United States General Accounting Office

GAO

Performance and Accountability Series

January 1999

Major Management Challenges and Program Risks

Department of the Treasury

GAO/OCG-99-14

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

Comptroller General of the United States

January 1999

The President of the Senate
The Speaker of the House of Representatives

This report addresses the major performance and management challenges affecting the ability of the Department of the Treasury to effectively carry out its mission. Specifically, this report discusses the challenges facing three Treasury bureaus—the Internal Revenue Service, Customs Service, and the Financial Management Service—as well as departmentwide financial management challenges. It also discusses corrective actions that Treasury and its bureaus have taken or initiated to address these challenges and further actions that are needed. For many years, we have reported significant problems at Treasury. These problems are the result of serious deficiencies in (1) information and financial management systems, (2) internal controls at the department level and in the three bureaus, and (3) the organizational structure at IRS.

Treasury has made progress in addressing its key management challenges and continues to plan future improvements. Progress has been made, for example, in the financial management area, as indicated by (1) the unqualified opinions both IRS and Customs received on their financial statements and (2) the removal of Customs' financial management from our high-risk list of federal government programs. The Commissioner of Internal Revenue and the leadership team at IRS has given a top priority to addressing deficiencies. However, while the efforts of the Department and its bureaus are encouraging, Treasury must do more. Because of the complexity of many of Treasury's challenges, long-term efforts are still needed if effective solutions are to be developed and implemented. In particular, we continue to believe that several areas within IRS and the asset forfeiture program at Customs remain at high risk.

This report is part of a special series entitled the Performance and Accountability Series: Major Management Challenges and Program Risks. The series contains separate reports on 20 agencies—1 on each of the cabinet departments and on most major independent agencies as well as the U.S. Postal Service. The series also includes a governmentwide report that draws from the agency-specific reports to identify the performance and management challenges requiring attention across the federal government. As a companion volume to this series, GAO is issuing an update to those government operations and programs that its work has identified as "high risk" because of their greater vulnerabilities to waste, fraud, abuse, and mismanagement. High-risk government operations are also identified and discussed in detail in the appropriate performance and accountability series agency reports.

The performance and accountability series was done at the request of the Majority Leader of the House of Representatives, Dick Armey; the Chairman of the House Government Reform Committee, Dan Burton; the

Chairman of the House Budget Committee, John Kasich; the Chairman of the Senate Committee on Governmental Affairs, Fred Thompson; the Chairman of the Senate Budget Committee, Pete Domenici; and Senator Larry Craig. The series was subsequently cosponsored by the Ranking Minority Member of the House Government Reform Committee, Henry A. Waxman; the Ranking Minority Member, Subcommittee on Government Management, Information and Technology, House Government Reform Committee, Dennis J. Kucinich; Senator Joseph I. Lieberman; and Senator Carl Levin.

Copies of this report series are being sent to the President, the congressional leadership, all other Members of the Congress, the Director of the Office of Management and Budget, the Secretary of the Treasury, and the heads of other major departments and agencies.

David M. Walker
Comptroller General of
the United States

Contents

Overview

One of the primary responsibilities of the Department of the Treasury is to manage the government's finances. This includes collecting over $1.7 trillion in federal tax revenues and making payments totaling more than $1 trillion annually. Treasury faces many challenges in managing the government's finances and, like other parts of the government, is experiencing demands to be more effective and accountable in carrying out its mission. Many of the issues affecting Treasury's ability to effectively manage the government's finances involve challenges relating to information systems. Until Treasury and its bureaus and offices are better able to address the numerous performance and management challenges they are facing, their ability to manage the government's finances will remain impaired.

The Challenges

Management and Performance Issues Affecting the Internal Revenue Service

The Internal Revenue Service (IRS) faces formidable challenges as it attempts to fulfill its mission while addressing major organizational, management, and performance issues. These issues include the need for (1) restructuring IRS' organization and business practices to better balance its efforts between taxpayer assistance and enforcement, (2) correcting management and technical weaknesses in its systems modernization efforts, (3) resolving financial management and control weaknesses that affect its ability to adequately manage its financial operations, (4) addressing problems relating to its ability to collect federal tax receivables and other unpaid assessments, (5) assessing the impact of various efforts it has under way to reduce filing fraud, (6) improving security controls over information systems to address weaknesses that place taxpayer data at risk to both internal and external threats, and (7) modifying information systems to properly function in the year 2000.

Customs' Financial Management Removed From High-Risk List, but Challenges Remain

The Customs Service has made significant improvements in its financial management; as a result, we have removed it from our list of high-risk federal government programs. However, Customs still needs to address certain challenges related to controlling access to sensitive data in its automated systems and maintaining complete and reliable information in its core financial systems. In addition, our recent work has shown that an incomplete systems architecture has hindered Customs' management of major technology investments, such as its Automated Commercial Environment system.

Financial Management Challenges Affecting the Financial Management Service

Treasury's Financial Management Service (FMS) faces challenges in addressing several financial management issues. First, FMS' ability to prepare reliable consolidated financial statements for the U.S. government is primarily hindered by other federal agencies' weaknesses in recordkeeping, documentation, and internal controls. Second, general computer control weaknesses at FMS and its contractor data centers place the data in its financial systems at significant risk of unauthorized modification, disclosure, loss, or impairment. Third, FMS has experienced some difficulties in effectively fulfilling Treasury's responsibilities under the Debt Collection Improvement Act.

Departmentwide Financial Management Weaknesses

At the Departmental level, Treasury's financial management weaknesses hinder its ability to maintain reliable financial records on the results of its operations. Specifically, weaknesses exist in the Department's (1) accountability for and reporting on seized and forfeited property; (2) computer security controls; (3) integration of financial management systems; and (4) process that is used to prepare Departmentwide financial statements. In addition, the Department's financial management systems did not comply with federal requirements.

Progress and Next Steps

Treasury has made progress in addressing its key managerial challenges and continues to develop plans aimed toward making future improvements. Progress, for example, is signified by the (1) unqualified opinions both IRS and Customs received on their financial statements and (2) removal of Customs' financial management from our list of high-risk federal government programs. While Treasury deserves to be recognized for the progress it has made in addressing its key problems, more needs to be done. Because of the complexity of many of Treasury's challenges, long-term efforts may be required to effectively plan and implement solutions.

To meet congressional demands to become more effective and accountable, Treasury began moving toward a performance-based approach to management before the Government Performance and Results Act requirements became mandatory.[1] For example, for several years, Treasury has included in its budget request performance goals that are derived from its strategic plan. In addition, Treasury's fiscal year 1999 performance plan, which was prepared under the Results Act requirements, was combined with its budget request and included reports on performance goals for the preceding 2 fiscal years. However, Treasury's performance plan would be more useful to the Congress and other stakeholders if it included performance goals to specifically address all of the significant management challenges, including the numerous high-risk areas that the Department faces. The performance plan briefly acknowledges some of these major challenges, but it does not have performance goals that adequately address all of them.

We believe that Treasury must take action to develop comprehensive implementation strategies so that its financial and information systems are designed to meet the needs of the Department. Continued dialogue between the Congress, the

[1]The Government Performance and Results Act of 1993 is designed to improve the efficiency and effectiveness of federal programs by establishing a system to set goals for program performance and to measure results. The Act requires agencies to prepare multiyear strategic plans, annual performance plans, and annual performance reports.

Department, and other stakeholders is also necessary to help guide Treasury in devising strategies to more effectively address its major management challenges. In addition, Treasury must be able to show stakeholders evidence of the extent that progress is being made. One way to show commitment to improvement is to promptly implement corrective actions to address those challenges that lend themselves to short-term solutions. Treasury's annual performance plan under the Results Act could be used to convey the status of such progress.

Major Performance and Management Issues

Treasury performs key governmental roles, including administering and enforcing the nation's tax laws, collecting revenue, and managing the government's finances. Treasury also formulates and recommends economic, financial, tax, and fiscal policies and manufactures coins and currency. To carry out its diverse responsibilities, Treasury is divided into more than a dozen bureaus and offices. For its fiscal year 1999 budget, Treasury requested about $12.3 billion.

Our work and that of others have identified Departmentwide management problems at Treasury as well as significant problems in three bureaus—IRS, Customs, and FMS. Much of our work has focused on IRS because of the crucial role it plays in collecting taxes and administering the federal tax system. IRS is Treasury's largest bureau with about 102,000 staff years—two-thirds of the Department's total staff years—and a fiscal year 1999 budget request of nearly $8.3 billion—about two-thirds of the Department's total budget. Several key areas in IRS remain on our high-risk list of government programs, and IRS continues to face new organizational challenges that may affect its ability to effectively carry out its mission. For these reasons, this report highlights IRS' major performance and management issues relating to restructuring, systems modernization, financial management, accounting for and collecting taxes owed the government, filing fraud, information systems security, and century date conversion efforts. This report also addresses important management issues affecting Customs and FMS as well as Departmentwide financial management problems. These challenges hinder Treasury's ability to manage the government's finances.

Management and Performance Issues Affecting IRS

The Congress, in passing the IRS Restructuring and Reform Act of 1998, reaffirmed its commitment to addressing the performance and management issues confronting IRS. In the same vein, the IRS Commissioner has set goals for restructuring the nation's tax collection agency to provide better customer service. One key to restructuring IRS' business operations to provide better service to taxpayers is acquiring modernized systems. Modernized systems are also critical for IRS to address its weaknesses relating to financial management, information systems security, accounting for and collecting taxes, and filing fraud. At the same time it is planning business restructuring and systems modernization, IRS must also manage its century date conversion efforts—which are crucial to its continued operation.

