



441 G St. N.W.
Washington, DC 20548

May 29, 2015

The Honorable John Koskinen
Commissioner of Internal Revenue

Management Report: Improvements Are Needed to Enhance the Internal Revenue Service's Internal Control over Financial Reporting

Dear Mr. Koskinen:

In November 2014, we issued our report on the results of our audit of the financial statements of the Internal Revenue Service (IRS) as of, and for the fiscal years ending, September 30, 2014, and 2013, and on the effectiveness of its internal control over financial reporting as of September 30, 2014.¹ We also reported our conclusions on IRS's compliance with selected provisions of applicable laws, regulations, contracts, and grant agreements. In March 2015, we issued a separate report on information security issues identified during our audit, along with associated recommendations for corrective actions.²

The purpose of this report is to present those internal control deficiencies identified during our audit of IRS's fiscal years 2014 and 2013 financial statements for which we do not already have any recommendations outstanding. Although some of these deficiencies were not discussed in our report on the results of our financial statement audit because they were not considered to be material weaknesses or significant deficiencies, they nonetheless warrant IRS management's attention.³ This report provides recommendations to address the internal control issues we identified during our fiscal year 2014 audit, and presents the status, as of September 30, 2014, of IRS's corrective actions taken to address our recommendations, detailed in our previous management report, that remained open at the beginning of our audit.⁴

¹GAO, *Financial Audit: IRS's Fiscal Years 2014 and 2013 Financial Statements*, [GAO-15-173](#) (Washington, D.C.: Nov. 12, 2014).

²GAO, *Information Security: IRS Needs to Continue Improving Controls over Financial and Taxpayer Data*, [GAO-15-337](#) (Washington, D.C.: Mar. 19, 2015).

³A material weakness is a deficiency, or combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected, on a timely basis. A significant deficiency is a deficiency, or combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis.

⁴GAO, *Management Report: Improvements Are Needed to Enhance the Internal Revenue Service's Internal Controls*, [GAO-14-433R](#) (Washington, D.C.: July 2, 2014).

Results in Brief

During our audit of IRS's fiscal years 2014 and 2013 financial statements, we identified new internal control deficiencies in the following areas that contributed to IRS's continuing material weakness in internal control over unpaid tax assessments as of September 30, 2014.⁵

- **Corrective action plan for addressing system deficiencies involving unpaid tax assessments.** IRS's corrective action plan was not adequate to reasonably assure that system control deficiencies contributing to a material weakness in unpaid tax assessments would be effectively addressed. This increases the risk that IRS's efforts to address numerous control issues affecting the reporting of unpaid assessment amounts and the resultant material weakness will be hampered.
- **Accuracy of penalty assessments.** IRS's controls over penalty assessments were not operating effectively to reasonably assure the accuracy of penalties recorded in taxpayers' accounts. This increases the risk of errors in IRS's financial statements, may burden taxpayers who are assessed higher amounts in penalties than they actually owe, or result in lost revenue to the federal government when taxpayers are assessed lower penalty amounts than they actually owe.

In addition, our fiscal year 2014 audit identified other new deficiencies in the following areas in IRS's internal control over financial reporting that while they individually and collectively do not constitute or contribute to a material weakness or significant deficiency, nonetheless warrant IRS management's attention.

- **Transmission of taxpayer receipts and information.** IRS's managerial review controls were not effectively designed or implemented to provide reasonable assurance that taxpayer receipts and information sent from taxpayer assistance centers were received by the intended service center campuses. This increases the risk that IRS will not promptly prevent or detect loss of, theft of, or unauthorized access to taxpayer receipts and related sensitive information.
- **Unauthorized access awareness training for contractors.** IRS did not consistently enforce its policies and procedures requiring that contractors receive unauthorized access awareness training prior to gaining unescorted access to IRS facilities. This increases the risk of unauthorized disclosure, loss, or theft of taxpayer receipts and related sensitive information.
- **Candling procedures at receipt processing facilities.** IRS did not adequately enforce its candling policies and procedures at certain receipt processing facilities.⁶ This increases the risk of inadvertent loss or destruction of taxpayer receipts and information.
- **Capitalization of internal use software costs.** IRS did not have sufficient controls in place to reasonably assure that it properly and consistently capitalized certain internal use

⁵An unpaid tax assessment is a legally enforceable claim against a taxpayer and consists of taxes, penalties, and interest that have not been collected or abated (i.e., reduced by IRS). Internal Revenue Manual (IRM) § 1.34.4 (June 23, 2009).

⁶Candling is a process IRS uses to determine if any contents remain in opened envelopes. This is often achieved by passing an envelope over a light source.

software costs in accordance with federal accounting standards. This increases the risk of IRS misstating assets and expenses in its financial statements.

- **Recording property and equipment acquisitions.** IRS's controls were not effectively designed to reasonably assure that asset purchases were properly recorded in its asset management systems. This increases the risk of misstatements to its financial statements and undetected loss or theft of assets, and jeopardizes the integrity of the information IRS management uses for decision making.

This report provides two recommendations pertaining to the new control deficiencies that contributed to IRS's continuing material weakness in internal control over unpaid tax assessments and 9 recommendations related to the other identified deficiencies, for a total of 11 new recommendations. These recommendations are intended to improve IRS's internal controls over its financial management and accountability of resources as well as bring IRS into conformance with its own policies, *Standards for Internal Control in the Federal Government*,⁷ and Office of Management and Budget (OMB) Circular No. A-123, *Management's Responsibility for Internal Control*.⁸

As of September 30, 2014, IRS had completed corrective action on 20 of the 51 recommendations from our prior financial audits and other financial management-related work that remained open at the beginning of our fiscal year 2014 audit. As a result, IRS currently has 42 GAO recommendations to address, which consist of the previous 31 open recommendations and the 11 new recommendations we are making in this report. Enclosure I provides details on the status of IRS's actions to address the open recommendations from our prior audits. Our recommendations related to IRS's information systems security are reported separately and are not included here because of the sensitive nature of many of the control deficiencies that gave rise to the recommendations.⁹

In commenting on a draft of this report, IRS stated that it remains committed to implementing appropriate improvements to ensure that the IRS maintains sound financial practices. IRS agreed with the 11 new recommendations we are making in this report and provided planned actions to address each recommendation. IRS's comments are reprinted in their entirety in enclosure III.

Scope and Methodology

This report addresses internal control deficiencies we identified during our audit of IRS's fiscal years 2014 and 2013 financial statements. As part of our financial statement audit, we tested

⁷GAO, *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).

⁸Office of Management and Budget, *Management's Responsibility for Internal Control*, OMB Circular No. A-123 (Dec. 21, 2004), defines management's responsibilities for developing and maintaining effective internal control, including federal managers' responsibilities for establishing, assessing, correcting, and reporting on internal control.

⁹Although most of our recommendations regarding our information security work are sensitive and reported to IRS separately, we have reported our objectives, summary results, and nonsensitive recommendations in a publicly available report; see [GAO-15-337](#).

IRS's internal control over financial reporting.¹⁰ We designed our audit procedures to test relevant controls, including those for proper authorization, execution, accounting, and reporting of transactions and for the safeguarding of assets and taxpayer information. In conducting the audit, we reviewed applicable IRS policies and procedures, observed operations, tested statistical and nonstatistical samples of transactions, examined relevant documents and records, and interviewed IRS management and staff. Further details on our audit scope and methodology are provided in our November 2014 report on the results of our audit of IRS's fiscal years 2014 and 2013 financial statements.¹¹

We performed our audit of IRS's fiscal years 2014 and 2013 financial statements in accordance with U.S. generally accepted government auditing standards. We believe our audit provided a reasonable basis for our conclusions in this report.

Internal Control Deficiencies Identified during Our Fiscal Year 2014 Audit

Corrective Action Plan for Addressing System Deficiencies Involving Unpaid Tax Assessments

During our fiscal year 2014 audit, we found that IRS's corrective action plan was not adequate to reasonably assure that IRS is effectively addressing its material weakness over unpaid tax assessments. This long-standing material weakness is due, in large part, to system deficiencies that render IRS's systems unable to readily distinguish unpaid assessments among taxes receivable, compliance assessments, and write-offs in order to properly classify these components for financial reporting purposes.¹² Primarily because of such deficiencies, IRS uses a labor-intensive, manual, statistical estimation process to determine the amount of taxes receivable, which comprised over 80 percent of total assets reported on IRS's fiscal year 2014 balance sheet. Through this compensating process, IRS made almost \$17 billion in adjustments to the fiscal 2014 year-end gross taxes receivable balance produced by its financial systems. Absent the use of this statistical estimation process, the various unpaid tax assessment balances produced by its financial systems would have been materially inaccurate.

IRS has taken actions over the years to address various system deficiencies contributing to the material weakness in internal control over unpaid tax assessments, including the phased-in

¹⁰An entity's internal control over financial reporting is a process effected by those charged with governance, management, and other personnel, the objectives of which are to provide reasonable assurance that (1) transactions are properly recorded, processed, and summarized to permit the preparation of financial statements in accordance with U.S. generally accepted accounting principles, and assets are safeguarded against loss from unauthorized acquisition, use, or disposition, and (2) transactions are executed in accordance with the laws governing the use of budget authority and other laws and regulations that could have a direct and material effect on the financial statements.

¹¹See [GAO-15-173](#).

¹²Federal accounting standards classify unpaid tax assessments into one of the following three categories for reporting purposes: federal taxes receivable, compliance assessments, and write-offs. Federal taxes receivable are taxes due from taxpayers for which IRS can support the existence of a receivable through, for example, taxpayer agreement or a court ruling in favor of IRS determining that a tax payer owes an assessment. Compliance assessments are proposed tax assessments where neither the taxpayer (when the right to disagree or object exists) nor the court has affirmed that the amounts are owed. Write-offs represent unpaid tax assessments for which IRS does not expect further collections because of factors such as the taxpayer's death, bankruptcy, or insolvency. IRM § 1.34.1, *Revenue Accounting Definitions and Acronyms* (June 23, 2009). Federal accounting standards require only federal taxes receivable, net of an allowance for uncollectible amounts, to be reported on the financial statements. See Statement of Federal Financial Accounting Standards No. 7, *Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting* (May 10, 1996).

implementation of, and enhancements to, its subsidiary ledger for unpaid tax assessments.¹³ These actions have enabled IRS to analyze and classify unpaid tax assessment account balances from its master files into the various financial reporting categories.¹⁴ However, IRS's actions to date have not been fully effective at correcting the system limitations that continue to hinder its ability to accurately report and manage unpaid assessments. IRS has developed a plan to remediate the material weakness over unpaid tax assessments and related system limitations; however, our audit found that the plan does not include all of the enhancements needed to enable IRS's systems to more accurately report unpaid assessment amounts. For example, IRS's plan states that IRS will address the system deficiencies through the implementation of the Customer Account Data Engine 2 (CADE2);¹⁵ however, CADE2 is intended to replace only the Individual Master File, and there is no discussion in the plan regarding needed enhancements to the Business Master File. In addition, the plan lacks certain key elements, such as detailed actions that must be performed to resolve the deficiencies, parties responsible for taking specific actions, resource requirements, or incremental milestones so that interim actions and progress can be monitored and assessed.

Internal control standards require management to evaluate and document internal control deficiencies and determine appropriate corrective actions on a timely basis.¹⁶ In addition, OMB Circular No. A-123 requires management of federal agencies to develop corrective action plans for all material weaknesses and assess progress periodically to ensure timely and effective results.¹⁷ OMB Circular No. A-123's implementation guide includes guidance for preparing well-defined corrective action plans.¹⁸ According to the implementation guide, well-defined corrective action plans should include specific corrective actions in sufficient detail to facilitate a common understanding of the deficiency and the steps that must be performed to resolve it, a clear delineation of agency personnel responsible for completing the planned corrective actions and monitoring progress toward resolution, and incremental milestones and completion dates. Inclusion of all of these elements is necessary to allow management to effectively evaluate how to implement the plan and avoid delays, and should help IRS and others monitor progress toward addressing the system deficiencies that are contributing to the material weakness. Without a well-defined corrective action plan, IRS is at risk that its efforts to address numerous control issues affecting the reporting of unpaid assessment amounts will be hampered.

