United States Government Accountability Office

Report to the Secretary of the Treasury

November 2018

FINANCIAL AUDIT

IRS's Fiscal Years 2018 and 2017 Financial Statements

GAO-19-150

GAO Highlights

Highlights of GAO-19-150, a report to the Secretary of the Treasury

November 2018

FINANCIAL AUDIT

IRS's Fiscal Years 2018 and 2017 Financial Statements

Why GAO Did This Study

In accordance with the authority conferred by the Chief Financial Officers Act of 1990, as amended, GAO annually audits IRS's financial statements to determine whether (1) the financial statements are fairly presented and (2) IRS management maintained effective internal control over financial reporting. GAO also tests IRS's compliance with selected provisions of applicable laws, regulations, contracts, and grant agreements.

IRS's tax collection activities are significant to overall federal receipts, and the effectiveness of its financial management is of substantial interest to Congress and the nation's taxpayers.

What GAO Recommends

Based on prior financial statement audits, GAO made numerous recommendations to IRS to address internal control deficiencies. GAO will continue to monitor and will report separately on IRS's progress in implementing prior recommendations that remain open. Consistent with past practice, GAO will also be separately reporting on the new internal control deficiencies identified in this year's audit and providing IRS recommendations for corrective actions to address them.

In commenting on a draft of this report, IRS stated that it continues to increase its focus on information security and internal controls.

View GAO-19-150. For more information, contact Cheryl E. Clark at (202) 512-3406 or clarkce@gao.gov.

What GAO Found

In GAO's opinion, the Internal Revenue Service's (IRS) fiscal years 2018 and 2017 financial statements are fairly presented in all material respects, and although controls could be improved, IRS maintained, in all material respects, effective internal control over financial reporting as of September 30, 2018. GAO's tests of IRS's compliance with selected provisions of applicable laws, regulations, contracts, and grant agreements detected no reportable instances of noncompliance in fiscal year 2018.

During fiscal year 2018, IRS continued to make important progress in addressing a long-standing material weakness in internal control over unpaid assessments. These efforts included enhancing data quality and improving controls over the complex statistical process that IRS uses to estimate the amounts of taxes receivable, compliance assessments, and write-offs for financial reporting purposes. Based on the cumulative effects of these and other efforts, GAO no longer considers the remaining deficiencies to represent a material weakness. However, the remaining control deficiencies collectively are significant enough to merit attention by those charged with governance, and therefore represent a significant deficiency in internal control over unpaid assessments. Further enhancements to IRS's financial systems are needed to address continuing issues with the accuracy of tax records, enable IRS to rely on its systems to record reliable taxes receivable transaction detail, improve IRS's ability to effectively manage taxpayers' accounts, and reduce taxpayer burden.

During fiscal year 2018, IRS also continued to make progress in addressing deficiencies in internal control over its financial reporting systems. However, continuing and newly identified control deficiencies in IRS's information security placed IRS systems and data at risk. Collectively, these deficiencies represent a significant deficiency in IRS's internal control over financial reporting systems. Until IRS takes the necessary steps to address these deficiencies in controls, its financial reporting and taxpayer data will remain at increased risk of inappropriate and undetected use, modification, or disclosure.

In addition to its internal control deficiencies, IRS faces significant ongoing financial management challenges related to (1) safeguarding taxpayer receipts and associated information, (2) preventing and detecting fraudulent refunds based on identity theft, and (3) implementing the tax-related provisions of the Patient Protection and Affordable Care Act.

Contents

Abbreviations

CFO	chief financial officer
CMS	Centers for Medicare & Medicaid Services
FASAB	Federal Accounting Standards Advisory Board
FMFIA	Federal Managers' Financial Integrity Act
HCERA	Health Care and Education Reconciliation Act of 2010
IDT	identity theft
IRS	Internal Revenue Service
PPACA	Patient Protection and Affordable Care Act
PTC	premium tax credit
RRP	Return Review Program
RSI	required supplementary information
W-2	Wage and Tax Statement

U.S. GOVERNMENT ACCOUNTABILITY OFFICE

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

November 9, 2018

The Honorable Steven T. Mnuchin
Secretary of the Treasury

Dear Mr. Secretary:

The accompanying report presents the results of our audits of the fiscal years 2018 and 2017 financial statements of the Internal Revenue Service (IRS). Specifically, we found

- IRS's financial statements as of and for the fiscal years ended September 30, 2018, and 2017, are presented fairly, in all material respects, in accordance with U.S. generally accepted accounting principles;
- although internal controls could be improved, IRS maintained, in all material respects, effective internal control over financial reporting as of September 30, 2018; and
- no reportable noncompliance for fiscal year 2018 with provisions of applicable laws, regulations, contracts, and grant agreements we tested.

This report also provides a discussion of a significant deficiency[1] in IRS's internal control over financial reporting related to unpaid assessments[2] and a continuing significant deficiency in IRS's internal control over financial reporting systems that we believe merit attention by those charged with governance of IRS. In addition, this report discusses ongoing financial management challenges that IRS faces related to (1) safeguarding taxpayer receipts and associated information,

[1]A significant deficiency is a deficiency, or a 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 material weakness is a deficiency, or combination of deficiencies, in internal control over financial reporting, 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 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.

[2]An unpaid 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., the assessment reduced by IRS). Internal Revenue Manual § 1.34.1.2(138), *Definitions and Acronyms* (June 23, 2009).

(2) preventing and detecting fraudulent refunds based on identity theft, and (3) implementing the tax-related provisions of the Patient Protection and Affordable Care Act.

We performed our audit pursuant to authority conferred by the Chief Financial Officers Act of 1990, as amended by the Government Management Reform Act of 1994.

We are sending copies of this report to the Chairman and Vice Chairman of the Joint Committee on Taxation, the Chairmen and Ranking Members of the Senate Committee on Finance and the House Committee on Ways and Means, and other interested congressional committees and subcommittees. We are also sending copies of this report to the Commissioner of Internal Revenue, the Director of the Office of Management and Budget, and other interested parties. In addition, the report is available at no charge on the GAO website at http://www.gao.gov.

If you or your staff have any questions concerning this report, please contact me at (202) 512-3406 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.

Sincerely yours,

Cheryl E. Clark

Cheryl E. Clark
Director, Financial Management and Assurance

U.S. GOVERNMENT ACCOUNTABILITY OFFICE
441 G St. N.W.
Washington, DC 20548

Independent Auditor's Report

To the Commissioner of Internal Revenue

In our audits of the fiscal years 2018 and 2017 financial statements of the Internal Revenue Service (IRS), we found

- IRS's financial statements as of and for the fiscal years ended September 30, 2018, and 2017, are presented fairly, in all material respects, in accordance with U.S. generally accepted accounting principles;
- although internal controls could be improved, IRS maintained, in all material respects, effective internal control over financial reporting as of September 30, 2018; and
- no reportable noncompliance for fiscal year 2018 with provisions of applicable laws, regulations, contracts, and grant agreements we tested.

The following sections discuss in more detail (1) our report on the financial statements and on internal control over financial reporting, which includes required supplementary information (RSI)[1] and other information included with the financial statements,[2] and three significant financial management challenges confronting IRS related to safeguarding taxpayer receipts and associated information, preventing and detecting fraudulent refunds based on identity theft (IDT), and implementing Patient Protection and Affordable Care Act (PPACA) tax-related provisions;[3] (2) our report on compliance with laws, regulations, contracts, and grant agreements; and (3) agency comments.

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[1]The RSI consists of Management's Discussion and Analysis and the Required Supplementary Information section, which are included with the financial statements.

[2]Other information consists of information included with the financial statements, other than the RSI and the auditor's report.

[3]Pub. L. No. 111-148, 124 Stat. 119 (Mar. 23, 2010), as amended by the Health Care and Education Reconciliation Act of 2010 (HCERA), Pub. L. No. 111-152, 124 Stat. 1029 (Mar. 30, 2010). In this report, references to PPACA include any amendments made by HCERA.

Report on the Financial Statements and on Internal Control over Financial Reporting

In accordance with our authority conferred by the Chief Financial Officers (CFO) Act of 1990, as amended by the Government Management Reform Act of 1994, we have audited IRS's financial statements.[4] IRS's financial statements comprise the balance sheets as of September 30, 2018, and 2017; the related statements of net cost, changes in net position, budgetary resources, and custodial activity for the fiscal years then ended; and the related notes to the financial statements. We also have audited IRS's internal control over financial reporting as of September 30, 2018, based on criteria established under 31 U.S.C. § 3512(c), (d), commonly known as the Federal Managers' Financial Integrity Act (FMFIA).

We conducted our audits in accordance with U.S. generally accepted government auditing standards. We believe that the audit evidence we obtained is sufficient and appropriate to provide a basis for our audit opinions.

Management's Responsibility

IRS management is responsible for (1) the preparation and fair presentation of these financial statements in accordance with U.S. generally accepted accounting principles; (2) preparing, measuring, and presenting the RSI in accordance with U.S. generally accepted accounting principles; (3) preparing and presenting other information included in documents containing the audited financial statements and auditor's report, and ensuring the consistency of that information with the audited financial statements and the RSI; (4) maintaining effective internal control over financial reporting, including the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; (5) evaluating the

[4]See the CFO Act of 1990, Pub. L. No. 101-576, 104 Stat. 2838 (Nov. 15, 1990), codified, in relevant part, as amended, at 31 U.S.C. § 3521(g); see also the Government Management Reform Act of 1994, Pub. L. No. 103-356, 108 Stat. 3410 (Oct. 13, 1994), codified, in relevant part, as amended, at 31 U.S.C. § 3515(c). Pursuant to the authority of 31 U.S.C. § 3515, the Office of Management and Budget requires IRS to issue annual audited financial statements that are separate from those of the Department of the Treasury or that are presented separately in the department's audited, consolidated financial statements. Although the CFO Act designates the agency's inspector general, or where applicable an independent external auditor, as the responsible auditor of an agency's financial statements, the act also gives GAO the authority to perform such audits at its discretion. Based on that authority, we audit IRS's financial statements because of the significance of IRS's tax collections to the consolidated financial statements of the U.S. government, which GAO is required to audit. See 31 U.S.C. § 331(e)(2).

effectiveness of internal control over financial reporting based on the criteria established under FMFIA; and (6) its assessment about the effectiveness of internal control over financial reporting as of September 30, 2018, included in the accompanying Management's Report on Internal Control over Financial Reporting in appendix I.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements and an opinion on IRS's internal control over financial reporting based on our audits. U.S. generally accepted government auditing standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free from material misstatement, and whether effective internal control over financial reporting was maintained in all material respects. We are also responsible for applying certain limited procedures to the RSI and other information included with the financial statements.

An audit of financial statements involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the auditor's assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances. An audit of financial statements also involves evaluating the appropriateness of the accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

An audit of internal control over financial reporting involves performing procedures to obtain evidence about whether a material weakness exists.[5] The procedures selected depend on the auditor's judgment, including the assessment of the risk that a material weakness exists. An

[5]A material weakness is a deficiency, or combination of deficiencies, in internal control over financial reporting, 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 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.

audit of internal control over financial reporting also includes obtaining an understanding of internal control over financial reporting, and evaluating and testing the design and operating effectiveness of internal control over financial reporting based on the assessed risk. Our audit of internal control also considered IRS's process for evaluating and reporting on internal control over financial reporting based on criteria established under FMFIA. Our audits also included performing such other procedures as we considered necessary in the circumstances.

We did not evaluate all internal controls relevant to operating objectives as broadly established under FMFIA, such as those controls relevant to preparing performance information and ensuring efficient operations. We limited our internal control testing to testing controls over financial reporting. Our internal control testing was for the purpose of expressing an opinion on whether effective internal control over financial reporting was maintained, in all material respects. Consequently, our audit may not identify all deficiencies in internal control over financial reporting that are less severe than a material weakness.

Definition and Inherent Limitations of Internal Control over Financial Reporting

An 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 provisions of applicable laws, including those governing the use of budget authority, regulations, contracts, and grant agreements, noncompliance with which could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent, or detect and correct, misstatements due to fraud or error. We also caution that projecting any evaluation of effectiveness to future periods is subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Opinion on Financial Statements

In our opinion, IRS's financial statements present fairly, in all material respects, IRS's financial position as of September 30, 2018, and 2017, and its net cost of operations, changes in net position, budgetary resources, and custodial activity for the fiscal years then ended in accordance with U.S. generally accepted accounting principles.

In accordance with federal accounting standards, IRS's financial statements do not include an estimate of the dollar amount of taxes that are owed the federal government but have not been reported by taxpayers or identified through IRS's enforcement programs, often referred to as the tax gap,[6] nor do they include information on tax expenditures.[7] Further detail on the tax gap and tax expenditures, as well as the associated dollar amounts, is discussed in the other information included with the financial statements.

Opinion on Internal Control over Financial Reporting

In our opinion, although internal controls could be improved, IRS maintained, in all material respects, effective internal control over financial reporting as of September 30, 2018, based on criteria established under FMFIA.

In connection with our previous audits of IRS's financial statements, we have reported a material weakness in internal control over unpaid assessments.[8] Primarily in response to our recommendations, IRS has taken significant actions over the years to strengthen its internal control in this important area. As a result of IRS's efforts to address many of the deficiencies we previously found in its internal control over unpaid assessments and the continuing improvements we found during our fiscal year 2018 audit, we concluded that the remaining long-standing deficiencies related to unpaid assessments no longer represent a material weakness. However, the remaining control deficiencies, while not

[6]The tax gap arises when taxpayers, whether intentionally or inadvertently, fail to (1) accurately report tax liabilities on tax returns (underreporting), (2) pay taxes due from filed returns (underpayment), or (3) file required tax returns altogether or on time (nonfiling). The tax gap does not include actual or estimated refund payments disbursed because of IDT-based fraudulent refund claims, which are financial management challenges for IRS and are discussed later in this report. Based on its most recent study, which relied on 2008-2010 data, IRS estimated the average annual net tax gap to be about $406 billion.

[7]Tax expenditures are revenue forgone because of preferential provisions of the tax code, such as special exclusions, exemptions, deductions, credits, deferrals, and tax rates.

[8]An unpaid 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., the assessment reduced by IRS). Internal Revenue Manual § 1.34.1.2(138), *Definitions and Acronyms* (June 23, 2009).

considered a material weakness, are important enough to merit attention by those charged with governance of IRS. Therefore, we considered these remaining issues affecting IRS's internal control over unpaid assessments collectively to be a significant deficiency in internal control as of September 30, 2018.[9] This significant deficiency is discussed in more detail below.

In addition, our fiscal year 2018 audit identified continuing and new deficiencies concerning IRS's financial reporting systems that while not considered a material weakness, are important enough to merit attention by those charged with governance of IRS. Therefore, we also considered these continuing and new issues affecting IRS's internal control over financial reporting systems collectively to be a significant deficiency in internal control as of September 30, 2018. This significant deficiency is also discussed in more detail below.

We considered these significant deficiencies in determining the nature, timing, and extent of our audit procedures on IRS's fiscal year 2018 financial statements. Although the significant deficiencies in internal control did not affect our opinion on IRS's fiscal year 2018 financial statements, misstatements may occur in unaudited financial information reported internally and externally by IRS because of these significant deficiencies.

We will be reporting additional details concerning any new issues relating to these significant deficiencies separately to IRS management, along with recommendations for corrective actions. We also identified other deficiencies in IRS's internal control over financial reporting that we do not consider to be material weaknesses or significant deficiencies. Nonetheless, these deficiencies warrant IRS management's attention. We have communicated these matters to IRS management and, where appropriate, will report on them separately along with related recommendations for corrective actions.

[9]A significant deficiency is a deficiency, or a 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.

Significant Deficiency in Internal Control over Unpaid Assessments

We have reported a material weakness in IRS's internal controls over unpaid assessments each year beginning with our first audit of IRS's financial statements in fiscal year 1992.[10] This condition was primarily due to significant limitations in the financial systems IRS uses to account for federal taxes receivable and other unpaid assessment balances, as well as other control deficiencies that led to errors in taxpayer accounts. As a result, these systems were unable to provide the timely, reliable, and complete transaction-level financial information necessary to enable IRS to classify and report unpaid assessment balances in accordance with federal accounting standards.[11]

These deficiencies also impaired management's ability to effectively manage the unpaid assessment balances on a daily basis throughout the year and created a burden on the taxpayers whose accounts were affected. Beginning with the reported balance as of September 30, 1992, IRS has utilized a complex and labor-intensive statistical estimation process to compensate for system limitations and errors in taxpayer accounts and determine its estimated federal taxes receivable balance, consisting of the gross taxes receivable balance and an associated allowance for uncollectible amounts.[12] However, IRS's estimates for the fiscal years 1992 through 1996 were either unverifiable or flawed and unreliable. Ultimately, IRS was first able to produce an estimated balance

[10]GAO, *Financial Audit: Examination of IRS' Fiscal Year 1992 Financial Statements*, GAO/AIMD-93-2 (Washington, D.C.: June 30, 1993).