The Need for Restructuring IRS' Organization and Business Practices

The Congress had several reasons for passing the IRS Restructuring and Reform Act of 1998, including concerns about IRS' treatment of taxpayers. To address these concerns and to institute his own initiatives, the Commissioner of Internal Revenue announced a multiyear business modernization plan for IRS that is aimed at improving customer service. The Commissioner has categorized his proposed changes into several key areas, including (1) an organization built around taxpayer needs, (2) balanced performance measures, and (3) new technology.

Managing the restructuring will be a challenge for IRS because (1) the proposed changes in the way IRS does business are extensive, (2) collecting taxes requires IRS to balance its efforts between taxpayer assistance and enforcement, and (3) business restructuring must be coordinated with systems modernization.

The proposed restructuring would be the biggest reorganization of IRS in decades. Currently, IRS has about 100,000 employees who are organized by tax administration function such as returns processing and collection. Under the proposed changes, IRS would be organized into four units that would specialize in serving the needs of different types of taxpayers. The proposed units are (1) wage and investment income; (2) small business, self-employment, and supplemental income; (3) middle market and large corporate; and (4) tax exempt.

While the magnitude of the restructuring task is daunting, management of restructuring is complicated by the need to balance IRS' tax collection efforts and resources between providing service to taxpayers and enforcing compliance with the tax laws. To reinforce the appropriate relationship between these objectives, a balanced set of IRS performance measures is needed. The Commissioner has also emphasized the importance of measures of organizational performance that balance customer satisfaction, business results, employee satisfaction, and productivity. The intent is to provide incentives for service-oriented behavior toward taxpayers, while also emphasizing the need for achieving efficiencies in collecting revenue. Although IRS is striving to improve its overall performance measurement system, it faces particular challenges as it develops and implements performance measures to gauge its efforts to reduce taxpayer burden through improved customer service. The key challenges we identified are (1) developing a reliable measure of taxpayer burden, including the portion that IRS can influence; (2) developing measures that can be used to compare the effectiveness of the various customer service programs; and (3) refining or developing new measures that gauge the quality of the services provided. Additionally, as IRS refines its strategic goals and related measures, it is important that IRS obtain stakeholder involvement to balance its efforts between assisting taxpayers and enforcing compliance with the tax laws.

Reengineering business practices that focus on solving taxpayer problems is a central element of the restructuring concept. For example, IRS is planning efforts to identify as promptly as possible taxpayers who may present a risk of nonpayment and to work out a payment plan that addresses the particular payment problems of those taxpayers. This early identification is intended to help the taxpayer make the necessary payments and minimize the need for subsequent enforcement actions.

New technology is essential to addressing the problems that have hampered IRS' ability to better serve taxpayers. This is critical in that IRS' existing computer systems do not provide ready access to needed information and, consequently, do not adequately support modern work processes or facilitate the attainment of the high level of customer service that IRS hopes to achieve under restructuring. Modernized systems should help IRS collect taxes by providing its collectors with on-line access to the information they need when they need it. These systems, along with the Commissioner's emphasis on balanced performance measures, should help provide IRS with the management information it needs to evaluate the effectiveness of its programs.

The Commissioner's restructuring plan acknowledges that deficiencies exist in IRS' computer systems. In that regard, the plan points out that the new business practices and organizational structure provide a basis for completing and implementing the modern systems outlined in the technology modernization blueprint. One challenge for

IRS is to ensure that the systems development plans under the modernization blueprint and restructuring plan are aligned. In addition, for the Commissioner's restructuring plan to be successful, it is also critical that the long-standing internal control and system weaknesses related to financial management be fully addressed and corrected.

Key Contact

James R. White, Director
Tax Policy and Administration Issues
General Government Division
(202) 512-9110
whitej.ggd@gao.gov

The Need to Address Management and Technical Weaknesses in Systems Modernization Efforts

For more than a decade, IRS has been attempting to modernize its outdated, paper-intensive approach to tax return processing. We reviewed IRS' management of its systems modernization program and, in 1995, reported on serious management and technical weaknesses that jeopardized the program's successful completion. At that time, we made recommendations to correct the weaknesses and designated the modernization program as a high-risk information technology investment. Since then, we have reviewed IRS' actions to address our recommendations and strengthen its systems modernization capability, and we have made additional recommendations to aid in this endeavor.

IRS has made progress in strengthening its modernization capability, and according to IRS' Chief Information Officer (CIO), the Service plans to (1) fully implement our recommendations before it begins building modernized systems and (2) reexamine its modernization blueprint in light of ongoing IRS organizational restructuring and the IRS Restructuring and Reform Act of 1998. However, until our recommendations have been fully implemented, IRS lacks the ability to effectively modernize its tax systems.

IRS' Efforts to Address Long-Standing Systems Modernization Management and Technical Weaknesses

In July 1995, we reported that IRS (1) did not have a comprehensive business strategy to reduce paper tax return filings in a cost-effective manner and (2) had not fully developed and put in place the requisite management, software development, and technical infrastructure necessary to successfully implement its ambitious systems modernization. We also reported that IRS lacked an overall systems architecture to guide the modernization's development and evolution.

At that time, we made over a dozen recommendations to address these weaknesses, including calling for IRS to (1) implement processes for investment management; (2) implement disciplined procedures for software development; and (3) complete and enforce an integrated systems architecture, including data and security subarchitectures. IRS agreed with our recommendations.

In 1996, because IRS had made progress in implementing our recommendations and to minimize the risk of IRS' investing in systems before the recommendations were implemented, we suggested that the Congress limit IRS' information technology spending to certain cost-effective categories. In the fiscal year 1997 Omnibus Consolidated Appropriations Act, the Congress directed IRS to, among other things, establish a schedule for implementing our recommendations and submit an architecture for the modernization by May 15, 1997.

Since then, IRS has taken actions to address these challenges. For example, IRS hired a new CIO and created an investment review board to select, control, and evaluate its information technology investments.

Additionally, IRS provided the first two levels of a four-level modernization blueprint to the Congress on May 15, 1997. Also, in March 1998, IRS released a request for proposals for a prime systems integration services contractor. This contractor, in partnership with IRS, was to be responsible for defining key components of the blueprint and for acquiring and implementing modernized tax systems in accordance with the blueprint. IRS awarded the contract in December 1998.

In early 1998, we reported that the blueprint was a good first step that provided a solid foundation from which to define the level of detail and precision needed to effectively and efficiently build a modernized system of interrelated systems. The Commissioner agreed with our findings. Subsequently, the Congress limited IRS' ability to obligate information technology investment funds until certain conditions were met. These conditions included that IRS was to submit to the Congress for approval an expenditure plan that (1) implements the blueprint, (2) complies with requirements of the Office of Management and Budget's (OMB) system investment guidelines, (3) passes reviews and approvals by OMB and Treasury's IRS

Management Board, and (4) is reviewed by us.

IRS Plans to Implement Our Recommendations

In January 1998, the Commissioner of Internal Revenue announced plans for restructuring IRS' organization. However, this restructuring will affect the very business processes and requirements that the blueprint is based on, thus raising questions about the blueprint's validity and applicability. Additionally, IRS has continued to follow through with its plans to use contractors to modernize its systems, rather than follow its past practice of developing the systems itself. However, as we reported in our 1997 high-risk report on IRS, increasing the use of contractors will not automatically increase the likelihood of successful modernization because IRS has historically lacked the capability to effectively manage its contractors. For this strategy of acquiring modernized systems, rather than developing them in-house, to be successful, IRS would first have to strengthen and improve its ability to manage contractors. Further, Treasury's fiscal year 1999 annual performance plan, submitted under the Results Act, only describes IRS' modernization-related activities in general terms. For example, the plan states that IRS will conduct software maturity activities and establish and maintain systems life cycle processes to manage the prime systems modernization contractor. These general statements do not provide objective, quantifiable, and measurable performance goals and do not specify measures for assessing progress toward the goals, as required by the Results Act.

In December 1998, IRS awarded its prime contract for systems modernization. According to IRS' CIO, the Service plans to partner with the prime contractor to complete the modernization blueprint, as we recommended, and to account for (1) changes in system requirements and priorities caused by IRS' organizational restructuring and (2) changes to accommodate new technology and to implement the IRS Restructuring and Reform Act of 1998 requirements. Additionally, the CIO stated that IRS plans to establish disciplined life cycle management processes and structures and mature software development and acquisition capabilities before it begins building modernized systems.

Because of the importance and high cost of the modernization and the fact that our key recommendations remain open, we plan to continue evaluating IRS' ability and readiness to effectively modernize its systems and will continue to categorize IRS' systems modernization effort as a high-risk program.

