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United States Government Accountability Office  
Washington, DC 20548

June 4, 2008

The Honorable Douglas H. Shulman  
Commissioner of Internal Revenue

Subject: *Management Report: Improvements Needed in IRS's Internal Controls*

Dear Mr. Shulman:

In November 2007, we issued our report on the results of our audit of the Internal Revenue Service's (IRS) financial statements as of, and for the fiscal years ending, September 30, 2007, and 2006, and on the effectiveness of its internal controls as of September 30, 2007.<sup>1</sup> We also reported our conclusions on IRS's compliance with significant provisions of selected laws and regulations and on whether IRS's financial management systems substantially comply with the requirements of the Federal Financial Management Improvement Act of 1996 (FFMIA).

The purpose of this report is to discuss issues identified during our audit of IRS's financial statements as of, and for the fiscal year ending, September 30, 2007, regarding internal controls that could be improved for which we currently do not have a specific recommendation outstanding. Although not all of these issues were discussed in our fiscal year 2007 audit report, they all warrant management's consideration. This report contains 24 recommendations that we are proposing IRS implement to improve its internal controls. We will issue a separate report on the implementation status of recommendations from our prior IRS financial audits and related financial management reports, including this one. We conducted our audit in accordance with U.S. generally accepted government auditing standards.

### **Results in Brief**

During our audit of IRS's fiscal year 2007 financial statements, we identified several internal control matters not addressed by previous recommendations. These matters concern the following:

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<sup>1</sup>GAO, *Financial Audit: IRS's Fiscal Years 2007 and 2006 Financial Statements*, GAO-08-166 (Washington, D.C.: Nov. 9, 2007).

- Summary information reported in the Interim Revenue Accounting Control System (IRACS), IRS's general ledger system for tax-related transactions, could not be traced to the underlying detailed transaction records.
- Supervisory review procedures for IRS's unpaid assessments estimation process were not effective in preventing or detecting errors.
- Controls over computer programs affecting penalty assessments did not ensure that the programs always functioned in accordance with IRS's policies and procedures.
- Documentation of off-site Taxpayer Assistance Center (TAC) managers' reviews was not always readily available and, when provided, lacked the information needed to effectively assess the internal control environment at 5 of the 10 TACs we visited.<sup>2</sup> In addition, these managers lacked clear, comprehensive, and up-to-date guidance for conducting and documenting TAC reviews.
- Computer access rights of employees responsible for processing cash deposits were not properly restricted to prevent unauthorized adjustments to certain taxpayer account information at 4 of the 10 TACs we visited.
- First responders to duress alarms were not always qualified or located to effectively respond to emergencies at 5 of the 10 TACs we visited.
- Documentary evidence demonstrating that background investigations—with favorable results—had been completed for contractors before they were given unescorted access to the facilities was not obtained at six TACs and three field offices<sup>3</sup> we visited.
- Documentary evidence that background investigations—with favorable results—had been completed for contractors working at off-site shredding facilities was not obtained before they were given access to taxpayer and sensitive information. IRS also was not performing periodic, unannounced inspections of these facilities.
- New policies and procedures for hiring juveniles were not fully implemented.

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<sup>2</sup>TACs are field assistance units, located within IRS's Wage and Investment operating division, designed to serve taxpayers who choose to seek help from IRS in person. Services provided include interpreting tax laws and regulations, preparing tax returns, resolving inquiries on taxpayer accounts, receiving payments, forwarding those payments to appropriate service center campuses for deposit and further processing, and performing other services designed to minimize the burden on taxpayers in satisfying their tax obligations. These offices are much smaller facilities than service center campuses or lockbox banks, with staffing ranging from 1 to about 35 employees.

<sup>3</sup>Field offices comprise various units located within IRS's Small Business and Self Employed (SB/SE), Large and Mid-Size Business (LMSB), and Tax-Exempt and Government Entities (TE/GE) operating divisions that administer tax services to corporations, partnerships, small businesses, state and Indian tribal governments, major universities, community organizations, municipalities, pension funds, and individuals with certain types of nonsalary income.

- Evidence of supervisory reviews of documentation demonstrating compliance with key controls related to the processing of Tax Exempt/Government Entity (TE/GE) user fees was lacking.<sup>4</sup>
- Key controls over IRS's purchase card program were not adequate.
- Information on new assets was not always recorded in IRS's property and equipment inventory system within required time frames.
- Travel authorizations for employees were not always approved before travel was initiated.

These internal control matters increase the risk that IRS may fail to prevent or timely detect (1) errors in financial data and reporting, computer-generated penalty assessments, and user fee processing; (2) the loss, theft, or misuse of taxpayer receipts, information, and government property; (3) improper or fraudulent procurement; and (4) unauthorized travel.

At the end of our discussion of each of the internal control matters in the following sections, we make recommendations for strengthening IRS's internal controls. These recommendations are intended to bring IRS into conformance with IRS's policies or with the *Standards for Internal Control in the Federal Government*, or both.<sup>5</sup>

In its comments, IRS agreed with our recommendations and described actions it had taken or planned to take to address the control weaknesses described in this report. At the end of our discussion of each of the issues in this report, we have summarized IRS's related comments and provide our evaluation. We have also reprinted IRS's comments in enclosure II.

## **Scope and Methodology**

This report addresses issues we observed during our audit of IRS's fiscal years 2007 and 2006 financial statements. As part of our audit, we tested IRS's internal controls and its compliance with selected provisions of laws and regulations. We designed our audit procedures to test relevant controls, including those for proper authorization, execution, accounting, and reporting of transactions. To assess internal controls related to safeguarding taxpayer receipts and information, we visited 5 service center campuses, 4 lockbox banks, 10 TACs, and 4 field offices. We conducted our fieldwork between January 2007 and November 2007.

Further details on our audit scope and methodology are included in our report on the results of our audits of IRS's fiscal years 2007 and 2006 financial statements.<sup>6</sup>

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<sup>4</sup>IRS collects user fees from employee pension plans and other organizations for making rulings and determinations about their tax exempt status.

<sup>5</sup>GAO, *Standards for Internal Control in the Federal Government*, GAO/AIMD-00-21.3.1 (Washington, D.C.: November 1999) contains the internal control standards to be followed by executive agencies in establishing and maintaining systems of internal control as required by 31 U.S.C. § 3512 (c), (d) (commonly referred to as the Federal Managers' Financial Integrity Act of 1982).

<sup>6</sup>GAO-08-166.

Additionally, details on our methodology are reproduced in their entirety in enclosure I.

## **Interim Revenue Accounting Control System**

During our audit of IRS's fiscal year 2007 financial statements, we found that balances reported in IRS's core general ledger system for reporting tax-related transactions are not traceable to source documents for underlying transactions, and reported this issue as a component of the material weakness in IRS's financial reporting process.<sup>7</sup> This system, the Interim Revenue Accounting Control System (IRACS), does not appropriately document, or permit independent verification, that the transactions it reports were recorded in conformance with the posting requirements of the *U.S. Government Standard General Ledger* (SGL). As a result, IRACS does not substantially comply with the (1) SGL at the transaction level or (2) Federal Financial Management Systems Requirements (FFMSR) as embodied in the Office of Management and Budget (OMB) Circular No. A-127, *Financial Management Systems*. Thus, it did not comply with the requirements of the Federal Financial Management Improvement Act of 1996 (FFMIA).<sup>8</sup> The transactions recorded in IRACS primarily consist of tax revenue, tax refunds, and unpaid tax assessments, including taxes receivable. Taxes receivable accounts for over 80 percent of the assets IRS reports on its balance sheet, and tax revenues and related refunds preponderantly account for the activity IRS reports on its Statement of Custodial Activity. However, since its inception in October 1984, IRACS's reported balances have not been supported by audit trails traceable to source documents for individual transactions.

FFMSR require application of the SGL at the transaction level and state that conformance requires, among other items, that transaction detail for SGL accounts be readily available in the financial management system and traceable to specific SGL account codes. Similarly, internal control standards require that all transactions and other significant events be clearly documented, and that the documentation be readily available for examination. However, IRACS does not conform to these standards because tax revenue and tax refund transactions are posted to it at a summary level, and are not traceable from IRACS to underlying supporting transaction records. Consequently, in order to assure that IRACS balances reported in the financial statements for revenue and refunds are supported by transaction detail in taxpayer accounts, IRS must first compare IRACS to its master files to demonstrate that they materially agree, and then trace individual items back from the master files to underlying documentation.<sup>9</sup> In addition, IRS's balance for taxes receivable, which accounted for over 83 percent of IRS's total assets on its balance sheet as of September 30, 2007, was derived from a complex statistical estimation process rather than the traditional posting of individual transactions. Consequently, IRS's taxes receivable were neither posted to IRACS nor traceable to underlying transaction detail.

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<sup>7</sup>GAO-08-166.

<sup>8</sup>Federal Financial Management Improvement Act of 1996, Pub. L. No. 104-208, div. A., § 101(f), title VIII, 110 Stat. 3009, 3009-389 (Sept. 30, 1996).

<sup>9</sup>The master files contain detailed records of taxpayer accounts. However, the information residing in this system is not integrated with nor directly traceable to related information in IRACS.

During fiscal year 2006, IRS implemented the first phase of the Custodial Detail Data Base (CDDB), which is an automated system that IRS ultimately intends will provide transaction traceability for all of its tax-related transactions. As part of its progress toward this goal, IRS informed us that during fiscal year 2008, it added trace identification numbers to revenue and refund transactions to provide the traceability required by FFMSR. We will follow-up during our audit of IRS's fiscal year 2008 financial statements to assess the effectiveness of this approach. However, it is unclear when IRS will achieve similar traceability for its more complex taxes receivable transactions.

### Recommendation

We recommend that you direct appropriate IRS officials to verify that when it becomes fully operational, CDDB, when used in conjunction with IRACS, will provide IRS with the direct transaction traceability for all of its tax-related transactions as required by the SGL and FFMSR, and thus FMIA.