¹³IRS's Custodial Detail Data Base functions as its subsidiary ledger for unpaid tax assessments.

¹⁴IRS's master files contain the detailed records of taxpayer accounts. There are several master files, the most significant of which are the Individual Master File, which contains tax records of individual taxpayers, and the Business Master File, which contains tax records of corporations and other businesses.

¹⁵CADE2 is a relational database intended to enhance the data and accuracy of available information in individual taxpayer accounts. IRS is using a phased-in approach for the implementation of CADE2 and has completed the first phase.

¹⁶[GAO/AIMD-00-21.3.1](#).

¹⁷Office of Management and Budget, *Management's Responsibility for Internal Control*.

¹⁸The Implementation Guide for OMB Circular A-123, *Management's Responsibility for Internal Control: Appendix A, Internal Control Over Financial Reporting* (July 2005), is intended to assist federal managers with implementing a process for assessing the effectiveness of the entity's internal control over financial reporting.

Recommendation for Executive Action

We recommend that you direct the appropriate IRS officials to include all key elements as recommended by the OMB Circular No. A-123 implementation guide in IRS's corrective action plan to adequately address the control deficiencies in its systems that are contributing to the material weakness in unpaid tax assessments.

Accuracy of Penalty Assessments

During our fiscal year 2014 audit, we found that IRS's controls over penalty assessments did not reasonably assure that IRS consistently calculated and recorded taxpayer penalties in accordance with established policies and procedures.

The Internal Revenue Code grants IRS broad authority to assess penalties against taxpayers for noncompliance with tax laws, such as failing to file a tax return, failing to pay taxes owed, or inaccurately reporting taxes.¹⁹ IRS has implemented computerized programs to calculate and record penalty amounts in taxpayer accounts in the master files. However, there are certain situations, of which IRS is aware, in which its computerized programs are unable to accurately calculate the penalty amount. For instance, IRS's computer programs cannot accurately calculate the failure-to-pay (FTP) penalty²⁰ when IRS audits a taxpayer and determines the taxpayer was ineligible for certain refundable tax credits that IRS had initially paid to the taxpayer in the form of a larger refund.²¹ For such situations, IRS has developed a compensating process to prevent the computer from recording an incorrect penalty amount in a taxpayer's account. This process, which is documented in IRS's Internal Revenue Manual (IRM), requires IRS personnel to identify affected taxpayer accounts and record transactions in a manner that suppresses the computer program from determining the penalty amount. IRS personnel must then manually compute the penalty amount and record the amount in the taxpayer's account.²²

During our testing of a statistical sample selected from IRS's fiscal year 2014 population of taxpayer accounts with unpaid tax assessments, we identified several accounts, all of which involved refundable tax credits, that contained inaccurate FTP penalty amounts.²³ These errors

¹⁹See 26 U.S.C. § 6651 and 26 U.S.C. § 6662, which grant IRS the authority to assess penalties against taxpayers in these instances.

²⁰The FTP penalty is a penalty that IRS assesses against taxpayers when taxpayers fail to pay their outstanding tax liability by the return due date. The FTP penalty is calculated based on the amount of taxes outstanding in a taxpayer's account, a penalty rate stipulated in the Internal Revenue Code and the IRM, and the number of months the taxes remain unpaid. IRM, § 20.1.2, *Failure to File/Failure to Pay Penalties* (July 2, 2013).

²¹Congress has provided assistance to certain individuals and businesses in the form of tax credits. For the majority of tax credits, the economic benefit is limited to the taxpayer's tax liability. Credits limited in this manner are termed nonrefundable tax credits. Refundable tax credits, such as the Additional Child Tax Credit, in contrast, are fully payable to the taxpayer, even if the credit exceeds the tax liability. These types of credits provide greater economic benefits because the taxpayer realizes the full benefit of the credit, regardless of the underlying tax liability. The American Recovery and Reinvestment Act of 2009, Pub. L. No. 111-5, 123 Stat. 115 (Feb. 17, 2009), as amended by the American Taxpayer Relief Act of 2012, Pub. L. No. 112-240, 126 Stat. 2313 (Jan. 2, 2013) (codified at 26 U.S.C. § 24).

²²See IRM § 20.1.2.1.5, *Manual Penalty Adjustments* (Apr. 19, 2011), and § 20.1.2.1.6.1.3, *Problems Involving Refundable Credits/Payments* (Apr. 19, 2011).

²³We identified 5 accounts containing errors in penalty amounts in a statistical sample of 93 taxpayer accounts from IRS's March-end interim population of approximately 35 million taxpayer accounts with unpaid tax assessments. A

occurred because IRS was not following its compensating procedures to prevent the computer program from calculating and recording incorrect penalty amounts for these types of transactions. Further, IRS did not have agency-wide procedures to regularly monitor the accuracy of the penalty amounts recorded in taxpayer accounts, so it was not aware of these errors, or that the compensating process was not being followed, until we brought it to IRS's attention.

In prior years we have reported similar deficiencies in IRS controls over penalty computations,²⁴ and in each instance, IRS management was unaware of the errors recorded in taxpayer accounts until we brought them to its attention. Internal control standards require management to design control activities so that all transactions are completely and accurately recorded.²⁵ These standards also require management to design internal control to assure that ongoing monitoring occurs in the course of normal operations. According to IRS, it has yet to address its computer programming issues affecting penalty calculations because of limited resources. However, until IRS develops and implements procedures to routinely monitor and verify the accuracy of penalty assessments recorded in taxpayer accounts, it may unknowingly continue to assess and record erroneous taxpayer penalties. Such errors may burden taxpayers who are assessed higher penalty amounts than they actually owe, result in lost revenue to the federal government when taxpayers are assessed lower penalty amounts than they actually owe, and increase the risk of errors in IRS's financial statements.

Recommendation for Executive Action

We recommend that you direct the appropriate IRS officials to develop and implement agency-wide procedures to routinely monitor the accuracy of penalties recorded in taxpayer accounts to timely detect and correct errors.

Transmission of Taxpayer Receipts and Information

During our fiscal year 2014 audit, we identified deficiencies in IRS's controls over tracking and safeguarding taxpayer receipts and information during transit from certain taxpayer assistance centers (TAC) we visited to other IRS locations.²⁶ When a TAC transmits hard copy taxpayer receipts, information, or both to another IRS location, the IRM requires that IRS personnel use (1) traceable mail and (2) transmittal forms—either a Daily Report of Collections Activity, if sent alone, or a Document Transmittal form for transmitting multiple reports—in order to record and document the items being transmitted.²⁷ In addition, the IRM requires that managers take responsibility for the security and accountability of taxpayer receipts and information during

statistical projection of the 5 errors indicates that approximately 10.9 percent, or approximately 4 million taxpayer accounts in IRS's population, contained errors in penalty accounts.

²⁴See section A of the table in enc. II for a list of relevant prior year reports.

²⁵[GAO/AIMD-00-21.3.1](#).

²⁶TACs 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, 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. During fiscal year 2014, there were 389 TACs located throughout the United States.

²⁷IRM § 1.4.11.19, *Payment Processing – First Line Manager's Responsibilities* (Jan. 1, 2013).

transit. The IRM also requires recipients, such as service center campuses, to acknowledge receipt of the items. If the recipient does not acknowledge receipt within 10 days, the sender is required to initiate follow-up.²⁸ To facilitate this process and in order to identify transmittals that require follow-up, senders must maintain a control copy of each transmittal form sent and track which transmittals have been appropriately acknowledged by the recipient. To assist with the monitoring of the transmittal requirements, IRS's *Field Assistance Guide for Managers* requires that TAC managers use the Follow-up Review Log to document, track, and review transmittal activity and follow-up actions for all unacknowledged transmittals.²⁹ According to the guide, once all taxpayer receipts, information, or both have been acknowledged, or all follow-up procedures have been performed for that month, management must document its review in the Follow-Up Review Log—no later than the last day of the following month.

During our fiscal year 2014 internal control testing at the eight TACs we visited, we found the following deficiencies in the transmission of taxpayer receipts and information:

- At five of the TACs, managerial reviews of the transmittal process were not consistent with requirements. For example, we found instances in which the TAC managers did not (1) identify instances in which personnel did not enter transmittals in the Follow-up Review Log or entered them incorrectly, (2) monitor employee follow-up on the status of unacknowledged transmittals, (3) perform the review of the Follow-Up Review Log by the last day of the following month, or (4) document that a review had been completed over a period of 5 months. Furthermore, we found several instances in which a TAC manager documented a review prior to an employee updating the Follow-up Review Log with the transmittal activity for that month.
- At four of the TACs, management did not retain acknowledgment copies of transmittal forms for the required 3-year retention period.
- At two of the TACs, employees did not use traceable overnight mail when shipping taxpayer receipts and information from one location to another. The TAC manager for one of these TACs indicated that nontraceable mail was used to save money.

During previous audits, we have reported similar findings.³⁰ For example, during our fiscal year 2005 audit, we found several deficiencies related to controls designed to ensure that document transmittals were received and acknowledged on time. IRS responded to our findings by revising the IRM to require (1) the sender to monitor and perform follow-up procedures on unacknowledged transmittals and (2) TAC managers to use the Follow-Up Review Log to document their reviews.³¹ However, the requirements IRS established were not always followed by TAC managers and lacked a critical procedure to prevent these similar issues from resurfacing again, as we found in fiscal year 2014. Specifically, the IRM still does not include a procedure to reconcile transmittal forms for a given month with the associated Follow-Up Review Log, which would help reasonably assure that personnel have properly recorded all

²⁸IRM § 1.4.11.19.1 (4), *Maintaining Form 795-A/310 Files* (Jan. 1, 2015).

²⁹The *Field Assistance Guide for Managers* provides TAC managers with various techniques, methods, and guidelines for managing a successful and effective TAC. See IRM § 1.4.11, *Field Assistance Guide for Managers*.

³⁰See section B of the table in enc. II for a list of relevant prior year reports.

³¹IRM § 1.4.11.19.1, *Maintaining Form 795-A/Form 3210 Files* (Jan. 8, 2015).

transmittal forms in the Follow-Up Review Log and have appropriately documented follow-up for unacknowledged transmittals.

Internal control standards require agencies to establish controls, such as management reviews, to enforce employees' adherence to management policies and procedures, create and maintain records providing evidence that these controls are executed, and appropriately safeguard assets.³² In addition, the standards state that internal control should be designed to ensure that ongoing monitoring occurs in the course of normal operations. Without effective monitoring or enforcement of document transmittal requirements, IRS increases the risk that it will not prevent or promptly detect errors in the transmission of taxpayer receipts or the loss or theft of, or unauthorized access to, taxpayer receipts and related sensitive information.

Recommendations for Executive Action

We recommend that you direct the appropriate IRS officials to take the following two actions:

- Determine the reason(s) why TAC managers and personnel did not consistently comply with existing IRM requirements that TAC managers and personnel (1) perform and document reviews of the Follow-Up Review Log by the last day of the following month, (2) maintain control copies of transmittal forms, and (3) ship taxpayer receipts and information via traceable overnight mail and, based on this determination, establish a process to better enforce compliance with these requirements.
- Update the IRM to require managers to reconcile transmittal forms with the Follow-Up Review Log to reasonably assure that personnel are properly entering transmittal forms into the log and are appropriately documenting follow-up on unacknowledged transmittals of taxpayer receipts and information.

Unauthorized Access Awareness Training for Contractors

During our fiscal year 2014 audit, IRS was unable to provide evidence that all contractors with routine, unescorted access to IRS facilities had received unauthorized access awareness training.³³ IRS uses unauthorized access awareness training to educate its employees and contractors on (1) authorized and unauthorized disclosures of taxpayer information, (2) basic protection policies concerning taxpayer receipts and information, and (3) federal penalties for not protecting this information. However, at one service center campus (SCC) and six of eight field offices we visited, we observed that IRS did not consistently ensure that security guard contractors with unescorted access to IRS space completed unauthorized access awareness training. At the same SCC, we also observed that IRS did not consistently ensure that janitorial contractors with unescorted access to IRS space completed unauthorized access awareness training.