Key Contact

Jack L. Brock, Jr., Director
Governmentwide and Defense Information Systems
Accounting and Information Management Division
(202) 512-6240
brockj.aimd@gao.gov

The Need to Continue to Address Financial Management Weaknesses

In fiscal year 1997, IRS received an unqualified opinion on its custodial financial statements for the first time since we began auditing them in fiscal year 1992.[1] This achievement was largely attributable to IRS' efforts to improve significant internal controls in critical areas, such as the reconciliation of tax receipts and refunds between its systems and those of FMS. However, IRS had to use extensive ad hoc procedures to enable it to prepare auditable financial statements. This resulted from IRS'

[1]The custodial financial statements did not report on activities related to IRS' administrative costs that were funded by appropriations and reimbursements from other agencies, state and local governments, and the public. These activities were reported separately in IRS' administrative financial statements, which were audited by the Treasury Office of Inspector General.

inability to rely on its general ledger system to support its financial statements because of its deficiencies. A core purpose of a general ledger system is to support the preparation of financial statements. To compensate for deficiencies, IRS uses specialized computer programs to extract information from its master files—its only detailed database of taxpayer information—to derive amounts to be reported in the financial statements. However, the amounts produced by this approach needed material audit adjustments to produce reliable financial statements. In our audit report on IRS' fiscal year 1997 financial statements, we cited long-standing material weaknesses in IRS' financial management that prevented it from routinely generating timely and reliable information as a tool for managing IRS operations or as a basis for preparing financial statements. These weaknesses also affect IRS' ability to adequately manage its financial operations, expose the federal government and taxpayers to financial loss, and create undue burden to taxpayers.

IRS' primary internal control weaknesses relate to tax receipts, taxpayer data, and unpaid tax assessments. IRS initiated corrective actions designed to address some of the pervasive financial management problems we have reported since 1992. However, many of IRS' initiatives—which include its systems modernization effort and plans to improve its financial reporting capabilities—are long term and, according to IRS' plans, may take 10 years or more of sustained effort to fully implement. Some other issues can be resolved in the next few years by improving policies, procedures, and internal controls. These weaknesses in IRS' financial management systems and internal controls reflect the extent to which IRS still has extensive work ahead to fully address and resolve its financial management and internal control deficiencies. Therefore, IRS' financial management continues to be designated as a high-risk area.

Internal Control Weaknesses Regarding Tax Receipts and Taxpayer Data

IRS' controls over tax receipts and taxpayer data do not adequately reduce the vulnerability of the federal government and taxpayers to loss from the theft and inappropriate disclosure of proprietary taxpayer information. For example, receipts were left in unrestricted areas accessible to individuals not authorized to handle receipts. In addition, employees were hired and worked in positions requiring the handling of cash, checks, or sensitive taxpayer information before IRS received the results of their background or fingerprint checks. Of the 80 thefts that IRS investigated at service centers from January 1995 to July 1997, 12 (15 percent) were committed by individuals who had previous arrest records or convictions that were not identified before their employment. In addition, single, unarmed couriers in ordinary civilian vehicles were used to transport IRS deposits totaling hundreds of millions of dollars to the depository institutions during the peak filing season. One courier left a deposit totaling more than $200 million unattended in an open vehicle while he returned to the service center. At one district office, IRS relied on a bicycle messenger to deliver daily deposits ranging from more than $1 million during the nonpeak season to more than $100 million during the peak season.

Although receipts and taxpayer information will always be vulnerable to theft, IRS has a responsibility to protect the government and taxpayers from such losses. In November 1998, we made recommendations to IRS that would address the internal control weaknesses that our work identified, including prohibiting new employees from being assigned to process receipts until fingerprint checks are received and reviewed by management, enhancing physical security over receipts and taxpayer data, and reviewing the level of security provided receipts and taxpayer data in transit to depository institutions. IRS generally agreed with our recommendations and has indicated that it plans to address most of the control deficiencies relating to tax receipts and taxpayer data we identified.

Internal Control Weaknesses Over Unpaid Tax Assessments

IRS does not have a detailed listing or subsidiary ledger that tracks and accumulates unpaid tax assessments on an ongoing basis. The lack of a subsidiary ledger impairs IRS' ability to effectively manage its unpaid assessments. This weakness has resulted in IRS' inappropriately directing collection efforts against taxpayers after amounts owed had been paid. In one case, three taxpayers had multimillion dollar tax liabilities and liens placed against their property, although the taxes had actually been paid and two of the individuals were owed refunds. In addition, IRS must rely on computer programs to extract data from its master files to prepare its financial statements, a process that necessitated tens of billions of dollars in adjustments to correct misclassifications and eliminate duplicate transactions in fiscal year 1997. IRS also lacks adequate documentation to support its unpaid assessments. For example, the estate case files we reviewed generally did not include audited financial statements or an independent appraisal of the estate's assets—information that would greatly assist in determining potential collectibility and potential underreporting in these cases. These weaknesses hinder IRS' ability to effectively manage its unpaid assessments by contributing to IRS' inability to focus its collection efforts on those accounts exhibiting the greatest degree of collection potential.

During fiscal year 1998, we issued a report discussing these issues in detail and providing recommendations to address them. IRS has agreed to consider studying ways of addressing these problems, pending implementation of its long-term system enhancements.

Key Contact

Gregory D. Kutz, Associate Director
Governmentwide Accounting and Financial Management Issues
Accounting and Information Management Division
(202) 512-9505
kutzg.aimd@gao.gov

The Need to Address Problems Relating to Federal Taxes Receivable and Other Unpaid Assessments

Each year, IRS collects tax revenue to fund government operations. In fiscal year 1998, IRS collected over $1.7 trillion. However, IRS has not been able to collect a significant portion of the amount of federal taxes it identifies as due the government. This problem has been compounded by serious financial management system deficiencies and the lack of sound, reliable information, which impede IRS' efforts to collect unpaid tax assessments.

As of September 30, 1997, IRS had identified $214 billion in unpaid tax assessments that were due to the federal government. These assessments, which have historically been referred to as IRS' accounts receivable, consist of (1) $90 billion in taxes due from taxpayers for which IRS can support the existence of a federal tax receivable through taxpayer agreement or a favorable court ruling;[2] (2) $48 billion in compliance assessments for which neither a taxpayer nor a court has affirmed that the amounts are owed; and (3) $76 billion in write-offs, which represent unpaid assessments for which IRS does not expect further collection because of such factors as the taxpayer's

[2]When Statement of Federal Financial Accounting Standards No. 7 became effective for fiscal year 1998, these transactions were redefined and are now appropriately referred to as federal taxes receivable.

death, bankruptcy, or insolvency. Under federal accounting standards, only the $90 billion in unpaid assessments that IRS can support by taxpayer agreement or favorable court ruling represent federal taxes receivable. For the first time since we began auditing IRS, the agency has reported a reasonable estimate of the amount of federal taxes receivable it expects to ultimately collect. This amount, $28 billion as of September 30, 1997, represents just 31 percent of the total federal taxes receivable and just 13 percent of the total balance of unpaid assessments.

Our work has shown that this low level of expected collectibility is a reasonable estimate given the composition of IRS' unpaid assessments. The $76 billion in write-offs are amounts primarily due from bankrupt and insolvent taxpayers, including billions in delinquent taxes that are owed by failed financial institutions and thus have virtually no hope of collection. The $48 billion in compliance assessments are primarily amounts that are owed by individuals and businesses for income and payroll taxes. However, IRS' future prospects of collecting these amounts are low because (1) these taxpayers have not acknowledged the debt and (2) in many instances these amounts are derived through IRS' various compliance and enforcement programs and may not ultimately represent the amounts actually owed by the taxpayer.

This leaves $90 billion in unpaid assessments that represent federal taxes receivable. Yet, our work has shown that $62 billion (68 percent) of this balance is also not likely to be collectible. This $62 billion is owed primarily by taxpayers who are (1) experiencing financial hardships, (2) undergoing bankruptcy, or (3) unwilling to pay some or all of the amounts they owe. Only $28 billion of the $90 billion of federal taxes receivable represent amounts where collection is likely based on the financial status and willingness of the taxpayers to pay some or all of the amounts they owe. However, despite these problems, IRS' goal is to pursue collection of all federal taxes due.

Striving to close the gap between the amount of tax revenue owed the government and the amount likely to be collected is a major challenge for IRS. However, IRS' long-standing systems deficiencies make this challenge even more difficult. IRS has continually tried to manage its federal taxes receivable and other unpaid assessments with systems that are unable to provide timely, useful, and reliable information on the status of taxpayers' accounts. Consequently, IRS does not have the complete and reliable information it needs to effectively focus collection efforts on accounts with the greatest collection potential. This is critical given that 87 percent of IRS' estimated unpaid assessments, including the $62 billion in federal taxes receivable, have little or no potential for collection. Additionally, because IRS' systems are not integrated with one another, they create high rates of error in taxpayers' accounts and, in some cases, create unnecessary taxpayer burden. These burdens result in costs to both the taxpayer and IRS in resolving the errors caused by these system deficiencies. System weaknesses and the lack of adequate data also have an impact on IRS' ability to identify delinquencies so that it can target its compliance and enforcement initiatives. These deficiencies impede IRS' efforts to detect noncompliant taxpayers earlier, thereby increasing the likelihood that such amounts, if and when detected, will yield little collection.

We have provided IRS with a series of long- and short-term recommendations to assist it in addressing the serious financial management issues that are associated with federal taxes receivable and other unpaid assessments. However, these issues and their implications continue to expose the government to significant loss of tax revenue. Consequently, we believe federal taxes receivable should continue to be designated as a high-risk area for the government.

