the Internal Revenue Service (IRS) and the Customs Service in complying with the financial reporting and other requirements of the Chief Financial Officers (CFO) Act of 1990. I will discuss

-- the results of our attempts to audit IRS' and Customs' fiscal year 1993 financial statements,

-- the short-term actions needed by IRS and Customs to continue their progress in resolving serious financial management problems, and

-- IRS' and Customs' efforts to establish the financial management organizations and systems called for by the CFO Act.

AUDIT RESULTS

For fiscal year 1993, we were again unable to provide opinions on IRS' and Customs' financial statements because of financial management problems that have not yet been resolved. Although we have not yet been able to provide an opinion, significant improvements in financial management operations are occurring at these agencies prompted by the CFO Act. CFO audits also have provided insights that have assisted both agencies in focusing their efforts to develop more effective financial management systems and internal controls. Ultimately, improvements in these areas will enhance IRS' and Customs' ability to accomplish their missions more effectively and efficiently.

Major strides include the following.

-- Customs has begun a program to reliably measure the trade community's compliance with trade laws based on inspections of statistically valid random samples of imported goods and related import documents. After testing a limited number of goods in fiscal year 1993, Customs expanded the scope of the program during fiscal year 1994, and even broader national coverage is planned for fiscal 1995.

-- Both IRS and Customs developed and applied methodologies for more accurately reporting their collectible accounts receivable, which totaled $29 billion and $900 million, respectively, as of the end of fiscal year 1993. In addition, Customs reorganized its debt collection unit, formalized its collection procedures, and aggressively pursued collection of old receivables. According to Customs, this effort resulted in collections of about $32 million.

-- Customs conducted the first nationwide physical inventory of its seized assets, which include firearms, thousands of pounds of illegal narcotics, millions of dollars in cash, and various types of other goods. It also evaluated the adequacy of physical safeguards over these assets, constructed needed facilities in two districts, and developed plans for renovating other facilities.

-- IRS and Customs conducted physical inventories of their fixed assets, which will provide better accountability over these assets and help ensure that they are used effectively. In addition, Customs initiated monthly reconciliations between its accounting records and its logistical records that identify where fixed assets are located.

-- IRS implemented a new integrated accounting and budget system agencywide to provide critical supporting information for its administrative expenditures, which was not available for our fiscal year 1992 audit. Also, IRS provided critical supporting information for revenue transactions, such as tax returns, cash receipts, and refunds, which was not available for our fiscal year 1992 audit.

Progress was achieved, in large part, because IRS and Customs demonstrated a sincere commitment towards developing reliable information. We met frequently with key financial management officials at both agencies. Also, the Commissioner of Customs met with us monthly to obtain prompt advice on how to correct problems.

However, despite these efforts, unresolved serious deficiencies in the supporting information and in the systems that produce this information precluded us from providing opinions on IRS' and Customs' financial statements for fiscal year 1993.[1] For example, for fiscal year 1993, we could not audit several important account balances because supporting information was not available. Also, neither IRS nor Customs had instituted adequate controls to safeguard assets, determine compliance with pertinent laws and regulations, or assure that there were no material misstatements in their financial statements.

Although efforts are under way to address almost all of the recommendations resulting from our audits of IRS' and Customs' fiscal year 1992 statements, few have been completed. As of May 1994, 4 of the 44 recommendations we made to IRS had been

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[1]Our audit results and the status of our recommendations are discussed in detail in our reports entitled Financial Audit: Examination of IRS' Fiscal Year 1993 Financial Statements (GAO/AIMD-94-120, June 15, 1994) and Financial Audit: Examination of Customs' Fiscal Year 1993 Financial Statements (GAO/AIMD-94-119, June 15, 1994).

completed, and actions were either in progress or planned for 38. At Customs, 11 of the 54 recommendations we made had been completed, and actions were either in progress or planned for 38.

The most significant deficiencies are common to both agencies and seriously impair their ability effectively to carry out their missions and reliably report on their operations. Specifically, neither agency has instituted procedures to adequately ensure that

-- all revenues due to the federal government are identified so that collection can be pursued;

-- errors in taxpayer and import information are detected and refunds of taxes and duties are appropriate;

-- seized assets, including illegal drugs seized by Customs agents, are accounted for and protected from theft;

-- appropriated funds are spent in accordance with applicable laws and accurately accounted for; and

-- sensitive computerized information, such as taxpayer records, import inspection criteria, and law enforcement data, is protected from unauthorized access, disclosure, or modification.