[11]Federal accounting standards classify unpaid 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 determining an assessment. Compliance assessments are proposed tax assessments where neither the taxpayer (when the right to disagree or object exists) nor a court has affirmed that the amounts are owed. Write-offs represent unpaid assessments for which IRS does not expect further collections because of factors such as the taxpayer's death, bankruptcy, or insolvency. Federal accounting standards require only federal taxes receivable, net of an allowance for uncollectible taxes receivable, 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). See also Internal Revenue Manual, § 1.34.1.

[12]The estimation process has evolved over time but currently involves IRS manually testing statistical samples of unpaid assessments extracted from its master files (the detailed records of taxpayer accounts) and extrapolating the results to estimate the year-end balances to be reported as (1) federal taxes receivable reported in its financial statements and in the associated RSI and (2) compliance assessments and write-offs reported in the RSI.

of federal taxes receivable that was free of material misstatement for fiscal year 1997.[13] However, this result was achieved only after recording adjustments totaling tens of billions of dollars to correct the effects of continued material errors in IRS's underlying data.

Since fiscal year 1997, primarily in response to our recommendations based on our audits, IRS has devoted significant resources to addressing systemic limitations and errors in taxpayer accounts and to refine the process for estimating the balance of federal taxes receivable reported on its balance sheet. For example, IRS implemented a subsidiary ledger system for unpaid assessments in 2008, which it had previously lacked,[14] and has taken steps to address the causes of data errors, including enhancing its capability to accurately report balances that arise as a result of complex assessment situations. Additionally, IRS has implemented a number of quality control reviews to timely monitor, identify, and correct errors that affect taxpayer accounts at the transaction level. These efforts have yielded positive results over the years, and the magnitude of errors identified through the estimation process has significantly decreased.

During fiscal year 2018, IRS continued to improve internal controls over the management and reporting of unpaid assessments, including implementing recommendations made by an internal task force to address related data quality concerns. In addition, IRS made progress in completing its long-term corrective action plan for resolving this area of deficiency by implementing several programming changes to systemically classify unpaid assessments more accurately. IRS also enhanced its estimation process by revising sampling parameters to improve the reliability of its resulting statistical estimates of reported unpaid assessments balances and adding additional levels of management review, which improved the effectiveness of IRS's fiscal year 2018 analyses of taxes receivable accounts used as a basis for the estimate reported on its balance sheet and disclosures.

However, the remaining deficiencies in unpaid assessments, while not collectively considered a material weakness, are important enough to

[13]GAO, *Financial Audit: Examination of IRS' Fiscal Year 1997 Custodial Financial Statements*, GAO/AIMD-98-77 (Washington, D.C.: Feb. 26, 1998).

[14]GAO, *Financial Audit: IRS's Fiscal Years 2008 and 2007 Financial Statements*, GAO-09-119 (Washington, D.C.: Nov. 10, 2008).

merit attention by those charged with governance of IRS. Therefore, these issues represent a significant deficiency in IRS's internal control over financial reporting as of September 30, 2018. Specifically, IRS's continued use of a manual estimation process to determine amounts of unpaid assessments, necessitated by ongoing financial system limitations and errors in taxpayer accounts, does not provide IRS with readily available, reliable unpaid assessment information throughout the year to support informed management decision making. In addition, while the enhancements to its estimation process and overall data quality are yielding materially accurate balances of unpaid assessments for financial reporting purposes, IRS is still not able to fully rely on its subsidiary ledger for systematically recording and tracking reliable and complete taxpayer data as management originally intended. Such inaccurate tax records also place an undue burden on taxpayers who may be compelled to respond to IRS inquiries caused by errors in their accounts. Further, during this year's audit, we found that IRS did not clearly document several key management decisions regarding the design and use of the estimation process, such as its revised sampling procedures for estimating taxes receivable. This increases the risk that IRS may perform sampling procedures inconsistent with management intent or plans, potentially rendering its estimates statistically invalid. Absent the use of this statistical estimation process, IRS had no other means of determining reported and disclosed unpaid assessment balances that are free of material misstatement. Continued management commitment and sustained efforts are necessary to build on the progress made to date and to fully address IRS's remaining unresolved issues concerning the management and reporting of unpaid assessments.

Significant Deficiency in Internal Control over Financial Reporting Systems

IRS has taken actions to address certain previously reported deficiencies in information systems controls, however, our fiscal year 2018 audit found continuing and new deficiencies in IRS's information systems controls pertaining to access controls, configuration management, and security management.[15] Specifically, IRS did not correct previously reported

[15]Access controls limit or detect access to computer resources such as data, programs, equipment, and facilities, thereby protecting them against unauthorized modification, loss, and disclosure. Configuration management prevents unauthorized changes to information system resources, such as software programs and hardware configurations, and provides reasonable assurance that systems are configured and operating securely and as intended. Security management provides a framework and continuing cycle of activity for managing risk, developing and implementing effective security policies, assigning responsibilities, and monitoring the adequacy of the entity's information system controls.

control deficiencies concerning (1) unnecessary access rights granted to accounts, (2) inconsistent encryption of data in financial reporting systems, (3) inconsistent monitoring of systems and accounts, (4) change controls over tax and financial management processing on the mainframe, and (5) developing and implementing effective policies and procedures as part of IRS's security management program.[16] In addition, during this year's audit we found that IRS did not (1) require multifactor authentication, (2) restrict unnecessary access to financial databases, (3) reasonably assure that hardware and software was supported by the vendor and consistently updated, (4) segregate incompatible duties, or (5) enforce the authenticity of digitally signed documents.

The cumulative effect of the internal control risks created by IRS's ongoing and new information system control deficiencies, while not collectively considered a material weakness, is important enough to merit attention by those charged with governance of IRS and therefore represents a significant deficiency in IRS's internal control over financial reporting systems as of September 30, 2018. Continued and consistent management commitment and attention will be essential to addressing existing system deficiencies and continually improving IRS's information system controls. Until IRS takes the necessary steps to address these unresolved recurring and newly identified control deficiencies, its financial reporting and taxpayer data will remain at increased risk of inappropriate and undetected use, modification, or disclosure.

In addition, because of the significant deficiencies in internal controls over unpaid assessments and financial reporting systems that existed during fiscal year 2018, IRS's financial management systems did not substantially comply with federal financial management system requirements as required by the Federal Financial Management

[16]We have previously reported deficiencies in certain information system control deficiencies and made recommendations to address them, and reported on IRS's associated corrective actions, in various reports to IRS concerning its information security. See, for example, GAO, *Information Security: IRS Needs to Rectify Control Deficiencies That Limit Its Effectiveness in Protecting Sensitive Financial and Taxpayer Data*, GAO-18-391 (Washington, D.C.: July 31, 2018).

Improvement Act of 1996, based on criteria established under 31 U.S.C. § 3512.[17]

Other Matters

Required Supplementary Information

U.S. generally accepted accounting principles issued by the Federal Accounting Standards Advisory Board (FASAB) require that the RSI be presented to supplement the financial statements. Although the RSI is not a part of the financial statements, FASAB considers this information to be an essential part of financial reporting for placing the financial statements in appropriate operational, economic, or historical context. We have applied certain limited procedures to the RSI in accordance with U.S. generally accepted government auditing standards, which consisted of inquiries of management about the methods of preparing the RSI and comparing the information for consistency with management's responses to the auditor's inquiries, the financial statements, and other knowledge we obtained during the audit of the financial statements, in order to report omissions or material departures from FASAB guidelines, if any, identified by these limited procedures. We did not audit and we do not express an opinion or provide any assurance on the RSI because the limited procedures we applied do not provide sufficient evidence to express an opinion or provide any assurance.

Other Information

IRS's other information contains a wide range of information, some of which is not directly related to the financial statements. This information is presented for purposes of additional analysis and is not a required part of the financial statements or the RSI. We read the other information included with the financial statements in order to identify material inconsistencies, if any, with the audited financial statements. Our audit was conducted for the purpose of forming an opinion on IRS's financial

[17]Section 803 of the Federal Financial Management Improvement Act of 1996, which is reprinted in 31 U.S.C. § 3512 note, requires that agencies implement and maintain financial management systems that comply substantially with federal financial management systems requirements, applicable federal accounting standards, and the *U.S. Government Standard General Ledger* at the transaction level. IRS's financial management systems did not substantially comply with federal financial management systems requirements because of the financial management system-related internal control deficiencies discussed in this report. However, IRS's financial management systems did substantially comply with federal accounting standards and the *U.S. Government Standard General Ledger* at the transaction level.

statements. We did not audit and do not express an opinion or provide any assurance on the other information.

Other Financial Management Challenges

We have identified several other matters that, in our professional judgement, are relevant to users' understanding of our report. Specifically, in addition to the challenge of addressing its internal control deficiencies, IRS also faces other significant ongoing financial management challenges related to (1) safeguarding taxpayer receipts and associated information, (2) preventing and detecting fraudulent refunds based on IDT, and (3) implementing PPACA tax-related provisions.

Safeguarding Taxpayer Receipts and Associated Information

Although levels of electronic filing of tax returns and related payments have been steadily increasing, IRS faces an ongoing management challenge from the millions of hard copy tax returns and hundreds of billions of dollars in associated taxpayer payments it continues to receive and process each year. As long as IRS continues to receive large volumes of hard copy taxpayer payments and supporting data, there will be a significant risk to the government and taxpayers alike that loss of receipts or inappropriate disclosure or compromise of taxpayer information may occur during this process.[18] Safeguarding these taxpayer receipts and associated taxpayer information to prevent such events is among IRS's most important and demanding responsibilities.

During our financial audit, we continued to identify deficiencies in the internal controls that IRS designed to safeguard hard copy taxpayer receipts and associated taxpayer information. Specifically, the results of our audit tests during fiscal year 2018 identified continuing, new, and reemerging deficiencies related to (1) physical security,[19] (2) procedural

[18]26 U.S.C. § 6103 provides that all returns and return information shall be confidential and shall not be disclosed, subject to limited exceptions listed in the section or authorized elsewhere under Title 26 of the United States Code.

[19]IRS uses multiple layers of physical security controls to safeguard its assets. The layers include (1) access to sensitive areas or information, (2) intrusion detection and duress alarms, (3) new-hire prescreening suitability, (4) security guards, (5) incident reporting, (6) perimeter and facility security, (7) policies and procedures, and (8) internal reviews.

safeguards,[20] and (3) transportation of receipts and taxpayer information.[21] Furthermore, IRS lacks a strategy to reasonably assure that these controls are being effectively implemented uniformly and consistently across all of its facilities.[22] IRS stated that it agrees and stated that there is a breakdown in coordination, communication, and accountability within some of its business units. While not constituting a significant deficiency or material weakness either individually or in the aggregate, the deficiencies were nonetheless sensitive matters requiring IRS's management attention. As IRS continues to respond to deficiencies identified during our audits, it is critical that it undertake a nationwide approach to maintaining the effective internal controls necessary to appropriately mitigate the risk related to taxpayer receipts and associated taxpayer information. This includes ongoing monitoring to reasonably assure that the operating effectiveness of controls does not deteriorate over time.

Preventing and Detecting Fraudulent Refunds Based on Identity Theft

IRS continues to face an ongoing management challenge associated with IDT tax refund fraud, which occurs when a perpetrator seeking a tax refund obtains an individual's identifying information, such as a Social Security number, and uses it to file a fraudulent tax return. IDT tax refund fraud is an evolving and costly problem that causes hardship for legitimate taxpayers who are victims of the crime and demands an

[20]IRS has various controls in place to account for and protect electronic and hard copy taxpayer receipts and other nontax collections and receipts while they are being processed within IRS facilities. These controls are related to the following processes: (1) candling, (2) discovered remittances, (3) overstamping, and (4) internal reviews.

[21]IRS has various controls in place to safeguard hard copy receipts and taxpayer information during transfer by courier between IRS business units and to or from third parties. These controls are related to the following processes: (1) transmittal documentation (for hard copy taxpayer receipts and taxpayer information) and related acknowledgments, (2) transportation security of couriers, and (3) periodic internal inspections of courier security and off-site shredding facilities.

[22]These facilities include the following: 364 Taxpayer Assistance Centers, 432 Small Business/Self Employed offices, 139 Tax Exempt & Government Entities offices, 261 Large Business & International offices, 5 submission processing centers, 5 lockbox banks, and 5 consolidated campuses.

increasing amount of IRS's resources.[23] Moreover, taxpayer authentication has become more difficult for IRS with the wide availability of personally identifiable information and perpetrators' ability to develop more complex and sophisticated methods to commit fraud undetected. Over the years, IRS has taken several actions to help combat IDT tax refund fraud. More recently, because of earlier access to Wage and Tax Statement forms (W-2) data, IRS has been able to conduct systemic verification checks before issuing billions of dollars in potentially fraudulent refunds.[24] In addition, in fiscal year 2018, IRS implemented a more secure online authentication option through its mobile application, IRS2Go,[25] and launched the first phase of its improved online authentication service for the Taxpayer Protection Program, called ID Verify.[26] Further, to address a sharp increase in the number of fraudulent business and partnership tax returns in recent years, IRS has been working to develop rules, models, and filters in its Return Review Program (RRP) to better detect fraud in these returns.[27]

While systemic verification shows promise for preventing fraudulent tax refunds, IRS has faced challenges that limited success in its implementation, such as limitations with its information technology systems and issues with employers filing W-2s after the filing deadline.[28]

[23]Given current and emerging risks, IRS's efforts to address IDT tax refund fraud is part of our high-risk area for enforcement of tax laws. See GAO, *High-Risk Series: Progress on Many High-Risk Areas, While Substantial Efforts Needed on Others*, GAO-17-317 (Washington, D.C.: Feb. 15, 2017).

[24]In 2017, IRS implemented a provision of the Protecting Americans from Tax Hikes Act of 2015 to allow earlier access to W-2s that IRS uses in a process called systemic verification, which helps IRS verify return information against employer-provided information on W-2s before issuing refunds to combat fraud.

[25]See GAO, *Identify Theft: Strengthening Taxpayer Authentication Efforts Could Help Protect IRS Against Fraudsters*, GAO-18-702T (Washington, D.C.: Sept. 26, 2018), for additional information on IRS's efforts to improve taxpayer authentication.

[26]See GAO, *Identity Theft: IRS Needs to Strengthen Taxpayer Authentication Efforts*, GAO-18-418 (Washington, D.C.: June 22, 2018), for additional information related to IRS's progress on implementing its authentication strategy.

[27]RRP is a pre-refund system that screens tax returns claiming refunds using characteristics predictive of IDT and other refund fraud.

[28]See GAO, *Tax Fraud and Noncompliance: IRS Can Strengthen Pre-refund Verification and Explore More Uses*, GAO-18-224 (Washington, D.C.: Jan. 30, 2018), for additional information on the challenges and limitations IRS faced implementing systemic verification during the 2017 filing season.

Additionally, although RRP provides opportunities for IRS to combat refund fraud, IRS has not fully examined opportunities for improving the availability of information on which RRP's analytic tools rely. Even as IRS has adapted its IDT defenses, perpetrators create new schemes in an effort to obtain fraudulent tax refunds despite IRS's ongoing efforts. Therefore, it is important that IRS continue its efforts to effectively identify, design, and implement the most effective systems, processes, and internal controls for preventing and detecting IDT tax refund fraud and thereby minimizing the effects on taxpayers and the associated losses to the federal government.

Implementing Patient Protection and Affordable Care Act Tax-Related Provisions

IRS continues to face management challenges related to implementing the complex tax-related provisions of PPACA, as additional tax-related provisions become effective and the related payments continue to increase.[29] Among these challenges is the extensive coordination needed, not only within IRS but also with multiple agencies and external partners tasked with responsibilities under the act.[30] For example, since IRS is responsible for managing and administering payments to health plans and the financial reporting of PPACA-related payment transactions, IRS must work closely with the Department of Health and Human Services' Centers for Medicare & Medicaid Services (CMS), which administers the programs that process, approve, and calculate advance premium tax credit (PTC) and other PPACA-related monthly payments.[31] IRS must also rely on individuals to report information on household

[29]PPACA was enacted in March 2010 and includes responsibilities for IRS pertaining to 47 provisions. While some provisions took effect immediately or retroactively, others will phase in through 2020. PPACA-related payments made by IRS have tripled since fiscal year 2014. In fiscal year 2014, PPACA-related payments were $13,067 million, and in fiscal year 2018, PPACA-related payments were $46,470 million.

[30]PPACA's provisions involve major health care stakeholders, including federal and state governments, employers, issuers of qualified health plans, and health care providers. IRS is one of several agencies accountable for implementing the legislation.