### IRS Comments and Our Evaluation

IRS agreed with our recommendation and stated it will verify that summary tax revenue, tax refunds, and unpaid assessments recorded in IRACS are directly traceable to transactions in CDDB when it is fully implemented by September 30, 2009. We will evaluate the effectiveness of IRS's efforts after they are fully implemented during future audits.

### **IRS's Unpaid Assessments Estimation Process**

During our fiscal year 2007 financial audit, we identified errors in IRS's unpaid assessments<sup>10</sup> estimation process that its internal review procedures either did not detect or did not detect in a timely manner. As we have reported previously,<sup>11</sup> IRS lacks a detailed listing, or subsidiary ledger, that tracks and accumulates unpaid assessments and their status on an ongoing basis. This is a primary reason we have been reporting a long-standing material internal control weakness with respect to IRS's unpaid assessments. Consequently, IRS must rely on a labor-intensive compensating estimation process to report balances for taxes receivable and other unpaid assessments in its financial statements and supplemental information. This estimation process involves a combination of: (1) computer programs, (2) statistical sampling, (3) manual case file review, (4) statistical projections, and (5) the use of spreadsheets to compile results and to roll forward the results to fiscal year-end.

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<sup>10</sup>Unpaid tax assessments consist of (1) federal taxes receivable, which are taxes due from taxpayers for which IRS can support the existence of a receivable through taxpayer agreement or a favorable court ruling; (2) compliance assessments where neither the taxpayer nor the court has affirmed that the amounts are owed; and (3) write-offs, which represent unpaid tax assessments for which IRS does not expect further collections because of factors such as the taxpayer's death, bankruptcy, or insolvency. Of these three classifications of unpaid tax assessments, only net federal taxes receivable are reported on the principal financial statements.

<sup>11</sup>GAO-08-166.

Strong controls over its estimation process are critical to IRS's ability to report a reliable balance for the largest component of its balance sheet. However, we found several errors that were not detected by its internal reviews. Specifically, we found that IRS personnel did the following:

- They did not include all taxes receivable account modules<sup>12</sup> in the population from which the taxes receivable sample was selected. Although IRS did identify this error, it did not do so until after it had begun obtaining the source documentation for the sample to conduct the manual case file reviews. Since it had already expended significant resources to obtain the source documents, IRS chose to select and test an additional sample from the omitted subpopulation rather than reselecting the taxes receivable sample from the population of all taxes receivable account modules. This increased the total number of cases its staff had to review.<sup>13</sup> Consequently, IRS expended additional resources to retrieve documents and to review additional case files.
- IRS personnel made a \$2,000 data entry error when entering the case file review results into the statistical projection computer program, resulting in an overstatement of the projected error in the write-off population of approximately \$10 million.
- IRS personnel erroneously deducted \$2.6 billion when calculating the fiscal year-end write-off balance, understating the write-off amount that would have been reported in its supplemental information by \$2.6 billion.

We also found that IRS currently does not have documented procedures detailing the steps that its statistician should perform throughout the process, nor does it have documented procedures supervisors should perform as part of their reviews. Due to the complexity of the estimation process, officials responsible for reviewing IRS's unpaid assessments statistical estimates require documented detailed procedural guidance to assist them in performing effective and timely reviews.

Internal control standards require internal control and all transactions and other significant events to be clearly documented, and the documentation to be readily available for examination. Such documentation should appear in management directives, administrative policies, or operating manuals. Furthermore, internal control standards require that qualified and continual supervision be provided to ensure that internal control objectives are achieved. The lack of clear, documented procedures for the preparation and review of IRS's unpaid assessments estimation process inhibits effective supervisory review. The lack of effective supervisory

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<sup>12</sup> A taxpayer may have multiple account modules within IRS's master files under a unique taxpayer identification number (i.e., social security number or an employer identification number). Each unique account module is identified by the taxpayer identification number, specific tax period (e.g., year, quarter), and tax type (e.g., excise tax, individual tax, payroll tax, etc.).

<sup>13</sup> IRS's estimation methodology requires the selection and testing of 465 taxes receivable account modules. If IRS reselected this sample from the complete taxes receivable population, the number of items selected and tested would still have been 465. However, by choosing to select and test an additional sample from the omitted subpopulation, IRS tested the original 465 account modules plus an additional 20 account modules.

review, in turn, increases the risk that errors made in the preparation of IRS's unpaid assessments estimates will not be detected or detected in a timely manner, increasing the risk that inaccurate amounts will be reported in its financial statements.

According to IRS officials, the various aspects of its estimation process undergo supervisory review. Nevertheless, these officials could not explain why this review did not detect the errors we identified. In addition, the lack of detailed guidance describing the procedures the statistician should perform in the unpaid assessments estimation process and detailed review procedures for supervisors increase the risk that errors will not be detected and that erroneous balances will be reported in IRS's financial statements.

### Recommendations

We recommend that you direct appropriate IRS officials to do the following:

- Document and implement the specific procedures to be performed by the statistician in each step of the unpaid assessments estimation process.
- Document and implement specific detailed procedures for reviewers to follow in their review of unpaid assessments statistical estimates. Specifically, IRS should require that a detailed supervisory review be performed to ensure: (1) the statistical validity of the sampling plans, (2) data entered into the sample selection programs agree with the sampling plans, (3) data entered into the statistical projection programs agree with IRS's sample review results, (4) data on the spreadsheets used to compile the interim projections and roll-forward results trace back to supporting statistical projection results, and (5) the calculations on these spreadsheets are mathematically correct.

### IRS Comments and Our Evaluation

IRS agreed with our recommendations concerning documented procedures for preparing and reviewing its unpaid assessments statistical estimates. IRS stated that by June 30, 2008, it will document procedures to be (1) performed by the statistician in each step of the unpaid assessments estimation process and (2) followed by reviewers during their review of the unpaid assessments statistical estimates. We will evaluate the effectiveness of IRS's efforts in this area during our audit of IRS's fiscal year 2008 financial statements.

### **Computer Programs Affecting Penalty Assessments**

IRS's controls over computer programs affecting penalty assessments did not always ensure that the programs were designed or functioned in accordance with the intent of established policies and procedures.

The Internal Revenue Code (IRC)<sup>14</sup> grants IRS broad authority to assess penalties against taxpayers for noncompliance with tax laws such as failing to file a tax return,

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<sup>14</sup>See 26 U.S.C. § 6651, 6654, 6655, 6662.

failing to pay taxes owed, or inaccurately reporting taxes. IRS establishes the specific policies and procedures for calculating and assessing penalties in its Internal Revenue Manual (IRM).<sup>15</sup> In accordance with the IRM, IRS's business operating divisions work with its Modernization and Information Technology Services to implement computerized programs within its master files<sup>16</sup> to calculate and assess penalties against taxpayers in relation to unpaid tax assessments or violations of the tax laws. Our tests of penalty and interest transactions in each of the past 2 years have identified issues that, while not a violation of the IRC, resulted in IRS making modifications to computer programs affecting penalty assessments.

During our fiscal year 2007 IRS financial audit, we found that IRS did not apply the same rule for assigning the effective date of accuracy penalties against business and individual taxpayers. The IRC authorizes IRS to assess taxes and penalize taxpayers if taxpayers substantially underreport their income tax liability.<sup>17</sup> If IRS determines that a taxpayer substantially underreported the amount of taxes owed, it can assess the taxpayer an accuracy penalty and a failure-to-pay penalty, along with the additional taxes owed. Since IRS makes this determination on examining the taxpayer's return, the assessment of the additional taxes due and the related penalties occurs later than the due date of the tax return. When IRS assesses a business an accuracy penalty, the computer program in its Business Master File (BMF) assigns the effective date of the accuracy penalty to match the due date of the original tax return. However, when IRS assesses the same type of penalty against an individual taxpayer, the computer program in its Individual Master File (IMF) assigns the effective date of the accuracy penalty to match the date of the subsequent additional tax assessment.

The date assigned as the effective date of the accuracy penalty is significant because it ultimately affects the amount of the associated failure to pay penalty<sup>18</sup> that IRS assesses against the taxpayers. IRS policies generally require that taxpayer payments first be applied to reduce assessed tax until it is fully paid off, then to reduce assessed penalties, and finally to reduce assessed interest. However, IRS policies also allow it to apply taxpayer payments to pay off penalties before the assessed tax if payment is made before the subsequent deficiency tax assessment (deficiency assessment).<sup>19</sup> The failure-to-pay penalty program uses the posted transaction date of a penalty to determine the effective date of that penalty. BMF uses the return due date as the transaction date for the accuracy penalty, while IMF uses the deficiency assessment date. Consequently, if, as in the case of the BMF, the effective date of the accuracy penalty is the due date of the original tax return, any taxpayer payments received prior to a deficiency assessment and a related accuracy penalty assessment are applied first to this penalty before they are applied to the deficiency assessment. In contrast, for IMF taxpayer accounts, any taxpayer payments received are applied first to the deficiency assessment because the

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<sup>15</sup>See IRM, § 20.1.2, *Failure to File/Failure to Pay Penalties* (July 31, 2001).

<sup>16</sup>IRS's master file system consists of two major files, the individual master files (IMF) and business master files (BMF).

<sup>17</sup>See 26 U.S.C. § 6662 and IRS guidance in the Internal Revenue Manual at Section 20.1.5, *Return Related Penalties* (Oct. 1, 2005).

<sup>18</sup>Failure-to-pay penalty is a penalty that IRS assesses against taxpayers when taxpayers fail to pay their outstanding tax liability by the return due date. The failure-to-pay penalty is calculated based on the amount of taxes outstanding in the taxpayer's account module, a penalty rate stipulated in the IRC and IRM, and the number of months the taxes remain unpaid.