Key Contact

Gregory D. Kutz, Associate Director
Governmentwide Accounting and Financial Management Issues
Accounting and Information Management Division
(202) 512-9505
kutzg.aimd@gao.gov

The Need to Assess the Impact of Efforts to Reduce Filing Fraud

Since we first identified filing fraud as a high-risk area in February 1995, IRS has taken several steps in an attempt to reduce its exposure to filing fraud. For example, IRS (1) expanded the number of up-front filters in the electronic filing system that is designed to screen electronic submissions for problems, such as missing or incorrect Social Security numbers (SSN), to prevent returns with those problems from being filed electronically; (2) strengthened the process for checking the suitability of persons applying to participate in the electronic filing program as return preparers or transmitters by requiring fingerprint and credit checks; (3) revised the computerized formulas used to score all tax returns to determine their fraud potential; (4) upgraded the Electronic Fraud Detection System to give staff in the Questionable Refund Program better research capabilities; and (5) placed an increased emphasis on validating SSNs on filed paper returns.

A significant change in IRS' return processing procedures in 1997 enhanced its ability to' deal with paper returns involving missing or incorrect SSNs. That year, as legislatively authorized, IRS began treating missing or incorrect SSNs as math errors, which was similar to the way it had historically handled computational errors. That meant that IRS could adjust refunds claimed by persons filing paper returns if the required SSNs were missing or incorrect. Before 1997, IRS could not make adjustments to a refund involving a missing or incorrect SSN until it had gone through more time-consuming and labor-intensive examination procedures. As we reported in 1996, those procedures limited the number of cases IRS could work and resulted in millions of questionable refunds being issued.

Most of the fraudulent refund claims identified by IRS involved the Earned Income Credit (EIC), which is a refundable tax credit that is available to low-income, working taxpayers. In April 1997, IRS released the results of its study of EIC noncompliance on tax returns filed in 1995 (i.e., tax year 1994 returns). The study showed that of the $17.2 billion in EIC claims on tax year 1994 returns, about $4.4 billion (25.8 percent) was estimated to be overclaims. How much of this $4.4 billion involved fraud, as opposed to less serious noncompliance, is unknown. The returns included in IRS' study were filed before IRS was given increased authority to deal with missing or invalid SSNs. However, even after adjusting for the potential effect of that increased authority, IRS determined that the rate of EIC noncompliance would still be over 20 percent.

Our work relating to the audit of IRS' financial statements also showed that IRS' internal controls are not adequate to ensure that only valid tax refunds are disbursed. As a result, IRS has sometimes issued refunds that were duplicated, based on erroneous or fraudulent tax returns, or payable to IRS employees who had manipulated IRS' records to generate invalid refunds payable to themselves.

In response to IRS' findings, the Congress passed legislation that gave IRS (1) new enforcement tools and (2) additional funding that was specifically designated for EIC-related activities. With those new tools and funds, IRS, in 1998, began implementing a 5-year EIC compliance initiative that involved several components directed at issues that were identified by IRS' study as major sources of EIC noncompliance. For example, IRS initiated enforcement efforts that focused on (1) cases where an EIC-qualifying child's SSN was used on more than one tax return for the same tax year and (2) returns filed by certain EIC claimants who claimed the head-of-household filing status. IRS also began a study of noncompliance among EIC claimants who report income from self-employment, increased staffing in the Questionable Refund Program, and issued procedures requiring tax return preparers to exercise due diligence in preparing returns involving EIC claims.

As we reported in July 1998, most of IRS' efforts under the EIC compliance initiative had not progressed far enough at the time we completed our audit work for us to judge their effectiveness. To help assess the overall effectiveness of its efforts, IRS plans to do annual studies of EIC compliance starting with a baseline study of returns filed in 1998 (i.e., tax year 1997 returns), which is currently under way. Using the results of that baseline study and subsequent years' studies, IRS plans to measure the rate of compliance and improvement in that rate over time. Those annual studies should eventually provide the necessary data to assess the impact of IRS' efforts on reducing the incidence of noncompliance associated with the EIC. Until sufficient data on the results and impact of IRS' efforts are available through these studies and better controls are instituted through systems modernization, which is still in the planning stages, filing fraud should remain a high-risk area.

Key Contacts

James R. White, Director
Tax Policy and Administration Issues
General Government Division
(202) 512-9110
whitej.ggd@gao.gov

Gregory D. Kutz, Associate Director
Governmentwide Accounting and Financial Management Issues
Accounting and Information Management Division
(202) 512-9505
kutzg.aimd@gao.gov

The Need to Improve Security Controls Over Information Systems

For the past 5 years, we have reported significant and long-standing weaknesses with controls over IRS' information systems. Although IRS has made progress in improving computer security, weaknesses in IRS' computer security controls continue to place IRS' automated systems and taxpayer data at serious risk to both internal and external threats. Such weaknesses could result in the denial of computer services or in the unauthorized disclosure, modification, or destruction of taxpayer data. These weaknesses affect IRS' ability to control physical access to its facilities and sensitive computing areas, control electronic access to sensitive taxpayer data and computer programs, prevent and detect unauthorized changes to taxpayer data or computer software, and restore essential IRS operations following an emergency or natural disaster.

Similar to receipts and hard-copy taxpayer data, the need is clear for IRS to implement strong and effective security over taxpayer data contained in its information systems. IRS relies on its information systems to annually process more than 200 million taxpayer returns, account for over $1.7 trillion collected in tax revenues, and issue over $150 billion in tax refunds. In addition, IRS systems contain sensitive taxpayer information, such as name, address, SSN, and details of taxpayers' financial holdings. As we have previously reported, similar information has been used to commit financial crimes and identify fraud nationwide. Commonly reported financial crimes include using someone's personal information to fraudulently establish credit, run up debt, and take over and deplete taxpayers' financial accounts.

We previously recommended that IRS complete implementation of an effective servicewide computer security management program and establish the appropriate safeguards and control measures to adequately protect IRS' tax processing operations and taxpayer data. IRS agreed with our recommendations and stated that our conclusions and recommendations were consistent with its ongoing actions to improve systems security. Until stronger security controls are in place over its information systems, IRS' tax processing operations remain vulnerable to disruption. Furthermore, the sensitive taxpayer data maintained by IRS could be disclosed to unauthorized individuals, modified and improperly used, or destroyed, thereby exposing taxpayers to financial crimes such as identity fraud.

Key Contact

Robert F. Dacey, Director
Consolidated Audit and Computer Security Issues
Accounting and Information Management Division
(202) 512-3317
daceyr.aimd@gao.gov

The Need to Confront the Challenges Presented by the Year 2000 Computer Problem

IRS, like other Treasury offices and bureaus, is highly dependent on information technology to carry out its mission. Most of Treasury's information systems were not designed to read dates beyond December 31, 1999. As a result, IRS and the other Treasury offices and bureaus are in the midst of a massive effort to make their information systems Year 2000 compliant to avoid significant disruptions to their operations.

IRS accounts for the bulk of Treasury's Year 2000 undertaking. Of the estimated $1.9 billion earmarked for Treasury's Year 2000 program, $1.4 billion has been designated for IRS. These cost estimates include work needed for IRS' mission-critical information systems, telecommunications networks, and buildings. IRS' program also represents one of the largest civilian Year 2000 efforts. At the outset, IRS faced significant challenges in making its systems Year 2000 compliant. In addition to the size of its effort, IRS lacked a comprehensive inventory of information system assets, particularly of its information systems infrastructure (i.e., systems software, hardware, and telecommunications networks), and IRS' CIO did not control all mission-critical assets.

In a June 1998 report, we said that IRS had made more progress in fixing its applications than its infrastructure. Also, we said that two major Year 2000 system replacement efforts were experiencing schedule slippages. In addition, we identified two risk areas for IRS' Year 2000 effort—that is, the absence of an integrated master schedule showing the interdependencies among the many Year 2000 efforts and a limited approach to contingency planning.

IRS has begun taking action to address our concerns about a master schedule. We made no recommendations on that risk area in our June 1998 report. Concerning the second risk area, we recommended that the Commissioner take steps to broaden the contingency planning effort to help ensure that IRS had adequately assessed the vulnerabilities of its core business processes to potential Year 2000 system failures. Specifically, we recommended that the Commissioner (1) solicit input from the business functional areas to identify core business processes and identify those processes that must continue in the event of a Year 2000 failure, (2) map IRS' mission-critical systems to those core business processes, (3) determine the impact of information system failures on each core business process, (4) assess existing contingency plans for their applicability to potential Year 2000 failures, and (5) develop and test contingency plans for core business processes if existing plans are not appropriate.

Since we issued our report, IRS has been taking actions to address our recommendations. IRS had originally planned to have its first set of contingency plans by December 15, 1998; however, according to its officials, IRS did not meet that milestone. We plan to continue monitoring IRS' progress in developing contingency plans. If IRS is unable to make its mission-critical systems Year 2000 compliant, IRS could be rendered unable to properly and timely process tax returns, issue refunds, correctly calculate interest and penalties, effectively collect taxes, or prepare accurate financial statements and other financial reports.

Key Contact

James R. White, Director
Tax Policy and Administration Issues
General Government Division
(202) 512-9110
whitej.ggd@gao.gov

Customs' Financial Management Removed From the High-Risk List, but Challenges Remain

Since Customs was originally added to the high-risk list, it has developed and implemented actions to address the problems that contributed to its designation as a high-risk area. Because Customs' management has made progress in addressing its financial management weaknesses, especially those related to assessing and collecting revenues, we are removing Customs financial management from the high-risk list. However, similar to many other federal agencies, Customs still faces certain challenges that are primarily related to controlling access to sensitive data that are maintained in its automated systems and maintaining complete and reliable information in its core financial systems.