³²[GAO/AIMD-00-21.3.1](#).

³³IRS created the Unauthorized Access, Attempted Access or Inspection of Taxpayer Records program to implement the requirements of the Taxpayer Browsing Protection Act of 1997, Pub. L. No. 105-35, 111 Stat. 1104 (Aug 5, 1997), codified at 26 USC § 7213.7213A.7431. The Taxpayer Browsing Protection Act, in conjunction with this program, provides that willful unauthorized access or inspection of taxpayer records is a crime, punishable upon conviction by fines, imprisonment, and termination of employment. The program requires IRS employees and contractors to take unauthorized access awareness training annually. IRM § 10.5.5.1, *IRS Unauthorized Access, Attempted Access or Inspection of Taxpayer Records (UNAX) Program* (Aug. 26, 2013), and IRM § 10.5.5.2, *Service-wide Roles and Responsibilities for Administering the IRS UNAX Program* (Aug. 26, 2013).

We reported similar findings in a previous audit of IRS. Specifically, during our fiscal year 2009 audit, we found that IRS did not require annual unauthorized access awareness training for all of its SCC and field office contractors with unescorted access to IRS facilities containing taxpayer receipts and information.³⁴ In December 2014, IRS took corrective actions in response to this finding by issuing a policy and procedure memorandum establishing requirements for contractor personnel with access to IRS facilities, data, and related information to annually take unauthorized access awareness training.³⁵ However, in discussions with IRS officials concerning our fiscal year 2014 findings, IRS indicated that this training policy only applies to IRS contractors—that is, personnel contracted through IRS Procurement or through contracts administered by IRS Contractor Security Management. It does not address non-IRS contractors—personnel who have unescorted physical access to IRS facilities based on contracts with other federal agencies, such as the General Services Administration, or with privately owned entities.³⁶

IRS officials stated that IRS relies on these agencies and privately owned entities to provide this type of training to non-IRS contractors; however, we were not able to substantiate whether IRS has communicated this reliance to them. IRS officials acknowledged IRS's obligation to ensure that all contractors with unescorted access working at IRS facilities receive unauthorized access awareness training, but also acknowledged that it has not established monitoring procedures to determine whether the non-IRS contractors have received the training.

Internal control standards require that agencies establish controls to safeguard vulnerable assets and implement access restrictions to and accountability for resources and records, including taxpayer receipts and information.³⁷ In addition, the IRM requires employees and contractors who have unescorted access to IRS facilities to complete unauthorized access awareness training annually. However, since the IRM does not explicitly require non-IRS contractors to complete unauthorized access awareness training annually, IRS managers may not apply the policy to non-IRS contractors, resulting in non-IRS contractors who have unescorted physical access to IRS facilities being unaware of IRS's security policies. Further, by not monitoring or enforcing unauthorized access awareness training for all contractors with unescorted access to IRS facilities, whether under contract by IRS or by another entity, IRS increases the risk of unauthorized disclosure, loss, or theft of taxpayer receipts and related sensitive information.

Recommendations for Executive Action

We recommend that you direct the appropriate IRS officials to take the following three actions:

- Update the IRM to specify that unauthorized access awareness training requirements apply to non-IRS contractors who have unescorted physical access to IRS facilities.

³⁴GAO, *Management Report: Improvements Are Needed in IRS's Internal Controls and Compliance with Laws and Regulations*, [GAO-10-565R](#) (Washington, D.C.: June 28, 2010).

³⁵Internal Revenue Service Policy and Procedures Memorandum, No. 24.1, *Information Protection and Security Awareness Training Requirements*, (Dec. 30, 2014).

³⁶IRS operates in various facilities throughout the country. The administration and oversight authority of building services and security guards at these facilities are either provided under IRS contracts or provided by other federal agencies (e.g., the General Services Administration or Federal Protective Service) or commercial vendors.

³⁷[GAO/AIMD-00-21.3.1](#).

- Establish a process to ensure that the requirement for unauthorized access awareness training is explicitly communicated to non-IRS contractors who have unescorted access to IRS facilities.
- Establish procedures to monitor whether non-IRS contractors with unescorted physical access to IRS facilities are receiving unauthorized access awareness training.

Candling Procedures at Receipt Processing Facilities

During our fiscal year 2014 audit, we found that IRS employees at certain receipt processing facilities did not consistently adhere to IRS's candling policies and procedures designed to reasonably assure that all contents have been extracted from envelopes received from taxpayers as a means of safeguarding taxpayer receipts and information. In previous audits, we have reported similar findings. Specifically, from 2002 to 2006, we provided IRS with 18 recommendations related to IRS's candling processes, and IRS took corrective actions that sufficiently addressed our recommendations.³⁸ However, during our fiscal year 2014 audit, we found that some of the control deficiencies we identified in previous audits had resurfaced. Specifically, during our visits to two IRS SCCs and one lockbox bank,³⁹ we found the following:

- At one SCC, employees did not follow the IRM requirement to immediately document in the candling log remittances found during final candling.⁴⁰
- At the same SCC, employees did not follow IRM requirements to properly store remittances found during final candling in a secure container from the time the remittances were initially discovered until they were logged and delivered to the deposit unit.⁴¹ Employees stored the unlogged remittances in a locked drawer with other documents and office supplies. Even though the drawer was locked, the key was stored in plain sight to all other employees working in the area.
- At both SCCs we visited, employees did not consistently follow IRM requirements to take remittances found during final candling to the deposit unit as many times in a day as necessary to ensure that timely deposit rules were met.⁴² For example, we observed multiple remittances, including high dollar remittances that employees discovered before noon, that were not taken to the deposit unit until the following day.
- At the lockbox bank we visited, we performed a limited review of three excerpts of security camera footage and found that employees allowed envelopes to overlap while they performed final candling, potentially obscuring documents in the envelopes that the candling

³⁸See section C of the table in enc. II for a list of relevant prior year reports.

³⁹Lockbox banks are financial institutions designated as depositories and financial agents of the U.S. government under contract with the Department of the Treasury's Bureau of the Fiscal Service to perform certain financial services, including processing tax documents, depositing the receipts, and forwarding the documents and data to IRS's SCCs, which update taxpayers' accounts. During fiscal year 2014, there were five lockbox banks processing taxpayer receipts on behalf of IRS.

⁴⁰IRM § 3.10.72.5.6, *Candling Procedures (Initial and Final)* (June 5, 2014).

⁴¹IRM § 3.10.72.5.6.

⁴²IRM § 3.10.72.5.6.

is intended to detect, and did not visually inspect the envelopes as they passed them over the light source as required by IRS's *Lockbox Processing Guidelines*.⁴³

Internal control standards require that management establish physical controls to secure and safeguard vulnerable assets.⁴⁴ IRS has numerous policies and procedures designed to safeguard remittances found during candling to ensure that they are not inadvertently overlooked and destroyed;⁴⁵ however, we found that IRS did not effectively enforce these policies and procedures. By not enforcing its candling policies at SCCs and lockbox banks, IRS decreases the potential effectiveness of the candling process and, as a result, increases the risk of inadvertent loss or destruction of taxpayer receipts.

Recommendation for Executive Action

We recommend that you direct the appropriate IRS officials to determine why staff did not consistently comply with IRS's existing requirements for the final candling of receipts at SCCs and lockbox banks, including logging remittances found during final candling on the final candling log at the time of discovery, safeguarding the remittances at the time of discovery, transferring the remittances to the deposit unit promptly, and passing one envelope at a time over the light source, and based on this determination, establish a process to better enforce compliance with these requirements.

Capitalization of Internal Use Software Costs

During our fiscal year 2014 audit, we found that IRS did not consistently obtain or review sufficient evidence to properly support the capitalization of administrative or project management-related internal use software (IUS) costs.⁴⁶ Capitalized IUS costs accounted for over 59 percent of IRS's general property and equipment balance reported on its fiscal year 2014 balance sheet.⁴⁷ According to federal accounting standards, administrative and project management-related costs should only be capitalized when they are incurred during the development phase of an IUS project.⁴⁸

⁴³Lockbox banks have internal security cameras to aid in monitoring its extraction activities; however, SCCs do not use internal security cameras to monitor their extraction activities.

⁴⁴[GAO/AIMD-00-21.3.1](#).

⁴⁵IRM § 3.10.72, *Receiving, Extracting and Sorting* (Oct. 31, 2014).

⁴⁶IUS can be purchased from commercial vendors "off-the-shelf," internally developed by IRS employees, or contractor developed, for the sole purpose of meeting IRS's internal or operational needs. Administrative and project management-related costs are associated with services provided for the oversight and support of IUS projects. These services generally support multiple IUS projects and occur throughout the life of a project.

⁴⁷In its fiscal year 2014 financial statements, IRS reported general property and equipment at \$1,648 million, of which IUS activity made up \$976 million. IRS's IUS activity consists mostly of IUS projects related to the Patient Protection and Affordable Care Act and the Foreign Account Tax Compliance Act. Pub. L. No. 111-148 (Mar. 23, 2010), as amended by the Health Care and Education Reconciliation Act of 2010, Pub. L. No. 111-152 (Mar. 30, 2010); Pub. L. 111-147, 124 Stat. 97-117 (Mar. 18, 2010) (codified at 26 U.S.C. §§ 1471 -74). These two projects alone account for over 50 percent of IRS's fiscal year 2014 IUS activity.

⁴⁸Statement of Federal Financial Accounting Standards (SFFAS) No. 10, *Accounting for Internal Use Software* (Oct. 9, 1998). Each IUS project has an enterprise life cycle consisting of three phases: (1) the preliminary design phase, which entails planning; (2) the software development phase, which encompasses software configuration,

In our review of property and equipment transactions, we identified several instances where it was unclear how IRS determined that administrative or project management-related IUS costs met the criteria for capitalization in accordance with federal accounting standards. To determine whether IUS-related costs meet the capitalization criteria, IRS relies on (1) the Statement of Work detailing the general services to be performed under the contract, (2) related vendor invoices, and (3) an internal work-in-process project life cycle tracking schedule used to monitor the entry and exit dates of the IUS project life cycle phases. However, we found that these documents did not always provide sufficient details for clearly determining which IUS project release the services were related to and therefore whether the services occurred during the development phase of the project.

Specifically, during our statistical testing of fiscal year 2014 property and equipment acquisitions, we initially could not validate whether costs were properly capitalized for four IUS transactions involving administrative or project management-related services based on our review of the documentation that management used for making its capitalization decisions. For example, the invoices submitted to IRS by the vendor in these four instances included services performed on multiple IUS project releases, with each release having a different date for exiting the development phase. While the Statement of Work provides general information on the types of services that will be performed on a contract, it does not provide the detailed information needed to link any administrative or project management-related services to a specific IUS project release. Similarly, the internal work-in-process schedule IRS uses to track IUS projects and releases through their life cycles does not identify the entry and exit dates for administrative or project management-related services since those services could relate to multiple IUS project releases. As a result, based solely on the three sources of information that IRS uses to make a determination, we were unable to determine whether the costs were accurately capitalized.

During our further inquiry on these four transactions, we found that additional sources and documentation were available to support accurately determining to which IUS project release these administrative or project management-related services related to and therefore during which phase of the release's life cycle they occurred. For example, based on our inquiry of contracting officer's representatives (COR) responsible for monitoring contract performance and our review of additional documentation provided by the CORs pertaining to one of our sample items, we were able to determine that the administrative or project management-related services were performed for an IUS project release that had exited the development phase and therefore a portion of the costs on the invoice should have been expensed instead of capitalized. There were no exceptions noted with the remaining three transactions. We projected the one exception to the population and were able to conclude that there were no material misstatements in the general property and equipment balance.⁴⁹

Internal control standards state that an agency's internal control should provide reasonable assurance that transactions are accurately recorded.⁵⁰ The IRM requires monthly review of IUS

coding, installation to hardware, and testing; and (3) the post implementation/operational phase, which includes application maintenance. A project may consist of a single release or multiple releases, each with its own enterprise life cycle phases. SFFASs No. 10 requires costs incurred in the first and third phases to be expensed as incurred.