<sup>19</sup>Internal Revenue Manual, § 20.2.6.7.1, *Payment Allocation* (March 1, 2002).

accuracy penalty has the same effective date as this deficiency assessment. The result is that, for individuals, payments received before the effective date of the deficiency assessment will always reduce the deficiency assessment before reducing the accuracy penalty while, for businesses, those payments will first reduce the accuracy penalty, then the deficiency assessment, when the failure-to-pay is computed. Because of the inconsistent way that transaction dates are assigned to the accuracy penalty between the BMF and the IMF, businesses are assessed a higher failure-to-pay penalty than individuals if they prepay part of the additional assessments but fail to pay the balance by the date indicated on the notice and demand for payment.

Neither the IRC nor the IRM specifically addresses the assignment of effective dates for accuracy penalties. After we brought the inconsistency we identified to their attention, IRS officials determined that it would treat business and individual taxpayers the same when assigning the effective date of an accuracy penalty, and that the date of the deficiency assessment would be used as the effective date of the accuracy penalty for both.

During our fiscal year 2006 financial audit,<sup>20</sup> we also identified and previously reported a computer program error that overassessed penalties against some taxpayers.<sup>21</sup> Internal control standards require agencies to establish controls to enforce adherence to management policies and procedural requirements. In each of the above situations, IRS was unaware of the issues until we identified them, and then it agreed that modifications to the computer programs were needed. Although we determined that neither of these two conditions constituted a violation of the IRC, the condition we identified in fiscal year 2007 resulted in different treatment among taxpayers, while the condition we identified in fiscal year 2006 resulted in the overassessment of penalties against some taxpayers. According to IRS officials, these issues date back to when these programs were initially implemented in the 1980s. Consequently, IRS did not have adequate procedures in place to ensure that programs affecting penalty calculations were designed and functioning in accordance with management policies and procedures.

IRS has instituted additional internal control procedures to ensure that current computer programs are designed and function in accordance with the intent of IRS policies and procedures. However, until mid-2007, IRS had not implemented any processes or procedures to review existing computer programs to ensure they were functioning in accordance with IRS policies. According to IRS officials, IRS formed a task force in August 2007 to initiate a broad-based review of the various programs affecting penalty calculations in its master files. These officials informed us that they have identified other issues that may require additional changes to existing programs in its master files that affect penalty assessments. Until IRS completes a comprehensive review of its computer programs affecting penalty assessments to verify that these programs are designed and functioning in accordance with its policies, it will continue

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<sup>20</sup>GAO, *Management Report: Improvements Needed in IRS's Internal Controls*, GAO-07-689R (Washington, D.C.: May 11, 2007).

<sup>21</sup>The specific situation involved taxpayers who: (1) owed outstanding taxes for a specific tax period, (2) failed to pay following repeated notification of taxes due, (3) subsequently paid off the outstanding taxes, and (4) were assessed additional taxes by IRS on the same tax period after paying off the original balance.

to be at risk that its computer programs may not function as intended by its established policies, which could result in inequitable treatment of taxpayers or potential lost revenue to the federal government.

### Recommendations

To address the inconsistency in assigning the effective date of an accuracy penalty, we recommend that you direct the appropriate IRS officials to modify the BMF computer program so that the date of the deficiency assessment is used as the effective date of any related accuracy penalty.

To address other issues that may exist in IRS's master files that affect penalty calculations, we recommend that you direct appropriate IRS officials to do the following:

- Complete and document the review of existing programs in the master files that affect penalty calculations to identify any instances in which programs are not functioning in accordance with the intent of the IRM.
- In instances where programs are not functioning in accordance with the intent of the IRM, take appropriate action to correct the programs so that they function in accordance with the IRM.

### IRS Comments and Our Evaluation

IRS agreed with our recommendations concerning computer programs affecting penalty assessments. IRS plans to complete its ongoing review of the master file programs to identify instances where they are not functioning in accordance with the intent of the IRM by July 31, 2008. We will evaluate the results of IRS's study as part of our fiscal year 2008 audit. IRS also stated that it will not be able to implement changes to the BMF computer program to establish the date of the deficiency assessment as the effective date of any related accuracy penalty until July 31, 2009. We will evaluate the effectiveness of IRS's efforts after they are fully implemented during future audits.

### **Reviews Performed by Off-site Taxpayer Assistance Center Managers**

During our fiscal year 2007 financial audit, we found that the documentation maintained by IRS to summarize managerial visits by off-site taxpayer assistance center (TAC) managers was not always readily available and, when provided, did not address whether the visits determined whether key controls and policies governing the safeguarding of taxpayer receipts and information were operating as intended. Additionally, the documentation of their visits did not include evidence showing whether previously identified weaknesses were addressed. This occurred because TAC managers were not provided clear and comprehensive guidance instructing them to cover these key controls and policies during their reviews and how to document the results of these reviews. We also found that TAC managers were not always aware of recent IRM updates. As a result, IRS lacks assurance that the scope

and content of these reviews are sufficient to achieve management's objectives, and their utility as a tool to facilitate timely and effective resolution of any issues identified is impaired.

Some TACs do not have an on-site TAC manager to provide day-to-day supervision of personnel and monitoring of daily activities. In such cases, IRS policy requires that a designated off-site TAC manager periodically visit and perform various supervisory reviews intended to ensure that operations are performed according to applicable IRS policies and procedures outlined in the IRM. However, during our audit, we found the following:

- At the five TACs we visited that were managed by an off-site manager, documentation supporting the TAC managers' routine reviews was not readily available and did not address controls intended to safeguard taxpayer receipts and information nor the status of previously identified issues.
- TAC managers did not have clear and comprehensive guidance instructing them both to review, and how to review, key controls designed to (1) prevent unauthorized access to the TAC; (2) process and protect taxpayer receipts present in the TAC; and (3) safeguard taxpayer receipts and related taxpayer information during transit from one IRS location to another. In addition, there was no guidance clearly instructing the managers how to document the results of their reviews.
- TAC managers and their supervisors were either unaware of the July 2006 IRM update or were unaware of the specific procedures it required.

Internal control standards require agencies to establish controls to enforce adherence to management policies and procedural requirements, such as management review, to create and maintain records providing evidence that these controls are executed, and to assure that ongoing monitoring occurs to assess the quality of performance over time. These monitoring controls include ongoing management and supervisory activities, comparisons, and reconciliations. However, if TAC managers are not adequately documenting reviews, are not provided clear guidance for conducting reviews, and are not aware of updated IRM requirements and procedures, IRS cannot be assured that the internal controls over this activity are being effectively carried out. This, in turn, increases the risk that IRS will not timely detect or prevent the theft, loss, or unauthorized accessing of taxpayer receipts and information.

### Recommendations

We recommend that you direct appropriate IRS officials to do the following:

- Develop and provide comprehensive guidance to assist TAC managers in conducting reviews of outlying TACs and documenting the results. This guidance should include a description of the key controls that should be in place at outlying TACs, specify how often these key controls should be reviewed, and specify how the results of each review should be documented, including follow-up on issues identified in previous TAC reviews.

- Establish a process to periodically update and communicate the specific required reviews for all off-site TAC managers.

### IRS Comments and Our Evaluation

IRS agreed with our recommendations concerning the need to develop and better communicate updated guidance to help off-site TAC managers conduct reviews of outlying TACs. IRS stated that it would update the IRM to include (1) the expectation that Area Directors are responsible and accountable for the oversight of all TAC activities, and (2) the requirement to maintain documentation of managerial reviews. IRS indicated that Field Assistance will use the remittance and security database to validate that all required reviews are complete, and it will include directions related to this issue in the field operational reviews at the group, area, and territory levels by July 31, 2008. IRS also stated that the Director, Field Assistance, will issue a quarterly reminder for the required reviews beginning in July 2008. We will verify the changes to IRS guidance during our audit of IRS's fiscal year 2008 financial statements and evaluate the effectiveness of IRS's efforts during future audits.

### **Computer Access Rights of Employees Accepting Cash Payments**

During our fiscal year 2007 financial audit, we found that at 4 of the 10 TACs we visited, TAC managers did not always properly restrict the computer access rights of those employees who had the authority to accept cash payments from taxpayers. By not ensuring that the computer access rights of employees responsible for accepting cash payments from taxpayers have been appropriately restricted, IRS increases the risk of loss, theft, or misappropriation of such receipts.

The IRM requires that for TAC employees who receive cash payments from taxpayers, computer access to taxpayer account information be restricted to prevent them from improperly adjusting taxpayer account balances or changing the status of the taxpayer's liability. In addition, the IRM states that TAC managers are responsible for ensuring that the computer access rights of these employees be restricted. Internal control standards require key duties and responsibilities to be divided, or segregated, among different people to reduce the risk of error or fraud. This includes separating the responsibilities for authorizing transactions, processing and recording transactions, reviewing the transactions, and handling any related assets. No one individual should be in a position to both cause and conceal an error or irregularity by controlling certain key aspects of a transaction or event.

### Recommendation

We recommend that you direct appropriate IRS officials to establish a mechanism to monitor compliance with the existing requirement that TAC employees responsible for accepting taxpayer payments in cash have their computer system access appropriately restricted to limit their ability to adjust taxpayer accounts.

## IRS Comments and Our Evaluation

IRS agreed with our recommendation and stated that it updated the IRM in April 2008 to require the use of the “restrict” command code on computer access rights for all employees with the responsibility for collecting cash. IRS indicated that the Form 809 annual reconciliation will now include a reminder to group managers of the requirement to use restrict command codes. IRS also stated that it will direct areas and territories to review command code restrictions during ongoing operational reviews, and it will look for ways to systemically monitor compliance. We will verify the changes to IRS guidance during our audit of IRS’s fiscal year 2008 financial statements and evaluate the effectiveness of IRS’s efforts during future audits.

