November 2003

GAO

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Highlights

Highlights of GAO-04-126, a report to the Secretary of the Treasury

FINANCIAL AUDIT

IRS's Fiscal Years 2003 and 2002 Financial Statements

Why GAO Did This Study

Because of the significance of Internal Revenue Service (IRS) collections to federal receipts and, in turn, to the consolidated financial statements of the U.S. government, which GAO is required to audit, and Congress's interest in financial management at IRS, GAO audits IRS's financial statements annually to determine whether (1) the financial statements IRS prepares are reliable, (2) IRS management maintained effective internal controls, and (3) IRS complies with selected provisions of significant laws and regulations and its financial systems comply with the Federal Financial Management Improvement Act of 1996 (FFMIA).

What GAO Recommends

In prior audits, GAO made numerous recommendations to IRS to address issues raised in this audit. GAO will continue to monitor IRS's progress in implementing the nearly 80 recommendations that remain open as of the date of this report.

IRS agreed with the report's findings and noted that the report fairly presented IRS's progress and its remaining challenges. IRS cited a number of planned improvements and initiatives to address the matters raised in the report. IRS also recognizes that only by implementing its new integrated financial management systems will it be able to overcome the majority of the material weaknesses cited in the report.

www.gao.gov/cgi-bin/getrpt?GAO-04-126.

To view the full product, including the scope and methodology, click on the link above. For more information, contact Steven J. Sebastian at (202) 512-3406 or sebastians@gao.gov.

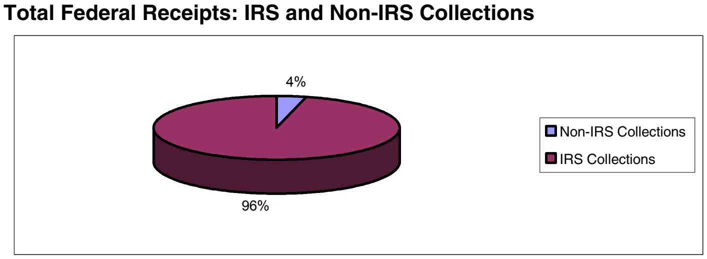
What GAO Found

In GAO's opinion, IRS's fiscal year 2003 financial statements were fairly presented in all material respects. Because of serious deficiencies in financial systems and internal control weaknesses, however, IRS again had to rely extensively on resource-intensive compensating processes to prepare its financial statements.

In fiscal year 2003, IRS continued to make great strides in a number of areas. IRS improved the accuracy and reliability of its property and equipment (P&E) inventory records and implemented a system to ensure that software and software licenses were properly controlled and used in accordance with license agreements. These and prior years' improvements allowed GAO to conclude that the remaining issues related to P&E no longer constitute a material internal control weakness. Because of other improvements by IRS, such as timely recording obligations and expenditures in its accounting system, GAO no longer considers the remaining control issues related to recording certain budgetary activity to be a reportable condition. However, IRS continues to be challenged by control weaknesses and system deficiencies affecting (1) financial reporting, (2) unpaid tax assessments, (3) tax revenue and refunds, and (4) computer security. IRS was also not always in compliance with laws concerning the structure of installment agreements it enters into with taxpayers and the timely release of federal tax liens.

Lack of a financial management system that can produce timely, accurate, and useful information needed for day-to-day decisions continues to be one of the largest obstacles facing IRS management. Through compensating processes, extraordinary efforts, and continued improvements to its financial processes and operations, IRS was able for the second consecutive year to issue its financial statements 6 weeks after the end of the fiscal year. Nevertheless, largely because its financial management systems do not comply with FFMIA, IRS remains unable to produce reliable, timely financial and cost-based performance information for decision making or to fully address the financial management and operational issues that affect its ability to fulfill its responsibilities as the nation's tax collector.

Total Federal Receipts: IRS and Non-IRS Collections



Source: IRS.

Note: IRS is responsible for collecting nearly all federal receipts. IRS's fiscal year 2003 financial statements show that IRS programs collected nearly $2 trillion in federal receipts, or about 96 percent of total federal receipts.