Significant Improvements at Customs Results in Removal From the High-Risk List

In 1991, we added Customs as a high-risk area because it had major weaknesses in its management and organizational structure that diminished its ability to detect trade violations on imported cargo; collect applicable duties, taxes, fees, and penalties; control financial resources; and report on financial operations. In February 1995, we reported that Customs had taken several actions in an effort to reduce risks in the general management area. For instance, Customs revised its 1993 5-year plan to clarify and set priorities for its trade enforcement objectives; improved controls over the identification and collection of duties, taxes, fees, and penalties; and embarked on a reorganization plan to correct institutional problems that were related to cooperation and coordination among its programmatic units and to ensure consistency in policy implementation.

We have made several recommendations to Customs to help promote better financial management and strengthen its controls over assessing and collecting revenues. We made these recommendations realizing that most of these problems would require long-term efforts to effectively plan and implement solutions to address the long-standing root causes. Over the past several years, Customs has continually shown a commitment to improving its financial management by implementing significant corrective actions to address our recommendations. Actions that have been implemented include statistically sampling compliance of commercial importations through ports of entry to better focus enforcement efforts; implementing a compliance measurement program (CMP) for bonded warehouses;[3] programming the Automated Commercial System in fiscal year 1995 to detect any drawback claims[4] that exceeded the total amount of duty and tax paid on related import entries; and aggressively pursuing the collection of delinquent receivables. Another indicator of Customs' progress in the financial management area is its ability to receive

[3]Foreign merchandise can be placed into bonded warehouses without the assessment of duties, taxes, and fees on the goods until the goods are released into the commerce of the United States.

[4]Drawback claims are refunds of duties and taxes paid on imported goods that are subsequently exported or destroyed.

unqualified audit opinions on its fiscal years 1996 and 1997 financial statements.

In addition to these actions, according to Customs officials, Customs has several initiatives under way to improve its controls over assessing and collecting revenues. For example, in September 1998, Customs began implementing a nationwide in-bond shipments CMP that is intended to provide some assurance over compliance of in-bond shipments through random examinations of such items.[5] The program involved system changes for in-bond shipments as well as the addition of compliance measurement inspections for randomly selected in-bond shipments. Additionally, Customs plans to implement a CMP for foreign trade zones[6] and is reviewing drawbacks and drawback claims for quality assurance.

Given the significant improvement efforts, including those related to assessing and

[5]In-bond shipment refers to goods that are authorized, by law, to be moved within the United States before release or export without appraisement or classification.

[6]Foreign trade zones are geographic areas, designated in accordance with the Foreign Trade Zone Act of 1934, where merchants may bring domestic or foreign merchandise for storage, exhibition, manipulation, manufacturing, assembly, or other processing without subjecting them to formal Customs entry procedures and payment of duties. Foreign goods held in foreign trade zones are not assessed duties, taxes, or fees until the goods are released into the commerce of the United States.

collecting revenues, undertaken by Customs since it was first added to the high-risk list, we are removing our high-risk designation.

Weaknesses Relating to Internal Controls Over Data in Automated Systems

Similar to many other federal agencies, Customs still faces certain challenges that are primarily related to controlling access to sensitive data that are maintained in its automated systems and maintaining complete and reliable information in its core financial systems. In its March 1998 audit report on Customs' fiscal year 1997 financial statements, the Treasury Office of Inspector General (OIG) reported the following material weaknesses in internal controls:[7] (1) core financial management systems need to be improved and integrated and (2) adherence to systems development standards for certain financial management systems was lacking. The Treasury OIG also identified reportable conditions, including (1) computer access vulnerabilities that could allow for unauthorized modification and deletion of production programs, systems software, and data in Customs' systems and (2) disaster recovery

[7]A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that errors or irregularities in amounts that would be material to the financial statements may occur and not be detected promptly by employees in the normal course of performing their duties.

capabilities that were in need of improvement.[8]

We and others have made several recommendations to Customs that are related to the access of its computer systems and to the improvement and integration of its core financial management systems. According to its officials, Customs has the following initiatives under way to address these recommendations: (1) implementing system enhancements to its Seized Assets and Case Management Tracking System (SEACATS); (2) continuing its efforts to replace all existing nonrevenue-related financial management systems with a single integrated system; (3) taking additional corrective actions on computer security control weaknesses, such as completing periodic reviews of user access capabilities and limiting users' access to operating system capabilities; (4) developing plans to conduct a business impact and recovery requirements analysis to identify critical systems and applications in the event of a

[8]Reportable conditions involve matters coming to the auditor's attention relating to significant deficiencies in the design or operation of internal controls that, in the auditor's judgment, could adversely affect an entity's ability to (1) safeguard assets against loss from unauthorized acquisition, use, or disposition; (2) ensure the execution of transactions in accordance with management's authority and in accordance with laws and regulations; or (3) properly record, process, and summarize transactions to permit the preparation of the financial statements or to maintain accountability for assets.

systems disaster; and (5) pending the receipt of funding, establishing a disaster recovery site in the year 2000.

We believe that Customs' improvement efforts are appropriately focused, but its management must provide the continuing support needed to ensure that these important actions are properly implemented and that related problems do not recur. As part of its annual audit of Customs' financial statements, the Treasury OIG plans to update the status of Customs' internal control weaknesses. Also, we will continue to monitor Customs' progress in addressing these areas.

Weaknesses Relating to the Development of Customs' Automated Commercial Environment System

Our recent work shows that an incomplete systems architecture has hindered Customs' ability to manage information technology investments, particularly large, mission-critical systems such as its Automated Commercial Environment (ACE) system. Pending funding, Customs plans to use ACE to replace the current system used for collecting, disseminating, and analyzing import-related data and ensuring the proper collection and allocation of revenues totaling about $19 billion annually. Customs initiated ACE in 1994. In January 1998, Customs estimated that it would cost $1.15 billion to develop, operate, and maintain ACE over the 15-year period between fiscal years 1994 and 2008. As of the end of fiscal year 1998, Customs reported that it had spent $62.1 million on ACE.

In May 1998, we reported that Customs' incomplete enterprise information systems architecture and limitations in its plans for enforcing compliance with an architecture, once one is completed, impair the agency's ability to effectively and efficiently develop or acquire operational systems, such as ACE, and to maintain existing systems. Furthermore, because Customs' incomplete architecture is not based on a thorough understanding of its enterprisewide functional and information needs, Customs did not have adequate assurance that its information systems, such as ACE, would optimally support its ability to (1) fully collect and accurately account for billions of dollars in annual federal revenue and (2) allow for the expeditious movement of legal goods and passengers across our nation's borders while preventing and detecting the movement of illegal goods and passengers. We recommended that Customs follow through on plans to complete its enterprise information systems architecture and require that information systems comply with the architecture, unless a thorough analysis supports a waiver. Customs agreed with our recommendations and is in the process of completing its enterprise systems architecture and instituting a requirement that systems comply with the architecture.

Key Contacts

Gary T. Engel, Associate Director
Governmentwide Accounting and Financial Management Issues
Accounting and Information Management Division
(202) 512-3406
engelg.aimd@gao.gov

Jack L. Brock, Jr., Director
Governmentwide and Defense Information Systems
Accounting and Information Management Division
(202) 512-6240
brockj.aimd@gao.gov

Financial Management Challenges Affecting FMS

FMS is the government's financial manager, central disburser, and collections agency as well as its accountant and reporter of financial information. FMS faces challenges in addressing financial management issues related to preparation of the government's consolidated financial statements (CFS), computer system security, and FMS' implementation of its requirements under the Debt Collection Improvement Act of 1996 (DCIA). We will continue to monitor FMS' efforts to implement its requirements under DCIA. In addition, we are evaluating FMS' efforts to address the other matters during our ongoing audit of the government's fiscal year 1998 CFS.

The Need to Address Issues Related to Preparing Reliable Consolidated Financial Statements for the Government

In our March 1998 audit report on the government's fiscal year 1997 CFS, we reported that problems with fundamental recordkeeping, incomplete documentation, and weak internal controls prevent the government from accurately reporting a large portion of assets, liabilities, and costs. These deficiencies, as described in the following paragraphs, affect the reliability of the CFS and much of the underlying information. As preparer of the CFS, FMS has a key responsibility to work with agencies to address some of these problems, including the government's inability to (1) properly account for billions of dollars of basic transactions, especially those between governmental entities; (2) ensure that the information in the CFS is consistent with agencies' financial statements; and (3) ensure that all disbursements are properly recorded.

To make the CFS balance, FMS recorded a net $12 billion item on the Statement of Changes in Net Position, which it labeled unreconciled transactions. FMS attributed this out-of-balance condition, which is the net of more than $100 billion in unreconciled transactions, to the government's inability to properly identify and eliminate transactions between federal government entities and to agency adjustments that affected net position. Agencies' accounts can be out of balance with each other, for example, when one or the other of the affected agencies does not properly record transactions with another agency or the agencies record the transactions in different time periods. These out-of-balance conditions can be detected and corrected by instituting procedures for reconciling transactions between agencies. Generally, such reconciliations are not performed. These unreconciled transactions result in material misstatements of assets, liabilities, revenues, and/or costs. Until effectively corrected, this problem could continue to prevent us from being able to form an opinion on the reliability of the CFS.