### **Duress Alarm First Responders**

During our fiscal year 2007 financial audit, we found that the persons IRS designated as the first person contacted by the central monitoring station (first responder) in the event a duress alarm sounds were not always appropriately qualified nor were they geographically located in sufficiently close proximity to the facility to enable them to provide a timely and effective response. IRS uses duress alarms to notify security personnel of situations that are potentially dangerous to its employees and to help protect its facilities, property, and taxpayer information and receipts. In about 97 percent of all TACs, the duress alarms are linked to a central monitoring station that is responsible for notifying a designated official or officials when an alarm is set off. We found that for one large metropolitan area, IRS had designated a physical security analyst to be contacted as the first responder by the central monitoring station for five of the TACs we visited. However, IRS officials informed us that physical security analysts are not qualified to act as first responders to duress alarm incidents because such alarms may indicate an event that the analyst is not trained to deal with, such as a crime in progress. In addition, we found that at any given time, this specific physical security analyst could be as far as 100 miles away from one of the five TACs. Depending on where the analyst happened to be at the time an alarm sounded, this could preclude a timely response. Also, the effectiveness of the central monitoring stations in facilitating timely and effective response to such emergencies can be diminished over time due to changes in the status or contact information of the individuals who are designated as first responders, or due to ongoing changes in IRS’s policies and procedures that might alter their responsibilities and thereby require additional training or otherwise affect which individuals are qualified to fulfill these responsibilities. However, we found that IRS did not routinely monitor the first responder designations provided to central monitoring stations to verify that on an ongoing basis, they were current, accurate and included only qualified personnel.

Internal control standards require physical controls to limit access to vulnerable assets and require that access to resources and records, such as IRS receipts and taxpayer information, be limited to authorized individuals to reduce the risk of unauthorized use or loss to the government. IRS’s IRM establishes security requirements intended to minimize the potential for loss of life and property, the disruption of services and functions, and the unauthorized disclosure of documents and information. However, the IRM does not establish requirements governing the qualifications or geographical proximity of individuals designated as first responders to duress alarms installed at IRS facilities, nor does it require that IRS periodically

review these elements to enforce adherence to such requirements over time. The effectiveness of security procedures, such as responding to a duress alarm, is impaired if the first responders are not appropriately qualified and properly positioned to handle emergency situations in an effective and timely manner. This increases the risk that IRS will not appropriately respond in an emergency situation to protect its employees and facilities, and to safeguard taxpayer receipts and information.

### Recommendations

We recommend that you direct appropriate IRS officials to do the following:

- Establish procedures requiring periodic verification that all individuals designated as first responders to TAC duress alarms are appropriately qualified and geographically located to respond to the potentially dangerous situations in an effective and timely manner.
- Modify the IRM to specify qualifications and geographical proximity requirements for individuals designated as first responders to duress alarms at IRS facilities, and to require that the responsibilities and qualifications of all designated first responders be periodically reviewed to verify that over time, they continue to be qualified and appropriately located, and to make any necessary adjustments.

### IRS Comments and Our Evaluation

IRS agreed with our recommendations concerning the qualifications and proximity of designated first responders to TAC duress alarms. IRS stated that by August 31, 2008, it would reissue guidance on the requirement that first responders be armed officials, such as on-site contract guards, Federal Protective Service Police, or local police, and that it is revising the IRM to include this requirement. IRS indicated that it will monitor that Territory Managers are periodically verifying the accuracy of the call listing for first responders provided to the Security Console/Mega Center by requiring that managers put the date of verification on the monthly TAC Duress Alarm Report. We will verify the changes to IRS guidance during our audit of IRS's fiscal year 2008 financial statements and evaluate the effectiveness of IRS's efforts during future audits.

### **Contractor Access to Taxpayer Assistance Centers and Field Offices**

During our fiscal year 2007 financial audit, we found that IRS's physical security controls at several TACs and IRS field office units we visited were not adequate to prevent unauthorized individuals from accessing areas that contained taxpayer receipts and information. This occurred at locations where contractors were working under General Services Administration–negotiated (GSA) cleaning service contracts and had unescorted access to IRS space during nonoperating hours.<sup>22</sup> We found that IRS does not have evidence demonstrating completion of favorable

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<sup>22</sup>The GSA is responsible for contracting cleaning services at federal government buildings and when the IRS leases space from third parties.

background investigations for contractors performing work at IRS facilities under GSA-negotiated contracts.

Specifically, during our fiscal year 2007 financial audit, we found the following:

- At 6 of 10 TACs we visited, IRS was unable to provide evidence documenting that contractors performing janitorial services in IRS space during nonoperating hours received favorable background investigation results prior to being allowed access. In addition, at one of the TACs we visited, we observed a janitor disarm and then reset the security system to the IRS space.
- At three field offices we visited, IRS was unable to provide evidence documenting that janitorial contractors, who had unescorted access to IRS-controlled space, received favorable background investigation results prior to being given access.

Internal control standards require that agencies establish physical control to secure and safeguard vulnerable assets, including providing security for, and limiting access to, assets that might be vulnerable to unauthorized use, such as taxpayer receipts and related confidential information.

On August 27, 2004, the President signed Homeland Security Presidential Directive 12, *Policy for a Common Identification Standard for Federal Employees and Contractors*, which requires federal agencies to conduct background investigations on contractors who require routine access to federally controlled facilities. Under this directive, background investigations were to be completed on all applicable contractors, including those covered under GSA-negotiated contracts, by October 27, 2007.

IRS's policies prohibit individuals without favorable background investigations from entering IRS space without an IRS escort. According to the IRM, all contractor employees associated with IRS-administered contracts whose duration of employment equals or exceeds 30 days must undergo, at a minimum, limited criminal history background checks as a condition of employment under the government contract. When a contractor's access is to be limited to less than 30 days total or access is infrequent, a background investigation is not required but he or she is to be escorted while in the IRS space. In addition, IRS issued a memorandum in August 2006 establishing a requirement for new and replacement leases and cleaning contracts negotiated by GSA. Under this requirement, new and replacement leases and new cleaning contracts for all IRS office space provide for janitorial services during normal business hours. Under this 2006 requirement, individuals responsible for review and clearance of the request for space will be expected to include this new provision in these leases and contracts. While requiring cleaning only during operating hours may reduce the risks associated with permitting cleaning staff to enter a controlled area after nonoperating hours, it will not address the risk of unauthorized access during operating hours. In addition, this policy will take time to implement due to the large number of existing leases and contracts that the IRS currently has in place that will need to be modified.

While the IRM requires that background investigations be completed and adequate documentation maintained for all contractors performing work at IRS facilities under IRS-administered contracts, it does not contain comparable requirements for contractors working at IRS facilities under contracts negotiated by GSA. Until IRS obtains evidence that favorable background investigations have been completed for contractors working at IRS facilities under non-IRS contracts, IRS will continue to lack assurance that contractor personnel with unescorted access to its facilities had the required background investigations completed before being allowed access.

### Recommendation

We recommend that you direct appropriate IRS officials to establish procedures to require documentation demonstrating that favorable background checks have been completed for all contractors prior to allowing them access to TAC and other field offices.

### IRS Comments and Our Evaluation

IRS agreed with our recommendation and stated that it expects to have agreement with GSA on established procedures for performing background investigations on GSA contractors by October 31, 2009. IRS also stated that it will use compensating controls outlined in the IRM to safeguard valuable assets, such as financial instruments and taxpayer and other sensitive data, from GSA contractors until background check requirements are implemented. We will evaluate the effectiveness of IRS's efforts after they are fully implemented during future audits.

### **Off-site Contractor Access to Sensitive Information**

During our fiscal year 2007 financial audit, we found that IRS did not have evidence that background investigations were being performed on shredding contractor personnel before they began work at the contractor's off-site facilities where sensitive IRS information was being shredded. IRS contracts with vendors to perform shredding of federal taxpayer information and other sensitive materials at many of its facilities, including Service Center Campuses, Computing Centers, TACs, and field offices. At these facilities, materials to be shredded are picked up by the contractor and taken to the contractor's off-site shredding facility for destruction. The materials being entrusted to these contractors for purposes of being shredded routinely include taxpayer and other sensitive information. We also found that IRS did not perform periodic unannounced inspections of contractor off-site shredding facilities where sensitive information was sent for disposal to ensure that sensitive IRS information was being properly safeguarded.

Specifically, during our audit, we found the following:

- Of the 16 shredding services contracts we reviewed: (1) 11 contracts, covering 14 IRS facilities, did not require that off-site contractors undergo background investigations before being granted access to sensitive IRS information, including federal taxpayer information, and (2) 10 contracts, covering 13 IRS facilities, did not require routine IRS inspections of off-site shredding contractor facilities.

- At 10 IRS facilities we visited (one service center campus, six TACs, and three field office units), IRS officials were unable to provide evidence indicating that off-site shredding contractors had undergone background investigations prior to being granted access to sensitive IRS information.
- At two of the five service center campuses we visited, IRS officials were unable to provide evidence that inspections of the off-site shredding facilities were performed.

The IRM requires that when the work is performed outside an IRS facility, contractor employees may not have access to IRS sensitive information or data unless IRS has received favorable background investigation results. However, as noted above, IRS's contracts with vendors providing IRS with off-site shredding services did not always require background checks or make provisions for periodic inspections by IRS. In addition, we found that the IRM does not require that IRS perform periodic unannounced inspections of off-site shredding contractor facilities to ensure that contractors continue to appropriately safeguard sensitive IRS information on an ongoing basis.

Internal control standards require that agencies establish physical controls to secure and safeguard vulnerable assets, which includes taxpayer information. The standards also state that internal controls should be designed to assure that ongoing monitoring occurs in the course of normal operations. By not requiring background investigations for off-site shredding contractors and not continually monitoring adherence to related safeguard requirements by performing periodic unannounced inspections of off-site contractor facilities, IRS increases the risk of allowing unauthorized access to sensitive IRS information, including federal taxpayer information.

Since IRS did not always enforce its requirement that background checks be performed on contractor employees at off-site shredding locations nor conduct periodic unannounced inspections of these facilities, IRS lacked assurance that the sensitive information being entrusted to these contractors was being properly safeguarded.

### Recommendations

We recommend that you direct appropriate IRS officials to do the following:

- Require including, in all shredding service contracts, provisions requiring (1) completed background investigations for contractor employees before they are granted access to sensitive IRS information, and (2) periodic, unannounced inspections at off-site shredding facilities by IRS to verify ongoing compliance with IRS safeguards and security requirements.
- Revise the IRM to include a requirement that IRS conduct periodic, unannounced inspections at off-site contractor facilities entrusted with sensitive IRS information, document the results, including identification of any security issues,

and verify that the contractor has taken appropriate corrective actions on any security issues observed.