[31]PTC is generally available to help pay the cost of premiums for taxpayers and their dependents who have coverage through a marketplace but are not eligible for other health insurance, such as employer-provided coverage, and with household incomes from 100 percent to 400 percent of the federal poverty level, among other requirements. See 26 U.S.C § 36B. Individuals can choose to have PTC paid in advance to their insurance companies, thus lowering their monthly premium payments, or may claim all of the credit when they file their tax returns.

income and family size, employers and government-sponsored programs to report health care coverage information to IRS, and health care marketplaces to determine individuals' eligibility to receive PTC that IRS processes on tax returns. In addition, IRS must work closely with the external partners to fully implement and maintain information systems that can share data among IRS, CMS, and other agencies. IRS also continues to face challenges related to the timeliness and availability of key data for verifying taxpayers' PTC claims. For example, employers and government-sponsored programs are not required to report health care coverage information to IRS until March, which is more than 2 months after the start of the calendar year. This delay in reporting impedes IRS's ability to verify PTC calculations prior to issuing tax refunds, putting IRS at risk of making improper PTC payments to individuals.

IRS has developed a strategic approach to managing the challenges related to implementing the tax-related provisions of PPACA. It is important for IRS to continue to work closely with the agencies and entities involved in carrying out its responsibilities in order to improve the timeliness and accuracy of the information those entities provide. It is also important for IRS to continue to design and implement effective systems and processes as new PPACA provisions continue to become effective, in order to reasonably assure that valid and accurate payment amounts are processed and reported.

Report on Compliance with Laws, Regulations, Contracts, and Grant Agreements

In connection with our audits of IRS's financial statements, we tested compliance with selected provisions of applicable laws, regulations, contracts, and grant agreements consistent with our auditor's responsibility discussed below. We caution that noncompliance may occur and not be detected by these tests. We performed our tests of compliance in accordance with U.S. generally accepted government auditing standards.

Management's Responsibility

IRS management is responsible for complying with laws, regulations, contracts, and grant agreements applicable to IRS.

Auditor's Responsibility

Our responsibility is to test compliance with selected provisions of laws, regulations, contracts, and grant agreements applicable to IRS that have a direct effect on the determination of material amounts and disclosures in IRS's financial statements, and perform certain other limited procedures. Accordingly, we did not test compliance with all laws, regulations, contracts, and grant agreements applicable to IRS.

Results of Our Tests for Compliance with Laws, Regulations, Contracts, and Grant Agreements

Our tests for compliance with selected provisions of applicable laws, regulations, contracts, and grant agreements disclosed no instances of noncompliance for fiscal year 2018 that would be reportable under U.S. generally accepted government auditing standards. However, the objective of our tests was not to provide an opinion on compliance with laws, regulations, contracts, and grant agreements applicable to IRS. Accordingly, we do not express such an opinion.

Intended Purpose of Report on Compliance with Laws, Regulations, Contracts, and Grant Agreements

The purpose of this report is solely to describe the scope of our testing of compliance with selected provisions of applicable laws, regulations, contracts, and grant agreements and the results of that testing, and not to provide an opinion on compliance. This report is an integral part of an audit performed in accordance with U.S. generally accepted government auditing standards in considering compliance. Accordingly, this report on compliance with laws, regulations, contracts, and grant agreements is not suitable for any other purpose.

Agency Comments

In commenting on a draft of this report, IRS stated that it was pleased to receive an unmodified opinion on its financial statements. IRS also commented on its many efforts to improve internal control over unpaid assessments. Further, IRS stated that it continues to increase its focus on information security and internal controls. The complete text of IRS's response is reproduced in appendix II.

Cheryl E. Clark

Cheryl E. Clark
Director
Financial Management and Assurance

November 8, 2018

Management's Discussion and Analysis

FISCAL YEAR 2018 MANAGEMENT'S DISCUSSION AND ANALYSIS

CONTENTS

About the IRS

History

The IRS is one of the oldest bureaus in the United States Government. Article 1, Section 8 of the Constitution gave the federal government the power to “lay and collect Taxes, Duties, Imposts and Excises, to pay the Debts and provide for the common Defence and general Welfare of the United States…” In 1862, President Lincoln and the Congress established the Bureau of Internal Revenue and the nation’s first income tax. In 1953, the Bureau of Internal Revenue’s name was changed to the Internal Revenue Service (IRS).

The IRS collects 95 percent of the revenue that funds the United States.

Mission

Provide America’s taxpayers top-quality service by helping them understand and meet their tax responsibilities and enforce the law with integrity and fairness to all.

Vision

The IRS will uphold the integrity of the nation’s tax system and preserve the public trust through the IRS’s talented workforce, innovative technology and collaborative partnerships.

Values

- Honesty and Integrity
- Respect
- Continuous Improvement
- Inclusion
- Openness and Collaboration
- Personal Accountability

Tax Statistics

FY 2018 Tax Statistics Highlights	
Total Returns Processed	225 million
Total Returns and Other Forms Processed	253 million
Total Revenue Collected	3.5 trillion
Enforcement Revenue Collected	$59.4 billion
Total Refunds and Outlays	464 billion
Average Individual Refund	$2,881
E-File Rate – Individual	87.2%
E-File Rate – Business	55.6%
IRS.gov Page Views	3.2 billion
Where’s My Refund? Usage	309 million
IRS.gov Downloads*	292.9 million

* Beginning with the downloads data for January 2018, IRS includes downloads that occur through external sites (e.g., directly from search engine results). Previous results only included downloads directly from links on IRS.gov. Because of this change, downloads in FY 2018 are higher than in previous years.

Organization

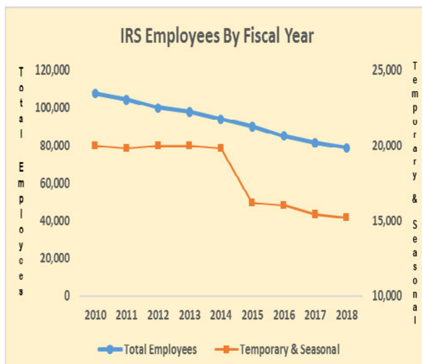
The IRS’s primary operations includes collection of individual and corporate taxes, examination of returns, taxpayer assistance, and tax-exempt organizations, as well as multiple refundable tax credit and other specialized programs. IRS operations are supported by four business units focused on unique groups of taxpayers: individual taxpayers, small business owners, large corporations and offshore activities, and tax-exempt and government entities.

Business Units
➢ Wage and Investment
➢ Small Business and Self-Employed
➢ Large Business and International
➢ Tax-Exempt and Government Entities

See Appendix A for a more comprehensive organizational chart.

State of the IRS Workforce

In FY 2018, the IRS employed about 78,739 employees, including more than 15,181 temporary and seasonal staff. The IRS lost more than 23,148 full time positions between FY 2010 and FY 2018.



The IRS continues to make strategic shifts within its existing workforce to accomplish its goals and meet the needs of taxpayers.

The IRS recognizes many emerging trends that offer challenges and opportunities for how the IRS operates, including:

- Changes in the taxpaying public and their expectations.
- Technological disruptions.
- Shifts in the workforce.
- An increasingly globalized and interconnected world.
- Changes in tax law.

Over the past several years, the IRS has operated with reduced funding and a declining workforce as workloads and responsibilities have increased. Since FY 2011, the IRS has had to operate through an exception-only hiring policy, which has limited its ability to replace employees lost through attrition.

Since FY 2010, several unfunded legislative mandates expanded the IRS's responsibilities and required the diversion of resources from core tax administration responsibilities. In FY 2018, the IRS received funding to implement the new Tax Cuts and Jobs Act of 2017 (TCJA), which includes significant modifications to U.S. tax law.

The IRS's FY 2018-2022 Strategic Plan discusses these trends under each strategic goal.

IRS FY 2018-2022 Strategic Plan

The IRS FY 2018-2022 Strategic Plan articulates the IRS vision to become a more taxpayer-centric and modern agency and will guide the IRS in moving forward over the coming years.

The core of the IRS vision for the future is to enhance the taxpayer experience. The IRS strives for excellent service to taxpayers and their representatives through their preferred service channel. The IRS also aims to reduce taxpayer burden and preempt noncompliance issues, allowing the IRS to focus enforcement on more complex cases and intentional abuses of tax law.

The IRS's ability to provide high-quality taxpayer service and maintain the integrity of the tax system requires modern, secure, and nimble operations, as well as a sustained and talented workforce. As the IRS strives to provide service to taxpayers and their representatives and ensure successful implementation of changes in tax laws, the IRS is embracing and integrating data into its culture. Using analytics, the IRS strives to continuously improve all facets of its operations — taxpayer service, enforcement efforts and a range of internal operations — maximizing learning from tests and data. The IRS is committed to using this research to guide organizational priorities. Greater collaboration with a variety of partners, such as government agencies, international tax administrations, software providers, and industry groups will enable the IRS to deliver on its mission more effectively and efficiently.

The IRS FY 2018-2022 Strategic Plan focuses on six goals that will help drive continued improvements in the customer experience.

Empower and Enable All Taxpayers to Meet Their Tax Obligations - Make it as easy as possible for taxpayers and their representatives to understand and meet their tax obligations.

Protect the Integrity of the Tax System by Encouraging Compliance Through Administering and Enforcing the Tax Code - Pursue innovative approaches to understand, detect and resolve potential noncompliance.

Collaborate with External Partners Proactively to Improve Tax Administration - Engage partners to improve service and outreach to taxpayers, enhance global collaboration and share leading practices.

Cultivate a Well-Equipped, Diverse, Flexible, and Engaged Workforce - Strive for a culture that values innovation, welcomes multiple perspectives and celebrates diversity.

Advance Data Access, Usability, and Analytics to Inform Decision Making and Improve Operational Outcomes - Continue to use data to drive decisions and make the most effective use of resources.

Drive Increased Agility, Efficiency, Effectiveness and Security in IRS Operations - Focus on streamlining and simplifying IRS business processes to serve taxpayers better and improve stewardship of taxpayer resources.

Performance Highlights

Goal: Empower and enable all taxpayers to meet their tax obligations

The IRS's aim is to increase voluntary compliance through simplifying the processes for tax filing, correction and payment, improving education and outreach on taxpayer rights and obligations, and modernizing and expanding service channels to meet taxpayer expectations.

The IRS launched a "Get Ready for Taxes" campaign that included a dedicated IRS.gov page to encourage taxpayers to prepare for the 2018 tax filing season. The IRS issued a series of news releases, tax tips, and social media messages to increase awareness of the refund delay for taxpayers claiming Earned Income Tax Credit (EITC) and/or Additional Child Tax Credit (ACTC) and the need for some taxpayers to have their prior year Adjusted Gross Income (AGI) to file tax returns electronically. Other reminders included Individual Taxpayer Identification Numbers (ITIN) renewals, end-of-the-year charitable contributions, and steps to take before December 31 in preparation for the upcoming tax filing season. The campaign also included 30 unique tweets, five graphic messages (four of them also in Spanish), four Twitter polls, and a Thunderclap push.

The IRS continued to educate taxpayers about tax scams, issuing news releases with an emphasis on providing early alerts. When new scams emerged, the IRS worked with external partners to assess the magnitude and warned taxpayers and other stakeholders, and/or issued alerts to targeted users.

Filing Season Accomplishments

The IRS held its twelfth annual EITC Awareness Day on January 26, 2018. This day marked the kickoff of a multilingual communication effort intended to increase awareness of EITC eligibility, encourage participation, and emphasize filing of accurate returns. The day also highlighted free tax preparation and electronic filing options through the Volunteer Income Tax Assistance (VITA), Tax Counseling for the Elderly (TCE), and Free-File programs. As part of this campaign, the IRS engaged external partners to hold outreach events and used social media to maximize reach. This outreach promoted the many useful resources available on IRS.gov, including key messages, web articles, newsletters, fast facts, local statistics, and marketing and communications materials to help partners conduct their EITC campaigns. Nationwide, partners held 226 events in support of the 2018 EITC Awareness Day. Social media communications reached millions.

The earlier availability of Form W-2, Wage and Tax Statement and Form 1099-MISC, Miscellaneous Income, data enhanced the IRS's defenses against identity theft and refund fraud. The IRS conducted systemic verification of information reported on taxpayers' returns against third-party information reporting and used the Form 1099-MISC for non-employee compensation data as a variable in the filtering process before issuing refunds. In addition, the Protecting Americans from Tax Hikes (PATH) Act of 2015 requires the IRS to hold refunds on all returns claiming EITC and/or ACTC until February 15. The IRS leveraged both filtering capabilities and the PATH Act refund hold to automate and expand the selection of potentially fraudulent returns. For 2018, the IRS held 9.4 million returns with $46.9 billion in refunds until February 15 and identified about 340,000 PATH returns with possible overstated income or withholding issues.

The IRS delivered a very successful filing season, which opened on January 29, 2018. During this filing season, the IRS received about 137 million individual returns and issued more than 95 million refunds totaling $265 billion. The average refund was $2,780. Taxpayers filed 91 percent of individual returns electronically and 9 out of 10 taxpayers received their refunds within 21 days. The IRS.gov website was visited 387 million times with 265 million taxpayers checking the Where's my Refund? tool for the status of their refund. This represents a 24 percent increase in the use of IRS.gov and an 8 percent increase in Where's my Refund? compared to last filing season. The IRS achieved an 80.0 percent filing season telephone level of service (LOS). Assistors answered 10 million calls and addressed another 17 million calls through automated systems during the 2018 filing season.

IRS Toll-Free Telephone Line

The IRS's toll-free telephone line is one of the world's largest customer service phone operations. It is a key part of the IRS's taxpayer service delivery and is just one of the many channels available to taxpayers to get help. While the IRS offers taxpayers a variety of self-service options, many taxpayers prefer assistance by telephone to resolve their tax issues and that demand often exceeds available staffing resources. For 2018, the IRS received funding that provided additional resources for answering telephone inquiries, which enabled delivery of a 76 percent telephone LOS for the full year. Assistors answered more than 25 million calls and almost 30 million calls were handled through automated systems, compared to FY 2017 where assistors answered more than 23 million calls and another 29 million calls were handled through automated systems.

Taxpayer Assistance Centers Appointment Line

In FY 2018, phone assistors answered nearly four million calls on the dedicated appointment line. Over half of the taxpayers calling to make an appointment at Taxpayer Assistance Centers (TACs) had their issues resolved by the IRS employee on the appointment phone line and no longer needed an in-person appointment. The IRS also tried to accommodate taxpayers who traveled to a TAC without an appointment. In FY 2018, the IRS assisted about 223,000 walk-in taxpayers. For the fiscal year, IRS customer service representatives served nearly five million taxpayers when combining the almost three million face-to-face assistor contacts and the two million who had their issues resolved over the phone when they called for an appointment.

Expanding Digital Service Options

The IRS continues to make significant strides to develop, implement, and improve digital tools that empower and enable all taxpayers to meet their tax obligations. These efforts provide additional customer service options and allow the IRS to maximize the effectiveness of its limited resources.

Based on significant user research, analytics, and stakeholder feedback, the IRS continued to make IRS.gov easier to navigate and more responsive on mobile devices. In FY 2018, taxpayers visited IRS.gov about 609 million times with 48 percent of visitors coming from a mobile device and viewed 3.2 billion pages. In February 2018, at the peak of filing season, 68 percent of 171 million total visits came from a mobile device or tablet.

Similarly, the IRS2Go mobile application gives users another way to interact with the Service, and the mobile app alone saw 118 million refund queries in the fiscal year. During the filing season, IRS2Go reached the top ten app downloads in the Apple App Store and Google Play Store.

The IRS continued to add new features and improvements to the Online Account (OLA) application, which allows taxpayers to access key information such as their tax account balance, tax records and transcripts, recent payments, or options to make payments or establish payment plans. In FY 2018, about two million unique taxpayers visited OLA 6.4 million times and submitted more than 581,000 payments worth about $1.8 billion through Direct Pay. Taxpayers also have established more than 195,000 payment agreements through OLA; this represents 20 percent of all online agreements, 389 percent more than last year.

In FY 2018, the IRS launched a tool, Identity Verify (IDVerify), for the Taxpayer Protection Program (TPP) that allows taxpayers to answer three simple questions to confirm their identity and validate suspected identity theft returns. The IRS also released an improved Tax-Exempt Organizations Search tool to allow users to search across several previously separate databases and view associated determination letters and copies of returns for many charities and non-profit entities. Beyond enhancing the customer experience, the IRS's digital tools help the IRS collect taxes efficiently. In FY 2018, the IRS collected 45 percent of individual payments (47.7 million payments worth $164 billion) electronically.

Implementing the Tax Cuts and Jobs Act (Public Law 115-097)

The Tax Cuts and Jobs Act (TCJA), P.L. 115-097, signed into law on December 22, 2017, represents the most sweeping change to U.S. tax law since the Tax Reform Act of 1986.