The government cannot ensure that the information in the CFS is consistent with agency financial statements. FMS relies on agencies to submit data needed to prepare the CFS; however, (1) several agencies were unable to provide assurance that amounts submitted to FMS agreed with their agency financial statements; (2) many agencies needed to make significant subsequent adjustments to their submissions in an effort to properly classify amounts in the CFS; and (3) we found misstatements, which FMS corrected, that totaled several hundred billion dollars in agency-submitted information and were primarily due to mistakes in coding, incorrect use of general ledger accounts, and misallocations among the net cost categories.

In our March report, we noted that several major agencies were not effectively reconciling their records with FMS' records of cash disbursements, resulting in the government's being unable to ensure that all disbursements are properly recorded. In our related report issued in October 1998, we indicated that auditors depend on FMS for support in fulfilling their reconciliation responsibilities. Several agencies reported problems with FMS' reconciliation processes and the assistance it provides agencies in carrying out these processes. We found that FMS had taken some steps that attempt to improve the reconciliation process and was considering other actions to improve its assistance to agencies. We recommended that FMS work with agencies and provide sufficient resources to ensure that the reconciliation problems are fully addressed.

FMS has developed action plans and is working with us, OMB, and key agencies to address the noted problems. However, fixing these problems represents a significant challenge because of the size and complexity of the government and the discipline needed to comply with new accounting and reporting requirements. Meeting these challenges will require a significant commitment of agencies' and FMS' management as well as adequately trained staff and effective automated financial systems.

The Need to Improve Computer Security Controls

FMS faces considerable challenges in overseeing the development, implementation, and operation of its entitywide information systems, including the establishment of appropriate computer controls. FMS maintains a wide array of financial and information systems to help it process and reconcile money disbursed and collected by the various government agencies. Multiple banking, collection, and disbursement systems are also used to process agency transactions, capture relevant data, transfer funds to and from Treasury accounts, and facilitate the reconciliation of these transactions. In addition to operating six regional financial centers, FMS relies on a network of contractors and the Federal Reserve Banks to help carry out its financial management responsibilities.

In October 1998, we reported that general computer control weaknesses at FMS and its contractor data centers place the data maintained in FMS' financial systems at significant risk of unauthorized modification, disclosure, loss, or impairment.[9] The weaknesses we found included
(1) inappropriate access to computer programs, data, and equipment;
(2) inadequate segregation of duties;
(3) improper application software development and change control

[9]On July 31, 1998, we issued a "Limited Official Use" report to the Secretary of the Treasury detailing weaknesses in FMS' general controls. The October 1998 version of the excerpted report for public release, Financial Management Service: Areas for Improvement in Computer Controls (GAO/AIMD-99-10, Oct. 20, 1998), provided a general summary of the weaknesses we identified and the recommendations we made.

procedures; and (4) incomplete or untested service continuity and contingency plans.

Weak controls over FMS' computer systems place billions of dollars of payments and collections at risk of fraud. These weaknesses existed primarily because FMS does not have an effective entitywide computer security planning and management program to ensure that (1) computer controls are working and are reliable, (2) established policies and procedures are followed, (3) errors or fraudulent transactions are detected in a timely manner, and (4) identified deficiencies are promptly corrected.

Because of the large volume of transactions, the significance of the related amounts involved, and the number of weaknesses identified at the FMS data centers visited, we consider FMS' general computer control problems a material weakness. According to Treasury officials, FMS has planned or already taken actions to correct many of the individual weaknesses that we identified and communicated to FMS management during our testing. Although FMS is continuing to correct weaknesses we identified, FMS cannot ensure on an ongoing basis that weaknesses will be promptly detected and corrected until it has an effective entitywide security management program. Such a program, if implemented effectively across the organization, would go a long way toward helping FMS identify and promptly address its computer control weaknesses.

The Need to Effectively Implement the Debt Collection Improvement Act

DCIA provided significant opportunities for improving the government's ability to collect nontax delinquent debt. According to Treasury, the 24 executive branch agencies that are to comply with the Chief Financial Officers Act (CFO) of 1990 accounted for 99 percent of federal expenditures and held more than 90 percent ($43.1 billion) of federal nontax debt that was more than 180 days delinquent as of April 1998. Many of DCIA's provisions grant federal agencies additional authority to enhance their debt collection practices, and several key provisions affect Treasury.[10] Specifically, DCIA requires that agencies transfer most of their nontax debt that has been delinquent for more than 180 days to Treasury for collection through its offset or cross-servicing programs. Under the offset program, Treasury uses amounts that the federal government owes delinquent federal

[10]The Secretary of the Treasury assigned FMS primary responsibility to fulfill Treasury's responsibilities under DCIA.

debtors to satisfy any of the debtors' delinquent debt owed to a federal agency. For example, an income tax refund payment made by IRS may be offset to pay a taxpayer's delinquent student loan debt. Cross-servicing involves the collection of debts through centralized debt collection centers established by Treasury or private collection agencies. DCIA also requires the agencies to report information to Treasury annually on the debts owed to them and their efforts to collect them. In turn, Treasury is required to report this information to the Congress annually. By April 1999, Treasury is to provide a one-time report to the Congress on the collection services provided by the Department and other entities to collect federal debts.

The Congress has raised concerns about the slow pace at which DCIA has been implemented by Treasury and the other agencies with related responsibilities and the modest amounts actually collected since DCIA's enactment. As we testified in June 1998, our work at FMS has shown that because of systems development problems, FMS does not have a system capable of matching all federal payments against nontax delinquent debts owed the government. In addition, FMS' system development problems have caused delays in consolidating the administrative, tax refund, and federal salary offset programs, and thus any debt collection efficiencies envisioned by such a consolidation have not been realized. Our work has also identified areas in which actions by FMS are needed to reduce the risk of costly system modifications and further delays in the Treasury Offset Program (TOP). FMS has informed us that it has taken actions to address these areas. According to FMS officials, enhancements to the TOP system to incorporate additional payment types (e.g., Social Security benefit payments) are planned or ongoing, and the system has been modified to accommodate the tax refund offset program. However, FMS still faces challenges in effectively fulfilling its responsibilities under DCIA, including further modifying the TOP system. A sustained commitment by FMS' management will be needed to ensure that these challenges are successfully met.

Key Contact

Gary T. Engel, Associate Director
Governmentwide Accounting and Financial Management Issues
Accounting and Information Management Division
(202) 512-3406
engelg.aimd@gao.gov

Departmentwide Financial Management Weaknesses

A key to Treasury's ability to effectively carry out its mission is sound financial management, including information about the government's finances that is routinely available, accurate, and reliable. Without accurate and reliable financial systems and information, Treasury cannot be sure that the information it has is sufficient to manage its day-to-day operations, measure results of operations, account for resources, collect taxes and other debts owed the government, or safeguard assets. The requirements of the CFO Act and other legislation and recommendations that we and others made have provided the impetus for ongoing efforts to improve Treasury's financial management. Although progress has been made, some solutions to Treasury's financial management weaknesses require longer term actions and technological changes to information systems. The Treasury OIG is evaluating Treasury's efforts to address these financial management weaknesses during its ongoing audit of the Department's fiscal year 1998 Departmentwide financial statements. We will continue to monitor Treasury's actions in these areas.

Weaknesses Exist in Treasury's Asset Forfeiture Program

Treasury's asset forfeiture program was on our original high-risk list in 1990 because the program did not adequately focus on managing the items seized.[11] We identified and reported, in December 1992, major operational problems related to the management and disposition of seized and forfeited property.[12] We also reported that Customs had initiated corrective actions to address these problems. In our February 1995 high-risk report, we reported that although some management and systems changes had improved program operations, significant problems with seized property management remained.

Since our 1995 report, Customs has undertaken actions to address these

[11]The Congress established the Department of the Treasury Forfeiture Fund in October 1992 to supersede the Customs Fund. Customs is responsible for managing property seized by Treasury law enforcement agencies.

[12]Seized property includes, among other things, illegal drugs that have no resale value to the government. These items are subject to forfeiture and are typically held by the seizing agency until they are approved for destruction.

problems, including continuing to upgrade existing storage facilities and implementing a new seized property inventory system, but some challenges remain. In addition to these challenges, improvements are needed in Treasury's accountability and reporting over seized and forfeited property. Furthermore, we have reported that the Department of Justice and Treasury need to consolidate their separate, but similar, seized asset management and disposition functions. As a result of the remaining weaknesses, the sensitive nature of the asset forfeiture program, and the high visibility that the program has experienced, Treasury's asset forfeiture program continues to be designated as a high-risk area.

Improvements Made in Customs' Accountability Over Seized and Forfeited Property, but Challenges Remain

We have made several recommendations relating to improving Customs' accountability and stewardship over property seized. Specifically, we have recommended that Customs improve the (1) physical security at its locations that are used to store seized property, (2) reliability of the information maintained in its seized property tracking system, and (3) controls over access to critical and sensitive data and computer programs maintained in its systems that account for seized property and law enforcement operations.

Customs has made significant enhancements and is in the process of making other enhancements to improve security over seized assets and the reliability of information maintained in the information systems that it uses to track the seized assets. However, Customs still needs to (1) obtain the remaining funding for improvements to storage facilities, (2) complete enhancements to SEACATS, and (3) fully correct identified weaknesses in its computer controls over the system for law enforcement activities.