⁴⁹Our evaluation was based on a statistical sample from a population of 72,945 property and equipment acquisition transactions that were recorded from October 1, 2013, through May 31, 2014. Net and absolute dollar value totals for the population were \$278 million and \$360 million, respectively. We are 95 percent confident that the net upper error limit does not exceed our tolerable error, which is the maximum error in a population that the auditor is willing to accept.

⁵⁰[GAO/AIMD-00-21.3.1](#).

costs to determine proper classification and to use project life cycle entry and exit dates as a basis to record costs in accordance with federal accounting standards.⁵¹ However, the IRM does not include procedures for obtaining and reviewing the more detailed documentation necessary to adequately assess which project phase a cost was attributable to when the invoice, Statement of Work, and internal work-in-process schedule do not provide sufficient information. Absent sufficient procedures employed by IRS for determining an IUS project's life cycle phase, there is an increased risk that costs may be erroneously capitalized, thus overstating IRS's property and equipment and understating its operating expenses recorded on its financial statements.

Recommendation for Executive Action

We recommend that you direct the appropriate IRS officials to establish and implement detailed written procedures for properly determining whether IUS costs should be capitalized or expensed. The procedures should include steps for obtaining the complete documentation required to determine the project phase to which a cost was attributable, specifically for cases in which the invoice, Statement of Work, and internal work-in-process schedule do not provide sufficient information.

Recording Property and Equipment Acquisitions

During our fiscal year 2014 audit, we identified deficiencies in IRS's controls over the recording of capitalized property and equipment acquisitions in its asset management systems. In its fiscal year 2014 financial statements, IRS reported more than \$1.6 billion in capitalized property and equipment. Nearly 32 percent of this account balance, or over \$523 million, comprised tangible assets that IRS recorded and tracks in two separate asset management systems depending on the type of asset: (1) Knowledge Incident/Problem Service Asset Management (KISAM) and (2) Criminal Investigation Management Information System (CIMIS).⁵² Both of these asset management systems function as subsidiary ledgers in that they maintain detailed supporting information, such as the location of the asset, latest inventory date, and disposal data for the tangible asset acquisitions recorded in IRS's general ledger. IRS uses these systems to track acquisitions and disposals; however, these systems are not integrated with the general ledger. Therefore, management must access the two separately maintained systems in order to record and obtain detailed information supporting the existence of its capitalized tangible assets.

During our audit, we found that IRS did not have sufficient controls in place to reasonably assure that property and equipment acquisitions were properly recorded in KISAM. For example:

- During our testing of a statistical sample of asset acquisitions occurring from June 2014 through September 2014, we identified the procurement of an information technology asset—an uninterruptible power supply, valued at approximately \$2 million—that IRS received on July 31, 2014, but did not enter into KISAM until October 28, 2014, after we

⁵¹IRM § 1.35.6.10(4), *Internal Use Software* (May 5, 2014).

⁵²KISAM provides a central repository that is used to manage all tangible asset acquisitions, except for certain investigative equipment, throughout their entire life cycles from acquisition to disposal. IRS's Criminal Investigation unit uses CIMIS to maintain accountability over certain investigative equipment, including fleet vehicles, surveillance vehicles, radio communication equipment, firearms, body armor, electronic surveillance equipment, cameras and lenses, night vision equipment, and badges.

brought the issue to IRS's attention.⁵³ This asset purchase was initially incorrectly recorded as a leasehold improvement (intangible asset), which IRS policy does not require to be tracked in KISAM. However, during a routine voucher review process conducted by IRS's Financial Reporting (FR) office on October 4, 2014, it was reclassified as a tangible asset and therefore met the criteria for recording and tracking in KISAM.⁵⁴ Upon further review, we found that IRS acquired, as part of this purchase, a second uninterruptible power supply of the same value that was also reclassified as a tangible asset but was not entered into KISAM until we brought it to IRS's attention. We determined that these errors occurred because there were no written procedures instructing officials in the FR office to communicate reclassifications identified during the voucher review process to, in this case, the Hardware Asset Management team,⁵⁵ or other applicable unit, such as Criminal Investigation, responsible for ensuring that assets were properly added to its asset management systems for tracking and accountability purposes.

- There was no requirement for supervisory review to ensure that certain asset acquisitions were properly added to KISAM. IRS's Standard Operating Procedure for its Hardware Asset Management team includes procedures for obtaining notification of hardware asset purchases and for recording these purchases in KISAM;⁵⁶ however, the procedures do not require a periodic supervisory review to provide reasonable assurance that the asset purchases are properly recorded in KISAM.

Internal control standards require management to design control activities so that all transactions are completely and accurately recorded.⁵⁷ These standards also require management to perform ongoing monitoring of the operating effectiveness of the control activities. By not communicating reclassifications regarding property acquisitions to the appropriate unit and reviewing asset purchases for proper recording in its asset management systems, IRS is at increased risk that property and equipment balances in its financial statements could be misstated. In addition, these control deficiencies increase the risk of undetected loss or theft of assets and jeopardize the integrity of the information management uses for decision making.

Recommendations for Executive Action

We recommend that you direct the appropriate IRS officials to take the following two actions:

⁵³We selected a statistical sample of 15 property and equipment acquisition transactions that were recorded from June 1, 2014, through September 30, 2014, to assist with our substantiation of the general property and equipment balance. However, because our sample was for the single purpose of substantiating the general property and equipment balance, we could not use this exception to draw conclusions about controls over the sample population.

⁵⁴IRS's Financial Reporting office performs a voucher review process to ensure that transactions are properly capitalized or expensed during the normal course of business operations. Voucher review packages are prepared for all capitalized transactions greater than or equal to \$50,000 and those expense transactions greater than or equal to \$50,000 that are recorded in expense accounts and have the greatest potential for misclassification as expenses rather than assets. Any adjustments identified are posted to their respective general ledger accounts.

⁵⁵The Hardware Asset Management team is responsible for ensuring that information technology-related tangible assets are properly recorded in KISAM.

⁵⁶Internal Revenue Service, Standard Operating Procedure, Asset Management Hardware Group B, *Daily IPS Feed Review Process*, (Mar. 5, 2013).

⁵⁷[GAO/AIMD-00-21.3.1](#).

- Establish and implement written procedures to reasonably assure that assets that are reclassified during the voucher review process are properly added to KISAM or CIMIS for tracking purposes, as applicable.
- Update the Hardware Asset Management Standard Operating Procedure to include a requirement for periodic supervisory review to provide reasonable assurance that certain asset acquisitions are properly entered into KISAM.

Status of Prior Audit Recommendations

IRS has continued to work to address many of the control deficiencies related to open recommendations from our prior financial audits and other financial management-related work.⁵⁸ At the beginning of our fiscal year 2014 financial audit, there were 51 recommendations to improve IRS's financial operations and internal controls from prior year audits that we reported as open in our status of recommendations in the management report issued in July 2014.⁵⁹ In the course of performing our fiscal year 2014 financial audit, we identified numerous actions IRS took to address many of the previously identified control deficiencies. On the basis of IRS's actions taken through September 30, 2014, which we were able to substantiate through our audit, we are closing 20 of these recommendations. As a result, a total of 42 recommendations need to be addressed—31 remaining from our prior years' audits and the 11 new recommendations we are making in this report. See enclosure I for more details on our assessment of the status of IRS's actions to address our prior audit recommendations that remained open at the beginning of this year's audit.

Agency Comments and Our Evaluation

In his May 18, 2015, written comments on a draft of this report, the IRS Commissioner stated that the IRS is committed to implementing appropriate improvements to ensure that the IRS maintains sound financial management practices. IRS agreed with the 11 new recommendations we are making in this report and provided planned actions for addressing each recommendation. IRS's actions, if effectively implemented, should address the issues that gave rise to our recommendations. We will evaluate the effectiveness of IRS's efforts during our audit of IRS's fiscal year 2015 financial statements and future audits. IRS's written comments are reprinted in their entirety in enclosure III.

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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 to 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 this report. Furthermore, to ensure that 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

⁵⁸This does not include information systems security recommendations reported separately and with limited distribution because of their sensitive nature. See [GAO-15-337](#).

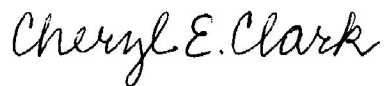
⁵⁹[GAO-14-433R](#).

open recommendations. Please send your statement of actions to me, at clarkce@gao.gov or Nina Crocker, Assistant Director, at crockern@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, House Committee on Appropriations, House Committee on Ways and Means, and House Committee on Oversight and Government Reform, and to the Chairman and Vice Chairman of the Senate Joint Committee on Taxation. We are also sending copies to the Secretary of the Treasury, the Director of the Office of Management and Budget, and the Chairman of the IRS Oversight Board. In addition, the report is available at no charge on the GAO website 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 2014 and 2013 financial statements. If you or your staff have any questions about this report, please contact me at (202) 512-9377 or clarkce@gao.gov. 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 IV.

Sincerely yours,

A handwritten signature in black ink that reads "Cheryl E. Clark". The signature is written in a cursive, flowing style.

Cheryl E. Clark
Director
Financial Management and Assurance

Enclosures – 4

Enclosure I: Status of Recommendations from Prior Audits Reported as Open in GAO's 2013 Management Report⁶⁰

Recommendation by control issue			Year initially reported	Source report	Status	
					Closed	Open
Excise tax						
1	13-14	Develop and implement written procedures requiring IRS to obtain documented concurrence from the other Treasury agencies involved in the excise tax collection and distribution process of any changes affecting how IRS calculates the amount of excise taxes it certifies to trust funds before IRS implements the change to its excise tax certification process. Action taken: During fiscal year 2014, IRS issued written guidance requiring IRS personnel to obtain documented concurrence from affected Treasury organizations before implementing any changes to how IRS calculates the amount of excise taxes certified to trust funds. In March 2014, IRS provided documentation of this new guidance. IRS's actions sufficiently address our recommendation.	2012	GAO-13-420R	X	
Financial reporting						
2	12-02	Enhance existing policies and procedures pertaining to monitoring internal control over the automated systems operated by IRS personnel to specifically provide for routine, documented monitoring of the specific internal controls within its financial reporting systems that are intended to ensure the integrity of the data reported in the financial statements and other financial reports. This monitoring process should (1) involve both automated systems specialists and individuals with expertise in accounting and reporting, as appropriate; (2) encompass the specific automated internal controls that affect the authorizing, processing, transmitting, or reporting of material financial transactions; and (3) be designed to determine whether these internal controls are in place and operating effectively. Action taken: IRS's efforts to address this recommendation are ongoing. IRS has updated the IRM to include a section on continuous monitoring, has created a crosswalk to map National Institute of Standards and Technology publications to the IRM requirements for information technology security, and has developed documents detailing flow analysis of automated systems supporting IRS's financial reporting. During fiscal year 2014, we noted that IRS had (1) formed a multidisciplinary team, including automated system specialists and	2011	GAO-12-683R		X

⁶⁰GAO, *Management Report: Improvements Are Needed to Enhance the Internal Revenue Service's Internal Controls*, [GAO-14-433R](#) (Washington, D.C.: July 2, 2014).

Recommendation by control issue		Year initially reported	Source report	Status	
				Closed	Open
3	12-04	2011	GAO-12-683R		X
individuals with accounting and financial reporting expertise, and (2) developed a testing schedule of the internal controls over the automated systems related to its annual OMB process in fiscal year 2015. We will review and evaluate these additional actions by IRS to address this recommendation during our fiscal year 2015 audit. Establish policies and procedures with respect to any external financial reporting system IRS personnel themselves do not directly monitor that specify required steps to routinely review periodic reports prepared by service providers' auditors in accordance with Statements on Standards for Attestation Engagements (SSAE) No. 16, including steps to document (1) an assessment of whether a review's scope, methodology, and timing is appropriate to satisfy IRS's objectives; (2) any control deficiencies disclosed in the report, and an assessment of their materiality to IRS's financial reporting process and related risks; and (3) any compensating internal controls needed to mitigate any actual or potential effects of identified deficiencies upon IRS's internal and external financial reports resulting from any (a) material weakness or (b) significant shortcoming in the scope, methodology, or timing of any SSAE No. 16 report reviewed relative to IRS's internal control objectives. Action taken: During fiscal year 2014 we reviewed IRS's revised/updated (May 2014) External System Review Standard Operating Procedures (SOP) and the Supporting Documentation Analysis form, Appendix A to the SOP. The SOP was revised to include instructions that the review team should (1) review the SSAE No. 16 report, if available; (2) identify any control deficiencies reported; (3) determine whether any corrective actions have been identified to mitigate the risks created by the control deficiencies; and (4) document their analysis of the provided documentation. These revisions partly address our recommendation. However, while the revised SOP does include a section on the scope of IRS's review and guidance on conducting the review, it does not address our recommendation that policies and procedures include documenting an assessment of whether the scope, methodology, and timing of the review by the service provider's auditor was appropriate to satisfy IRS's objectives, and whether any compensating controls are needed if the assessment found any shortcomings. We will review any additional steps taken by IRS with regard to this recommendation during our fiscal year 2015 audit.					