These significant deficiencies require prompt attention. Many of them can be resolved quickly through (1) improved guidance and oversight to ensure that agency staff understand and comply with existing procedures, such as properly performing fundamental reconciliations and supervising and approving routine transactions, (2) implementation of additional controls, such as new procedures for reconciliations and approvals, and (3) proper analysis of data to be included in reported financial management information. Other improvements, such as obtaining more useful information on unreported taxes, will require longer term system changes.

IRS and Customs have developed many actions that can be implemented relatively quickly. While we believe that these actions are appropriately focused, it is important that they be implemented promptly and that IRS and Customs take steps to ensure that the related problems do not recur. Further, we believe that there are additional actions that can be taken in the short term, such as minor enhancements to existing systems to mitigate some problems until broader system improvement efforts are complete.

I would now like to outline the major deficiencies that we identified, the actions that IRS and Customs plan to take, and additional short-term corrective measures needed.

Better Information Needed to Collect Unreported Taxes and Duties

At both IRS and Customs, we were able to confirm that the total reported revenues for fiscal year 1993 were collected and deposited into Treasury accounts. However, neither agency was able to reliably determine the amount of revenue that should have been assessed.

Customs' programs for monitoring goods entering the United States did not provide reasonable assurance that carriers, importers, and their agents complied with trade laws. As a result, revenue owed to the federal government may not have been identified and quotas and other legal restrictions may have been violated. Moreover, important trade statistics may not be reliable.

Customs does not yet have a means to reliably measure overall compliance with trade laws. As it did in fiscal year 1992, Customs focused its fiscal year 1993 inspection efforts on high-risk shipments in an effort to release low-risk shipments as expeditiously as possible. Consequently, most shipments were not inspected at all--according to Customs, about 92 percent of imported cargo was released without examination during fiscal year 1993. And, because the shipments selected for inspection were not a representative sample of all shipments, the results of the related inspections could not be used to estimate the overall effectiveness of efforts to ensure compliance with trade laws.

To reliably measure the level of compliance with trade laws, including payment of duties, Customs has, within a relatively short period, designed and set in motion a program of inspecting statistically valid random samples of imported goods and related import documents. In 1993, these tests covered relatively few commodities--five types of goods--and were limited to 45-60 day periods at selected ports. Therefore, the results cannot be used to estimate overall compliance for that year. However, Customs expanded the scope of the program during fiscal year 1994, and, for fiscal year 1995, Customs plans to begin nationwide, year-long tests of all major categories of goods. If conducted properly, these tests should allow Customs to reliably estimate compliance levels and the amount of duties owed that is not being assessed for fiscal year 1995.

Similarly, IRS needs more meaningful and useful information for determining the amount of unreported taxes, referred to as the tax gap. For 1992, IRS reported an estimated $127 billion in unreported taxes. However, this estimate is based primarily on information obtained in 1982--data that are too old to be meaningful considering changes in tax laws, economic conditions, and the composition of the taxpayer population. Also, the information used for tax gap estimates is limited to income taxes and does not include other taxes such as excise, employment, and gift taxes.

IRS recognizes its need for better information about noncompliant and delinquent taxpayers. It has planned a comprehensive audit program of randomly selected taxpayers to be performed in 1996, piloted models to estimate noncompliance for taxpayers in specific groups and geographic areas, piloted an audit program focused on specific noncompliant industry segments, and has begun to develop a system to assess the collectibility of accounts receivable. Additionally, IRS has developed a long-term strategic plan to increase compliance. However, these actions will not be fully implemented for several years and will not be effective unless IRS begins to capture reliable data. Developing reliable information requires major changes in IRS' systems, which were not designed to provide the management information needed to evaluate revenue-collection activities.

Improved Controls Needed to Ensure Accuracy of Taxpayer and Import Information and That Refunds Are Proper

At both IRS and Customs, we identified control weaknesses that impaired their ability to reasonably ensure that all revenues due were assessed and collected and that refunds were appropriate. Also, we identified weaknesses in IRS' ability to properly account for tax payments received. The most serious problems at IRS were as follows.