- Establish procedures to require obtaining and reviewing documentation of completed background investigations for all shredding contractors before granting them access to taxpayer or other sensitive IRS information.

### IRS Comments and Our Evaluation

IRS agreed with our recommendations concerning off-site contractor access to sensitive information. IRS stated that it is developing a statement of work for a National Shred/Burn Contract that will result in standard security procedures for the handling of sensitive information and will require specialized background investigations for employees who handle these materials before granting them access to IRS information. IRS also stated that these contracts will include provisions requiring periodic, random, and unannounced inspections of contractor facilities in line with the IRM, which requires contract provisions to allow IRS inspections in order to ensure the safeguarding of IRS information. IRS stated that it expects to implement the National Contract by October 31, 2008. Because IRS's planned actions in this area will not be completed until near the end of our fiscal year 2008 audit, we will evaluate the effectiveness of IRS's efforts during future audits.

### **Juvenile Hiring Practices**

During our fiscal year 2007 financial audit, we found that IRS employment office staff had not fully implemented new policies and procedures recently formulated to address related issues we identified during our audit of IRS's fiscal year 2005 financial statements. Specifically, during our fiscal year 2005 IRS financial audit, we found that for juvenile employee candidates, IRS (1) only required references for those individuals hired to work in receipt-processing functions, although taxpayer receipts and information are also accessible in other functions, and (2) accepted written references that were hand-delivered to IRS by the candidates themselves without independently verifying their source.<sup>23</sup> This condition increased the risk of unsuitable candidates being hired and permitted access to taxpayer receipts and information. In response to recommendations we made to address these issues, IRS issued a new Human Capital policy in August 2006 requiring employment office staff to utilize a revised Form 13094, *Recommendation for Juvenile Employment with the Internal Revenue Service*. The revised form required prospective juvenile employees to provide a character reference and detail the relationship and number of years the juvenile has known the reference. The new policy also required that employment office staff make direct contact with character references provided by juveniles on the Form 13094 to verify that information. However, as noted above, IRS did not fully implement these new policies in fiscal year 2007.

Specifically, we found that of the 142 juveniles IRS hired from October 2006 through April 2007

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<sup>23</sup>GAO, *Management Report: Improvements Needed in IRS's Internal Controls*, GAO-06-543R (Washington, D.C.: May 12, 2006).

- 118 were hired without the use of the newly revised Form 13094, and
- 140 were hired without IRS contacting and verifying character references provided by the potential juvenile hires.

IRS attributed these issues to its employment office staff's lack of awareness of recent revisions to its juvenile hiring policies.

Internal control standards require that agencies establish controls to safeguard vulnerable assets, including limiting access to these assets to only authorized persons. By not fully implementing its revised juvenile hiring policies, IRS increases the risk that juveniles with unacceptable backgrounds could be hired, thus increasing the risk of theft of taxpayer receipts and unauthorized access to taxpayer receipts and information.

### Recommendations

We recommend that you direct the appropriate IRS officials to reinforce existing policies requiring IRS personnel to do the following:

- Use the revised Form 13094 when hiring juveniles.
- Verify the information on Form 13094 by contacting the reference directly and documenting the details of this contact.

### IRS Comments and Our Evaluation

IRS agreed with our recommendations concerning reinforcing existing policies related to hiring juveniles. IRS stated that its Human Capital Office (HCO) issued notices in July and September 2007 to each Employment Branch Chief emphasizing the requirement to use the revised Form 13094 and to follow up on juvenile hiring recommendations. IRS also stated that it revised the form 13094 in December 2007 to include a signature and date block to document the verification process. IRS indicated that it reemphasized these policies during a recent Continuing Professional Education meeting and will monitor policy compliance as a part of the HCO's accountability program reviews. We will evaluate the effectiveness of IRS's efforts in this area during our audit of IRS's fiscal year 2008 financial statements.

### **Review of Tax Exempt/Government Entity User Fee Deposit Processing**

During our fiscal year 2007 financial audit, we found that IRS lacked evidence of supervisory reviews of key functions in its processing of Tax Exempt/Government Entity (TE/GE) user fees it collected from employee pension plans and other organizations for making rulings and determinations about their tax exempt status. IRS's Receipt and Control Operations Unit (RCO), at the Cincinnati Service Center Campus, records TE/GE user fee information in the Letter Information Network User Fee System (LINUS), a database established for tracking such fees collected from tax exempt entities. Using the fee code, LINUS automatically calculates the amount of

user fees to be allocated to the Treasury General Fund and the amount to be retained by the IRS.<sup>24</sup>

We tested a statistical sample of 14 TE/GE user fee transactions IRS recorded in LINUS from October 1, 2006, through June 30, 2007, to determine whether IRS adequately supported, properly classified, and recorded the TE/GE user fees in its accounting systems.<sup>25</sup> While conducting the substantive testing, we found several cases that did not include evidence of required supervisory review and approval by the RCO Unit Manager or Lead Technician of various key documents used in the TE/GE user fee receipt and deposit process. Specifically, of the 14 user fee transactions we reviewed, we found

- 11 transactions in which there was no evidence of supervisory review on the encoding tapes, which list the checks received and grouped for processing by sequence number;
- 8 transactions in which there was no evidence of supervisory review on the Recapitulation of Remittances, which is a concise summary of TE/GE user fees IRS processed for deposit on a particular day at a specific IRS location; and
- 7 transactions in which there was no evidence of supervisory review on the deposit ticket, which in some cases contained manual adjustments to computer-generated amounts.

The IRM requires the Unit Manager or Lead Technician to conduct supervisory reviews of the TE/GE deposit encoding tapes, Recapitulation of Remittances, and deposit tickets, and sign or initial the documents as evidence of their reviews. However, IRS staff did not adhere to its policy requiring signatures on deposit documentation. In addition, internal control standards require internal control activities to help ensure that management's directives are carried out and that all transactions are completely and accurately recorded. Control activities include the proper execution and accurate recording of transactions and events and reviews by management at the functional and activity level. Internal control should assure that monitoring, which includes regular management and supervisory activities, comparisons, reconciliations, and other actions people take in performing their duties, occurs in the course of normal operations.

By not conducting and documenting supervisory reviews of TE/GE user fee collection and deposit activities, IRS faces increased risk that it may not detect errors in the

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<sup>24</sup>IRS is allowed to retain a portion of the user fees it collects, based on criteria established in legislation, primarily in a provision included in the Treasury, Postal Service and General Government Appropriations Act, 1995, Pub. L. No. 103-329, 108 Stat. 2382, 2388 (Sept. 30, 1994) (reprinted in 26 U.S.C. § 7801 note). For the user fees it is allowed to retain, IRS records revenue and offsetting collections which are credited back to the operating appropriations. For the user fees it is not allowed to retain, IRS records revenue and transfers the funds to the General Fund of the Treasury.

<sup>25</sup>We selected a monetary unit sample from a population of 55,384 TE/GE user fee transactions totaling \$31.9 million primarily for the purpose of testing the accuracy of the recorded balance and projecting any substantive exceptions that occur to the entire population. While our testing included reviewing certain internal control attributes, our sample was not specifically designed for the purpose of projecting internal control exceptions.

processing of TE/GE user fee receipts or that it may incur losses from unrecorded and improperly recorded receipts.

### Recommendation

We recommend that you issue a memorandum to RCO Unit staff reiterating existing requirements for (1) supervisory reviews of the processing of TE/GE user fee deposits, and (2) key documentation to be signed and dated by the supervisor as evidence of that review.

### IRS Comments and Our Evaluation

IRS agreed with our recommendation and stated it issued a memorandum in April 2008 to appropriate managers reiterating the requirement to follow IRM procedures for supervisory review of key TE/GE documents and to sign and initial these documents as evidence of their review. We will evaluate the effectiveness of IRS's efforts in this area during our audit of IRS's fiscal year 2008 financial statements.

### **Controls over Purchase Card Processing**

During our fiscal year 2007 financial audit, we found that IRS lacked key internal controls over the processing of its purchase card transactions to prevent or detect erroneous, improper, or fraudulent purchases. IRS's business units use purchase cards primarily to make micropurchases. For micropurchases, IRS established a per transaction limit of \$2,000 for construction transactions, \$2,500 for services, and \$3,000 for goods or supplies.<sup>26</sup>

As part of our fiscal year 2007 financial audit, we statistically sampled 49 purchase and travel card transactions processed between October 9, 2006, and May 8, 2007.<sup>27</sup> In testing these transactions, we identified internal control weaknesses related to the lack of (1) evidence of supervisory reviews, (2) fund control, and (3) key documentation for purchase card transactions. Based on the results of our work, we estimate that 92.9 percent of total purchase and travel card transactions processed between October 9, 2006 and May 8, 2007 had control weaknesses and we are 95 percent confident that the actual percent is not more than 98.0 percent. This estimate exceeds the tolerable percentage in error of 5 percent.

Specifically, of the 49 sampled transactions we reviewed, we found the following:

- Thirty-five transactions in which the purchase card approving officials did not sign and date the monthly reports provided by the credit card company attesting to their review of the purchase card accounts' activity under their authority. On the basis of this work, we estimate that 79.6 percent of total purchase card transactions were not signed and dated by an approving official, and we are 95

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<sup>26</sup>This is consistent with the "micro-purchase threshold" in the Federal Acquisition Regulation. See 48 C.F.R. § 2.101.

<sup>27</sup>The sample population consisted of 155,264 purchase and travel card transactions totaling \$29.8 million.

percent confident that the actual percentage of purchase card transactions that are not signed and dated by an approving official is not more than 88.9 percent.