The TCJA includes 119 tax provisions that affect individual and business taxpayers as well as all areas of the IRS. While the IRS has implemented many tax law changes over the last several years, implementing the TCJA involves creating or changing more than 500 tax products and 57 systems, retraining the IRS workforce, and educating the taxpaying public about the changes. A high priority for the IRS is to ensure taxpayers and tax professionals have the information they need and the support of knowledgeable IRS employees to fulfill their tax obligations with the least burden. The TCJA had a minimal effect on 2017 tax returns filed during the 2018 filing season; however, most of the changes take effect in 2018 and will affect most of tax returns filed in 2019. In FY 2018, Congress appropriated $320 million to fund critical implementation activities.

The IRS faces many challenges due to the unprecedented magnitude of tax law changes that require delivery so quickly. Through Servicewide collaboration, the IRS is working to manage and mitigate these challenges. In addressing the effects of the TCJA enactment, the IRS identified implementing retroactive provisions, revising the income-tax withholding tables, creating a new Form W-4, Employee's Withholding Allowance Certificate, and updating the Withholding Calculator on IRS.gov as immediate priorities in the implementation sequence – timely completing these activities by their target dates.

Working closely with the IRS and the Department of the Treasury's Office of Tax Policy, the Office of Chief Counsel leads the effort to provide formal published guidance that interprets the tax law for taxpayers and tax professionals. Since December 2017, the IRS has published a host of formal guidance products and "soft" guidance such as press releases, Frequently Asked Questions, and IRS.gov updates.

Obtaining valuable feedback and input from tax professionals, industry associations, advisory groups, and other partners is key to implementing the TCJA. The IRS hosted roundtable discussions with external partners in February to gain insight into concerns, issues, and needs from the perspectives of IRS stakeholders. These discussions focused on specific areas of tax administration: International and Corporate, Small Businesses and Pass-Through Entities, Tax Exempt Organizations, and Individual Income Tax and Credits. Through a variety of education and outreach platforms, the IRS continues to leverage opportunities for engagement with partners when implementing provisions of the law. Included in these efforts are formal presentations and participation on panels with stakeholders ranging from national organizations and oversight bodies such as the American Bar Association and the Internal Revenue Service Advisory Council (IRSAC) or the Information Reporting Program Advisory Committee (IRPAC) to smaller, local alliances such as farmers' cooperatives. The IRS conducted tax reform educational sessions during each National Tax Forums held in 2018. The IRS established an extensive web page on IRS.gov to provide information to the public as it becomes available.

Withholding Tax Calculator

One of the TCJA's immediate changes affected individual income tax withholding in 2018. The IRS issued updated withholding tables for 2018 to incorporate the effect of the increase in the standard deduction, repeal of personal exemptions, limitations on itemized deductions, and changes in tax rates and brackets. The withholding tables produced the correct amount of tax withholding for filers with simple tax situations. In tandem with the updated withholding tables, on February 28 the IRS released a Withholding Calculator tool on IRS.gov. The updated Withholding Calculator is an interactive tool to help wage earners check to ensure the correct amount of tax is being withheld from their paychecks. Using the calculator to check withholding may help prevent potential under-withholding that could lead to an underpayment penalty. At the same time, some taxpayers may choose to reduce their historic rate of withholding to allow for a larger paycheck and smaller refund. If filers find that they need to change their withholding, the Withholding Calculator tool provides the information they need to fill out a new Form W-4.

In late March, the IRS launched a 'Paycheck Checkup' outreach campaign to encourage taxpayers to use the Withholding Calculator to check whether they were having the correct amount of tax withheld from their paychecks. The campaign included a new series of plain language Tax Tips and a YouTube video series. Along with creating the Withholding Calculator on IRS.gov, the IRS provided telephone services in English and Spanish to assist taxpayers with the new tool. The IRS also issued internal communications, held internal informational webinars on withholding, and created an informative intranet page as a resource for IRS employees to ensure they remain compliant with federal tax withholding requirements. The IRS conducted additional versions of the campaign later in the summer and the fall, leading to extensive national media coverage. In addition, material from the campaign was widely shared on social media and through partner groups inside and outside the tax community.

New Forms and Guidance

Given its extensive reach and broad scope, implementing the TCJA is a mission-critical task likely to span several years. It requires creating or revising hundreds of tax products, including worksheets, tax forms, form instructions, and publications as well as changing current IRS policies and procedures. The IRS revised all forms and publications affected by TCJA provisions needed to support taxpayers through the 2018 filing season. TCJA implementation activities continue to focus on helping taxpayers file their 2018 returns timely and accurately in 2019. The IRS is also on track to complete the necessary information technology (IT) programming to enable accurate processing of all revised and new forms in the 2019 filing season. The IRS is working with the Department of the Treasury to deliver guidance as soon as possible.

In August, the IRS issued the final update to the 2017-2018 Priority Guidance Plan. The revised plan contains many regulatory projects related to the TCJA. Published guidance items appear in the Federal Register and the Internal Revenue Bulletin and are available on IRS.gov.

The IRS plans to accelerate the timeline for hiring telephone assistors and other support staff in preparation for the 2019 filing season. The IRS also is executing a comprehensive training plan to ensure employees are prepared to process returns and answer taxpayers' questions.

Goal: Protect the integrity of the tax system by encouraging compliance through administering and enforcing the tax code

One of the IRS's key responsibilities is to ensure taxpayers comply with the tax law. The IRS continues to develop innovative approaches to understand, detect, and resolve potential noncompliance to keep taxpayer confidence in the tax system strong.

The IRS Criminal Investigation organization investigates potential criminal violations of the Internal Revenue Code and related financial crimes to enforce accountability and maximize deterrence. This includes money laundering, currency violations, tax-related identity theft fraud, and terrorist financing that adversely affects tax administration. Using its unique authority and financial expertise, the IRS Criminal Investigation organization contributed to important national law enforcement priorities. FY 2018 performance highlights included:

- Completed 3051 criminal investigations
- Achieved 1,879 convictions with a conviction rate of 91.7 percent
- Achieved a Department of Justice case acceptance rate of 93.1 percent and a U.S. Attorney case acceptance rate of 90.1 percent, which compares favorably with other federal law enforcement agencies.

Employment Tax

Enforcement of civil and criminal employment tax is a high priority. Employers have a responsibility to collect and pay taxes withheld from their employees' wages. When employers intentionally fail to collect, account for and deposit the IRS employment tax due, they are stealing from their employees and the United States.

The IRS has continued to focus on employers who have failed to pay employment taxes. The IRS initiated a cross-functional program where 46 employment tax cases, which would have normally gone to the Department of Justice (DOJ) Tax Division to begin the injunction process, were forwarded to the IRS's Fraud Program for review and potential referral for criminal investigation. Of the 46 cases, the Fraud Program referred 23 and 17 were accepted for criminal investigation. Without this initiative, some of these investigations would have proceeded in civil court, missing the deterrent effect of criminal enforcement.

Questionable Refund Program

Questionable Refund Program (QRP) schemes, which often include identity theft, are those that involve one or more individuals that use genuine identities to prepare and file false tax returns that claim bogus income and deductions to generate phony claims for refund. FY 2018 QRP performance results included:

- 149 Criminal Investigations Initiated
- 293 Criminal Investigations Completed
- 282 Convictions
- 90.7 percent Conviction Rate
- 74.9 percent Publicity Rate on settled investigations.

In FY 2018, the IRS Scheme Development Centers (SDCs) identified 286 QRP schemes comprised of 51,135 individual tax returns with more than $279 million in potentially false refund claims.

Return Preparer Program

The IRS encourages compliance in the return preparer community by engaging in enforcement strategies addressing the small percentage of untrustworthy or incompetent return preparers. These strategies include education, outreach, and coordinated cross-functional publicity. FY 2018 performance results included:

- 224 Criminal Investigations Initiated
- 254 Criminal Investigations Completed
- 150 Convictions
- 96.8 percent Conviction Rate
- 68.9 percent Publicity Rate

Cyber Crimes

The IRS's Cyber Fusion Team, established to identify and address the most alarming cyber threats affecting tax administration, comprises multiple functions within the IRS that collaborate to rebuff attempts to dodge existing IRS system safeguards or engage in unauthorized use of Personally Identifying Information (PII) for unlawful purposes.
FY 2018 accomplishments included:

- Addressing an emerging threat involving fictitious filing of forms to the IRS. Impostors submitted fraudulent forms that contained stolen PII of a business entity with the goal of obtaining sensitive tax information. The impostors use the businesses' stolen tax information to file false claims. In response, the IRS established new screening methods for identifying anomalies when criminals try to authenticate information and use online IRS procedures to find ways around the authentication standards and illegally obtain tax information. The new methods help prevent unauthorized disclosures.
- Developing additional screening procedures to detect fraudulent tax return filings that use stolen PII from tax practitioners' breached computer networks.

Implementing Tax Law Changes

This year, the IRS faced some challenges in implementing new tax law changes while processing tax returns. Because changes in tax laws happened late in the year, the IRS had very little time to assess these new laws.

Three significant pieces of legislation affected IRS operations for the 2018 filing season:

- The Disaster Tax Relief and Airport and Airway Extension Act of 2017, enacted into law September 29, 2017, provides relief for victims of Hurricanes Harvey, Irma, and Maria. It allows for casualty loss claims using a modified computation.
- In implementing the TCJA, discussed above, the IRS leveraged its long-standing relationships and forums with stakeholders to support implementation planning for the

TCJA.

- The Bipartisan Budget Act of 2018 (BBA) (P.L. 115-123), enacted into law on February 9, 2018, retroactively renewed dozens of tax provisions that had expired at the end of 2016 (referred to as "extenders"), and affected more than 100 completed tax products. The IRS quickly revised affected products, developed a communications strategy to alert partners and taxpayers of anticipated delivery dates and potential effects, and took quick action to program processing systems.

In FY 2018, the IRS continued its efforts to help taxpayers prepare for filing season by providing information on various changes related to the PATH Act, including:

- Mid-February issuance of refunds on tax returns claiming EITC and/or ACTC;
- Expiration of ITIN not used for three consecutive years;
- Refunds of wrongful incarceration awards and the need to file a Form 1040X, Amended U.S. Individual Income Tax Return, to claim them; and
- The provision requiring employers to file Forms W-2, Form W-3, Transmittal of Wage and Tax Statements, and Form 1099-MISC, with the Social Security Administration (SSA) by January 31.

Identifying and Resolving Tax Compliance Risks and Issues

Confronted with declining resources, growing filings, and an increasingly complex business environment, the IRS has shifted certain enforcement resources to an issue-based campaign approach. To establish a campaign, the IRS identifies specific issues of significant compliance risk, then selects and executes one or more treatment streams directed toward achieving compliance objectives with respect to those issues. In addition to audits, campaign treatment streams include: issuing administrative guidance, executing industry issue resolutions, conducting events and outreach, proposing legislation, publishing procedures or guidance, and modifying or creating IRS tax forms or publications. To date, the IRS has announced 45 campaigns, with more in different stages of development. The IRS manages its various compliance programs, including campaigns, according to a standard set of workstream processes, improving consistency and enhancing internal controls.

Furthermore, the IRS is seeking ways to increase efficiencies around emerging and significant tax law issues. The IRS has developed Servicewide strategies that address abusive tax compliance issues such as Conservation Easements, Research and Experimentation Tax Credits, Captive Insurance, and Offshore entities. The Servicewide Emerging Issue Strategy provides a formal structure to identify and evaluate emerging tax issues in a timely manner and to provide proper guidance to both employees and taxpayers. This Servicewide approach ensures consistent treatment of taxpayers and consistent application of the law.

The Federal Tax Deposit Alert program functions as an "early interaction" with taxpayers, designed to educate and prevent employers from falling behind on their employment tax obligations. In FY 2018, the IRS used analytics to refine the selection methodology on employment tax depositors to identify employers who were at risk of becoming delinquent. The IRS made efforts through personal and mail contacts to improve filing and payment compliance and limit expensive deposit penalties for taxpayers.

In FY 2018, the IRS completed a nonfiler strategic plan to reduce the nonfiler portion of the tax gap through early intervention and with minimal burden on taxpayers. The foundation of the nonfiler strategy relies on using data analytics and decision engineering to provide a framework based on both short-term and long-term desired performance outcomes. This strategy seeks to achieve balance between activities that secure filing and payment. It will identify and prioritize nonfiler work to maximize business results while promoting programs built to encourage voluntary taxpayer filing.

Goal: Collaborate with external partners proactively to improve tax administration

The IRS commits to strengthening and expanding its partnerships with stakeholders invested in and affected by tax administration.

International and Foreign Governments Tax Collaboration

The IRS continues to seek opportunities for increased collaboration with its foreign counterparts in combating offshore tax evasion, money laundering, transnational organized crime, cybercrimes, and terrorist financing. Offshore structures and financial instruments, when used to commit tax crime and money laundering, are a growing threat to the economic, fiscal, and social interests of the United States.

In FY 2018, the IRS established the Joint Chiefs of Global Tax Enforcement, which consists of the United States, the United Kingdom, the Netherlands, Canada, and Australia. This international collaboration will combat international and transnational tax crime and money laundering through increased enforcement collaboration. It will help reduce offshore tax evasion and threats posed by cryptocurrencies and cybercrime.

In FY 2018, the IRS also established the International Tax & Financial Crimes (ITFC) Group to focus on the most complex international Title 26 criminal tax investigations with support from the National Coordinated Investigations Unit (NCIU).

The ITFC areas of emphasis include:

- Investigations of U.S. expatriates residing in foreign jurisdictions.
- U.S. domestic taxpayers using foreign abusive trusts, companies, accounts, transactions and structures to evade taxes.
- Entities/individuals specifically engaging in schemes to evade Foreign Account Tax Compliance Act (FATCA) reporting requirements.

Additionally, the IRS works with other organizations using bilateral and/or multilateral agreements and resources to confront international tax noncompliance where it poses a threat to the national and economic security of the United States. The Simultaneous Criminal Investigation Program (SCIP) facilitates exchanges of information under tax treaties in cases where there appear to be substantial criminal tax violations in both the United States and a foreign country. The objectives of the SCIP are to conduct simultaneous criminal tax investigations of individuals and/or companies in the United States and the foreign country under their respective authorities to eliminate obstacles caused by taxpayers using the border to avoid production of records and reporting of income.

The IRS educates foreign governments and agencies on crime detection, investigative techniques, case studies, emerging trends, and best practices.

Identity Theft Prevention and Outreach

The IRS conducted outreach events designed to educate private-sector entities and law enforcement partners about tax-related identity theft.

The Security Summit partnership, a public-private sector partnership between the IRS, state revenue departments, software developers, tax professionals, and financial services groups, conducted awareness campaigns for tax professionals – Protect Your Clients; Protect Yourself: Don't Take the Bait – and for taxpayers – National Tax Security Awareness Week – because everyone has a role in fighting identity theft.

A summer campaign – Protect Your Clients; Protect Yourself: Tax Security 101 – featured 10 news releases. In addition to raising awareness, the series helped support identity theft education efforts at five Nationwide Tax Forum sessions attended by more than 10,000 tax professionals.

In late November and early December, the IRS worked with Security Summit partners to conduct the second Tax Security Awareness Week. The sweeping effort generated news articles across the country following 32 local press and partner events. In all, 24 state revenue departments and dozens of other partner groups participated.

In FY 2018, the IRS participated in more than 167 outreach presentations focused on theft from tax preparation and payroll service businesses. It coordinated outreach efforts with private industry and other law enforcement agencies as well as tax symposiums, the Federal Trade Commission, the National Association of Enrolled Agents, and private industry software companies.

For the first time in advance of the filing season, the IRS developed and distributed multiple data security messages directly to the individual Preparer Tax Identification Number (PTIN) accounts of more than 700,000 active tax return preparers addressing the importance of data security for the preparer community. Additionally, in early FY 2018, the IRS broadened education and outreach efforts by conducting a messaging campaign about the availability of continuing education credit for data and information security courses for tax return preparers.

Private Debt Collection

The Fixing America's Surface Transportation (FAST) Act requires the IRS to use private collection agencies (PCA) for the collection of outstanding inactive taxes receivable. Through FY 2018, the IRS has assigned more than 730,000 delinquent tax accounts with balances ranging from $500 to $100,000 to PCAs, with collection potential of more than $5.7 billion. By the end of calendar year 2018, the IRS expects to assign about one million cases with collection potential totaling more than $7 billion. To date, there have been no security breaches and no substantiated complaints.

The IRS understands the use of PCAs may increase the risk to taxpayers of impersonation scams, since the program will involve contact with taxpayers on behalf of the government by non-IRS employees. The IRS urges taxpayers to be on the lookout for scam phone calls from anyone claiming to be collecting on behalf of the IRS and encourages taxpayers to visit IRS.gov to verify the private collection agency before calling a number received on a letter. The IRS continues to issue news releases and maintains a social media presence (Twitter and YouTube) about this program.