-- Controls over federal tax deposit (FTD) payments by businesses, the source of most of the government's tax revenues, did not ensure that these payments were properly applied to the appropriate taxpayer accounts. These errors are caused both by taxpayers and by IRS. In fiscal year 1993, IRS corrected about 2 million misapplied FTD payments totaling $30 billion.

   Our sample of 4,206 transactions contained 738 FTD payments, 124, or 17 percent, of which were applied to the wrong taxpayer accounts or periods, principally due to taxpayer error. Although all but one were detected and corrected by IRS, such errors can result in late and misapplied payments, inaccurate distribution of funds, unnecessary taxpayer contact, and time-consuming resolution efforts. This is because significant delays often occur between the time FTD payments are initially recorded and related errors are discovered.

   IRS is exploring ways to better identify improperly applied payments, which will likely require significant systems changes. In the interim, IRS should consider revising the FTD process to capture more complete data on payments at the time they are made.

-- IRS did not have adequate procedures to effectively identify erroneous or fraudulent claims for earned income credits (EICs). In fiscal year 1993, IRS granted over $9.4 billion under this program. Of the 109 cases in our sample of tax returns with EIC claims, 28 percent contained data that were either inconsistent, incomplete, or inaccurate. IRS estimates that as much as 25 percent of EICs filed in fiscal year 1994 will be improper due to taxpayer error or fraud. IRS was aware of this problem and recently implemented procedures at each service center to manually review all tax returns with EIC claims to identify potentially erroneous or fraudulent claims, until longer term systems changes can be implemented.

-- IRS views electronic filing as a cornerstone of its future operations. However, as we testified before this Committee on July 19, 1994,[2] IRS has not yet implemented adequate procedures to detect electronic filing fraud. The growth rate of detected fraudulent electronically filed returns is high, but it is unclear how much of the growth is due to an increase in fraudulent activity rather than an improvement in fraud detection. IRS has implemented several short-term measures designed to prevent refunds to fraudulent electronic filers. These include restrictions on first-time filers and verification of taxpayers' names and social security numbers before accepting their returns.

-- As in fiscal year 1992, IRS continued to improperly and inconsistently calculate interest on taxpayer accounts not subject to automatic calculation, which is referred to as restricted interest. These errors result in underassessment or overassessment of interest and unnecessary contacts with taxpayers. Of the 45 restricted interest transactions in our sample, 16, or 36 percent, were improperly calculated, with errors of up to $2.3 million. IRS was aware of this problem as early as 1986 and has proposed solutions, such as developing standardized personal computer software for calculating restricted interest, identifying areas in which IRS could suggest simplification of existing and proposed legislation, and improving available guidance and training. However, such solutions have not been fully and effectively implemented. It is important that IRS promptly implement solutions.

-- Refunds, especially manually processed refunds, were not adequately controlled. For instance, IRS sent a manual refund for over $2.3 million that incorrectly included approximately $400,000 because IRS entered the interest amount incorrectly. In another example, IRS erroneously issued duplicate refunds: a manual refund of over $1 million, which included interest owed

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[2] IRS Automation: Controlling Electronic Filing Fraud and Improper Access to Taxpayer Data (GAO/T-AIMD/GGD-94-183, July 19, 1994).

to the taxpayer, and an automated refund of $465,995, which did not. In both cases, the errors were identified by the refund recipient, who then notified IRS and returned the excess funds.

In addition, of the 118 refunds and credits greater than $1 million included in our sample, 113, or 96 percent, were authorized by IRS without proper notification of the Joint Committee on Taxation, as required by law. By implementing appropriate procedures and controls, such as supervisory reviews, to ensure that manual refunds are accurate and that the Joint Committee on Taxation is notified, these problems can largely be eliminated without significant systems changes.

-- Due to limitations in IRS' matching of information reported on tax returns by taxpayers and information provided by third parties, IRS is not identifying many erroneous or fraudulent tax returns and is experiencing significant delays in identifying others. Such matching does not occur until over a year after returns are processed. Delays in matching diminish the likelihood that IRS will fully collect any amounts identified as owed by the taxpayers. IRS officials say that they plan to develop new procedures that will allow earlier matching as part of Tax System Modernization (TSM).