Recommendation by control issue		Year initially reported	Source report	Status	
				Closed	Open
4	14-01	2013	GAO-14-433R		X
Revise the service organization monitoring procedures to require, when using an auditor's report prepared in accordance with the Statements on Standards for Attestation Engagements (SSAE) No. 16 to monitor internal control over financial reporting, clearly documenting that IRS appropriately (1) considered any user controls identified as not being included within the scope of the SSAE No. 16 report; (2) identified those user controls that are relevant and material to IRS; and (3) verified that either those controls or comparable, relevant user controls were in place and operating effectively at IRS. Action taken: During fiscal year 2014 we reviewed IRS's revised/updated (May 2014) External System Review SOP and the Supporting Documentation Analysis form, Appendix A to the SOP. Appendix A to the SOP was revised to direct preparers to review user controls to determine which are applicable to IRS and verify the controls included in the description of the report. This represents an important enhancement to this guidance. However, in the absence of more specific instruction or accompanying supplementary guidance on IRS's actions regarding those user controls considered applicable to IRS, this enhancement does not fully achieve the objective of this recommendation. We will continue to evaluate IRS's actions to address this recommendation during our fiscal year 2015 audit.					
5	14-02	2013	GAO-14-433R		X
For each service organization that is significant to IRS's financial reporting and related internal control and for which a current SSAE No. 16 report has not been prepared, establish a memorandum of understanding or agreement with the organization that requires (1) both parties to perform procedures that are consistent with the most current requirements of the Office of Management and Budget Circular No. A-123 and (2) the service organization to provide IRS access to the organization's personnel, documents, facilities, or combination of these necessary to allow IRS to timely and effectively conduct its own monitoring procedures or review and validate the reliability of monitoring documentation prepared by organization management, as appropriate. Action taken: Consistent with our recommendation, IRS plans to identify and establish procedures to secure the current SSAE No. 16 report or other third party/management control documents for review and validation of the reliability of controls significant to IRS's financial reporting. IRS indicated that its plan of action has been modified to account for requirements established by Appendix D to OMB Circular No. A-123, effective October 1, 2013, which					

Recommendation by control issue			Year initially reported	Source report	Status	
					Closed	Open
requires external service organizations to provide their customer agencies a Report on Controls at a Service Organization Relevant to Users' Entities Internal Control over Financial Reporting. We will continue to evaluate IRS's actions to address this recommendation during our fiscal year 2015 audit.						
Net cost						
6	11-05	Establish procedures to centrally review and monitor the timeliness of personnel action requests and approvals to help ensure compliance with the Internal Revenue Manual and applicable Office of Personnel Management regulations and guidance. Action taken: During fiscal year 2014, IRS established review and monitoring procedures to centrally monitor the timeliness of personnel action requests and approvals. IRS also issued an Employment Operations alert that documents its procedures to review, monitor, and analyze timeliness of personnel action requests. IRS's actions sufficiently address our recommendation.	2010	GAO-11-494R	X	
7	12-24	Revise the payroll standard operating procedures to require that the designated proxy for a manager required to approve time cards be at an equivalent or higher level as the manager, consistent with the Internal Revenue Manual. Action taken: IRS reported that in January 2015, it implemented a revised time and attendance approval process that significantly restructures who is authorized to approve time and attendance. IRS also reported that it had revised the related Delegation Order and that it issued an alert in January 2015 to notify managers of the policy change. As these actions occurred after the end of fiscal year 2014, we will evaluate IRS's actions to address this recommendation during our fiscal year 2015 audit.	2011	GAO-12-683R		X
8	12-25	Incorporate in the planned 2012 policy change requiring the manager or designated proxy to sign the electronic time card before transmitting payroll records to the National Finance Center the requirement that the designated proxy be at an equivalent or higher level than the employee's manager. Action taken: IRS reported that in January 2015, it implemented a revised time and attendance approval process that significantly restructures who is authorized to approve time and attendance. IRS also reported that it had revised the related Delegation Order and that it issued an alert in January 2015 to notify managers of the policy change. As these actions occurred after the end of fiscal year 2014, we will evaluate IRS's actions to address this recommendation during our fiscal year 2015 audit.	2011	GAO-12-683R		X

Recommendation by control issue			Year initially reported	Source report	Status	
					Closed	Open
9	13-08	Establish and implement written procedures to ensure that only costs are included in the cost allocation process. Action taken: In March 2014, IRS established and implemented written procedures directing senior staff to ensure that only costs are included in the cost allocation process. IRS's actions sufficiently address our recommendation.	2012	GAO-13-420R	X	
10	13-09	Revise existing procedures to require staff responsible for monitoring the cost allocation to review the Presentation 1.1 report to determine if costs were fully allocated to the direct business units and if not to allocate the remaining costs. Action taken: In June 2013, IRS revised its procedures to require staff to review the Presentation 1.1 report to determine if costs were fully allocated to its five operational business units. In May 2014, IRS updated its procedures to instruct staff to allocate any remaining costs identified during their reviews. IRS's actions sufficiently address our recommendation.	2012	GAO-13-420R	X	
11	13-10	Establish and implement written procedures to require that the Office of Cost Accounting inform the Debt Collection Unit of any changes to assigned functional area codes to be used for posting user fee transactions in IFS. Action taken: In October 2013, IRS established and implemented written procedures to require the Office of Cost Accounting to certify a list of assigned functional area codes to be used for posting user fee transactions in IFS. The procedures require a user fee accountant to forward this listing to the Debt Collection Unit at the beginning of each fiscal year and each time a functional area code change occurs, thus notifying the Debt Collection Unit of functional area codes changes. IRS's actions sufficiently address our recommendation.	2012	GAO-13-420R	X	
12	13-11	Establish and implement written policies or procedures that require the agency to record the obligation of funds when a contract or agreement is entered into and prior to taking delivery of goods or services.	2012	GAO-13-420R		X

Recommendation by control issue		Year initially reported	Source report	Status	
				Closed	Open
					Action taken: In response to our recommendation, on September 30, 2014, IRS reissued interim guidance that listed various goods and services contracted by IRS and specified, as appropriate, the time frame to record obligations of funds and that obligations must be recorded prior to the start of services and ordering of goods. This interim guidance was initially issued September 30, 2013. However, during the fiscal year 2014 audit, we continued to find instances where obligations of funds were not recorded prior to taking delivery of goods or services. As a result, we will evaluate IRS's actions to address this recommendation during our fiscal year 2015 audit.
13	14-03	2013	GAO-14-433R	X	Issue a reminder to employees responsible for approving time cards that they need to fully understand IRS policy regarding the number of regular work hours employees can record, particularly during pay periods with mandatory furlough hours, and their responsibility for enforcing the policy. Action taken: In fiscal year 2014, IRS issued alerts to appropriate managers or designees of their responsibility to fully understand and adhere to IRS policy when approving time cards. Additionally, IRS issued alerts of IRS policy to all employees regarding work hours. IRS's actions sufficiently address our recommendation.
14	14-04	2013	GAO-14-433R	X	Establish a written requirement for timekeeping staff to complete a review of all time cards with over 80 hours before IRS transmits time cards to the National Finance Center for processing or immediately after so that errors can be timely identified and corrected. Action taken: In September 2014, IRS established SOPs that require timekeeping staff to review all time and attendance records with over 80 hours before transmitting them to the National Finance Center for processing or immediately after, so that errors can be timely identified and corrected before employees are compensated. IRS's actions sufficiently address our recommendation.
15	14-05	2013	GAO-14-433R	X	Revise the desk procedures for the review of time cards with over 80 hours to include detailed guidance on what time charges are allowable for cases in which an employee has both furlough hours and paid hours in a pay period.

Recommendation by control issue		Year initially reported	Source report	Status	
				Closed	Open
				Action taken: In April 2014, IRS issued a revised "Posted Duty Over 80 Hours Report" desk guide. It includes specific instructions for determining what time charges are allowed when the employee records both furlough hours and paid hours in the same pay period. IRS's actions sufficiently address our recommendation.	
16	14-06	2013	GAO-14-433R		X
				Update the Internal Revenue Manual (IRM) to require monitoring the functions of all staff as they relate to receipt and acceptance functions, including applicable end users. Action taken: IRS actions to address this recommendation are ongoing. IRS stated that by July 2015, it will update the IRM to require monitoring of the functions of all staff, as they relate to receipt and acceptance functions, including applicable end users. We will continue to evaluate IRS's actions to address this recommendation during our fiscal year 2015 audit.	
17	14-07	2013	GAO-14-433R		X
				Establish and implement written procedures for the Office of Procurement to monitor the receipt and acceptance functions of all staff who perform receipt and acceptance. Such monitoring should include reviewing the accuracy and timeliness of receipt and acceptance dates and amounts. Action taken: IRS actions to address this recommendation are ongoing. IRS stated that by July 2015, it will establish and implement written procedures to be used by Procurement staff to monitor the receipt and acceptance functions of all staff who perform receipt and acceptance, which will include the accuracy and timeliness of receipt and acceptance dates and amounts. We will continue to evaluate IRS's actions to address this recommendation during our fiscal year 2015 audit.	
18	14-08	2013	GAO-14-433R		X
				Enhance existing mandatory training for all employees who are granted the Integrated Procurement System (IPS) access to perform receipt and acceptance to include specific instructions for determining the appropriate dates and amounts to enter for receipt and acceptance in IPS. Action taken: IRS actions to address this recommendation are ongoing. IRS stated that by April 2015, it will enhance existing mandatory training for all employees who are granted IPS access to perform receipt and acceptance to include specific instructions for determining the appropriate dates and amounts to enter for receipt and acceptance in IPS. We will continue to evaluate IRS's actions to address this recommendation during our fiscal year 2015 audit.	