Goal: Cultivate a well-equipped, diverse, flexible, and engaged workforce

The future of the IRS depends on a workplace culture that empowers employees to improve the taxpayer experience and uphold the tax code fairly. Enhanced skills development, succession planning, and knowledge transfer coupled with a forward-looking talent management strategy offering modernized training and tools are critical to passing on the leadership skills and institutional knowledge necessary for continued effective tax administration.

Talent Management

The IRS continues to support employee development with innovative training tools.

The Department of the Treasury is obtaining an Integrated Talent Management (ITM) system for use by all of its bureaus. The ITM is a single, integrated human capital information system made up of modules or segments that support various human capital business processes such as hiring, awards processing, and career development. An ITM system integrates these processes to improve efficiencies by providing a common interface, data platform, workflow, and cross-process reporting and analytics.

Configuration and development work began in October 2017 with implementation of initial modules expected in November 2018. Current modules support the learning, workforce planning, succession planning, and business performance processes. Legacy human capital systems will either migrate to or integrate with the ITM. For example, the ITM Learning Management module will replace the IRS Enterprise Learning Management System (ELMS).

Knowledge Management

The IRS continues to focus on encouraging the transfer of institutional knowledge and has developed three strategies for a Servicewide approach to knowledge management solutions based on four best practice pillars: promote collaboration (Connect), knowledge capture before employee separation (Learn), data sharing (Share), and build employee expertise (Improve). These strategies include:

- A centralized online content repository (virtual library and video library) to capture and transfer best practices from an experienced workforce, promoting cross collaboration on mission-critical jobs, and providing consistency in messaging;
- A learning portal designed to consolidate various resources into a one-stop site for all aspects of training, course development, curriculum development, and career enhancement; and
- A corporate interactive platform to identify and transfer knowledge and expertise across all IRS business organizations.

The IRS Knowledge Management Solution accomplishments were:

- Implemented a three-year strategic plan;
- Conducted a knowledge mapping pilot to identify knowledge sharing opportunities, understand knowledge gaps, barriers, and flows;
- Built a Virtual Library of more than 35 active knowledge bases, with 27 pending;
- Implemented automated tools to streamline the process to build books in the Virtual Library;
- Launched the Self-Help Online Tutorial (SHOT) video library that houses more than 210 training videos; and
- Established and supported more than 34 cross-functional Communities of Practice (COPs), which encourage members to share ideas and resources. COPs comprise 9 business units organized around topics in the areas of tax administration, IT, content development, budget, and project management.

Staffing for Tax Reform

The IRS continues to make strategic shifts within its existing workforce to accomplish its goals and meet the needs of taxpayers.

The skill sets and expertise necessary to implement and execute extensive tax reform are in high demand in government and private industry, making recruitment of experienced professionals difficult.

In late FY 2018, the Office of Personnel Management granted the IRS several hiring and recruitment flexibilities - a streamlined approval process for re-employed annuitants and direct hire authority to fill positions in three occupational groups (information technology specialist, computer engineer, and computer science) specifically to support implementation of the TCJA. Direct hire authority enables the IRS to recruit and fill critical hiring needs in an expedited manner. This authority is vital because of the unique skillsets required to implement tax reform in the compressed timeline required.

In most cases, the newly hired employees will not be ready to help with implementing TCJA, so they will contribute by filling gaps created due to the reassignment of existing, skilled employees to work on TCJA. While it is essential that the IRS fill positions as quickly as possible, the IRS will continue to experience workload and resource supply issues due to the sheer number of new hires required, coupled with anticipated attrition.

Goal: Advance data access, usability, and analytics to inform decision making and improve operational outcomes

The IRS strives to operate more efficiently to provide superior service to taxpayers and their representatives and ensure successful implementation of changes in tax laws. Using analytics, the IRS works continuously to improve all facets of its operations - taxpayer service, enforcement efforts and a range of internal operations.

Taxpayer Service

Preparer Tax Identification Number Process

The IRS redesigned the online PTIN renewal process to improve the user experience and subsequently, reduced tax return preparer PTIN renewal time by 30 percent. The IRS also implemented a new document upload process within the PTIN system, allowing for 100 percent self-service. Return preparers no longer need to submit on paper unless they choose to do so. A new cloud infrastructure provided excellent system performance, even with the very high traffic volume during the PTIN renewal season. This demand sustained without any signs of system degradation. Because of these enhancements, the call/chat demand at the PTIN call center decreased by 9 percent during peak season and paper receipts declined by 28 percent, even though the number of PTIN transactions increased by more than 6 percent.

Redesigned Notices

The IRS is incorporating analytics in the development of redesigned notices. The IRS has used behavioral design to tailor certain notices to meet specific taxpayer characteristics. For taxpayers who meet criteria for an installment payment agreement, the IRS developed a letter providing information that helps them establish an agreement online without having to call or meet with the IRS.

New Installment Agreement Criteria

The IRS piloted streamlined guidance for processing taxpayer installment agreement requests. Under the new rules, the IRS evaluated payment performance both in terms of collecting the unpaid taxes and ensuring future compliance. The success of the payment plans improved in many facets; the streamlined criteria reduce both the demand on IRS resources to process installment agreement requests and reduce taxpayer burden by making it easier for taxpayers to establish payment plans. The IRS is in the process of making the streamlined guidance permanent.

Appointment Scheduling Tool

The IRS deployed the Field Assistance Appointment Scheduling Tool (FAST) for the 2018 filing season. IRS assistors use the tool to schedule appointments for taxpayers who wish to meet with IRS representatives face-to-face in one of the TACs. The new tool features are more intuitive, easier to use, and ensure more efficient service to taxpayers by allowing phone and TAC assistors to fill appointment slots more effectively and resulted in improvements in Average Handle Time (AHT) by phone assistors. For the calendar year, with the use of the tool, phone assistor AHT decreased by more than one minute per call. Since phone assistors answered nearly four million calls this calendar year, one minute of savings per call translates to nearly 70,000 hours available to provide services. For taxpayers who request an appointment, the FAST uses logic to schedule the appointment with an assistor who is skilled in supporting the specific tax service(s) at the most convenient location for the taxpayer at the earliest date possible. FAST enables the IRS to monitor demand and produces data and analytics that help inform hiring and training decisions based on trends in taxpayers' needs in specific locations.

The IRS used data from the FAST to pinpoint locations where appointments for identity theft and the TPP extended past the April 17 filing deadline. FAST data also enabled the IRS to identify an opportunity for additional support at these locations during the last three weeks of the filing season to help meet the demand. As a result, more than 100 employees volunteered to assist in 27 TACs identified using the data from the scheduling tool. To facilitate this effort, TAC employees contacted taxpayers whose scheduled appointments were beyond the filing season and offered to reschedule their appointment to an earlier date, ensuring filing compliance. During the last three weeks of filing season, employees assisted about 12,000 taxpayers with TPP IDVerify issues, a 13.6 percent increase over the previous year. In addition, between April 3 through April 23, additional employees provided support to the Puerto Rico TAC and accepted more than 7,000 returns and processed more than 5,000 payments.

Enforcement Efforts

Fraud and Identity Theft Detection Improvements

The profile of tax-related identity theft has changed and continues to grow more sophisticated. Today, identity theft returns often mirror the actual taxpayer's return. This is due to the efforts by identity thieves to acquire actual federal tax information, such as employees' Forms W-2, through phishing schemes targeting employers and/or payroll providers. To protect taxpayers from tax-related identity theft, the IRS proactively identifies those accounts that require additional review.

The IRS has made significant progress in combatting stolen identity refund fraud over the last several years.

- Identity theft and fraud detection systems contain complex models and filters developed from historical and newly emerging known fraud characteristics that identify questionable income, withholding, and refundable credits. Continuous review and enhancements to identity theft screening filters to improve the ability to detect false returns before processing and issuing refunds resulted in a continued decline in the number of taxpayers reporting to the IRS that they are victims of identity theft. Through September calendar year (CY) 2018, the IRS received about 167,000 cases compared to 209,000 through September CY 2017, a decrease of 20 percent.
- The IRS initiated more than 1,800 identity theft criminal investigations and recommended prosecution of 2,576 alleged identity theft perpetrators from FY 2015 to FY 2018. About 1,965 identity theft fraudsters received an average jail term of 38 months.
- The IRS performs an annual statistical estimation of the amount of revenue protected and unprotected from identity theft refund fraud. The IRS identity theft filters defended against a significant amount of known identity theft during processing year (PY) 2016. Identity thieves submitted millions of unauthorized claims for a tax refund. The IRS defenses prevented an estimated $10.56 to $10.61 billion in identity theft refunds. For PY 2016, the IRS issued refunds amounting to an estimated $1.68-$2.31 billion in unprotected identity theft. Both estimates for the protected and unprotected revenue are lower than PY 2015. In PY 2015, there was an estimated $2.24-$3.34 billion in unprotected identity theft and an estimated $12.35-$12.88 billion protected.

Modernize Criminal Investigative Tool

The Nationally Coordinated Investigations Unit (NCIU) is a centrally led, team-based approach intended to modernize criminal investigative tools to rely more upon data analytics to identify the most egregious criminal cases from information received through the Compliance Data Warehouse and other internal and external data sources. Using data to drive decisions on case identification, selection and technology, it focuses on identifying patterns of noncompliance and potential cases within those patterns which will enhance effectiveness and efficiency.

The IRS NCIU's investigative efforts focus on multiple initiatives identified as priority areas. The NCIU has developed successful data algorithms for three initiatives and is in the process of applying the same methodology to the other initiatives. Since November 2017, NCIU has referred 55 cases to 25 field offices for criminal investigation. NCIU initiatives include:

- International Tax
- Employment Tax
- Virtual Currency
- Microcap Stock
- Northeast Food Distributors
- Biofuel Tax Credit Scheme(s)
- Whistleblower Referrals
- Transnational Criminal Organizations and Third-Party Money Laundering
- Captive Insurance

Workload Selection

The IRS continues to improve its ability to select returns for examination that are the most likely to have issues. The IRS examination and research divisions collaborated on projects to analyze data for various examination workstreams, such as partnership filings, paid tax return preparers, and claims for refund. The IRS expanded the Return Preparer Database to include additional referral information to improve the identification of potential noncompliant tax return preparers. In addition, the IRS initiated workload studies for excise taxes, employment taxes, and Bank Secrecy Act cases to improve workload selection models based on available resources, including FinCEN data. Following the passage of the TCJA, the IRS began additional analysis to study the effect of the new tax law provisions, including the Section 199A, Qualified Business Income deduction, to determine the effect on current workload selection models for tax year 2018.

The IRS has improved its use of data and analytics in collection workload selection and case routing. The IRS is using predictive models to understand balance due collection amounts over time, probable resolution of a case via an installment agreement, or determination to be currently uncollectible. These models, balanced with policies and prioritization rules, help IRS managers make data-driven decisions to identify the next best case to assign. The IRS is continuously working to expand and enhance the predictive capabilities of these models.

Estimating the Collectable Portion of Unpaid Tax Assessments

The methods the IRS uses to estimate the collectible amount of unpaid tax assessments has been a key component of a long-standing material weakness identified in Government Accountability Office (GAO) audits of the IRS's financial statements. In response to this material weakness, the IRS has developed econometric models to estimate potential recovery of unpaid tax assessments. The IRS will use these estimates to automate unpaid assessments valuation and improve the accuracy of financial statements. The econometric model estimates also will reduce or eliminate the need to conduct extensive case reviews as part of the audit and thus free up resources for service and compliance activities. With an investment in IT, the IRS collection operations could use the model estimates to improve workload prioritization and allocation of resources.

Internal Operations

Operations Integration

The IRS used analytics to realign two business organizations' outreach and communications functions to its Communications and Liaison organization in the first quarter of FY 2018. A design team gathered detailed data on types of work done, skills needed to do work, and potential staffing alignments. Data analytics determined core outreach and communications work and resource requirements to develop an implementable organization structure. The team also used the data to determine skill and process gaps. These efforts led to streamlined communications efforts and increased efficiency.

Real Estate Project Development

The IRS developed a new real estate project estimating tool (STAR), used to estimate the space, time, and resources needed for project development, implementation, and funding. This allows the IRS to plan resource allocation more effectively, acquire data, and report on various aspects of the project process. The IRS automated the ability to use timekeeping data in conjunction with telework data to determine the type and amount of workspace required by employees, making the real estate project development phase more efficient.

Statistics and Research

The IRS Statistics of Income (SOI) office's analyses provided customers, including the Department of the Treasury's Office of Tax Analysis and the Congressional Joint Committee on Taxation, with critical information that supported the evaluation and development of tax reform proposals over the past year. SOI's customers will use these analytics and similar SOI products to examine the effects of TCJA and other tax law changes. Additionally, SOI projections of return filings provide a foundation for workload planning and staffing in IRS processing and customer assistance centers. SOI analyses of program performance data and customer satisfaction scores provide important guidance for improving programs across the IRS.

Goal: Drive increased agility, efficiency, effectiveness and security in IRS operations

Another IRS priority is to streamline processes and manage costs by reducing redundancies, a task necessary for sound financial stewardship. The IRS understands its responsibility to safeguard taxpayer and IRS data, particularly given the growing incidence and sophistication of cyber and identity theft. The IRS remains dedicated to maintaining the physical and digital security of its systems, enhancing internal controls, managing risks, and upholding Servicewide accountability.

Physical Security

The IRS continues to improve the physical security of IRS facilities against internal and external threats with emphasis on refining controls to increase access authentication and implementation of appropriate countermeasures, as prescribed by the Department of Homeland Security, Interagency Security Committee guidelines. The IRS introduced emerging security technology, such as facial recognition and thermal imaging to safeguard its facilities.

In FY 2018, the IRS implemented an employee verification program to enhance taxpayer confidence when dealing with IRS professionals outside of IRS facilities. The employee verification program allows taxpayers and local law enforcement officials to validate the employment status of IRS personnel who conduct field appointments.

Space Strategies

The IRS continued to release excess office space through building closures and consolidations. The IRS released 10 buildings and 492,110 square feet of space from its portfolio in FY 2018, which will generate about $10.5 million in annual rent savings. The IRS expanded the number of offices that incorporate hoteling or shared workspace for employees and contractors who do not require full-time space. The IRS is also working to determine how the submission processing ramp downs in Covington, KY and Fresno, CA will affect office space needs in those locations.

Cybersecurity

While several initiatives are underway to develop capabilities to detect and respond to cybersecurity threats, the IRS requires continued investment in infrastructure, technology, tools, processes, and people to strengthen information systems capabilities and capacity to defend against expanding threats. FY 2018 performance results included:

- Detected and mitigated 2,181 phishing and malware sites. The IRS identified and responded to 471 cyber incidents, 113 of which involved common threats such as removable media, email, and web-based activity. Additionally, the IRS implemented 1,182 content filtering restrictions to mitigate Internet content deemed a security risk to IRS information systems.
- Employed the Department of Homeland Security's Continuous Diagnostics and Mitigation (CDM) Phase 1 capability, which enables the IRS to identify authorized hardware and software assets and continuously ensure proper configuration with weaknesses moderated. In support of this phase, the IRS has implemented technical tools for Network Device Discovery, Vulnerability Scanning, Hardware/Software Discovery, Data Aggregation as well as an Enterprise Dashboard capability.
- Developed indicators and models to proactively detect and prevent fraudulent activity in IRS online applications. The IRS's Cybersecurity Operations team responds to any abnormal activity and takes appropriate action – from the initial discovery through investigation and provision of recommendations for improved security.

Targeted attacks by skilled and persistent cyber criminals are now a business reality. Cyber-attacks have become more sophisticated and attackers use a variety of tactics such as:

- Social engineering, including manipulation of users and acquisition of sensitive information through phishing and other probes;
- Malware, which is malicious software that damages computer networks or corrupts or steals information; and
- Ransomware, which may encrypt data on computers and networks and extort money from owners to obtain the decryption key and restore the information.

Investments Supporting Taxpayer Filings

The IRS is improving its mainframe application components supporting Modernized eFile (MeF) and DirectPay in preparation for the 2019 filing season in response to the outage experienced on April 17, 2018. The improvements will allow systems to switch to backup servers in the event of another outage, which will in turn keep the systems running as smoothly as possible. Other improvements will improve system monitoring and automated recovery activities, as well as incident management processes. In the event of filing season system failure, the IRS IT Incident Management process will execute to identify and implement a solution or workaround with the goal of restoring service in a timely manner for all priority incidents; ideally in two hours or less.