At Customs, we found weaknesses in the agency's ability to ensure that all imported goods were declared on import documents and that only those goods approved for release were entered into U.S. commerce. Our specific findings are described below.

-- Customs has no agencywide requirements for observing the unloading of carriers and determining that related documents provided to Customs are complete. As a result, Customs did not have reasonable assurance that it was aware of all goods arriving at ports of entry and entering U.S. commerce. As a short-term measure, during fiscal year 1994, Customs began testing manifest completeness by observing the unloading of randomly selected shipments. Customs has stated that it plans to perform such tests on a nationwide basis during fiscal year 1995. These tests will help determine if any further actions are needed.

-- Customs was not taking advantage of its Automated Manifest System to monitor the release of goods arriving at ports of entry. Of the 88 shipments we reviewed, 26 had not been properly accounted for in this system, and, as a result, Customs could not readily determine whether these shipments had been released. Customs' compliance measurement tests during fiscal year 1995 should help determine the severity of this problem. In the interim, Customs said that it planned to remind all of its regions to promptly investigate and resolve apparent discrepancies in the Automated Manifest System.

-- Customs did not adequately monitor the goods that were moved to other ports prior to their release or export. Under federal law, importers may transport merchandise (1) from the initial U.S. port of entry to another port prior to paying duties and taxes or (2) through the United States for exportation to another foreign country without the payment of duty. However, Customs personnel did not consistently record departure and arrival data and investigate overdue shipments of such transferred goods, which are referred to as in-bond transfers.

At the close of our review, Customs was planning compliance measurement tests for fiscal year 1995 that would help determine the level of violations that actually occur for in-bond transfers. Also, an In-Bond Task Force had been appointed and was considering changes to the processing of in-bond transfers. Such changes, including consideration of modifications to legal provisions that allow in-bond transfers, may be appropriate since the cost of monitoring them and the risk of violations are likely to grow as international trade increases.

In the interim, we believe it is important for Customs to promptly implement our recommendation to (1) distribute written guidance emphasizing to district offices the importance of maintaining accurate data on in-bond shipments and resolving discrepancies and (2) monitor the districts to ensure they comply with related policies.

-- Customs cannot reliably detect and prevent duplicate and excessive refunds of duties, referred to as drawbacks, because its automated system could not link drawback claims to related import entries or maintain a cumulative record of the amount of duty refunded and goods exported or destroyed for each entry. As a result, Customs processed about 49,000 drawback claims, totaling approximately $482 million, during fiscal year 1993 using manual procedures that were ineffective because of the volume of transactions involved. These deficiencies in Customs' accounting for drawback payments precluded us from determining if all such payments made during fiscal year 1993 were appropriate.

Customs has acknowledged weaknesses in controls over drawback payments but delayed action to correct them until passage of the Customs Modernization and Informed Compliance Act in late 1993, which included changes to the drawback law. Customs plans to design new automated capabilities to address control weaknesses, but the improved systems are not expected to be implemented until after fiscal year 1995. In the interim, Customs plans to implement, by the end of fiscal year 1994, our recommendation to require use of representative sampling procedures for reviewing drawbacks that involve too many transactions to review completely.

Controls Over Seized Assets Were Weak

Neither IRS nor Customs had implemented adequate controls to account for the assets they had seized as part of their enforcement efforts. However, IRS and Customs took important steps toward gaining such control. Customs conducted its first-ever physical inventory of seized asset inventories, while IRS reconciled its detailed records to the amounts reported in its financial statements. Controlling Customs' seizures is especially important because of the thousands of pounds of illegal narcotics and other contraband that Customs confiscates each year, in addition to millions of dollars in cash.

Customs' inventory of seized assets was conducted by approximately 200 Customs employees at over 100 storage facilities located throughout the United States. Although it was not performed until February 1994, it was intended to establish an accurate baseline for monitoring and reporting seizure activity from that date forward. As a result of the inventory, Customs was able to identify and correct many significant errors in the recorded quantities and values of seized property. For example, the records showed 51,600 pounds of cocaine and 65,800 pounds of marijuana that could not initially be located. Labor-intensive procedures, involving the review of over 100 case files, resulted in all but 86 pounds of drugs being accounted for by Customs as having been destroyed or transferred to another agency or to a different Customs location prior to the inventory date. In several cases, we found that the transfers were made more than 2 years ago, but the related records had not been updated.