In May 1997, we reported that Customs had recently built 6 new storage facilities in locations it determined to be the most vulnerable and had improved security at 28 other locations by installing various security devices, such as motion sensors and surveillance cameras. Also, Customs told us that four storage facilities, which are to be located in remote areas where significant amounts of illegal drugs are routinely seized, were in the preconstruction phase, but funding for construction had not been provided. We also reported in May 1997 that security devices that had been procured to upgrade numerous locations had not been placed in operation because the funding necessary to install them had not been received.

More recently, Customs said that the General Services Administration has built one of the planned storage facilities and that Customs now leases it. However, Customs is awaiting the final approval of funding for the remaining three storage facilities. Also, according to Customs officials, Customs has now received partial funding for the installation of security devices, has installed them at several locations, and is awaiting the final approval for the remaining funds.

Regarding the reliability of information maintained in the information systems used to track seized assets, Customs has undertaken several improvement efforts. For example, Customs has conducted annual nationwide physical inventories of its seized property and implemented additional policies and procedures. In addition, Customs has developed and implemented a new system called SEACATS. However, in its fiscal year 1997 audit report, the Treasury OIG reported that SEACATS experienced numerous data conversion problems. As a result, SEACATS did not contain accurate and sufficient data that could be relied upon to prepare the required analysis of changes in forfeited and seized currency and property disclosures reported by Customs. To address the problems, Customs had to develop postconversion programs to process and correct erroneous data, conduct exhaustive case file reviews, and perform a complete physical inventory. On the basis of the preliminary results of work performed by the Treasury OIG for its audit of Customs' fiscal year 1998 financial statements, Customs appears to have corrected many of the early implementation problems it experienced with the property information in SEACATS. However, Customs officials acknowledged that additional enhancements to SEACATS are necessary for the system to perform as originally envisioned. For example, Customs must still obtain currency information from outside the system to compile financial statement disclosures.

In addition, the Treasury OIG reported that although improvements to computer controls have been made during fiscal year 1997, controls for the computer application system for law enforcement activities showed that this system continued to be vulnerable to unauthorized access. Since the law enforcement system is a source of key data to seizure activity recorded in SEACATS, this vulnerability could affect the reliability of information in SEACATS. Customs recently contracted for a review of electronic data processing controls for SEACATS, which upon completion will be reviewed by the Treasury OIG.

Weaknesses in Treasury's Accountability and Reporting Over Seized and Forfeited Property

Treasury and its OIG have reported weaknesses in the Department's accountability and reporting over seized and forfeited property. Specifically, Treasury reported material weaknesses related to seized property in the Federal Managers' Financial Integrity Act section of its fiscal year 1997 Accountability Report.[13] In addition, although the Treasury Forfeiture Fund received an unqualified audit opinion on its fiscal year 1997 financial statements, the Fund's auditor cited three material weaknesses in its report on internal controls: (1) the Fund's accounting records were primarily maintained on the cash basis of accounting; (2) the Fund's general ledger did not record all balances and transactions that were reflected in the financial statements; and (3) as previously noted, SEACATS did not

[13]This text refers to the Department's third annual Accountability Report for fiscal year 1997, which describes Treasury's missions and goals and demonstrates how its financial performance is tied to the Department's broader objectives.

contain accurate and sufficient data that could be relied on to prepare the analysis of changes in forfeited and seized currency and property without substantial manual manipulation and reconciliation.

Furthermore, in its March 1998 report on Treasury's fiscal year 1997 financial statements, the Treasury OIG reported as a Departmentwide reportable condition the need for Treasury to improve accountability and reporting over its seizure and forfeiture activities. Specifically, in addition to the Treasury Forfeiture Fund internal control problems, the Treasury OIG reported that the Department's law enforcement bureaus used different inventory tracking systems that collected and accounted for seized property and forfeited assets differently and used slightly different data definitions. In addition, Treasury could not provide all of the required disclosure information for certain IRS and Secret Service seizure and forfeiture activity that was outside the Executive Office for Asset Forfeiture's responsibility.

According to a Treasury official, Treasury is developing a plan that includes actions designed to address the weaknesses previously noted. The action plan is to

(1) include a description of the problems identified, prioritize the problems, and propose solutions and (2) discuss plans to develop an integrated tracking system that will provide required financial reporting disclosures and will be used by the Treasury bureaus and integrated with SEACATS. As part of its audit of Treasury's fiscal year 1998 Departmentwide financial statements, the Treasury OIG plans to update the status of the asset forfeiture program weaknesses. We will also continue to monitor Treasury's progress in addressing these areas.

Consolidation of Treasury's and Justice's Seized Asset Management and Disposition Functions Needed

Justice and Treasury continue to operate two similar but separate seized asset management and disposal programs without plans for consolidation, despite legislation requiring them to develop and maintain a joint plan to consolidate postseizure administration of certain properties. In June 1991, we recommended consolidating the management and disposition of all noncash seized property and designating Justice's Marshals Service as the custodian. We estimated that program administration costs could be reduced if Justice and Customs consolidated the postseizure management and disposition of such items. We also reported that consolidation would likely result in lower contractor costs due to economies of scale. We still believe that consolidation of asset management and disposition functions makes sense. We encourage Treasury and Justice to continue to identify areas of duplication and pursue options for consolidation.

Weaknesses Exist in Computer Systems Security

In its auditors' report on Treasury's fiscal year 1997 Departmentwide financial statements, the Treasury OIG reported as a material weakness that computer security controls, which are designed to safeguard data, protect computer application programs, prevent system software from unauthorized access, and ensure continued computer operations, need to be strengthened. Although some improvements have been made, computer control weaknesses in financial systems access and physical security controls at certain bureaus reported by the Treasury OIG in previous years continued to exist during fiscal year 1997 and additional weaknesses were identified. These weaknesses primarily involve IRS, Customs, and FMS and are discussed in each bureau's separate section of this report.

Weaknesses Relating to Integrated Financial Management Systems

In its auditors' report on Treasury's fiscal year 1996 Departmentwide financial statements, the Treasury OIG reported that Treasury's lack of integrated financial management systems was a material weakness. An integrated system would perform basic accounting functions and provide integrated budget, financial, and performance information that managers could reliably use to make decisions. The auditors reported that several component entities maintained separate systems to support program and financial management and that these nonintegrated systems could not be relied on to provide complete and accurate information without extensive manual procedures, analyses, and reconciliations. The Treasury OIG had recommended that the Treasury Chief Financial Officers Council develop a strategy for improving the level of financial systems integration within and among the Department's bureaus.[14]

The Treasury OIG reported in its most recent audit report, which covers fiscal year 1997, that the Treasury CFO Council had initiated a

[14]The Treasury CFO Council was established in July 1994 to help ensure that all Treasury financial management systems provide timely, useful, and auditable information that incorporates financial and program performance measurements into the planning, budgeting, and reporting process. The Council comprises CFOs and deputy CFOs from all Treasury offices and bureaus.

project to define core financial data requirements, evaluate current systems capabilities, and develop recommendations for implementation of a Departmentwide data stewardship process. However, the Treasury OIG also reported that financial system integration issues continued to exist.

Weaknesses Relating to the Process Used to Prepare Departmentwide Financial Statements

In its auditors' report on Treasury's fiscal year 1996 Departmentwide financial statements, the Treasury OIG reported a material weakness related to deficiencies in the Department's financial statement preparation process. In its report on the fiscal year 1997 Departmentwide financial statements, the Treasury OIG reported that progress had been made in some areas, but a material weakness continued to exist related to the oversight and review of the Department's process to prepare the Departmentwide financial statements. For example, the bureaus submitted financial data that did not conform to the format requested by the Deputy CFO and contained inconsistencies, incorrect classifications, and inaccurate reporting of certain transactions. In addition, intradepartmental account balances and transactions reported by the bureaus that need to be eliminated during the financial statement preparation process were out of balance in excess of $100 million. Furthermore, the draft fiscal year 1997 Accountability Report provided to the Treasury OIG contained material discrepancies and omissions that should have been detected and addressed in the supervisory review process. The Treasury OIG reported that, if not mitigated by actions that required a significant amount of the Department's and Treasury OIG's resources, these weaknesses may have caused material misstatements in the Departmentwide financial statements. According to Treasury officials, Treasury is taking actions to address these problems. For example, Treasury is making enhancements to its system used in the financial statement preparation process that it believes will improve the system's consolidating, reporting, and analyzing functions.

Weaknesses Relating to the Compliance of Financial Management Systems With Federal Requirements

The Federal Financial Management Improvement Act of 1996 (FFMIA) requires auditors performing financial audits to report whether agencies' financial management systems substantially comply with federal accounting standards, financial systems requirements, and the government's standard general ledger at the transaction level. In its fiscal year 1997 auditors' report on compliance with laws and regulations, the Treasury OIG identified instances where the Department's financial management systems did not substantially comply with the requirements detailed in FFMIA. Treasury reported that it had various actions planned to correct the problems. For example, according to a Treasury official, one of its bureaus recently implemented a new system that complies with FFMIA requirements.

Key Contact

Gary T. Engel, Associate Director
Governmentwide Accounting and Financial Management Issues
Accounting and Information Management Division
(202) 512-3406
engelg.aimd@gao.gov

Further Action Needed

The Department of the Treasury has embraced efforts by the Congress, us, and other stakeholders to present better information on the results of the Department's programs and activities. In doing so, Treasury has sought to link its Departmentwide strategic goals to the goals and missions of its bureaus and offices. Along the same lines, Treasury has taken steps to devise strategies for achieving its goals and on how it can best measure performance. This is not necessarily an easy task because data on program results are typically more difficult and resource intensive to obtain than data on program activities. In some instances, Treasury lacks information systems that are necessary to obtain such data. However, it is of vital importance for the Department to be accountable to its stakeholders at times when resources are limited and public demands are high. Like other parts of the federal government, Treasury needs to improve its ability to apply the provisions of certain statutes, such as the (1) Results Act; (2) CFO Act, as expanded by the Government Management Reform Act; and (3) Clinger-Cohen Act. Collectively, these statutes hold substantial promise for making Treasury a more accountable and effective part of the federal government.