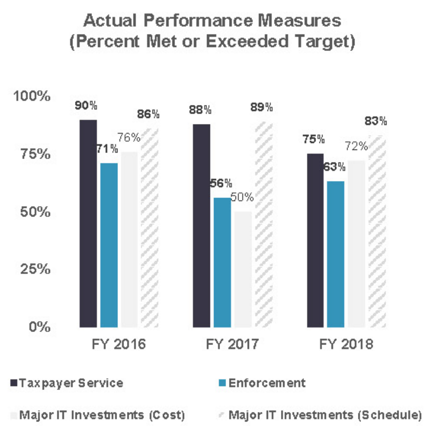
Performance Results

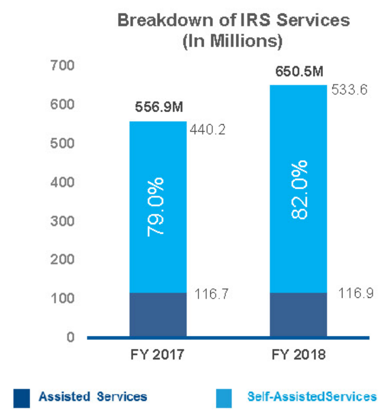
The IRS performance measures serve as metrics for improvement, accountability, and traceability to the organization's goals and objectives. The IRS reports its budget-level performance measures each year, providing transparency to internal and external stakeholders on IRS performance.

In FY 2018, the IRS met or exceeded the targets for 16 of its 26[1] performance measures for an overall success rate of 62 percent. The IRS overcame several challenges, including resource and technology issues, to achieve this number. Taxpayer Service finished the year achieving 75 percent of its targets (6 of 8), while Enforcement reached 63 percent (10 of 16) of its targets. For this fiscal year, the IRS had 18 major IT investments, of which the IRS met or exceeded the cost and schedule variance on 72.2 percent and 83.3 percent of the investments, respectively.

See detailed information on performance measures in Appendices B through E.

Internal Revenue Service – FY 2018 Management's Discussion & Analysis

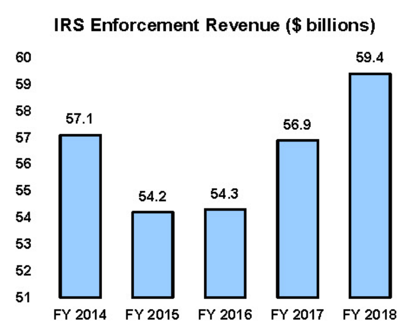




[1] The IRS tracked 29 budget level measures in FY 2018; two are indicators and one was baselined; those three measures did not have targets. The Taxpayer Service measures link to the *Empower and Enable all Taxpayers to Meet Their Tax Obligations* goal; the Enforcement measures link to the *Protect the Integrity of the Tax System by Encouraging Compliance through Administering and Enforcing the Tax Code* goal; and, the Cost/Schedule Variance measures link to the *Drive increased agility Efficiency, Effectiveness and Security in IRS Operations* goal.

Expanding secure digital options while maintaining and improving traditional service options remains a key objective. In 2017, the IRS revised the previous Taxpayer Self-Assistance Rate measure to include additional self-service interactions. The IRS now measures improvement to taxpayer service through its new Enterprise Self-Assistance Participation Rate (ESAPR). The ESAPR metric demonstrates progress towards providing more services for the individual taxpayer through self-service tools, such as Get Transcript and the Direct Pay and Online Payment Agreements payment applications. As the IRS provides new self-assistance applications to the public, the IRS will add them to the calculation.

Enforcement of the tax law is an integral part of the IRS's efforts to enhance voluntary compliance, especially as tax administration becomes increasingly complex. The IRS has maintained a balanced enforcement program despite many challenges, collecting $59.4 billion in enforcement revenue in FY 2018, a 4.3 percent increase from FY 2017. The steady increase in enforcement revenue is primarily a result of concerted efforts by the IRS to detect and deter noncompliance with the tax code and, in part, a reflection of the strengthening economy.



Financial Management Highlights

Financial Resources

The IRS's FY 2018 base appropriated level was $11.1 billion, an increase of about $165 million over FY 2017 enacted, excluding administrative provision Section (§) 113. Taxpayer Services increased by $350 million, Enforcement remained the same, Operations Support decreased by $4 million, and Business Systems Modernization decreased by $180 million. An administrative provision in the *Consolidated Appropriations Act of 2018*, Internal Revenue Service Administrative Provisions Section (§) 113 provided $320 million for TCJA (based on TJCA spend plan $19 million was provided to Taxpayer Services, $10 million to Enforcement, and $291 million to Operations Support), which increased the IRS's total FY 2018 appropriation to $11.4 billion.

In addition to the annually appropriated budget, IRS funding also included $1.35 billion from user fees, offsetting collections, and unobligated balances from prior years. This raised the IRS's budget authority to $12.8 billion.

Unfortunately, the IRS continues to face resource challenges. The enacted level did not cover the cost of labor and non-labor inflationary increases of about $185 million. The IRS required about $55 million more for other mandatory labor increases, including career ladder promotions and step increases. The IRS absorbed these unfunded requirements by continuing to defer critical IT infrastructure refreshment development, modernization and enhancement of IT systems, facilities projects, and by continuing its exception-only hiring policy for most of the year; resulting in further staffing level declines.

The IRS expects more than 30 percent of its workforce will be able to retire by 2020, creating a significant risk of a large knowledge and experience gap. Current resource constraints challenge the IRS to address this risk through efforts to hire new multi-generational staff. Without a sustained ability to hire a workforce with a greater projected longevity, the IRS will have great difficulty developing the leaders it will need in five to ten years.

The IRS has shouldered these losses across the agency. The IRS full-time permanent workforce lost since 2010 includes more than 8,000 key enforcement personnel. These employees include Revenue Agents and Revenue Officers who audit returns and perform collection activities; Special Agents in the IRS's Criminal Investigation organization who investigate stolen identity refund fraud and other tax-related crimes; and other staff who engage in critical Compliance activities. The result of these losses has been a steady decline in the number of individual audits over the past seven years.

The IRS remains one of the most cost-effective investments in the federal government. Historical collection results suggest that the reductions to the IRS budget have resulted in the government forgoing more than $10 billion a year in enforcement revenue to achieve budget savings of a few hundred million dollars. For every $100 the government collects in taxes, the IRS spends only 35 cents. This makes the IRS one of the most efficient tax administrators in the world per the Organization for Economic Co-operation and Development (OECD).

The lack of Operations Support funding weakens the IRS's ability to address the increased information technology workload associated with identity theft, refund fraud, and improper payments. For the past few years, the IRS has experienced an increased demand for IT projects and services, with significant resources going toward implementing unfunded legislative mandates passed since 2010. Examples of these mandates are FATCA, the Affordable Care Act (ACA), Identity Theft, the Achieving a Better Life Experience (ABLE) Act, retroactive extension of the Health Care Tax Credit (HCTC), and Private Debt Collection (PDC). This has severely limited the IRS's capacity to address other operational areas, including maintenance for newly deployed IT infrastructure. Since 2013, the IRS has incurred more than $95.5 million in increased annual requirements due to business systems modernization (BSM) deployments but has not received commensurate increases to the Operations Support appropriation. Continued underfunding of the IRS in the Operations Support and Modernization accounts threatens to erode its effectiveness and ability to be efficient.

Funding by Appropriation ($ thousands)

Taxpayer Services [$2,512,554, includes §113 allocation of $19,000 and an inter-appropriation transfer to Operations Support of $13,000] funds staffing for the processing of tax returns and related documents, and assistance for taxpayers in filing returns and paying taxes due.

Enforcement [$4,627,000, includes §113 allocation of $10,000 and an inter-appropriation transfer to Operations Support of $243,000] funds staffing for the examination of tax returns, collection of balances due, the administrative and judicial settlement of taxpayer appeals of examination findings, and provides resources for strengthening enforcement to reduce invalid claims and erroneous filings associated with the EITC program as well as other refundable tax credits.

Operations Support [$4,181,000, includes §113 allocation of $291,000 and inter-appropriation transfers of $256,000 from Taxpayer Services and Enforcement] funds overall planning, direction, operations management and control, and critical infrastructure activities for the IRS. These activities include IT and cybersecurity that keep tax systems running and protect taxpayer data, the financial management activities that ensure effective stewardship of the nation's revenues, and the physical infrastructure and security that helps keep IRS employees and customers safe and well served in office, campus, and Taxpayer Assistance Center (TAC) sites. Human resource, telecommunications, and communications infrastructure are also critical components of this appropriation and are vital to maintaining adequate levels of customer service and the post-filing processes that ensure the tax system's fairness and equity.

Business Systems Modernization [$110,000] funds capital asset acquisitions of information technology to modernize key tax administration systems.

In addition to the core appropriations, the IRS has the following appropriations (special funds): **Other Resources**: **User Fees** [$387,410] from payment for services provided and [$405,557] from prior year balances brought forward October 1, **Offsetting Collections Resources** [$197,210], **Unobligated Balance Transferred In** (50 percent Carryover) [$5,458], and **Unobligated Balances** [$351,715 brought forward October 1.

In FY 2018, the IRS transferred to the Operations Support account, with Congressional approval, $243 million and $13 million from the Enforcement and Taxpayer Services accounts, respectively. These late-in-the-year funds transfers reflect an imbalance of appropriated resources between these appropriations that has been growing since FY 2013. Thus, yearly transfers have been critical to providing the necessary information technology infrastructure for IRS personnel to carry out their duties and to support customer service programs.

Use of Resources

The IRS uses a cost allocation methodology to assign support and overhead costs to each program described below. The Statement of Net Cost reflects the use of IRS resources in conducting its major programs and reports the full cost of these programs in accordance with the Statement of Federal Financial Accounting Standards No. 4, *Managerial Cost Accounting*.

Taxpayer Assistance and Education activities [4 percent] include taxpayer education and outreach, tax publication issuance and distribution.

Filing and Account Services activities [35 percent] include filing tax returns, maintaining customer accounts, processing taxpayer information, providing service to taxpayers, and resolving issues.

Compliance activities [60 percent] include pre-filing agreements, document matching, examination, collection, and criminal investigation activities.

Administration of Tax Credit Programs [1 percent] primarily includes costs for EITC program activities.

In addition to the EITC, which is the single largest refundable tax credit program, the IRS also administers several other refundable and non-refundable tax credit programs. The IRS Financial Statements reflect those tax credits and the associated costs.

Use of Resources ($ thousands)		
Program	**FY 2017**	**FY 2018**
Taxpayer Assistance and Education	$544,719	$530,757
Filing and Account Services	$4,333,587	$4,684,737
Compliance	$7,700,759	$7,855,928
Administration of Tax Credit Programs	$138,259	$137,412

Overview of Revenue and Administrative Accounts

Financial Statements Analysis

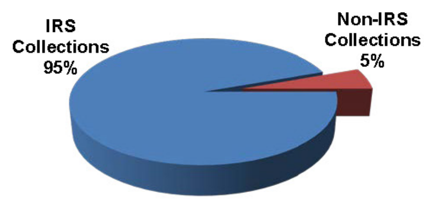
The IRS financial statements and footnotes have received an unmodified audit opinion for 17 consecutive years.

Administrative accounts reflect resources used and expenses incurred in administering the tax laws. Revenue accounts reflect net taxes receivable and taxes collected to support the federal government.

The total assets of $66.7 billion (comprised mostly of $58 billion in Federal taxes receivable that are expected to be primarily collected from past due accounts) and total liabilities of $63.3 billion (comprised mostly of Due to General Fund of the U S Government, which is the offset of Federal taxes receivable to be transferred when collected) yields a positive net position of $3.5 billion. This represents a 10.4 percent increase compared to FY 2017, which is due to an increase in appropriation.
The Statement of Net Cost consists of four major programs with a net cost of $12.6 billion. Total net cost of operations includes $13.2 billion in gross cost and $0.6 billion in exchange revenue. The gross cost increased by $0.5 billion (4 percent) while there was no significant change in revenue earned. The overall increase in net cost is related to the Filing and Account Services program primarily due to costs associated with Submission Processing and Account Management and Electronic Correspondence Assistance. The increase was in imputed cost for Submission Processing due to higher litigative payments for cases elevated to the Department of Justice and administrative payments for cases settled by Federal agencies.

The Statement of Custodial Activity reports collection of taxes resulting in $3.5 trillion of gross federal receipts before tax refunds. The IRS collections total 95 percent of Federal Government receipts.

Total Federal Receipts (Percent)



Revenue and Refund Trend Information

FY 2018 revenue receipts collected by the IRS totaled $3.5 trillion, representing an increase from $3.4 trillion in FY 2017. Federal tax revenues are collected through six major classifications: individual income and FICA/SECA, corporate income, excise taxes, estate and gift taxes, railroad retirement, and federal unemployment taxes.

FY 2018 tax refund and outlay activity totaled $464 billion, representing an increase from $437 billion in FY 2017. Federal tax refunds include refunds of tax overpayments, payments for interest, and disbursements for refundable tax credits such as EITC and the Additional Child Tax Credit.

Excise Tax Trust Fund

Trust Fund	Fiscal Year	
	2016	2017
Airport & Airway Trust Fund	$14,462,292,055	$14,879,254,564
Black Lung Disability Trust Fund	$434,942,559	$431,724,692
Highway Trust Fund	$41,410,628,686	$41,372,198,466
Total	**$56,307,863,300**	**$56,683,177,722**

Form 720, The Quarterly Federal Excise Tax Return, reports taxpayer liability for excise taxes. Taxpayers make periodic deposits in advance of filing the return. These deposits are classified as Federal Excise Tax. After the IRS receives and processes the returns, the IRS certifies amounts for several trust funds. Amounts reported on the Statement of Custodial Activity are for fiscal year collections (October 1 through September 30). Because Form 720 reporting requirements are completed after receipt of most of the deposits, the certification amounts will not match the amounts collected during the fiscal year. The table shows revised receipts certified to the Airport and Airway Trust Fund, Black Lung Disability Trust Fund, and the Highway Trust Fund for the eight liability quarters from December 2015 through September 2017. The Department of the Treasury prepares the warrants and allocations to the trust funds.

Analysis of Unpaid Assessments – Most Unpaid Assessments Are Not Receivables and Are Largely Uncollectible

The unpaid assessment balance includes amounts owed by taxpayers who file returns without sufficient payment as well as amounts assessed through the IRS enforcement programs. As reflected in the supplemental information to the IRS FY 2018 Financial Statements, the unpaid assessment balance was $398 billion, which includes $12 billion of Branded Prescription Drug Fees, Insurance Provider Fees, and non-delinquent IRC 965(h) collectible amounts as of September 30, 2018. Of the total unpaid assessments balance, $215 billion (54 percent) consists of interest and penalties. Also, 45 percent of the total outstanding balance of IRS unpaid assessments is largely uncollectible because it is composed of compliance assessments and write-offs. Under federal accounting standards, unpaid assessments require taxpayer or court agreement for consideration as federal taxes receivable. Assessments not agreed to by taxpayers or the courts are considered compliance assessments and are not considered federal taxes receivable. Write-offs are assessments considered to have no future collection potential.

Compliance assessments of $65 billion represent amounts not agreed to by either the taxpayer or a court. These assessments result primarily from various IRS enforcement programs promoting voluntary compliance.

Write-off amounts of $115 billion include amounts owed by defunct corporations with no assets and by failed financial institutions. Taxpayers with extreme economic and/or financial hardships, deceased taxpayers, and taxpayers who are insolvent due to bankruptcy owe the remaining amounts.

Taxes Receivable in 2018 (Dollars in Billions)	
Taxes Receivable (including outstanding branded prescription drug fees, insurance provider fees, and non-delinquent IRC 965(h) collectible amounts)	$218
Uncollectible	*$160*
Potentially Collectible	*$ 58*

The Integrated Financial System

The IFS is the financial management system for the IRS's administrative activities. It provides timely financial statements and reports in accordance with federal accounting and reporting standards, including information for budgeting, analysis, and government-wide reporting. In addition, IFS provides the core processes of General Ledger, Accounts Payable, Accounts Receivable, Procurement, Budget Execution, Cost Accounting, Administrative Tax and Travel Accounting, Cost Allocations, Budget Formulation, Labor Forecasting, Asset Accounting, and Budget Execution decision support.

Planning and Managing Risks to Anticipate Future Needs and Developments

Recognizing that risk is inherent to the operations of any organization, the IRS actively identifies and manages risks to the nation's tax administration system with a focus on those that affect the IRS mission and vision. As a large, complex, public-facing organization, the IRS acknowledges it must sometimes accept risk and uses thoughtful analysis to determine the level of risk it is willing to accept. The IRS seeks to limit exposure in areas where it is sensitive to risk, such as those that could adversely affect its ability to:

- Administer the tax law fairly and with integrity.
- Protect taxpayer rights.
- Safeguard taxpayer data.
- Serve as a responsible steward of taxpayer dollars.
- Provide an inclusive, safe and secure workplace.

Each IRS employee plays an important role in supporting the identification and management of risk in accordance with the IRS's risk appetite.