Recommendation by control issue			Year initially reported	Source report	Status	
					Closed	Open
19	14-11	Establish and document objective criteria for determining materiality for the purpose of determining whether to record an adjustment for installment agreement user fees collected but not yet recorded as exchange revenue or cash in IRS's fund balance with Treasury in IRS's accounting records by fiscal year-end. Action taken: In June 2014, IRS issued desk procedures that established materiality threshold to be used by IRS staff as a basis for determining whether to record an adjustment for installment agreement user fees collected but not yet recorded as exchange revenue or cash in the fund balance with Treasury in IRS's accounting records at fiscal year-end. IRS's actions sufficiently address our recommendation.	2013	GAO-14-433R	X	
20	14-12	Establish and implement written procedures for (1) estimating the potential financial statement impact of IA user fees collected but not yet recorded as exchange revenue or cash in IRS's accounting records by fiscal year-end, (2) comparing the potential impact against established materiality criteria, and (3) making an adjustment in IRS's accounting records for the amount of the potential impact if it meets or exceeds the established criteria for recording such an adjustment. Action taken: In June 2014, IRS issued desk procedures that provide guidance to staff for (1) estimating the potential financial statement impact of IA user fees collected but not yet recorded as exchange revenue or cash in IRS's accounting records by fiscal year-end, (2) comparing the potential impact against established materiality criteria, and (3) making an adjustment in IRS's accounting records for the amount of the potential impact if it meets or exceeds the established criteria for recording such an adjustment. IRS's actions sufficiently address our recommendation.	2013	GAO-14-433R	X	
21	14-13	Establish and implement procedures to periodically review master file data extracts of installment agreement user fee transactions to identify and investigate potential duplicate installment agreement user fees charged to taxpayers and make timely corrections. Action taken: IRS reported that in December 2014, it had established, documented, and implemented procedures to periodically review master file data extracts of installment agreement user fee transactions to identify and investigate potential duplicate installment agreement user fees charged to taxpayers and make timely corrections. As these actions occurred after the end of fiscal year 2014, we will evaluate IRS's actions to address this recommendation during our fiscal year 2015 audit.	2013	GAO-14-433R		X

Recommendation by control issue		Year initially reported	Source report	Status	
				Closed	Open
Property and equipment					
22	14-09	2013	GAO-14-433R	X	
Issue a memorandum to all business units reminding them of the existing policies and procedures that are intended to reasonably assure that (1) asset records are timely and accurately recorded, (2) approval is obtained prior to the disposal of assets and only approved by those properly authorized to do so, and (3) hard drives of disposal assets are wiped clean of sensitive information prior to the disposition. Action taken: We verified that IRS's IT organization issued Directive AM 061—"Asset Management Policy and Procedures for KISAM/CIMIS Asset Lifecycle Record Management, Sanitization, and Disposal of Assets"—and a related memorandum dated August 2014. The directive and related memorandum reinforced existing policies and procedures intended to reasonably assure that (1) asset records are timely and accurately recorded, (2) approval is obtained prior to the disposal of assets and only from those properly authorized to do so, and (3) hard drives of disposal assets are wiped clean of sensitive information prior to the disposition. IRS's actions sufficiently address our recommendation.					
23	14-10	2013	GAO-14-433R		X
Update the Enterprise Operations unit (EOps) policies and procedures as necessary, which may include providing requisite permissions to certain EOps staff to enable them to directly update the Knowledge, Incident/Problem, Service Asset Management, to reasonably assure that assets received are recorded in the asset management systems within 10 workdays as required by the IRM. Action taken: In August 2014, IRS's IT organization updated policies and procedures to allow EOps inventory staff the ability to directly update KISAM. IRS's corrective action occurred after our fiscal year 2014 detailed acquisition testing. We will evaluate IRS's actions to address this recommendation during our fiscal year 2015 audit to determine if they reasonably assure that assets received are recorded in the asset management systems within 10 workdays as required by the IRM.					
Refunds					
24	05-38	2004	GAO-05-274R	X	
Enforce requirements for monitoring accounts and reviewing monitoring of accounts for manual refunds. Action taken: Since the issuance of this recommendation in 2005, IRS has taken actions to address this recommendation. Specifically, IRS updated its IRM to require the use of the automated Erroneous Manual Refund Tool/Case Monitoring					

Recommendation by control issue		Year initially reported	Source report	Status	
				Closed	Open
25	05-39	2004	GAO-05-274R	X	
tool to conduct the required manual refund monitoring and managerial reviews of monitoring activity. In addition, in fiscal year 2013, IRS initiated quarterly reviews of the manual refund process to verify its compliance with the IRM requirements for monitoring accounts and reviewing monitoring activity for manual refunds. We reviewed a selection of the reviews conducted by IRS in fiscal year 2014 and concluded that IRS's efforts to enforce the requirements for monitoring accounts and reviewing monitoring of accounts for manual refunds sufficiently address our recommendation. Enforce requirements for documenting monitoring actions and supervisory review for manual refunds. Action taken: In October 2013, IRS clarified the requirements in its IRM for managers to document their supervisory reviews of monitoring activity in the Manager's Monitoring Confirmation Log. Further, in fiscal year 2013, IRS initiated reviews of the manual refund process documentation to verify compliance with the IRM. We reviewed a selection of the reviews conducted by IRS in fiscal year 2014 and concluded that IRS's efforts to enforce the requirements for documenting monitoring actions and supervisory review of manual refunds monitoring sufficiently address our recommendation.					
26	07-08	2006	GAO-07-689R	X	
Require that managers or supervisors provide the manual refund initiators in their units with training on the most current requirements to help ensure that they fulfill their responsibilities to monitor manual refunds and document their monitoring actions to prevent the issuance of duplicate refunds. Action taken: In March 2013, IRS developed a training analysis process to identify employees who have not completed the required training and to perform follow-up on delinquent employees to ensure that all employees who initiate, approve, or monitor manual refunds complete appropriate annual training. Based on our review of a selection of IRS's training analysis performed in fiscal year 2014, we concluded that IRS's training analysis process properly ensures that employees responsible for monitoring manual refunds and documenting their monitoring actions are provided and have taken the required training. IRS's actions sufficiently address our recommendation.					
27	13-03	2012	GAO-13-420R	X	
Finalize implementation of the automated process for (1) routinely updating date of death information and deceased status in the master files using SSA data and (2) preventing automatic processing of a tax return submitted using a deceased taxpayer's Social Security number.					

Recommendation by control issue		Year initially reported	Source report	Status	
				Closed	Open
				Action taken: In February 2013, IRS completed the implementation of the automated process, which was established to update the master files using SSA's decedent data to indicate whether a taxpayer is deceased, and to prevent the automatic processing of tax returns filed using a deceased taxpayer's Social Security number. IRS's actions sufficiently address our recommendation.	
28	13-04	2012	GAO-13-420R	X	
				Implement the policies and procedures that require the manual refund unit to verify that (1) any manual refund signature authorization forms that are signed by a delegated official are accompanied by a designation to act form and (2) the designation to act form is dated prior to the approval date on the manual refund signature authorization form.	
				Action taken: During our fiscal year 2014 audit, we verified that IRS implemented procedures for reviewing and rejecting manual refund signature authorization forms and designation to act forms that have incomplete or inaccurate information. IRS's review includes ensuring that (1) manual refund signature authorization forms that are signed by delegated officials are accompanied by a designation to act form and (2) designation to act forms are dated prior to the approval date on the manual refund signature authorization forms. IRS's actions sufficiently address our recommendation.	
29	14-14	2013	GAO-14-433R		X
				Update the training manuals and related training provided to Submission Processing examiners to ensure that the examiners are provided proper guidance for correctly processing refund claims associated with deceased taxpayers.	
				Action taken: IRS's efforts to address this recommendation are ongoing. IRS stated that by December 2015, it will update the training manuals and related mandatory training provided to Submission Processing examiners who process refund claims associated with deceased taxpayers. We will continue to evaluate IRS's actions to address this recommendation during our fiscal year 2015 audit.	
30	14-15	2013	GAO-14-433R		X
				Establish and implement policies and procedures requiring a review process to reasonably assure that the accounts related to deceased taxpayers are only reopened for valid refunds.	

Recommendation by control issue		Year initially reported	Source report	Status	
				Closed	Open
				Action taken: IRS's efforts to address this recommendation are ongoing. IRS updated the IRM to include review criteria to ensure that accounts related to deceased taxpayers are only reopened for valid purposes. IRS stated that by September 2015, it will implement a review process of the accounts related to deceased taxpayers to ensure that they are only reopened for valid refunds. We will continue to evaluate IRS's actions to address this recommendation during our fiscal year 2015 audit.	
31	14-16	2013	GAO-14-433R		X
				Establish and implement policies and procedures that require monitoring to reasonably assure that accounts related to deceased taxpayers that have been reopened are timely closed after processing the refund.	
				Action taken: In September 2014, IRS established procedures to require employees who reopen deceased taxpayer accounts to monitor and close the deceased taxpayer accounts after the required transactions post. Because the procedures were not established until the end of the fiscal year 2014, we will evaluate IRS's actions to address this recommendation during our fiscal year 2015 audit.	
32	14-17	2013	GAO-14-433R		X
				Issue a memorandum to IRS staff reminding them of the requirements and the procedures to follow to ensure that a representative is listed on a deceased taxpayer's account before issuing a refund on the account.	
				Action taken: IRS's efforts to address this recommendation are ongoing. IRS stated that by March 2015, it will issue a memorandum reminding IRS staff of the requirements and the procedures to follow to ensure that a representative is listed on a deceased taxpayer's account before issuing a refund on the account. We will continue to evaluate IRS's actions to address this recommendation during our fiscal year 2015 audit.	
Revenue					
33	06-05	2005	GAO-06-543R		X
				Equip all taxpayer assistance centers (TAC) with adequate physical security controls to deter and prevent unauthorized access to restricted areas or office space occupied by other IRS units, including those TACs that are not scheduled to be reconfigured to the "new TAC" model in the near future. This includes appropriately separating customer service waiting areas from restricted areas in the near future by physical barriers, such as locked doors marked with signs barring entrance by unescorted customers.	

Recommendation by control issue		Year initially reported	Source report	Status	
				Closed	Open
				Action taken: IRS's efforts to address this recommendation are ongoing. IRS stated that by September 2015, it will complete a study to determine if alternative mitigations can be put in place to equip all TACs with adequate physical security controls to deter and prevent unauthorized access to restricted areas. If these mitigations address the original security findings, IRS will then establish an implementation plan to secure all non-model TACs. We will continue to evaluate IRS's actions to address this recommendation during our fiscal year 2015 and future audits.	
34	09-05	2008	GAO-09-513R	X	
				Action taken: In October 2012, IRS updated its policies to require the use of the Form 795A, Remittance and Return Report, through the Accounts Management System, which will help ensure routine reporting of the total dollar amounts and volumes of receipts collected by TAC, group, territory, area, and nationwide. IRS was able to provide the total dollar amounts and volumes of receipts collected for the eight TACs we visited during our fiscal year 2014 audit. Additionally, IRS provided the total dollar amounts and volumes of receipts for TACs at the group, territory, area, and nationwide levels. IRS's actions sufficiently address our recommendation.	
35	09-09	2008	GAO-09-513R		X
				Action taken: IRS's efforts to address this recommendation are ongoing. IRS stated that by September 2015 it will revise the IRM to ensure that appropriate corrective actions have been planned for all incidents reported by the central monitoring station. Those corrective actions will include documenting annual testing and preventive maintenance for all alarms and documenting the tracking of corrective actions for failed equipment. The revision will also ensure that the emergency contact list for each location is current and includes only appropriate contacts. We will continue to evaluate IRS's corrective actions during our fiscal year 2015 audit.	

Recommendation by control issue		Year initially reported	Source report	Status	
				Closed	Open
36	10-20	2009	GAO-10-565R		X
Establish procedures to monitor the process used by service center campuses and lockbox banks to acknowledge and track transmittals of unprocessable items with receipts. These procedures should include monitoring discrepancies and instituting appropriate corrective actions as needed. Action taken: In December 2014, IRS revised the Data Collection Instrument and instructions used in its unannounced reviews of service center campuses and lockbox banks to include instructions for the reviewer to address the timely acknowledgment of Lockbox Document Transmittal (LDT) forms. IRS stated that it will continue to enforce the LDT requirements by conducting processing internal control quality reviews at lockbox sites and following up on the results. Also, IRS stated that it performs monthly managerial reviews to ensure transmittals are acknowledged and appropriate actions are taken for any discrepancies noted. IRS's corrective actions occurred subsequent to our fiscal year 2014 audit. We will continue to evaluate IRS's corrective actions during our fiscal year 2015 audit.					
37	10-29	2009	GAO-10-565R	X	
Analyze the various contractor access arrangements and establish a policy that requires security awareness training for all IRS contractors who are provided unescorted physical access to its facilities or taxpayer receipts and information. Action taken: In December 2014, IRS established Policy and Procedures 24.1, Information Protection and Security Awareness Training Requirements, which requires all IRS contractors who are provided unescorted access to IRS facilities, access to sensitive but unclassified information or information systems, or a combination of these to complete security awareness training. During subsequent discussions with IRS officials, we were informed that these requirements only apply to IRS contractors—personnel contracted through IRS Procurement or through contracts administered by IRS Contractor Security Management, and do not apply to non-IRS contractors—personnel who have unescorted access to IRS facilities but are under contract with other federal entities or privately owned entities. As a result, GAO has issued new recommendations to address the deficiencies related to non-IRS contractors in its May 2015 management report (GAO-15-480R).					

