Why GAO Did This Study

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

What GAO Found

In GAO’s opinion, IRS’s fiscal years 2008 and 2007 financial statements are fairly presented in all material respects. However, serious internal control and financial management systems deficiencies continued to make it necessary for IRS to rely on resource-intensive compensating processes to prepare its balance sheet. Because of these and other deficiencies, IRS did not, in GAO’s opinion, maintain effective internal control over financial reporting or compliance with laws and regulations, and thus did not provide reasonable assurance that losses, misstatements, and noncompliance with laws and regulations material in relation to the financial statements would be prevented or detected on a timely basis.

IRS continued to make significant strides in addressing its financial management challenges and material weaknesses in internal control. Specifically, IRS’s progress to address control deficiencies over the collection of unpaid taxes and the issuance of improper refunds is such that GAO no longer considers the remaining control deficiencies in this area to constitute a material weakness. Furthermore, during fiscal year 2008, IRS significantly improved internal controls that safeguard hard-copy taxpayer receipts and data at primary submission processing locations. These improvements, combined with prior years’ progress, enabled GAO to conclude that remaining issues related to this activity no longer constitute a significant deficiency. IRS also continued to make progress in developing cost accounting information to capture the full cost of its operating activities, and in establishing a framework for implementing a subsidiary ledger for its tax administration activities. However, continued management commitment and sustained efforts are necessary to build on the significant progress made to date and to fully address remaining financial management challenges. These remaining challenges pertain to material weaknesses in IRS’s control over financial reporting, management of unpaid tax assessments, and information security. Also, while GAO recognized improvements in controls over revenue collection and refund issuance, remaining issues over IRS’s enforcement collection activities constituted a significant deficiency. Furthermore, GAO found that IRS was not always in compliance with the law concerning the timely release of tax liens.

IRS management faces serious challenges from its continued use of obsolete financial management systems that do not conform to the requirements of FFMIA. These challenges adversely affect IRS’s ability to fulfill its responsibilities as the nation’s tax collector because it is unable to routinely obtain comprehensive, timely, accurate, and useful information for day-to-day decision making. As IRS continues to progress toward ever more automated financial management processes, the presence of material weaknesses in controls over these systems, especially in the area of information security, could have serious implications for our future ability to determine whether IRS’s financial statements are fairly stated.

What GAO Recommends

Based on prior audits, GAO made numerous recommendations to IRS to address the internal control and compliance issues that continued to persist during fiscal year 2008. GAO will continue to monitor IRS’s progress in implementing the 147 recommendations that remain open as of the date of this report, of which 66 relate to the material weakness in information security.

IRS stated that it was dedicated to improving financial management and cited several initiatives and related benefits. It noted that it has a solid management team in place to address remaining financial management challenges, and is committed to improving information security as an ongoing priority.

To view the full product, including the scope and methodology, click on GAO-09-119. For more information, contact Steven J. Sebastian at (202) 512-3406 or sebastians@gao.gov.