Related GAO Products

IRS

Systems Modernization

Tax Systems Modernization: Blueprint Is a Good Start But Not Yet Sufficiently Complete to Build or Acquire Systems (GAO/AIMD/GGD-98-54, Feb. 24, 1998).

High-Risk Series: Information Management and Technology (GAO/HR-97-9, Feb. 1997).

IRS Operations: Critical Need to Continue Improving Core Business Practices (GAO/T-AIMD-96-188, Sept. 10, 1996).

Tax Systems Modernization: Actions Underway But Management and Technical Weaknesses Not Yet Corrected (GAO/T-AIMD-96-165, Sept. 10, 1996).

Internal Revenue Service: Business Operations Need Continued Improvement (GAO/AIMD-96-152, Sept. 9, 1996).

Tax Systems Modernization: Cyberfile Project Was Poorly Planned and Managed (GAO/AIMD-96-140, Aug. 29, 1996).

Tax Systems Modernization: Actions Underway but IRS Has Not Yet Corrected

Management and Technical Weaknesses (GAO/AIMD-96-106, June 7, 1996).

Security Weaknesses at IRS' Cyberfile Data Center (GAO/AIMD-96-85R, May 9, 1996).

Tax Systems Modernization: Management and Technical Weaknesses Must Be Overcome to Achieve Success (GAO/T-AIMD-96-75, Mar. 26, 1996).

Tax Systems Modernization: Management and Technical Weaknesses Must Be Corrected If Modernization Is to Succeed (GAO/AIMD-95-156, July 26, 1995).

IRS Financial Management

Internal Revenue Service: Physical Security Over Taxpayer Receipts and Data Needs Improvement (GAO/AIMD-99-15, Nov. 30, 1998).

Excise Taxes: Internal Control Weaknesses Affect Accuracy of Distributions to the Trust Funds (GAO/AIMD-99-17, Nov. 9, 1998).

Internal Revenue Service: Immediate and Long-Term Actions Needed to Improve Financial Management (GAO/AIMD-99-16, Oct. 30, 1998).

Internal Revenue Service: Composition and Collectibility of Unpaid Assessments (GAO/AIMD-99-12, Oct. 29, 1998).

Management Letter: IRS' Accounting Procedures and Internal Controls (GAO/AIMD-98-211R, Sept. 2, 1998).

Internal Revenue Service: Remaining Challenges to Achieve Lasting Financial Management Improvements (GAO/T-AIMD/GGD-98-138, Apr. 15, 1998).

Financial Audit: Examination of IRS' Fiscal Year 1997 Custodial Financial Statements (GAO/AIMD-98-77, Feb. 26, 1998).

IRS Management: Improvement Needed in High-Risk Areas (GAO/T-GGD-97-79, Apr. 14, 1997).

IRS High-Risk Issues: Modernization of Processes and Systems Necessary to Resolve Problems (GAO/T-GGD-97-52, Mar. 4, 1997).

Federal Taxes Receivable and Other Unpaid Assessments

Tax Administration: IRS' Use of Enforcement Authorities to Collect Delinquent Taxes (GAO/T-GGD-97-155, Sept. 23, 1997).

Issues Affecting IRS' Collection Pilot (GAO/GGD-97-129R, July 18, 1997).

Filing Fraud

Earned Income Credit: IRS' Tax Year 1994 Compliance Study and Recent Efforts to Reduce Non-Compliance (GAO/GGD-98-150, July 28, 1998).

Earned Income Credit: IRS' 1995 Controls Stopped Some Noncompliance, But Not Without Problems (GAO/GGD-96-172, Sept. 18, 1996).

Tax Administration: Electronic Filing Fraud (GAO/T-GGD-94-89, Feb. 10, 1994).

Tax Administration: IRS Can Improve Controls Over Electronic Filing Fraud (GAO/GGD-93-27, Dec. 30, 1992).

Information Systems Security

IRS Systems Security: Although Significant Improvements Made,Tax Processing Operations and Data Still at Serious Risk (GAO/AIMD-99-38, Dec. 14, 1998).

IRS Systems Security: Tax Processing Operations and Data Still at Risk Due to Serious Weaknesses (GAO/AIMD-97-49, Apr. 8, 1997).

Year 2000

Internal Revenue Service: Impact of the IRS Restructuring and Reform Act on Year 2000 Efforts (GAO/GGD-98-158R, Aug. 4, 1998).

IRS' Year 2000 Efforts: Business Continuity Planning Needed for Potential Year 2000 System Failures (GAO/GGD-98-138, June 15, 1998).

IRS' Year 2000 Efforts: Status and Risks (GAO/T-GGD-98-123, May 7, 1998).

Customs

Customs Financial Management

Customs Service Modernization: Architecture Must Be Complete and Enforced to Effectively Build and Maintain Systems (GAO/AIMD-98-70, May 5, 1998).

FMS

Financial Management Service: Areas for Improvement in Computer Controls (GAO/AIMD-99-10, Oct. 20, 1998).

Financial Audit: Issues Regarding Reconciliations of Fund Balances With Treasury Accounts (GAO/AIMD-99-3, Oct. 14, 1998).

Debt Collection Improvement Act: Significant Challenges Remain to Effectively Implement Treasury's Administrative Offset Program (GAO/T-AIMD-98-195, June 5, 1998).

Financial Audit: 1997 Consolidated Financial Statements of the United States Government (GAO/AIMD-98-127, Mar. 31, 1998).

Debt Collection: Improved Reporting Needed on Billions of Dollars in Delinquent Debt and Agency Collection Performance (GAO/AIMD-97-48, June 2, 1997).

Departmentwide Financial Management

High-Risk Program: Information on Selected High-Risk Areas (GAO/HR-97-30, May 1997).

Performance and Accountability Series

Major Management Challenges and Program Risks: A Governmentwide Perspective (GAO/OCG-99-1)

Major Management Challenges and Program Risks: Department of Agriculture (GAO/OCG-99-2)

Major Management Challenges and Program Risks: Department of Commerce (GAO/OCG-99-3)

Major Management Challenges and Program Risks: Department of Defense (GAO/OCG-99-4)

Major Management Challenges and Program Risks: Department of Education (GAO/OCG-99-5)

Major Management Challenges and Program Risks: Department of Energy (GAO/OCG-99-6)

Major Management Challenges and Program Risks: Department of Health and Human Services (GAO/OCG-99-7)

Major Management Challenges and Program Risks: Department of Housing and Urban Development (GAO/OCG-99-8)

Major Management Challenges and Program Risks: Department of the Interior (GAO/OCG-99-9)

Major Management Challenges and Program Risks: Department of Justice (GAO/OCG-99-10)

Major Management Challenges and Program Risks: Department of Labor (GAO/OCG-99-11)

Major Management Challenges and Program Risks: Department of State (GAO/OCG-99-12)

Major Management Challenges and Program Risks: Department of Transportation (GAO/OCG-99-13)

Major Management Challenges and Program Risks: Department of the Treasury (GAO/OCG-99-14)

Major Management Challenges and Program Risks: Department of Veterans Affairs (GAO/OCG-99-15)

Major Management Challenges and Program Risks: Agency for International Development (GAO/OCG-99-16)

Major Management Challenges and Program Risks: Environmental Protection Agency (GAO/OCG-99-17)

Major Management Challenges and Program Risks: National Aeronautics and Space Administration (GAO/OCG-99-18)

Major Management Challenges and Program Risks: Nuclear Regulatory Commission (GAO/OCG-99-19)

Major Management Challenges and Program Risks: Social Security Administration (GAO/OCG-99-20)

Major Management Challenges and Program Risks: U.S. Postal Service (GAO/OCG-99-21)

High-Risk Series: An Update (GAO/HR-99-1)

The entire series of 21 performance and accountability reports and the high-risk series update can be ordered by using the order number GAO/OCG-99-22SET.

Ordering Information

The first copy of each GAO report and testimony is free. Additional copies are $2 each. Orders should be sent to the following address, accompanied by a check or money order made out to the Superintendent of Documents, when necessary. VISA and MasterCard credit cards are accepted, also. Orders for 100 or more copies to be mailed to a single address are discounted 25 percent.

Orders by mail:

U.S. General Accounting Office
P.O. Box 37050
Washington, DC 20013

or visit:

Room 1100
700 4th St. NW (corner of 4th & G Sts. NW)
U.S. General Accounting Office
Washington, DC

Orders may also be placed by calling (202) 512-6000 or by using fax number (202) 512-6061, or TDD (202) 512-2537.

Each day, GAO issues a list of newly available reports and testimony. To receive facsimile copies of the daily list or any list from the past 30 days, please call (202) 512-6000 using a touchtone phone. A recorded menu will provide information on how to obtain these lists.

For information on how to access GAO reports on the INTERNET, send an e-mail message with "info" in the body to: info@www.gao.gov

or visit GAO’s World Wide Web Home Page at: http://www.gao.gov