Recommendation by control issue			Year initially reported	Source report	Status	
					Closed	Open
38	11-11	Perform a review of all existing contracts under \$100,000 that (1) do not have an appointed contracting officer's technical representative and (2) do not require that contract employees obtain background investigations to assess whether the services performed under each contract warrant a requirement that contract employees obtain background investigations. Action taken: IRS stated that in December 2014, it implemented Policy and Procedure Memorandum 4.13, <i>Contractor Submission of Security Documentation</i>, which requires background investigations for all new IRS contractors who are provided unescorted access to IRS facilities, access to sensitive but unclassified information or information systems, or a combination of these. However, IRS is still in the process of reviewing existing contracts to assess whether the services performed under each contract warrant a requirement that contract employees obtain background investigations. According to IRS, the review and mitigation plan, if necessary, will be completed no later than March 6, 2015. We will continue to evaluate IRS's actions to address this recommendation during our fiscal year 2015 audit.	2010	GAO-11-494R		X
39	11-12	Based on a review of all existing contracts under \$100,000 without an appointed contracting officer's technical representative that should require contract employees to obtain favorable background investigation results, amend those contracts to require that favorable background investigations be obtained for all relevant contract employees before routine, unescorted, unsupervised physical access to taxpayer information is granted. Action taken: IRS stated that in December 2014, it implemented Policy and Procedure Memorandum 4.13, <i>Contractor Submission of Security Documentation</i>, which requires background investigations for all new IRS contractors who are provided unescorted access to IRS facilities, access to sensitive but unclassified information or information systems, or a combination of these. However, IRS is still in the process of reviewing existing contracts to assess whether the services performed under each contract warrant a requirement that contract employees obtain background investigations. According to IRS, the review and mitigation plan, if necessary, will be completed no later than March 6, 2015. We will continue to evaluate IRS's actions to address this recommendation during our fiscal year 2015 audit.	2010	GAO-11-494R		X

Recommendation by control issue		Year initially reported	Source report	Status	
				Closed	Open
40	11-13	2010	GAO-11-494R		X
Establish a policy requiring collaborative oversight between IRS's key offices in determining whether potential service contracts involve routine, unescorted, unsupervised physical access to taxpayer information, thus requiring background investigations, regardless of contract award amount. This policy should include a process for the requiring business unit to communicate to the Office of Procurement and the Human Capital Office the services to be provided under the contract and any potential exposure of taxpayer information to contract employees providing the services, and for all three units to (1) evaluate the risk of exposure of taxpayer information prior to finalizing and awarding the contract and (2) ensure that the final contract requires favorable background investigations as applicable, commensurate with the assessed risk. Action taken: IRS's efforts to address this recommendation are ongoing. IRS stated that by September 2015 it will establish a plan that identifies the remaining actions and time frames necessary to refine its policies, procedures, and processes. We will continue to evaluate IRS's actions to address this recommendation during our fiscal year 2015 audit.					
41	11-14	2010	GAO-11-494R		X
Establish procedures to provide a consistent methodology for calculating and establishing allowable deposit courier trip time limits to be used by both service center campuses and lockbox banks that would assist in detecting potential unauthorized stops or other contractual violations by deposit couriers. Such procedures should include instructions for documenting and supporting how the trip limits were determined and require justification and approval for all established time limits that exceed the average trip time. Action taken: IRS's efforts to address this recommendation are ongoing. IRS stated that by May 2015 it will revise the courier trip time methodology, based on an analysis of prior completed trips, to better reflect the actual courier time frames for each service center. We will continue to evaluate IRS's actions to address this recommendation during our fiscal year 2015 audit.					
42	11-24	2010	GAO-11-494R		X
Revise the post orders for the service center campuses (SCC) and lockbox bank security guards to include specific procedures for timely reporting exterior lighting outages to SCC or lockbox bank facilities management. These procedures should specify (1) whom to contact to report lighting outages and (2) how to document and track lighting outages until resolved.					

Recommendation by control issue		Year initially reported	Source report	Status	
				Closed	Open
				Action taken: IRS's efforts to address this recommendation are ongoing. IRS stated that by March 2015, for facilities with nondelegated authority, the Agency-Wide Shared Services organization will engage in discussions with the Federal Protective Service (FPS) and General Services Administration (GSA) regarding the responsibility for facilities and security services relating to light outages. According to IRS, Facilities Management and security services' local security offices will require that FPS and GSA initiate procedures for corrective actions regarding light outages and include those procedures in guard post orders. We will continue to evaluate IRS's actions to address this recommendation during our fiscal year 2015 audit.	
43	12-10	2011	GAO-12-683R		X
				Update the Internal Revenue Manual (IRM) to specify steps to be followed to prevent campus support clerks as well as any other employees who process payments through the electronic check presentment system from making adjustments to taxpayer accounts. Action taken: IRS's efforts to address this recommendation are ongoing. IRS stated that by April 2015, it would update its risk assessment covering TACs to outline and accept specific risks associated with individual taxpayer advisory specialists who process taxpayer remittances through the electronic check presentment system and can also adjust taxpayer accounts as part of their designated job duties. In addition, IRS stated that it would continue to monitor campus support clerks and other employees who process payments through the electronic presentment system to ensure that associated IRM requirements are followed. We will continue to evaluate IRS's actions to address this recommendation during our fiscal year 2015 audit.	
44	13-05	2012	GAO-13-420R		X
				Perform a risk assessment to determine the appropriate level of IDRS access that should be granted to employee groups that handle hard-copy taxpayer receipts and related sensitive taxpayer information as part of their job responsibilities. Action taken: IRS's efforts to address this recommendation are ongoing. As a result of its risk assessment efforts thus far, IRS updated the IRM to restrict the use of certain IDRS command codes for remittance perfection technicians. IRS stated that by April 2015, it would update its risk assessment covering TACs to outline and accept specific risks associated with individual taxpayer advisory specialists who process taxpayer remittances through the electronic check presentment system and can also adjust taxpayer accounts as part of their designated job duties. We will continue to	

Recommendation by control issue		Year initially reported	Source report	Status	
				Closed	Open
45	13-06	2012	GAO-13-420R		X
evaluate IRS's actions to address this recommendation during our fiscal year 2015 audit. Based on the results of the risk assessment, update the IRM accordingly to specify the appropriate level of IDRS access that should be allowed for (1) remittance perfection technicians and (2) all other employee groups with IDRS access that handle hard-copy taxpayer receipts and related sensitive information as part of their job responsibilities. Action taken: IRS's efforts to address this recommendation are ongoing. IRS stated that by April 2015, it would update its risk assessment covering TACs to outline and accept the specific risks associated with individual taxpayer advisory specialists who process taxpayer remittances through the electronic check presentment system and can also adjust taxpayer accounts as part of their designated job duties. As a result of its risk assessment efforts thus far, IRS updated the IRM to restrict the use of certain IDRS command codes for remittance perfection technicians. For other employee groups that handle hard-copy taxpayer receipts and related sensitive information, IRS stated that it continued to use the IRM to monitor for potential use of IDRS command codes that is not required as part of employees' designated job responsibilities. We will continue to evaluate IRS's actions to address this recommendation during our fiscal year 2015 audit.					
46	13-07	2012	GAO-13-420R		X
Establish procedures to implement the updated IRM, including required steps to follow to prevent (1) remittance perfection technicians and (2) all other employee groups that handle hard-copy taxpayer receipts and related sensitive information as part of their job responsibilities from gaining access to command codes not required as part of their designated job duties.					

Recommendation by control issue		Year initially reported	Source report	Status	
				Closed	Open
Action taken: IRS's efforts to address this recommendation are ongoing. IRS stated that by April 2015, it would update its risk assessment covering TACs to outline and accept the specific risks associated with individual taxpayer advisory specialists who process taxpayer remittances through the electronic check presentment system and can also adjust taxpayer accounts as part of their designated job duties. As a result of its risk assessment efforts thus far, IRS updated the IRM to restrict the use of certain IDRS command codes for remittance perfection technicians. For other employee groups that handle hard-copy taxpayer receipts and related sensitive information, IRS stated that it continued to use the IRM to monitor for potential use of IDRS command codes that is not required as part of employees' designated job responsibilities. We will continue to evaluate IRS's actions to address this recommendation during our fiscal year 2015 audit.					
Unpaid assessments					
47	08-06	2007	GAO-08-368R		X
In instances where computer programs that control penalty assessments are not functioning in accordance with the procedures of the Internal Revenue Manual (IRM), take appropriate action to correct the programs so that they function in accordance with the IRM. Action taken: IRS's efforts to address this recommendation are ongoing. IRS reported that it plans to complete corrective action by January 2018. During our fiscal year 2014 audit, we identified another computer program issue involving penalty amounts associated with refundable tax credits, which IRS is aware of and will need to address. We will continue to evaluate IRS's actions to address this recommendation during our fiscal year 2015 and future audits.					
48	10-01	2009	GAO-10-565R	X	
Review the results of IRS's unpaid tax assessments compensating statistical estimation process to identify and document instances where systemic limitations in the Custodial Detail Data Base (CDDb) resulted in misclassifications of account balances that, in turn, resulted in material inaccuracies in the amounts of reported unpaid assessments. Action taken: Over the past several years, IRS reviewed the results of its unpaid tax assessments compensating statistical estimation process, identified and documented instances where limitations with the CDDb classification program resulted in misclassifications of account balances, and analyzed this information to identify programming changes to CDDb. In March 2014, IRS provided documentation showing the results of					

Recommendation by control issue		Year initially reported	Source report	Status	
				Closed	Open
49	10-02	2009	GAO-10-565R	X	
its analysis. IRS's actions sufficiently address our recommendation. Research and implement programming changes to allow Custodial Detail Data Base (CDDDB) to more accurately classify such accounts among the three categories of unpaid tax assessments. Action taken: Over the past several years, IRS reviewed the results of its unpaid tax assessments compensating statistical estimation process, identified and documented instances where limitations with the CDDDB classification program resulted in misclassifications of account balances, and analyzed this information to identify programming changes to CDDDB. In March 2014, IRS provided documentation that it completed implementation of all planned programming changes to CDDDB in November 2013. According to IRS, it will address any remaining system limitations affecting its classification of unpaid assessment balances by implementing the Custodial Accounts Data Engine 2. IRS's actions sufficiently address our recommendation.					
50	10-03	2009	GAO-10-565R		X
Research and identify control weaknesses resulting in inaccuracies or errors in taxpayer accounts that materially affect the financial reporting of unpaid tax assessments. Action taken: During our fiscal year 2014 audit, we and IRS continued to identify misclassified unpaid assessments resulting from inaccuracies or errors in taxpayer accounts. IRS reported that in December 2014, it had completed its review and identified control weaknesses resulting in inaccuracies and errors in taxpayer accounts. As this occurred after the end of fiscal year 2014, we will evaluate IRS's actions to address this recommendation during our fiscal year 2015 audit.					
51	10-04	2009	GAO-10-565R		X
Once IRS identifies the control weaknesses that result in inaccuracies or errors that materially affect the financial reporting of unpaid tax assessments, implement control procedures to routinely prevent, or to detect and correct, such errors. Action taken: IRS's efforts to address this recommendation are ongoing. During fiscal year 2014, we and IRS continued to identify misclassified unpaid assessments that resulted from inaccuracies or errors in taxpayer accounts. By June 2015, IRS plans to develop a comprehensive, long-term action plan to include efforts to mitigate control weaknesses that cause inaccuracies and errors that materially affect the financial reporting of unpaid tax assessments. We will continue to evaluate IRS's actions to address this recommendation during our fiscal year 2015 and future audits.					