- One transaction in which the purchase cardholder did not obtain funding approval or verify that funds were available for the specific unit before making purchases. On the basis of this work, we estimate that 2.3 percent of total purchase card transactions did not have funding approval, and we are 95 percent confident that the actual percentage of purchase card transactions that did not have funding approval is not more than 10.3 percent.
- Twenty transactions in which the purchase cardholders did not properly document their purchase card monthly statement reconciliations to supporting documents or sign and date them when completed. On the basis of this work, we estimate that 45.5 percent of the total purchase card monthly statement reconciliations were not signed and dated, and we are 95 percent confident that the actual percentage of purchase card monthly statement reconciliations that were not signed and dated is not more than 58.9 percent.
- One transaction in which the purchase cardholder and purchase card approving official failed to retain their reconciliation documents for a reasonable period of time, such as 3 years. Based on this work, we estimate that for 2.3 percent of total purchase card transactions, the cardholders and approving officials did not retain their reconciliation documentation for a reasonable period of time, and we are 95 percent confident that the actual percentage of purchase card transactions for which the cardholders and approving officials did not retain their reconciliation documentation is not more than 10.3 percent.

Internal control standards require transactions to be authorized and executed only by persons acting within their scope and authority. This is defined as the principal means of assuring that only valid transactions to exchange, transfer, use, or commit resources and other events occur. The standards further state that internal control should assure that ongoing monitoring occurs in the course of normal operations. Monitoring includes regular management and supervisory activities, comparisons, and reconciliations. Finally, the standards require that internal control and all transactions and other significant events be clearly documented, and that documentation be readily available for examination.

Although IRS issued guidelines to govern the use of purchase cards, we found that the guidelines did not provide the detailed documented procedures needed to minimize the occurrence of the control weaknesses that we identified. By not requiring the proper documentation and implementation of appropriate controls over the processing of purchase card transactions, IRS's risk is increased that it may not detect erroneous, improper, or fraudulent purchase card transactions and uncontrolled or unintended use of agency funds.

### Recommendations

We recommend that you direct appropriate IRS officials to modify existing guidelines to require documentation and implementation of detailed internal control procedures

for IRS's purchase card program. Specifically, existing guidelines should be modified to provide for detailed internal control procedures requiring that

- purchase card approving officials and purchase cardholders sign and date monthly account statements attesting to their review and completion of the required reconciliation process,
- purchase cardholders obtain funding approval or verify that funds are available for the intended purpose prior to making a purchase,
- purchase card approving officials update and maintain appropriate supporting documentation, and
- purchase cardholders and purchase card approving officials retain copies of all supporting documents for a reasonable period of time, such as 3 years.

### IRS Comments and Our Evaluation

IRS agreed with our recommendations concerning detailed internal control procedures over its purchase card program. IRS stated that in October 2007, it implemented its electronic Purchase Card Module, which allows cardholders and approving officials to electronically reconcile and approve purchase card transactions and maintains evidence of their signatures, approvals, and dates of action. IRS also stated it issued guidance in July 2007 requiring verification of funds availability before purchases are made by cardholders and approved by managers. This guidance was incorporated in the IRM and purchase card training courses. IRS added that its Requisition Tracking System must show available funds in order to create a commitment for any purchase. Furthermore, IRS indicated that it modified its purchase card documentation guidelines in October 2007. Under this modified guidance, electronic records of purchase card activities and paper documents, such as packing slips and receipts, will be retained by IRS for 3 years. We will evaluate the effectiveness of IRS's efforts in this area during our audit of IRS's fiscal year 2008 financial statements.

### **Recording of Property and Equipment**

During our fiscal year 2007 financial audit, we found that IRS did not always record new assets in its property and equipment inventory system within required time frames. IRS policy requires that new assets be recorded in its inventory system within 10 days after receipt. In addition, internal control standards require agencies to implement internal control procedures to ensure the accurate and timely recording of transactions and events. The standards further state that transactions should be promptly recorded to maintain their relevance and value to management in controlling operations and making decisions.

As part of our fiscal year 2007 audit, we selected 168 transactions of new assets IRS paid for between October 1, 2006, and May 31, 2007, on a nonstatistical basis and tested whether IRS recorded the assets in its inventory records. For each of the selected items, we obtained identifying information from the purchase documents

such as requisition numbers, receipt dates, descriptions, order numbers, and serial numbers from invoices and traced the asset to IRS's property and equipment inventory records. In performing this test, we found four instances in which the recently acquired asset was not recorded in IRS's inventory system as of July 12, 2007. These assets had receipt and acceptance dates ranging from August 31, 2006, to February 27, 2007, which well exceeded the 10 days required by IRS for recording new assets into its inventory system.<sup>28</sup>

Property records that are incomplete or out of date impede management's ability to make sound operating decisions and control operations. Furthermore, these control weaknesses impede IRS's ability to timely detect the loss, theft, or misuse of government property.

### Recommendation

We recommend that you direct appropriate IRS officials to issue a memorandum addressed to all personnel responsible for updating inventory records that reiterates IRS existing policy requiring that new assets be inputted into the inventory system within 10 days after receipt.

### IRS Comments and Our Evaluation

IRS agreed with our recommendation and stated it will issue a memorandum by October 31, 2008, to all personnel responsible for updating the inventory records reiterating the IRS policy to record accountability data related to new assets into the inventory system within 10 days after receipt. We will review the memorandum to be issued during our audit of IRS's fiscal year 2008 financial statements and evaluate the effectiveness of IRS's efforts during future audits.

### **Employee Travel Authorization**

During our fiscal year 2007 financial audit, we found that IRS lacked controls to ensure that all employee travel was authorized before employees were allowed to travel. In conducting detailed testing of nonpayroll expense transactions that occurred from October 1, 2006 to May 31, 2007, we tested 14 employee travel transactions. In 5 of the 14 travel transactions, we found that an IRS approving official had not approved the employee's travel authorization prior to the beginning of the travel period.<sup>29</sup> As a result, IRS lacked assurance that these travel costs were

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<sup>28</sup>We selected transactions on a nonstatistical basis from IRS asset payments made during the first 8 months of fiscal year 2007. Therefore, we could and do select items that were delivered in an earlier period and paid in our audit year. Such items should be accrued in the period received but they are reversed out and recorded anew when paid.

<sup>29</sup>We selected two monetary unit samples, from a population of all nonpayroll expense transactions, consisting of those transactions greater than or equal to \$50,000 and those less than \$50,000. The sample populations consisted of 740,589 nonpayroll transactions totaling \$1,525.3 million. Because our sample was designed to test all nonpayroll expense transactions, not just those related to travel, we are unable to project the exceptions that only applied to travel transactions to the entire population.

necessary to accomplish the mission in the most economic and effective manner and that they were in compliance with IRS's travel policies.

In accordance with IRS's Official Travel Guide as reflected in the IRM, travel authorizations must be approved before travel commences. Furthermore, internal control standards require that transactions and other significant events be authorized and executed only by persons acting within the scope of their authority. According to the standards, this is the principal means of assuring that only valid transactions to exchange, transfer, use, or commit resources and other events occur.

In the five cases cited above, IRS did not follow its documented travel procedures or the federal internal control standards and, as a result, was at risk of being unable to ensure that the costs incurred for employee travel were valid or necessary.

### Recommendation

We recommend that you direct the appropriate IRS officials to issue a memorandum to employees that reiterates IRS policy requiring all employees to obtain appropriate approval of travel authorizations prior to the initiation of their travel.

### IRS Comments and Our Evaluation

IRS agreed with our recommendation and stated it has already issued periodic notices to employees in 2007 and 2008 that reiterated the policy to obtain approval of travel authorizations before initiation of travel. IRS also stated that from May through July 2008, it will implement an integrated travel system that will prevent employees from completing reservations in its online booking tool without an approved travel authorization. We will evaluate the effectiveness of IRS's efforts in this area during our audit of IRS's fiscal year 2008 financial statements.

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This report contains recommendations to you. The head of a federal agency is required by 31 U.S.C. § 720 to submit a written statement on actions taken on these recommendations. You should submit your statement to the Senate Committee on Homeland Security and Governmental Affairs and the House Committee on Oversight and Government Reform within 60 days of the date of this report. A written statement must also be sent to the House and Senate Committees on Appropriations with the agency's first request for appropriations made more than 60 days after the date of the report. Furthermore, to assure GAO has accurate, up-to-date information on the status of your agency's actions on our recommendations, we request that you also provide us with a copy of your agency's statement of actions taken on open recommendations. Please send your statement of action to me or Ted Hu, Assistant Director, at [HuT@gao.gov](mailto:HuT@gao.gov).

This report is intended for use by the management of IRS. We are sending copies to the Chairmen and Ranking Members of the Senate Committee on Appropriations; Senate Committee on Finance; Senate Committee on Homeland Security and Governmental Affairs; and Subcommittee on Taxation and IRS Oversight, Senate Committee on Finance. We are also sending copies to the Chairmen and Ranking Members of the House Committee on Appropriations and House Committee on Ways and Means, the Chairman and Vice-Chairman of the Joint Committee on Taxation, the Secretary of the Treasury, the Director of OMB, the Chairman of the IRS Oversight Board, and other interested parties. The report is available at no charge on GAO's Web site at <http://www.gao.gov>.

We acknowledge and appreciate the cooperation and assistance provided by IRS officials and staff during our audits of IRS's fiscal years 2007 and 2006 financial statements. Please contact me at (202) 512-3406 or [sebastians@gao.gov](mailto:sebastians@gao.gov) if you or your staff have any questions concerning this report. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. GAO staff who made major contributions to this report are listed in enclosure III.