Conversely, the inventory showed that thousands of pounds of drugs held had not been recorded in the inventory records. It is important that all discrepancies be identified and corrected since they increase the risk that drugs could be lost or stolen without detection.

The inventory also identified counterfeit items and items prohibited for sale in the United States that were recorded at a total value of over $20 million, even though they have no resale value to the government. In addition, items valued at over $27 million were incorrectly included in the inventory records even though the items were no longer in Customs' possession. Other items were overvalued by $15.7 million because the values had not been adjusted when accurate assessments became available.

Now that Customs has taken the initial step of improving the reliability of its seized asset records as of February 1994, it is essential that it develop and implement procedures to keep these records accurate and current. In this regard, Customs has stated that it plans monthly reconciliations of its seized asset inventory records and plans an end-of-year inventory in September 1994. In addition, because some locations did not effectively perform the inventory procedures designed to ensure that values were properly updated and that counterfeit or prohibited items were not assigned a value, Customs needs to direct all locations to ensure that valuations are properly adjusted prior to September 1994.

Customs also needs to continue strengthening security at many of its facilities that store seized assets. For fiscal year 1993, despite improvements, we still identified physical safeguard weaknesses at 20 of the 21 facilities we visited. As of the February 1994 inventory date, the 15 districts we visited held an average of 24,000 pounds of drugs that required safeguarding from theft and misuse. Over the past several years, drugs and property have occasionally been stolen from Customs storage facilities. For example, in fiscal year 1993, thieves broke into one facility and stole 356 pounds of cocaine. This case illustrates the risks associated with Customs' practice of storing large quantities of narcotics in facilities that do not provide adequate security.

Also, we found that drugs used in undercover operations were sometimes lost due to inadequate surveillance procedures and that losses from undercover operations were not routinely accounted for and reported. For example, one region did not properly account for a 660-pound cocaine seizure that was being used in an undercover operation, half of which was subsequently lost. By reviewing the enforcement case file, we found that, although the seizure had originally been entered, it was subsequently deleted and then re-entered under a different seizure number, giving the appearance that the two entries were not related. This case is currently under grand jury investigation. In another undercover operation, Customs lost 220 pounds of cocaine that was not accounted for in Customs' seizures records at all. This case is currently being investigated by Treasury's Inspector General.

We also found that cash advances to undercover operations were not reliably accounted for primarily because related transactions were not promptly recorded. Further, in three of the eight undercover operations we tested, some amounts of drugs or currency were not reliably accounted for. For example, we found that up to 631 pounds of high-purity cocaine had been held in a safe for one undercover operation for a period of 8 months but had not been reported in Customs' accounting records.

To address problems related to its undercover operations, Customs said that it has recently established a task force comprised of experts inside and outside the government. Customs plans to defer corrective actions until the task force finishes its work in September 1994.

At IRS, we were unable to audit amounts reported for seized assets because the agency could not provide reliable detailed records that supported its reported balance of $521 million. For example, out of a judgmental sample of 245 seized assets selected from IRS' detailed records, 31 items, or 13 percent, had already been disposed of, and 4 items, or 2 percent, were seized as of the end of 1993 but not included in IRS' detailed records. Also, IRS' seized assets records did not include information that would be useful in evaluating the program, such as sale proceeds or storage, sale, and other related expenses. IRS says that it plans to implement systems and controls to provide proper accountability for seized assets in fiscal year 1995.

Poor Control Over the Use of Operating Funds

In response to our recommendations, both IRS and Customs instituted some improvements in accounting for their operating funds. Both agencies implemented new accounting systems, obtained payroll services from the Department of Agriculture's National Finance Center, and conducted nationwide physical inventories of their fixed assets.

However, many problems remained. As a result of the lack of integrated systems and ineffective processes and controls, IRS and Customs could not provide full accountability for their assets and the use of their appropriated funds, ensure that such funds were spent only as authorized, or reliably determine the costs of their programs and computer modernization efforts.