The reduced funding, additional responsibilities, and loss of staffing have compounded risks in some areas while also reducing the IRS's options for responding to risks. The challenges of the IRS's future environment manifest themselves in many ways, but the IRS's Enterprise Risk Management program efforts give senior leadership greater transparency into the most significant risks facing the IRS:

1. **Tax Reform Implementation** – The risk that failure to timely and effectively implement and communicate tax reform could inhibit taxpayers' abilities to understand and comply with their tax obligations; inhibit the IRS's ability to execute filing season and deliver its compliance plan; and erode trust and confidence in the IRS.

2. **Cyber and Data Security** – The risk that the increased complexity, sophistication and volume of cyber threats, including insider threats, social engineering and unauthorized access to sensitive information may result in data loss, refund fraud, identity theft, ransomware, or denial of service.

3. **Aging Hardware and Software** – The risk that aged hardware and software may cause outages or failures and inhibit the IRS's ability to deliver filing season, conduct daily operations and perform its core tax administration responsibilities.

4. **Critical Staffing Shortages** – The risk that increased attrition and continued constraints in hiring, onboarding, and retaining employees and managers with needed skills and expertise may result in critical business

failures and an over-reliance on contractors.

5. **Adverse Effect of Reduced Service and Enforcement on Voluntary Compliance** – The risk that reduced service and/or enforcement activities may erode confidence in the tax administration system and reduce voluntary compliance.

Internal Control and Legal Compliance with Other Laws

The IRS continued to enhance financial management and appropriate controls that are an integral component of all IRS programs.

As required by Office of Management and Budget (OMB) Circular No. A-123, Management's Responsibility for Enterprise Risk Management and Internal Control, the IRS evaluated its internal controls and financial management systems to ensure the IRS was operating in accordance with the procedures and standards prescribed by the Comptroller General and OMB guidelines. Results of these evaluations are below.

Federal Managers' Financial Integrity Act (FMFIA)

During FY 2018, the IRS continued to make important progress in addressing its deficiencies in internal controls. Specifically, based on success in addressing internal controls over its estimation process for the total amount of tax receivables, the IRS considers unpaid assessments, previously reported as a long-standing material weakness, to be a significant deficiency. The IRS uses a well-documented estimation process to mitigate the risk of material misstatement. The IRS will continue to improve data quality and enhance financial systems through projects such as Pending Payments II, Financial Status Notice History (FSNH), and Revenue DataMart to maintain and improve the significant deficiency.

The IRS added seven initial actions to the FFMIA Remediation Plan scheduled for completion in FY 2019 and completed four actions in FY 2018. The long-term solution depends on funding for changes to the financial systems, the Business Masterfile, and operational processes.

OMB Circular A-123, Management's Responsibility for Enterprise Risk Management and Internal Control

The IRS assessed its internal controls over financial reporting in accordance with OMB Circular A-123, Appendix A, Management of Reporting and Data Integrity Risk. Based on the results of this assessment, the IRS can provide reasonable assurance that the internal controls over financial reporting as of September 30, 2018, were operating effectively, with no identified material weaknesses.
The FY 2018 OMB Circular A-123 testing included the following activities:

- Tested internal control sets for 21 transaction processes identified by the Department of the Treasury that are material to its Consolidated Financial Statements. The tests included eleven administrative processes covering material portions of the $11.4 billion in annual administrative transactions, five information system processes, and five custodial processes covering material portions of the $3.5 trillion in tax revenue receipts through September 30, 2018;
- Performed supplemental testing of the FY 2018 transactions during the fourth quarter, except for internal controls over financial reporting relative to unpaid assessments, and verified controls remained effective throughout the year;
- Reviewed controls over IRS financial reporting relative to unpaid assessments, and verified controls remained effective throughout the year;
- Reviewed and documented Affordable Care Act related controls over the procedures and processes for recording beginning of year funding into the general ledger, the monthly journaling and reconciliation of Centers for Medicare and Medicaid Services (CMS) payments of Advance Premium Tax Credit (APTC), the Premium

Tax Credit (PTC) to APTC reconciliation based on tax returns, the EITC report, and the pre-and post- refund error resolutions related to PTC error codes;
- Reviewed the FATCA process, including controls related to the following components: Online and Paper Registration, Withholding Refunds, International Data Exchange Services (IDES), and International Compliance Management Model (ICMM);
- Conducted a self-assessment of the internal control environment using GAO's Internal Control Evaluation Checklist and GAO's Green Book that included brief, written statements in support of the assessments;
- Reviewed IRS compliance with applicable laws and regulatory requirements regarding financial reporting and internal control; and
- Reviewed GAO and TIGTA audit reports and findings during the test plan development stage and at the end of the A-123 reporting period.

Integration of Enterprise Risk Management and Internal Controls

IRS management is responsible for implementing management practices that identify, assess, respond, and report on risks. Risk management practices are considered when designing internal controls and assessing their effectiveness. The IRS assessed its risk and internal controls in accordance with OMB Circular A-123. Based on the results of this assessment, the IRS provides reasonable assurance that the internal controls over strategic, operational, non-financial reporting, and compliance objectives were operating effectively as of September 30, 2018.

Internal Control over Operations and Compliance

The IRS conducted its assessment of internal control over the effectiveness and efficiency of operations and compliance with applicable laws and regulations in accordance with OMB Circular A-123. Based on the results of this assessment, the IRS provides reasonable assurance that internal control over operations and compliance with applicable laws and regulations were operating effectively as of September 30, 2018 and found no material weaknesses in the design or execution of the internal control over operations and compliance.

The FY 2018 Quality Assurance (QA) Program conducted review testing. The reviews tested consisted of a judgmental sample of quality assurance activities conducted by the IRS's operating and functional divisions to meet their performance and internal control goals and objectives. The QA program assessment activities included:

- Testing internal controls for 66 randomly selected reviews obtained from the 518 reviews on the FY 2018 Quality Assurance Review Listing. This testing evaluated reviews with high risk ratings and frequencies ranging from daily to annual performance from 15 operating and functional divisions. Specific test objectives included:
  - Assessing adherence to references, standard operating procedures, and/or authoritative directives;
  - Evaluating control activities;
  - Identifying risk factors, including audit recommendations from external auditors and internal testers;
  - Examining associated FY 2017 Internal Control Managerial Assessments for each selected review; and
  - Determining the review outcomes on accounting information recorded in the financial systems and/or the annual audited financial statements.
- Identifying 43 FY 2018 findings with recommendations for process improvements in FY 2019 around control activities including physical security, password protection, internal use only and PII, and elements of the control environment including adherence to and updating guidance.
- Examining the status of one open FY 2016 finding scheduled for closure in FY 2019.

- Examining the status of 11 open FY 2017 findings scheduled for closure in FY 2019.

While the QA testing identified 43 FY 2018 findings, the IRS found that all the QA tested reviews generally were effective.

Federal Financial Management Improvement Act (FFMIA)

The IRS assessed its financial management systems in accordance with OMB Circular A-123, Appendix D, Compliance with the FFMIA. The IRS's financial management systems did substantially comply with the federal accounting standards and the USSGL at the transaction level. However, the IRS's financial management systems did not substantially comply with federal financial management systems requirements as of September 30, 2018.

The IRS evaluated its internal controls and financial management systems to determine whether these objectives are compliant. The long-standing material weakness for internal control over financial reporting related to unpaid assessments is downgraded to a significant deficiency. The IRS provides an unmodified statement of assurance that its internal controls and financial management systems meet the objectives relative to FMFIA Sections 2 and 4. In addition, the IRS continues to be in noncompliance with the Improper Payments Information Act (IPIA), as amended by the Improper Payments Elimination and Recovery Act (IPERA) of 2010, and the Improper Payments Elimination and Recovery Improvement Act (IPERIA) of 2012, due to our inability to report an improper payment rate for the EITC program below the established threshold.

Information Security Significant Deficiency

The IRS worked diligently during FY 2018 to continue to enhance its IT security, currently identified as a significant deficiency. The IRS implemented a strategy and assessment process to verify the effectiveness of internal controls for the financial systems that affect the financial statements. This process supports the IRS's overall internal control framework and provides assurance that the likelihood of a material weakness reoccurring in the IT environment is low. In FY 2018, the IRS completed the following activities:

- Complied with Federal Information Security Management Act [amended by the Federal Information Security Modernization Act of 2014] (FISMA); FMFIA Sections 2 and 4; and OMB, National Institute of Standards and Technology (NIST), Department of the Treasury, and IRS security requirements.
- Performed security assessments in compliance with OMB Circular No. A-123, Appendix A, to provide an integrated view of the security controls affecting confidence in and integrity of the financial statements, enabling the IRS to assess the effect of control deficiencies on the financial statements, prioritize mitigation efforts, and demonstrate progress as the IRS resolves deficiencies. It is important to note that controls require time to mature and show evidence of their effectiveness.
- Facilitated GAO's review of the IRS's IT Security Controls including Boundary Protection, Identification and Authentication, Authorization, Cryptography, Audit and Monitoring, Physical Security, Configuration Management, Segregation of Duties, Contingency Planning, Risk Assessments, Policies and Procedures, Security Plans, Training, Testing and Evaluation, and Remedial Actions.
- Analyzed and prioritized 2018 activities based on the greatest effect on the financial statements, developed corrective actions to mitigate the risk and apply compensating controls, and communicated the strategy to key stakeholders.
- Tested and validated prior year GAO recommendations to prevent premature closure. The IRS Compliance Assessment and Validation (CAV) Team conducted 81 reviews of planned corrective actions and statement of facts findings and sent 63 to

GAO during the 2018 financial statement audit for closure consideration.

- For FY 2018, there are 166 open recommendations – 98 new recommendations and 68 prior year recommendations. During FY 2018, 49 recommendations were closed as compared to 19 closed recommendations in FY 2017.
- For the GAO Information Security audit reports, there were 120 Planned Corrective Actions (PCAs) in FY 2018. Actions for FY 2018 include projected closures (as of 9/30/18): 96 PCAs were submitted to GAO with 35 confirmed closed by GAO (as of 10/12/18 – still awaiting GAO report). The breakdown of those projected for FY 2018 are as follows:
  - 82 Compliance, Assessment and Validation Team (CAV) approved PCAs were submitted to GAO;
  - Eight 2014 PCAs to be reviewed by GAO due to age; and
  - Six additional recommendations from the 37 new open recommendations have been approved by the CAV team for submission to GAO. *(The six (6) recommendations are from the newly released Final Report of GAO-18-390SU & GAO-18-391.)*
- For FY 2018, there are 19 findings with 37 associated recommendations.
- Performed continuous monitoring of internal controls for systems that affect the financial statements to demonstrate that management, technical, and operational controls are in place and are effective.
- Reviewed the security monitoring controls for IT systems owned or operated by external entities to provide assurance that their systems' security management programs have adequate documentation. During FY 2018, there were 74 Contractor Security Assessments (CSA) completed: 23 associated with the Mission Essential Functions aligned with Critical Business Processes (CBPs) 1-2-3 that support Processing of Remittances, Processing of Returns, and Processing of Refunds; 31associated with contractor site assessments for environments and facilities supporting tax examination, customer surveys, identity theft initiatives, and other non-CBPs; 23 associated with security assessments to support the IRS's PDC programs, which are aligned with CBP-1; and 9 associated with contractor sites conducting printing activities.

Federal Information Security Management Act (FISMA)

In accordance with FISMA requirements and OMB Circular A-130, the IRS maintained an agency-wide information security program and provided a comprehensive framework for validating the effectiveness of information security controls over resources that support IRS business operations and goals. Specifically, the IRS inventory of FISMA reportable systems is compliant with the security requirements from OMB, NIST, the Department of the Treasury, and IRS internal policies. The IRS completed annual security control testing on these systems, participated in required security authorization and assessment activities, and addressed required Plans of Actions and Milestones (POA&Ms) for identified weaknesses.

Continuity of Operations (COOP)

The IRS Information System Contingency Plan (ISCP) testing program incorporates critical business processes and system infrastructure into ISCPs and ensures that each plan has a documented Business Impact Analysis (BIA) attachment. The IRS validated that each ISCP for all IRS FISMA master inventory systems contained keystroke recovery procedures for each asset, and that plans are updated and tested. The IRS conducted over 260 exercises and tests to validate that contingency plans were current and executable, backup data was available and readable, and Critical Infrastructure Protection systems had designated alternate processing sites that can recover within their defined Recovery Time Objective. For vulnerabilities identified during testing, POA&Ms were assigned for resolution.

Improper Payments Elimination and Recovery Act (IPERA) of 2010

As of September 30, 2018, the IRS generally complied with improper payments laws and regulations, except for the noncompliance with improper payments reporting related to bringing the overall EITC improper payment rate below 10 percent. The IRS continues to face challenges to reducing the EITC error rate and plans to report on the actions taken in the FY 2018 Department of the Treasury Agency Financial Report (AFR). The AFR discussion includes a report on the root causes of EITC improper payments and future planned corrective actions intended to reduce the program's payment error rate. In December 2015, Congress enacted the PATH Act of 2015, which contains significant legislative changes intended to help reduce improper EITC, ACTC, and AOTC claims. Employers were to file Forms W-2 with the Social Security Administration by January 31, 2018. The earlier filing date for paper and electronic returns and statements gave IRS more time to verify EITC and ACTC claims before issuing refunds; however, it did not expand the IRS's authority to systematically correct erroneous claims identified for processed tax returns. The IRS included several legislative change proposals in both the FY 2018 and FY 2019 budget requests to improve EITC compliance. These proposals include providing greater flexibility to address correctable errors to help the IRS deny certain erroneous EITC claims before issuing refunds and increasing oversight of paid tax return preparers to promote high quality services and improve voluntary compliance. If enacted, these legislative changes would provide the IRS with additional tools to combat waste and fraud and additional authority to take actions to prevent payment errors and improve EITC compliance.

Digital Accountability and Transparency Act of 2014 (DATA Act) and USAspending.gov

In accordance with the requirements of the Digital Accountability and Transparency Act of 2014 (DATA Act), the IRS provides quarterly certification of the completeness, timeliness, and accuracy of the financial and award data published on USASpending.gov. The IRS reconciled the Appropriation Accounts file data, Award Financial file data, and Financial Assistance file data. The IRS established corrective action plans to address discrepancies for future resolution. Internal controls over spending data, agency source systems, and the DATA Act submission on USASpending.gov are effective. Internal control assessments provide reasonable assurance that the IRS adhered to the data standards established by OMB and the Department of the Treasury for implementation of the DATA Act, and that the internal controls are designed, implemented, and operating effectively, except for the discrepancies noted in the second and third quarter submissions.

Government Charge Card Abuse Prevention Act of 2012

In accordance with the requirements of the Government Charge Card Abuse Prevention Act of 2012, the IRS provides assurance that its internal control over the use of government charge cards was effective. Specifically, the IRS complied with the Department of the Treasury Charge Card Management Plan and provided agency-wide purchase card guidance for the proper use of government charge cards. The IRS conducted monthly and quarterly reviews of charge card activity to verify proper card use and to address potential inappropriate use. TIGTA reviewed the IRS's current charge card guidance and determined that policies and controls are established and designed to mitigate the risk of fraud and inappropriate government travel and purchase card practices, including controls that address centrally billed travel card accounts. (See report #2018-10-057 dated July 27, 2018.)

Reports Consolidation Act of 2000

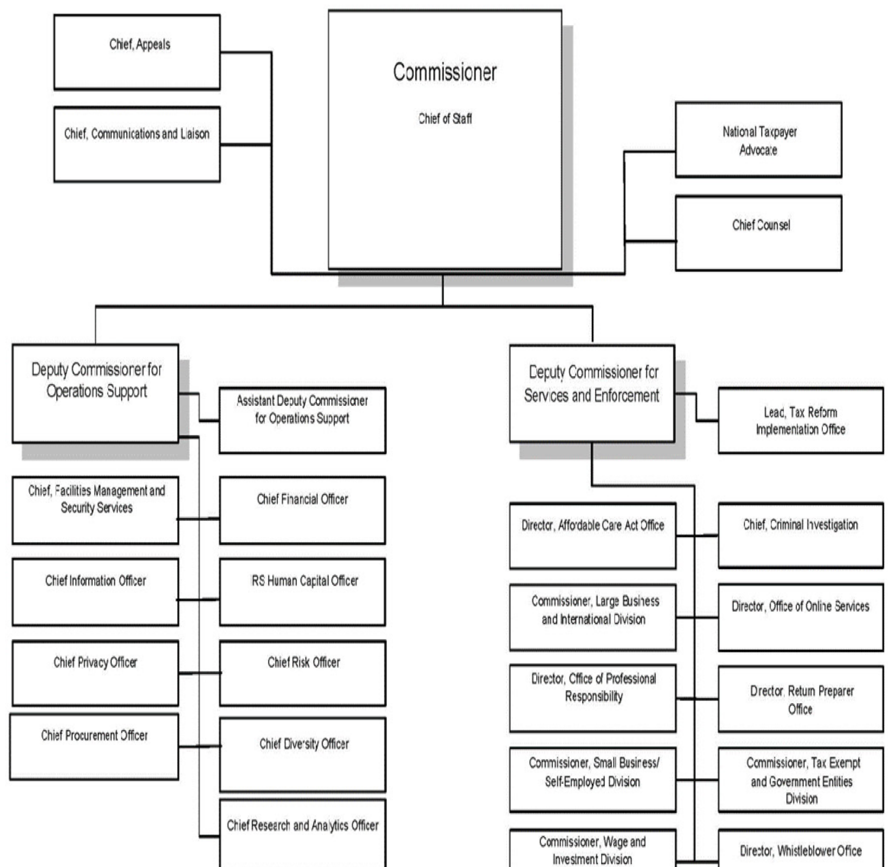
In accordance with the Reports Consolidation Act of 2000, the IRS provides assurance that the IRS Critical Performance Measures are reliable. Internal Revenue Manual 1.5.1, Managing Statistics in a Balanced Measurement System, The IRS Balanced Performance Measurement System, provides a detailed template that documents each measure's definition, formula, reliability, and reporting frequency. These controls verify that performance data is consistent and accurately collected over time.