Sincerely yours,



Steven J. Sebastian  
Director  
Financial Management and Assurance

Enclosures – 3

## Details on Audit Methodology

To fulfill our responsibilities as the auditor of the Internal Revenue Service's (IRS) financial statements, we did the following:

- We examined, on a test basis, evidence supporting the amounts and disclosures in the financial statements. This included selecting statistical samples of unpaid assessment, revenue, refund, accrued expenses, payroll, nonpayroll, property and equipment, accounts payable, and undelivered order transactions. These statistical samples were selected primarily to substantiate balances and activities reported in IRS's financial statements. Consequently, dollar errors or amounts can and have been statistically projected to the population of transactions from which they were selected. In testing some of these samples, certain attributes were identified that indicated deficiencies in the design or operation of internal control. These attributes, where applicable, can be and have been statistically projected to the appropriate populations.
- We assessed the accounting principles used and significant estimates made by management.
- We evaluated the overall presentation of the financial statements.
- We obtained an understanding of internal controls related to financial reporting (including safeguarding assets) and compliance with laws and regulations (including the execution of transactions in accordance with budget authority).
- We obtained an understanding of the design of internal controls relating to the existence and completeness assertions related to the performance measures reported in IRS's Management Discussion and Analysis, and determined that they have been placed in operation.
- We tested relevant internal controls over financial reporting (including safeguarding assets) and compliance, and evaluated the design and operating effectiveness of internal controls.
- We considered IRS's process for evaluating and reporting on internal controls and financial management systems under 31 U.S.C. § 3512 (c), (d), commonly referred to as the Federal Managers' Financial Integrity Act of 1982, and Office of Management and Budget Circular No. A-123, *Management's Responsibility for Internal Control*.
- We tested compliance with selected provisions of the following laws and regulations: Anti-Deficiency Act, as amended (31 U.S.C. § 1341(a)(1) and 31 U.S.C. § 1517(a)); Purpose Statute (31 U.S.C. § 1301); Release of lien or discharge of property (26 U.S.C. § 6325); Interest on underpayment, nonpayment, or extensions of time for payment of tax (26 U.S.C. § 6601); Interest on overpayments (26 U.S.C. § 6611); Determination of rate of interest (26 U.S.C. § 6621); Failure to file tax

return or to pay tax (26 U.S.C. § 6651); Failure by individual to pay estimated income tax (26 U.S.C. § 6654); Failure by corporation to pay estimated income tax (26 U.S.C. § 6655); Prompt Payment Act (31 U.S.C. § 3902(a), (b), and (f) and 31 U.S.C. § 3904); Pay and Allowance System for Civilian Employees (5 U.S.C. §§ 5332 and 5343, and 29 U.S.C. § 206); Federal Employees' Retirement System Act of 1986, as amended (5 U.S.C. §§ 8422, 8423, and 8432); Social Security Act, as amended (26 U.S.C. §§ 3101 and 3121 and 42 U.S.C. § 430); Federal Employees Health Benefits Act of 1959, as amended (5 U.S.C. §§ 8905, 8906, and 8909); Department of the Treasury Appropriations Act, 2006, Pub. L. No. 109-115, div. A, tit. II, 119 Stat. 2396, 2432 (Nov. 30, 2005); and Revised Continuing Appropriations Resolution, 2007, Pub. L. No. 110-5, 121 Stat. 8 (Feb. 15, 2007).

- We tested whether IRS's financial management systems substantially comply with the three requirements of the Federal Financial Management Improvement Act of 1996. Pub. L. No. 104-208, div. A, § 101(f), title VIII, 110 Stat. 3009, 3009-389 (Sept. 30, 1996).

Comments from the Internal Revenue Service



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

May 16, 2008

Mr. Steven J. Sebastian  
Director  
Financial Management and Assurance  
U.S. Government Accountability Office  
441 G Street, N.W.  
Washington, D.C. 20548

Dear Mr. Sebastian:

I am writing in response to the Government Accountability Office (GAO) draft of the Fiscal Year (FY) 2007 Management Report titled, *Improvements Needed in IRS's Internal Controls (GAO-08-386R)*. As GAO noted in the report titled, *Financial Audit: IRS's Fiscal Years 2007 and 2006 Financial Statements*, we continue to make progress in addressing our financial management challenges and have substantially mitigated weaknesses in our internal controls.

In FY 2007, we separately reported estimated receipts of Social Security and Medicare taxes in our other accompanying information to the financial statements and significantly accelerated the certification of excise tax receipts to the recipient trust funds. These improvements enabled you to conclude that these matters no longer constitute internal control deficiencies. We also enhanced the capabilities of the Custodial Detail Database (CDDDB) to begin journalizing tax debt information from our master file systems to our general ledger weekly. These improvements enabled you to conclude that this was the first step in establishing CDDDB's capability to serve as a subsidiary ledger for unpaid tax debt. We believe our work this year in implementing corrective actions will further improve our financial management. I have enclosed a response which addresses all of your recommendations separately.

We are committed to implementing appropriate improvements to ensure that the IRS maintains sound financial management practices. If you have any questions, please contact Alison Doone, Chief Financial Officer, at (202) 622-6400.

Sincerely,

A handwritten signature in black ink, appearing to read "D. Shulman".

Douglas H. Shulman

Enclosure

GAO Recommendations and IRS Responses to  
GAO FY 2007 Management Report  
Improvements Needed in IRS Internal Controls  
GAO-08-386R

**Recommendation:** Verify that when it becomes fully operational, Custodial Detail Database (CDDDB), when used in conjunction with Interim Revenue Control System (IRACS), will provide the Internal Revenue Service (IRS) with the direct transaction traceability for all of its tax related transactions as required by the Standard General Ledger (SGL) and Federal Financial Management Systems Requirement (FFMSR), and thus Federal Financial Manager's Integrity Act (FFMIA).

**Comments:** We agree with this recommendation. The Revenue Financial Management Unit will verify that the summary tax revenue, tax refunds, and unpaid assessments recorded in IRACS are traceable to the direct transactions in CDDDB when CDDDB is fully implemented by September 30, 2009. As part of the FY 2008 financial statement audit, the IRS is providing GAO the information posted in CDDDB to show that tax revenue is traceable through use of the Trace ID number and that tax refunds are traceable using the refund schedule number. The IRS also provided GAO the high-level requirements to incorporate the SGL into Redesign Revenue Accounting Control System (RRACS) Release 1 scheduled for Fiscal Year (FY) 2010 implementation.

**Recommendation:** Document and implement the specific procedures to be performed by the statistician in each step of the unpaid assessments estimation process.

**Comments:** We agree with this recommendation. The Revenue Financial Management Unit will document the procedures the statistician performs in each step of the unpaid assessments estimation process by June 30, 2008.

**Recommendation:** Document and implement specific detailed procedures for reviewers to follow in their review of unpaid assessments statistical estimates. Specifically, IRS should require that a detailed supervisory review be performed to ensure: (1) the statistical validity of the sampling plans, (2) data entered into the sample selection programs agree with the sampling plans, (3) data entered into the statistical projection programs agree with the IRS sample review results, (4) data on the spreadsheets used to compile the interim projections and roll-forward results trace back to supporting statistical projection results, and (5) the calculations on these spreadsheets are mathematically correct.

**Comments:** We agree with this recommendation. The Revenue Financial Management Unit will document procedures for reviewers to follow during their review of the unpaid assessments statistical estimates by June 30, 2008.

**Recommendation:** Modify the Business Master File (BMF) computer program so that the date of the deficiency assessment is used as the effective date of any related accuracy penalty.

**Comments:** We agree with this recommendation. The IRS plans to implement changes to the BMF computer program so that the date of the deficiency assessment is the effective date of any related accuracy penalty by July 31, 2009.

**Recommendation:** Complete and document the review of existing programs in the master files that affect penalty calculations to identify any instances in which programs are not functioning in accordance with the intent of the IRM.

**Comments:** We agree with this recommendation. The IRS is reviewing master file programs to identify any instances in which programs are not functioning in accordance with the IRM and plans to complete the review by July 31, 2008.

**Recommendation:** To address other issues that may exist in the IRS master files that affect penalty calculations, in instances where programs are not functioning in accordance with the intent of the IRM, take appropriate action to correct the programs so that they function in accordance with the IRM.

**Comments:** We agree with this recommendation. The IRS has initiated corrective actions in instances where programs were not functioning in accordance with the IRM.

**Recommendation:** Develop and provide comprehensive guidance to assist Taxpayer Assistance Centers (TAC) managers to use in conducting reviews of outlying TACs and documenting the results. This guidance should include a description of the key controls that should be in place at outlying TACs, specify how often these key controls should be reviewed, and specify how the results of each review should be documented, including follow-up on issues identified in previous TAC reviews.

**Comments:** We agree with this recommendation. The Director, Field Assistance established the expectation that Area Directors are responsible and accountable for the oversight of all TAC activities, including outlying posts of duty, and is updating IRM 1.4.11.6 to include this statement. IRM 1.4.11.6 also will include the requirement to maintain documentation of managerial reviews, including operational reviews and site visits. IRM 1.4.11.9, "Reviews/Reports/Certifications Template" provides a description of the key controls that should be in place in all TACs, including the frequency of the reviews and how to document the results of the reviews. Field Assistance will review the reports and annotate which reports are required for each TAC location with the necessary documentation and summarize these in IRM 1.4.11.6. Field Assistance will validate the reviews are complete using the remittance and security database and will include these directions in the field operational reviews at the group, area, and territory levels by July 31, 2008.

**Recommendation:** Establish a process to periodically update and communicate the specific required reviews for all off-site TAC managers.

**Comments:** We agree with this recommendation. The Director, Field Assistance will issue a quarterly reminder for the required reviews beginning in July 2008. Field Assistance will review IRM 1.4.11.9 before the issuance of the quarterly reminders to ensure its accuracy. Field Assistance requires the area offices to routinely report on corrective actions identified during the operational review process to ensure completion of needed improvements.

**Recommendation:** Establish a mechanism to monitor compliance with the existing requirement that TAC employees responsible for accepting taxpayer payments in cash have their computer system access appropriately restricted to limit their ability to adjust taxpayer accounts.