Although new systems would help correct these problems, short-term improvements are achievable so that IRS and Customs can better oversee implementation of policies and procedures that have already been established. In this regard, it is important that IRS and Customs take immediate steps to ensure that fundamental internal controls--such as account reconciliations and supervisory approvals--are promptly performed and that supporting documentation is properly maintained.

The following are specific examples of some of the problems we identified.

-- Neither IRS nor Customs had fully resolved cash reconciling items or unidentified charges held in suspense accounts. While IRS has made significant progress resolving discrepancies between its records and Treasury's, more than $79 million remained as of the end of our audit. Further, by reviewing activity for fiscal years 1986 through 1993, we found that IRS had written off at least $179 million of cash differences because it could not locate supporting documents. Customs had not resolved a $32 million backlog of differences between its records of cash receipts and Treasury's, even though $16 million of this total was over 1 year old.

   Customs and IRS also had not effectively resolved over $43 million and $31 million, respectively, of unidentified charges that had been recorded in suspense accounts for at least governing the use of appropriated funds, such as management reviews and additional guidance and training.

Serious Weaknesses in Computer Security

Both IRS and Customs have serious computer security weaknesses that compound the weaknesses previously discussed and jeopardize the security and reliability of the operations that are central to their missions. Most of these weaknesses involve inadequate controls over access to sensitive data and computer programs. However, the weaknesses we found at both agencies are symptomatic of broader computer security management issues. Specifically, IRS did not clearly delineate responsibility for computer security or establish an ongoing process to assess the effectiveness of computer controls. At Customs, computer security responsibilities were fragmented, formal procedures had not been established for analyzing and investigating apparent computer security violations, and no routine independent assessments of Customs' information management security program had been implemented.

Customs' controls were inadequate in preventing or detecting unauthorized access and modifications to critical and sensitive data and computer programs, primarily because Customs had not restricted access for individual programs and data files to only those users who needed it to perform their duties. Access control software had been implemented in a way that provided all users with overly broad access when it should have been tailored to the specific needs of individual users or groups of users. As a result, thousands of internal and external users had inappropriate access to critically sensitive production programs and data files. Also, although Customs has conducted a series of studies regarding recovery of its mainframe and telecommunications environment in the event of a disaster, a comprehensive disaster recovery plan had not been developed.

These problems jeopardize the security and reliability of sensitive systems and data, such as the systems and criteria used to monitor the payment of duties, fees, and taxes; identify high-risk import shipments; account for seized goods and drugs; and account for law enforcement operations. In addition, they could result in inappropriate disclosure of sensitive importer information.

The computer security weaknesses we identified at Customs are especially disturbing because most of them were reported to Customs in a 1989 risk assessment. According to the responsible officials, some corrective actions were taken in response to that assessment, and Customs, believing that the weaknesses had been adequately addressed, certified, in 1992, that its three sensitive systems conformed to federal computer security guidelines. However, our findings show that the weaknesses we identified were not adequately addressed. Therefore, in our opinion, Customs' accreditation of its sensitive systems, which was based on these certifications, is not valid.

In commenting on our findings in June 1994, Customs said that, promptly upon learning of the deficiencies we identified, it took numerous actions to restrict access to its sensitive programs and data. Customs also said that it is in the process of centralizing and better defining responsibility for computer security. Because these actions were only recently taken, we have not reviewed their effectiveness. Customs estimated that analyzing user needs in detail and adjusting access controls accordingly are likely to take about 9 months.

At IRS, the significant weaknesses in computer controls that we reported last year[3] continued. IRS has been aware of such weaknesses since at least 1992, when it reported material access control weaknesses in its Federal Managers Financial Integrity Act report as a result of our fiscal year 1992 audit.

As we testified before this Committee on July 19, 1994, although IRS has begun to implement corrective actions, its controls do not yet ensure that taxpayer data are adequately protected from unauthorized access, change, disclosure, or disaster. For fiscal year 1993, we found that IRS still did not adequately (1) restrict access to taxpayer data to only those employees who needed it, (2) monitor the activities of thousands of employees who were authorized to read and change taxpayer data, (3) limit use of computer programs to only those that were authorized, and (4) prepare and test its disaster recovery plans.