Legend: CIMIS = Criminal Investigation Management Information System; IA = Installment Agreement; IFS = Integrated Financial System; IDRS = Integrated Data Retrieval System; IRM = Internal Revenue Manual; IRS = Internal Revenue Service; IT = information technology; KISAM = Knowledge Incident/Problem Service Asset Management; OMB = Office of Management and Budget; SSA = Social Security Administration; Treasury = Department of the Treasury.
Source: GAO. | GAO-15-480R

Enclosure II: Selected Fiscal Year 2014 Reportable Issues and Related GAO Reports

Reportable issue for fiscal year 2014	Related GAO report
A. Accuracy of penalty assessments	<i>Management Report: Improvements Are Needed to Enhance IRS's Internal Controls and Operating Effectiveness.</i> GAO-09-513R . Washington, D.C.: June 24, 2009.
	<i>Management Report: Improvements Needed in IRS's Internal Controls.</i> GAO-07-689R . Washington, D.C.: May 11, 2007.
B. Transmission of taxpayer receipts and information	<i>Management Report: Improvements Needed in IRS's Internal Controls and Compliance with Laws and Regulations.</i> GAO-10-565R . Washington, D.C.: June 28, 2010.
	<i>Management Report: Improvements Needed in IRS's Internal Controls.</i> GAO-06-543R . Washington, D.C.: May 12, 2006.
	<i>Management Report: Improvements Needed in IRS's Internal Controls.</i> GAO-05-247R . Washington, D.C.: April 27, 2005.
C. Candling procedures at receipt processing facilities	<i>Internal Revenue Service: Status of GAO Financial Audit and Related Financial Management Report Recommendations.</i> GAO-09-514 . Washington, D.C.: June 25, 2009.
	<i>Internal Revenue Service: Status of GAO Financial Audit and Related Financial Management Report Recommendations.</i> GAO-08-693 . Washington, D.C.: July 2, 2008.
	<i>Internal Revenue Service: Status of GAO Financial Audit and Related Financial Management Report Recommendations.</i> GAO-07-629 . Washington, D.C.: June 7, 2007.
	<i>Internal Revenue Service: Status of Recommendations from Financial Audits and Related Financial Management Reports.</i> GAO-06-560 . Washington, D.C.: June 6, 2006.
	<i>Management Report: Improvements Needed in IRS's Internal Controls.</i> GAO-06-543R . Washington, D.C.: May 12, 2006.
	<i>Internal Revenue Service: Status of Recommendations from Financial Audits and Related Financial Management Reports.</i> GAO-05-393 . Washington, D.C.: April 29, 2005.
	<i>Management Report: Improvements Needed in IRS's Internal Controls.</i> GAO-05-247R . Washington, D.C.: April 27, 2005.
	<i>Internal Revenue Service: Status of Recommendations from Financial Audits and Related Financial Management Reports.</i> GAO-04-523 . Washington, D.C.: April 28, 2004.
	<i>Management Report: Improvements Needed in IRS's Internal Controls and Accounting Procedures.</i> GAO-04-553R . Washington, D.C.: April 26, 2004.
	<i>Management Report: Improvements Needed in IRS's Internal Controls.</i> GAO-03-562R . Washington, D.C.: May 20, 2003.
	<i>Management Report: Improvements Needed in IRS's Accounting Procedures and Internal Controls.</i> GAO-02-746R . Washington, D.C.: July 18, 2002.

Legend: IRS = Internal Revenue Service.

Source: GAO. | GAO-15-480R

Enclosure III: Comments from the Internal Revenue Service



COMMISSIONER

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

May 18, 2015

Ms. Cheryl E. Clark
Director
Financial Management and Assurance
U.S. Government Accountability Office
441 G Street, NW
Washington, DC 20548

Dear Ms. Clark:

I am writing in response to the Government Accountability Office (GAO) draft report titled *Management Report: Improvements Are Needed to Enhance the IRS's Internal Control over Financial Reporting (GAO-15-480R)*. We are pleased that GAO acknowledged our progress in addressing our financial management challenges and agreed to close 20 prior year financial management recommendations. We continue to make significant progress in addressing internal control deficiencies and financial management as evidenced by 15 consecutive years of clean audit opinions on our financial statements.

During fiscal year 2014, IRS strengthened its processes and controls over manual refunds, tax receipts tracking at Taxpayer Assistance Centers, excise tax certifications, cost allocations, personnel actions, and installment agreement user fees, allowing for the closure of several older recommendations. The enclosed response addresses each of your new recommendations.

We are committed to implementing appropriate improvements to ensure that the IRS maintains sound financial management practices. If you have any questions, please contact me, or a member of your staff may contact Robin Canady, Chief Financial Officer, at (202) 317-6400.

Sincerely,

A handwritten signature in blue ink, appearing to read "John A. Koskinen".

John A. Koskinen

Enclosure

Enclosure

**GAO Recommendations and IRS Responses to
GAO FY 2014 Management Report
“Improvements Are Needed to Enhance the Internal Revenue Service’s
Internal Control over Financial Reporting”
GAO-15-480R**

Recommendation #1: We recommend that you direct the appropriate IRS officials to include all key elements as recommended by the OMB Circular No. A-123 implementation guide in its corrective action plan to adequately address the control deficiencies in its systems that are contributing to the material weakness in unpaid tax assessments.

Comments: The IRS agrees with this recommendation. By June 2015, the Chief Financial Officer (CFO) organization will develop a long-term action plan to address the control deficiencies in IRS systems that are contributing to the material weakness in unpaid tax assessments. The plan will identify actions to improve the accuracy and detail in the core tax accounts processed by the Customer Account Data Engine (CADE 2) and the ability for the financial systems to leverage this data, thereby reducing classification errors caused by systemic limitations. While closure of the material weakness is largely dependent on the implementation of CADE 2 Transition State 2, the IRS is also working on long-term actions that are needed to improve reporting on individual and business taxpayer accounts not currently within the scope of CADE 2. As actions from the long-term plan are approved and funding is identified to implement them, the CFO organization will add them to the Custodial Financial Management Systems remediation plan.

Recommendation #2: We recommend that you direct the appropriate IRS officials to develop and implement agency-wide procedures to routinely monitor the accuracy of penalties recorded in taxpayer accounts to timely detect and correct errors.

Comments: The IRS agrees with this recommendation. By March 2017, the Small Business/Self-Employed (SB/SE) organization will develop a comprehensive plan to address long-term issues related to the timely and accurate recording of penalties in taxpayer accounts, as well as lead agency-wide efforts in fiscal year 2015 to develop and implement procedures to routinely monitor the accuracy of penalties recorded.

Recommendation #3: We recommend that you direct the appropriate IRS officials to determine the reason(s) why TAC Managers and personnel did not consistently comply with existing IRM requirements that TAC managers and personnel (1) perform and document reviews of the Follow-Up Review Log by the last day of the following month, (2) maintain control copies of transmittal forms, and (3) ship taxpayer receipts and information via traceable overnight mail and, based on this determination, establish a process to better enforce compliance with these requirements.

Comments: The IRS agrees with this recommendation. By November 2015, the Wage and Investment (W&I) organization will determine the reasons why Taxpayer Assistance Center (TAC) managers and personnel did not consistently comply with IRS existing requirements and will establish a process to better enforce compliance for the document transmittal process and shipping of taxpayer receipts and information.

Recommendation #4: We recommend that you direct the appropriate IRS officials to update the IRM to require managers to reconcile transmittal forms with the Follow-Up Review Log to reasonably assure that personnel are properly entering transmittal forms into the log and are appropriately documenting follow-up on unacknowledged transmittals of taxpayer receipts and information.

Comments: The IRS agrees with this recommendation. By April 2016, the W&I organization will update the IRM to require TAC managers to periodically reconcile the document transmittal forms to the associated Follow-Up Review logs to monitor employee compliance with IRM requirements and document this review using a newly created form. The W&I organization will also include questions on this new reconciliation in the TAC Security and Remittance Review Database, which is used to track the progress of actions on issues identified during operational reviews and prior audit findings.

Recommendation #5: We recommend that you direct the appropriate IRS officials to update the IRM to specify that unauthorized access awareness training requirements apply to non-IRS contractors who have unescorted physical access to IRS facilities.

Comments: The IRS agrees with this recommendation. By March 2016, the Agency-Wide Shared Services (AWSS) organization will coordinate the update to IRM 10.8.2.2.1.18, *Contractor*, to specify that the unauthorized access awareness training requirement for contractors applies equally to non-IRS contractors who have unescorted physical access to IRS facilities.

Recommendation #6: We recommend that you direct the appropriate IRS officials to establish a process to ensure that the requirement for unauthorized access awareness training is explicitly communicated to non-IRS contractors who have unescorted access to IRS facilities.

Comments: The IRS agrees with this recommendation. By May 2016, the AWSS organization will work with the Federal Protective Service and the General Services Administration to establish a process to ensure that the requirement for security awareness training is explicitly communicated to non-IRS contractors who have unescorted physical access to IRS facilities.

Recommendation #7: We recommend that you direct the appropriate IRS officials to establish procedures to monitor whether non-IRS contractors with unescorted physical access to IRS facilities are receiving unauthorized access awareness training.

Comments: The IRS agrees with this recommendation. By March 2016, the AWSS organization will send out a communication to the Facilities Management and Security Services field offices that will include standard operating procedures for monitoring training and acquiring unauthorized access awareness training documentation for each non-IRS contractor in each location.

Recommendation #8: We recommend that you direct the appropriate IRS officials to determine the reasons why staff did not consistently comply with IRS's existing requirements for the final candling of receipts at SCCs and lockbox banks, including logging remittances found during final candling on the final candling log at the time of discovery, safeguarding the remittances at the time of discovery, transferring the remittances to the deposit unit promptly, and passing one envelope at a time over the light source and, based on this determination, establish a process to better enforce compliance with these requirements.

Comments: The IRS agrees with this recommendation. By October 2015, the W&I organization will obtain feedback from management staff at the service center campuses (SCC) to determine the reasons why staff did not consistently comply with IRM requirements on final candling of receipts and will establish a process to measure and enforce compliance with existing requirements for the final candling of receipts at the SCCs and lockbox banks.

Recommendation #9: We recommend that you direct the appropriate IRS officials to establish and implement detailed written procedures for properly determining whether IUS costs should be capitalized or expensed. The procedures should include steps for obtaining the complete documentation required to determine the project phase to which a cost was attributable, specifically for cases in which the invoice, Statement of Work, and internal work-in-process schedule do not provide sufficient information.

Comments: The IRS agrees with this recommendation. By August 2015, the CFO organization will develop and implement written procedures to determine whether Internal Use Software costs should be capitalized or expensed in accordance with Statement of Federal Financial Accounting Standards Number 10, *Accounting for Internal Use Software*. The procedures will include steps for obtaining supporting documentation (e.g., communications with project managers, status reports/memos) to determine the project phase to which a cost was attributable, specifically for cases in which the invoice, Statement of Work, and internal work-in-process schedule do not provide sufficient information.

Recommendation #10: We recommend that you direct the appropriate IRS officials to establish and implement written procedures to reasonably assure that assets that are reclassified during the voucher review process are properly added to KISAM or CIMIS for tracking purposes, as applicable.

Comments: The IRS agrees with this recommendation.

- By August 2015, the CFO organization will revise the 'PPE – Workpaper Procedure Outline' to include steps to require the Financial Reporting (FR) office to notify the appropriate KISAM or CIMIS personnel of transactions reclassified from expense to asset accounts during its voucher review process that should be input into KISAM or CIMIS.
- By August 2015, the Information Technology (IT) organization will update its standard operating procedures to require that assets reclassified during the FR office's voucher review process are added to or updated in KISAM Asset Manager.
- By December 2015, the Criminal Investigation organization will revise IRM 9.11.3.4.1, *Responsibilities for Equipment*, to require that assets reclassified during the FR office's voucher review process are added to or updated in CIMIS.

Recommendation #11: We recommend that you direct the appropriate IRS officials to update the Hardware Asset Management Standard Operating Procedure to include a requirement for periodic supervisory review to provide reasonable assurance that certain asset acquisitions are properly entered into KISAM.

Comments: The IRS agrees with this recommendation. By August 2015, the IT organization will update its IRS Feed Review Standard Operating Procedure to reflect a quarterly supervisory review to ensure that asset acquisitions are properly entered into KISAM.

Enclosure IV: GAO Contact and Staff Acknowledgments

GAO Contact

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Staff Acknowledgments

In addition to the contact named above, the following individuals made major contributions to this report: Nina Crocker (Assistant Director), Melanie Darnell (Auditor-in-Charge), John Sawyer, Tulsi Bhojwani, Richard Guthrie, Chari Nash-Cannaday, Christopher Spain, Vanessa Taja, Ted Hu, and Delores Lee.