**Comments:** We agree with this recommendation. The Director, Field Assistance revised the language in IRM 1.4.11.19.4.1.1 in April 2008 to mandate the use of the "restrict" command code in all cases. The change is reflected in the annual reconciliation of official receipts process, IRM 1.4.11.19.4.1.1, that provides for the Separation of Duties and Form 809, Receipt for Payment of Taxes. Group managers will continue to be reminded as part of the Form 809 annual reconciliation of the existing requirements to restrict command codes. We will direct areas and territories to include restricted Integrated Data Retrieval System (IDRS) command codes in on-going operational reviews. Field Assistance will explore systemic ways to monitor use of restricting command codes.

**Recommendation:** Establish procedures requiring periodic verification that all individuals designated as first responders to TAC duress alarms are appropriately qualified and geographically located to respond to the potentially dangerous situations in an effective and timely manner.

**Comments:** We agree with this recommendation. Agency-Wide Shared Services (AWSS) will reissue by August 31, 2008, guidance requiring that first responders to TAC duress alarms be armed officials such as onsite contract guards, Federal Protective Service Police, or local police, whoever may respond in the most expedient manner. We are modifying the existing monthly TAC Duress Alarm Report that the Territory Managers submit to the Physical Security Headquarters Office to show the date the managers verified that the call listing for first responders located at the Security Console/Mega Center is accurate.

**Recommendation:** Modify the IRM to specify qualifications and geographical proximity requirements for individuals designated as first responders to duress alarms at IRS facilities, and to require that the responsibilities and qualifications of all designated first responders be periodically reviewed to verify that over time, they continue to be qualified and appropriately located, and to make any necessary adjustments.

Comments: We agree with this recommendation. AWSS is revising IRM 10.2.14 to include the requirement that first responders to duress alarms be armed officials such as onsite contract guards, Federal Protective Service Police, or local police.

Recommendation: Establish procedures to require documentation demonstrating that favorable background checks have been completed for all contractors prior to allowing them access to TAC and other field offices.

Comments: We agree with this recommendation. AWSS is working with the General Services Administration (GSA) to establish procedures for performing background investigations on GSA contractors/janitors and expects completion by October 31, 2009, contingent on full cooperation and support from GSA. In the interim, the controls identified in IRMs 1.16.3, 5.1.2, 1.16.14.2, 1.16.14.5, and 1.16.15 address safeguarding valuable assets, including financial instruments and protection of taxpayer and other sensitive data. Compliance with these IRMs should address concerns regarding physical controls to secure and safeguard vulnerable assets from GSA contractors.

Recommendation: Require including, in all shredding service contracts, provisions requiring (1) completed background investigations for contractor employees before they are granted access to sensitive IRS information, and (2) periodic, unannounced inspections at off-site shredding facilities by IRS to verify ongoing compliance with IRS safeguards and security requirements.

Comments: We agree with this recommendation. AWSS is developing a Statement of Work (SOW) for a National Shred/Burn Contract. This will result in standard security procedures for the handling of shred and specialized background investigations for employees who will handle IRS materials to be shredded. Additionally, the IRS will establish provisions to ensure periodic, unannounced inspections of contractor facilities, and combine local contracts into the national contract to create a standardized process for overseeing thorough and timely background investigations and maintaining records. We expect implementation by October 31, 2008.

Recommendation: Revise the IRM to include a requirement that IRS conduct periodic, unannounced inspections at off-site contractor facilities entrusted with sensitive IRS information, document the results, including identification of any security issues, and verify that the contractor has taken appropriate corrective actions on any security issues observed.

Comments: We agree with this recommendation. IRM 1.16.13 Document Protection requires contract provisions to allow IRS inspection of the contractor facility and operations to ensure the safeguarding of IRS information. We are currently developing a National Shred/Burn Contract and will include provisions for off-site inspections on a periodic, random, and unannounced basis by October 31, 2008.

**Recommendation:** Establish procedures to require obtaining and reviewing documentation of completed background investigations for all shredding contractors before granting them access to taxpayer or sensitive IRS information.

**Comments:** We agree with this recommendation. AWSS is working on a SOW for a National Shred/Burn Contract that will ensure that contractor background investigations are completed before granting access to IRS information. The IRS expects to combine local contracts into the national contract by October 31, 2008.

**Recommendation:** Reinforce existing policies requiring use of the revised Form 13094, Recommendation for Juvenile Employment with IRS when hiring juveniles.

**Comments:** We agree with this recommendation. The Human Capital Office (HCO) issued a notice in September 2007 to each Employment Branch Chief emphasizing adherence and compliance with these policies and reinforced adherence at a recent Continuing Professional Education (CPE) meeting and through periodic reminders to the Employment Offices.

**Recommendation:** Reinforce existing policies requiring verification of the information on Form 13094 by contacting the reference directly and document the details of this contact.

**Comments:** We agree with this recommendation. In July 2007, the HCO issued a notice to the Employment Operations Centers reemphasizing the requirement to use the revised Form 13094 and to implement follow-up procedures on juvenile recommendations. The IRS revised Form 13094 in December 2007 to include a signature and date block for the Human Resources specialist to document completion of the verification process. HCO provided the form and accompanying instructions to employment staff in January 2008, and HCO reiterated compliance with this policy and mandatory use of the revised Form 13094 during a recent CPE with Human Resources specialists. HCO will monitor policy compliance as a part of its accountability program reviews.

**Recommendation:** Issue a memorandum to Receipt Control Operations Unit staff reiterating existing requirements for supervisory reviews of the processing of TE/GE user fee deposits and for key documentation to be signed and dated by the supervisor as evidence of that review.

**Comments:** We agree with this recommendation. Wage and Investment issued a memorandum in April 2008 to the Operations Manager, Receipt and Control, reiterating the requirement to follow procedures in IRM 3.45.1 to conduct supervisory reviews of the deposit encoding tapes, the Recapitulation of Remittances, deposit tickets, and to sign or initial the documents as evidence that the reviews were completed.

**Recommendation:** Modify existing guidelines to require documentation and implementation of detailed internal control procedures for the IRS purchase card

program. Specifically, existing guidelines should be modified to provide for detailed internal control procedures requiring that purchase card approving officials and purchase cardholders sign and date monthly account statements attesting to their review and completion of the required reconciliation process.

**Comments:** We agree with this recommendation. In October 2007, AWSS began using the electronic Purchase Card Module that provides the cardholder and approving official the ability to electronically reconcile and approve the transactions and provides evidence they signed and approved the transactions. This electronic reconciliation maintains separation of duties between purchaser and approver and produces an audit trail by maintaining history on the user login name and date of the action.

**Recommendation:** Modify existing guidelines to require documentation and implementation of detailed internal control procedures for the IRS purchase card program. Specifically, existing guidelines should be modified to provide for detailed internal control procedures requiring that purchase cardholders obtain funding approval or verify that funds are available for the intended purpose prior to making a purchase.

**Comments:** We agree with this recommendation. AWSS included funds verification requirements in guidance issued in July 2007, *Purchase Card Holder Roles and Responsibilities*, and in IRMs 1.32.4 and 1.32.6. Cardholders receive these requirements and guidelines, including the requirement to verify funds availability before making a purchase, during initial training and refresher training. The guidelines are also available in the Purchase Card Guide and on the IRS intranet. In addition, the requirement was included in the transition guidelines provided during conversion to the Purchase Card Module in October 2007. These controls also exist during the approval process. The business unit plan manager must approve all purchases, verifying both appropriateness of the purchase and available funds. The Requisition Tracking System must show available funds in order to create a commitment for any purchase.

**Recommendation:** Modify existing guidelines to require documentation and implementation of detailed internal control procedures for the IRS purchase card program. Specifically, existing guidelines should be modified to provide for detailed internal control procedures requiring that purchase card approving officials update and maintain appropriate supporting documentation.

**Comments:** We agree with this recommendation. AWSS modified the existing guidelines in October 2007 with the implementation of the Purchase Card Module. Documentation for purchase card activity is maintained electronically in the Purchase Card Module, and packing slips and receipts are kept by the cardholder. This documentation is available for review by the approving official.

**Recommendation:** Modify existing guidelines to require documentation and implementation of detailed internal control procedures for the IRS purchase card program. Specifically, existing guidelines should be modified to provide for detailed internal control procedures requiring that purchase cardholders and purchase card

approving officials retain copies of all supporting documents for a reasonable period of time, such as three years.

**Comments:** We agree with this recommendation. AWSS modified the guidelines in October 2007 to require cardholders and approving officials to maintain documentation for three years; paper documentation by the cardholders and electronic archives in the Purchase Card Module.

**Recommendation:** Issue a memorandum addressed to all personnel responsible for updating inventory records that reiterates its existing policy requiring that new assets be input into the inventory system within 10 days after receipt.

**Comments:** We agree with this recommendation. MITS will issue a memorandum by October 31, 2008, to all personnel responsible for updating inventory records reiterating the IRS policy that new assets be input into the inventory system within 10 days after receipt.

**Recommendation:** Issue a memorandum to employees that reiterates IRS policy requiring all employees to obtain appropriate approval of travel authorizations prior to the initiation of their travel.

**Comments:** We agree with this recommendation. We issue communications to all employees reiterating the policy requiring employees to obtain approval of travel authorizations before initiation of travel through periodic notices on the IRS intranet with links to *Travel Times*. In *Travel Times*, we have issued: Travel Authorization Reminders (October 2007 and February 2008) and Travel Authorization Reminder News from the business units (December 2007, February 2008, and May 2008). Further, the IRS is implementing GovTrip, an integrated travel system, from May through July 2008. GovTrip will not allow an employee to complete reservations in the on-line booking tool until the travel authorization has been approved.

Enclosure III

GAO Contact and Staff Acknowledgments

GAO Contact

Steven J. Sebastian, (202) 512-3406 or sebastians@gao.gov

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The following individuals made major contributions to this report: Ted Hu, Assistant Director; Stephanie Chen; Oliver Culley; John Davis; Charles Fox; Margery Glover; Bradley Klingsporn; Delores Lee; Gail Luna; Cynthia Ma; Joshua Marcus; Charles Payton; John Sawyer; Angel Sharma; Peggy Smith; Christopher Spain; LaDonna Towler; Gary Wiggins; Danietta Williams; and Ting-Ting Wu.

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