In August 1993, IRS developed 35 action steps to address weaknesses associated with its Integrated Data Retrieval System (IDRS), the primary system for accessing and adjusting taxpayer accounts. In addition to improvements in the system itself, these include improvements in management and use of IDRS. Also, in its recently issued report, the Commissioner's Task Force on Privacy, Security, and Disclosure made 30 recommendations for corrective actions. The Commissioner's Task Force also initiated nine additional task forces to study specific problems and to provide recommendations for corrective action, including one to determine how the agency should organize its management structure to ensure adequate controls over privacy and disclosure. We will continue to monitor these efforts as part of our fiscal year 1994 financial statement audit.

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

CFO ACT IMPLEMENTATION

IRS and Customs are working toward building the necessary financial management structure--systems and staffing organization--needed to fulfill the requirements of the CFO Act. However, neither has yet fully established the systems and organization to achieve the act's goals.

Although not required at the bureau level, both IRS and Customs have established CFO positions within their agencies. However, neither agency had established the adequately staffed and qualified CFO leadership teams that are needed to correct their major financial management problems. As with most federal agencies, personnel assigned to the CFO function and the CFO leadership teams have had little or no experience in developing the types of financial statements and systems required by the CFO Act. In this regard, the Commissioners and Deputy Commissioners at IRS and Customs and the CFO at IRS have expressed their commitment to strengthening their CFO leadership groups and are planning to increase the number of staff dedicated to financial management efforts.

Both agencies also have much work to do before they can implement improved automated systems that will allow them to efficiently maintain and report needed financial management information. IRS' and Customs' automated systems were not designed to provide the information needed for financial reporting. As a result, to prepare financial statements as mandated by the CFO Act, many accounting adjustments totaling billions of dollars were required, some of which could not be supported, and some important information was not reported. For example, Customs included about $100 million of unidentified cash sources in its statement of cash flows so that the accounts reported in its statements would balance, and IRS did not report $90 billion of in-process revenue transactions. Also, personnel at both agencies had to create several ad hoc processes that were labor-intensive and sometimes resulted in incomplete and erroneous financial information.

The inadequacy of the existing systems is illustrated by IRS' and Customs' efforts to reliably report their accounts receivable. Neither agency's systems had been designed to provide accounts receivable information needed for their financial statements. For example, their systems were not designed to distinguish between valid receivables and unsubstantiated receivables that the agencies maintained for enforcement purposes. In addition, the systems were not capable of determining whether a receivable was collectible. As a result, labor-intensive efforts were required to determine what was owed as of September 30, 1993. Further, although Customs was eventually able to provide balances for major receivables, it could not provide a summary of the transactions that accounted for the changes in the accounts receivable balances between the beginning and the end of the fiscal year.

Both IRS and Customs plan to address many of the problems stemming from unintegrated systems as part of long-term system redesign projects. However, these projects are not expected to result in significant benefits for several years. IRS' Tax System Modernization project will not be complete until after the year 2000, and Customs' project is still in the relatively early stages of development, with most efforts to date focusing on identifying user needs. In the interim, IRS and Customs will have to continue to rely on often cumbersome manual processes.

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The financial statement audits at IRS and Customs vividly demonstrate the importance of expanding and institutionalizing annual financial statement audits throughout the federal government. We have testified on several occasions, before this Committee in February 1994[4] and most recently on June 21, 1994,[5] on the substantive benefits and progress that have been achieved from the CFO Act's program of pilot agencywide financial statement audits. In this regard, we are encouraged by this Committee's efforts, through S. 2170, to require all 23 CFO agencies to prepare agencywide audited financial statements and by the House's passage of H.R. 3400, the Government Reform and Savings Act, which includes similar requirements.

Mr. Chairman, this concludes my statement. I will be glad to answer any questions that you or the other Members of the Committee may have at this time.

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[4]Improving Government: GAO's Views on H.R. 3400 Management Initiatives (GAO/T-AIMD/GGD-94-97, February 23, 1994).

[5]Financial Management: CFO Act Is Achieving Meaningful Progress (GAO/T-AIMD-94-149, June 21, 1994).

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