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 over financial reporting. 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 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 2010. GAO will continue to monitor and report on IRS’s progress in implementing the 173 recommendations that remain open as of the date of this report. In addition, as appropriate, we will report separately on any recommended actions to address the new deficiencies identified in this year’s audit.

IRS agreed that identified weaknesses continue to exist and stated that it has taken actions to reduce the risks associated with these identified weaknesses. IRS expressed confidence that GAO would find that significant progress has been made during its fiscal year 2011 audit.

What GAO Found
In GAO’s opinion, IRS’s fiscal years 2010 and 2009 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 use 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 as of September 30, 2010, and thus did not provide reasonable assurance that losses and misstatements material to the financial statements would be prevented or detected and corrected timely.

During fiscal year 2010, IRS continued to make strides in addressing its internal control deficiencies. Specifically, IRS made progress in addressing its financial management systems’ noncompliance with the requirements of FFMIA by bringing its financial management systems into compliance with the United States Standard General Ledger. IRS also corrected several information security weaknesses that GAO identified in previous audits. However, remaining deficiencies pertain to IRS’s (1) material weaknesses in internal control over unpaid tax assessments and information security, (2) noncompliance with the law concerning the timely release of tax liens, and (3) financial management systems’ substantial noncompliance with FFMIA requirements. Additionally, GAO’s fiscal year 2010 financial audit identified a significant deficiency in IRS’s internal control over tax refund disbursements.

IRS also faces serious challenges due to continued reliance on financial management systems that do not substantially comply with FFMIA requirements and that affect IRS’s ability to (1) produce reliable financial statements without significant compensating procedures and (2) make well-informed decisions. IRS’s continued material weakness in internal control over information security, which jeopardizes the reliability of the financial information it processes, could have implications for GAO’s future ability to determine whether IRS’s financial statements are fairly stated because as IRS continues to automate its processes, the availability of alternative methods of obtaining reasonable assurance that its financial statements are fairly stated diminish. This weakness also significantly increases the risk that sensitive taxpayer information may be compromised.

Further, during fiscal year 2010, IRS continued to face management challenges in developing and institutionalizing the use of financial management information, specifically cost- and revenue-based performance information, to assist it in making operational decisions and measuring the effectiveness of its programs. Sustained management efforts will be necessary to build on the progress made to date and to fully address IRS’s remaining internal control, compliance, and systems deficiencies and remaining financial management challenges.