Limitations of Financial Statements

The principal financial statements have been prepared to report the results of IRS operations, pursuant to the requirements of 31 U.S.C.3515(b). The statements were prepared from the books and records of the IRS in accordance with generally accepted accounting principles for federal entities and the format prescribed by OMB. The statements are in addition to the financial reports used to monitor and control budgetary resources, which are prepared from the same books and records. The statements should be read with the realization that the IRS is a component of the U.S. Government, a sovereign entity.

Internal Revenue Service – FY 2018 Management's Discussion & Analysis

Appendix A
IRS Organization Chart



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Appendix B
Performance Measures Descriptions

Drive increased agility, efficiency, effectiveness and security in IRS operations	
Percent of Major IT Investments within +/- 10% Cost Variance at the Investment Level[1]	Number of major IT investments within +/-10 percent variance between planned total cost and projected/actual cost within a fiscal year divided by the total number of major IT investments in that fiscal year.
Percent of Major IT Investments within +/- 10% Schedule Variance at the Investment Level [1]	Number of major IT investments within +/-10 percent variance between planned days and projected/actual days within a fiscal year divided by the total number of major IT investments in that fiscal year.
Rentable Square Feet per Person[2]	The amount of rentable square feet the IRS maintains per personnel requiring space. The IRS will use this as an indicator for FY 2018.
Empower and enable all taxpayers to meet their tax obligations	
Customer Service Representative (CSR) Level of Service	The number of toll free callers that either speak to a Customer Service Representative or receive informational messages divided by the total number of attempted calls.
Customer Contacts Resolved per Staff Year[3]	The number of Customer Contacts resolved in relation to staff years expended.
Customer Accuracy – Tax Law Phones	The percentage of correct answers given by a live assistor on Toll-free tax law inquiries.
Customer Accuracy – Accounts (Phones)	The percentage of correct answers given by a live assistor on Toll-free account inquiries.
Timeliness of Critical Individual Filing Season Tax Products to the Public	The percentage of critical individual filing season tax products (tax forms, schedules, instructions, and publications required by many filers to prepare a complete and accurate tax return) available to the public in a timely fashion.
Timeliness of Critical TE/GE & Business Tax Products to the Public	Percentage of critical business tax products (tax forms, schedules, instructions, and publications used by many TE/GE and Business filers to prepare a complete and accurate return or form) available to the public in a timely fashion.
Percent Individual Returns Processed Electronically	The percentage of electronically filed individual tax returns divided by the total individual returns filed.
Percent Business Returns Processed Electronically	The percentage of electronically filed business tax returns divided by the total business returns filed.
Refund Timeliness – Individual (Paper)	The percentage of refunds resulting from processing individual master file paper returns issued within 40 days or less.
Enterprise Self-Assistance Participation Rate[4]	The percentage of taxpayer assistance requests resolved using self-assisted automated services.
Protect the integrity of the tax system by encouraging compliance through administering and enforcing the tax code	
Examination Coverage – Individual (1040)	The sum of all individual 1040 returns closed by Small Business/Self Employed (SB/SE), Wage & Investment (W&I), Tax Exempt and Government Entities (TE/GE) and Large Business and International (LB&I) divided by the total individual return filings for the prior calendar year.
Field Exam National Quality Review Score	The score awarded to a reviewed field examination case by a Quality Reviewer using the National Quality Review System (NQRS) quality attributes.
Office Exam National Quality Review Score	The score awarded to a reviewed office examination case by a Quality Reviewer using the NQRS quality attributes.
Examination Quality – Large Business	The average of the scores of the Large Business Return cases reviewed by LB&I Quality Review & Analysis. Case scores are based on the percentage of elements passed within each of the three auditing standards.

Appendix B

Performance Measures Descriptions (Continued)

Protect the integrity of the tax system by encouraging compliance through administering and enforcing the tax code (Continued)	
Examination Coverage – Business (Assets >$10M)	The number of LB&I returns (C and S Corporations with assets more than $10 million and all partnerships) examined and closed by LB&I during the current fiscal year divided by the number of filings for the preceding calendar year.
Examination Efficiency – Individual (1040)	The sum of all individual 1040 returns closed by SB/SE, W&I, TE/GE and LB&I (Field Exam and Correspondence Exam programs) divided by the total Full Time Equivalent (FTE) expended in relation to those individual returns.
Automated Underreporter (AUR) Efficiency	The total number of W&I and SB/SE contact closures (a closure resulting from a case where the IRS made contact) divided by the total FTE, including overtime.
Automated Underreporter (AUR) Coverage	A percentage representing the total number of W&I and SB/SE contact closures (a closure resulting from a case where SB/SE and W&I made contact) divided by the total return filings for the prior year.
Collection Coverage	The volume of collection work disposed divided by the volume of collection work available.
Collection Efficiency	The volume of collection work disposed divided by total collection FTE.
Field Collection National Quality Review Score	The score awarded to a reviewed collection case by a Quality Reviewer using the NQRS quality attributes.
Automated Collection System (ACS) Accuracy	The percent of taxpayers who receive the correct answer to their ACS question.
Criminal Investigations Completed	The total number of subject criminal investigations completed during the fiscal year, including those that resulted in prosecution recommendations to the Department of Justice as well as those discontinued due to a lack of prosecution potential.
Number of Convictions	The number of criminal convictions.
Conviction Rate	The percent of adjudicated criminal cases that result in convictions.
TE/GE Determination Case Closures	The number of cases closed in the Employee Plans or Exempt Organizations Determination programs, regardless of type of case or type of closing.

[1] Starting in FY 2015, this measure includes all major IT investments (Business Systems Modernization (BSM) and non-BSM). In previous years, it included BSM only.

[2] A new measure was added to support the Operations Support Budget Appropriation. This indicator will help IRS better manage rental costs.

[3] Due to the modifications made to the Taxpayer Self-Assistance Rate measure for FY 2016, several components of the Customer Contacts Resolved Per Staff Year measure changed including: the way IRS counts transcripts, from "requested" to now counting "delivered;" the addition of Get Transcripts (Online & Mail); and, the discontinuation of Electronic Interactions.

[4] Starting in FY 2017, the IRS modified the Taxpayer Self Assistance Rate measures to include additional self-assistance applications, including Get Transcripts and payment applications, such as Direct Pay and Online Payment Agreements. In addition, Automated Collection System calls were added as well. As new self-assistance applications are provided to the public, they will be added to the methodology.

Appendix C
Performance Measurement Data

	2015	2016	2017	2018	
				Plan	Actual
Drive increased agility, efficiency, effectiveness and security in IRS operations					
Percent of Major IT Investments within +/- 10% Cost Variance at the Investment Level	73.7%	76.2%	50.0%	90.0%	72.2%
Percent of Major IT Investments within +/- 10% Schedule Variance at the Investment Level	89.5%	85.7%	88.9%	90.0%	83.3%
Rentable Square Feet per Person	N/A	N/A	297	Indicator	301
Empower and enable all taxpayers to meet their tax obligations					
Customer Service Representative (CSR) Level of Service	38.1%	53.4%	77.1%	75.0%	75.9%
Customer Contacts Resolved per Staff Year	26,245	28,497	25,535	Baseline	31,409
Customer Accuracy – Tax Law Phones	95.0%	96.4%	96.7%	95.0%	95.5%
Customer Accuracy – Customer Accounts (Phones)	95.5%	96.1%	96.0%	95.0%	96.1%
Timeliness of Critical Individual Filing Season Tax Products to the Public	89.0%	92.5%	93.1%	89.0%	59.6%
Timeliness of Critical TE/GE and Business Tax Products to the Public	92.6%	98.0%	96.7%	91.0%	100.0%
Percent Individual Returns Processed Electronically	85.3%	86.4%	86.9%	88.0%	87.2%
Percent Business Returns Processed Electronically	47.0%	50.0%	52.9%	54.0%	55.6%
Refund Timeliness – Individual (Paper)	98.8%	98.7%	98.4%	97.0%	98.2%
Enterprise Self-Assistance Participation Rate	88.7%	89.0%	79.0%	Indicator	82.0%
Protect the integrity of the tax system by encouraging compliance through administering and enforcing the tax code					
Examination Coverage – Individual	0.8%	0.7%	0.6%	0.6%	0.6%
Field Examination National Quality Review Score	86.7%	86.8%	85.0%	84.4%	89.1%
Office Examination National Quality Review Score	88.3%	88.4%	87.9%	86.7%	87.2%
Examination Quality – Large Business	86.0%	83.0%	78.0%	90.0%	76.0%
Examination Coverage – Business (assets >$10M)	3.9%	3.0%	2.5%	2.4%	2.2%
Examination Efficiency – Individual (1040)	148	143	121	134	131
Automated Underreporter (AUR) Efficiency	2,209	2,196	2,188	2,133	2,205
Automated Underreporter (AUR) Coverage	2.3%	2.3%	2.2%	1.9%	2.0%
Collection Coverage	46.3%	43.4%	42.2%	38.6%	41.6%
Collection Efficiency	2,448	2,266	2,135	2,101	2,216
Field Collection National Quality Review Score	79.2%	79.2%	76.7%	78.0%	79.2%
Automated Collection System (ACS) Accuracy	95.3%	95.4%	94.7%	95.0%	94.0%
Criminal Investigations Completed	4,486	3,721	3,089	3,000	3,051
Number of Convictions	2,879	2,672	2,300	1,900	1,879
Conviction Rate	93.2%	92.1%	91.5%	92.0%	91.7%
TE/GE Determination Case Closures	111,940	99,973	102,749	92,907	98,249

Appendix D

Explanation of Shortfalls

Percent of Major IT Investments within +/- 10% Cost Variance at the Investment Level: Thirteen of 18 major investments (72.2 percent) were within the cost variance threshold at the close of the 4th quarter.

1) Affordable Care Act Administration (ACA) cost underrun is due to all ACA projects being closed out and moved into operations and maintenance (O&M).
2) Customer Account Data Engine (CADE 2) cost underrun is caused by the Release 4 Authoritative Data Source (ADS) deployment project being closed out early due to budgetary constraints.
3) Web Applications cost underruns were caused by the actual spending for the 2018 Agile Development (First Half) and Program 11 activities being less than planned due to a reduction of anticipated funding for FY 2018.
4) Integrated Financial System/CORE Financial System (IFS) The cost overrun was due to the need for more contractor support than originally planned for the Milestone 5 activity.
5) IRS Mainframes and Servers Services and Support (MSSS) displays a cost underrun due to a project mistakenly entered into SPIKE and then closed out shortly after.

NOTE: The SharePoint Investment Knowledge Exchange (SPIKE) is the Department of the Treasury's system of record for cost and schedule reporting. Once a project has been entered into SPIKE, it cannot be removed but can be closed out, and the variances caused by the closeout will still be reported.

IRS IT will continue to closely monitor cost reporting for investments in FY 2019 to improve current performance levels for this measure.

Percent of Major IT Investments within +/- 10% Schedule Variance at the Investment Level: Fifteen of 18 major investments (83.3 percent) were within the schedule variance threshold at the close of the 4th quarter.

1) Affordable Care Act Administration (ACA) The schedule variance is showing ahead of schedule due to all ACA projects being closed out and moved into operations and maintenance (O&M).
2) Customer Account Data Engine (CADE 2) displays an ahead of schedule variance caused by the Release 4 Authoritative Data Source (ADS) deployment project being closed out early due to budgetary constraints.
3) IRS Mainframes and Servers Services and Support (MSSS) displays an ahead of schedule variance due to a project mistakenly entered into SPIKE and then closed out shortly after.

NOTE: SPIKE is the Department of the Treasury's system of record for cost and schedule reporting. Once a project has been entered into SPIKE, it cannot be removed but can be closed out, and the variances caused by the closeout will still be reported.

IRS IT will continue to closely monitor schedule reporting for investments in FY 2019 to improve current performance levels for this measure.

Timeliness of Critical Individual Filing Season Tax Products to the Public: FY 2018 results fell short of the 89 percent annual goal by 33 percent. Public Law 115-97, enacted December 22, 2017, affected 37 (39 percent) of the 94 total CIFS tax products. The legislation brought about extensive tax law changes and provided Media & Publications (M&P) only a 14-day window to incorporate all modifications, issue the affected tax products, and plan a coordinated release with the new withholding rates by the January 8 measure date. An additional 57 tax products were unexpectedly added to the work plan. Because the new tax law introduced new withholding tax rates, M&P was subjected to increased oversight and review which further affected timeliness. Despite the short timeframe, about 60 percent of CIFS tax products were timely made available to the public.

Percent Individual Returns Processed Electronically: FY 2018 results fell slightly short of the target (87.2% vs. 88.0%). Exceeded actual prior year performance but fell slightly short of the annual target for individual returns processed electronically. W&I will continue to process individual returns as efficiently as possible to meet the FY 2018 plan.

Appendix D

Explanation of Shortfalls (Continued)

Examination Quality – Large Business: The decline in the Examination Quality Score is a result of low scores in the Planning, Execution and Resolving technical standards. Actions taken to improve scores include: considering the filing/compliance requirements of related tax returns and subsequent year tax returns; documenting the reconciliation of the internal financial information to the tax return; and, documenting the audit trail and techniques used for resolving the case.

Examination Coverage – Business (assets >$10M): The IRS's Large Business & International Division met the mid-size corporations closure FY 2018 target but fell short of the target for flow-thru and high-corporation closures. Actions contributing to the shortfall included: suspension of new inventory for a period in FY 2017 while workload selection methods were reviewed; and, higher than predicted attrition coupled with Federal Emergency Management Agency disaster assistance and 2+ days of furlough led to decreased resources available to close large business returns. In addition, resources were redirected to develop and implement compliance campaigns. Some of the campaigns involve new treatment streams that impact compliance using methods other than examining returns which results in fewer return closures.

Examination Efficiency – Individual: Individual Exam Efficiency (the number of closures divided by total Exam FTE) was 131, below the FY 2018 target of 134 but higher than the FY 2017 actual of 121. While 9.5 percent fewer FTEs were expended for FY 2018 in closing individual returns, Examination completed only 22,600 fewer individual audits, a 2.5 percent decrease compared to FY 2017. Examination will continue to address cycle time, length of audits, work in process and planned starts to maintain the current level of closures to ensure FY 2019 targets are met. This will be balanced with the current level of attrition and reduction in FTE's, as well as the FY 2019 Hiring Initiative which will take current employees offline to instruct and coach new hires.

Automated Collection System (ACS) Accuracy: ACS Accuracy finished one percent below the FY 2018 plan. Factors such as new hires and more complex work contributed to this slight shortfall. Additionally, two new call sites in Ogden and Cincinnati stood up and were added to the quality results in May 2018. The more common defects are being shared with the staff and ACS will continue to work to improve accuracy rates by:

- Discussing the top defects with the sites during the monthly quality calls; and,
- Ensuring managers continue to review one employee's work per month.

Number of Convictions: FY 2018 year-end results reflect an 18.3 percent decrease compared to FY 2017 and 1.1 percent below target (1,900). Decreases in the number of special agents in recent years has led to a decline in the total amount of cases initiated and consequently recommended for prosecution, which contributed to lower inventory levels in the Judicial Process (pipeline). Despite this, quality investigations initiated and completed in previous years continue to be recommended for prosecution and processed by the Department of Justice (DOJ). Criminal Investigation (CI) management will continue to ensure appropriate and consistent contact with DOJ Tax Division and U.S. Attorney Offices regarding prosecutorial priorities and appropriate movement of pipeline investigations.

Conviction Rate: The FY 2018 conviction rate is slightly higher than FY 2017 (91.7 percent vs. 91.5 percent) but below the year-end target of 92 percent, due to attrition in upstream investigative positions, case complexity, and bandwidth at partner agencies. Acquittals and dismissals decreased by 31.3 percent and 19.8 percent, respectively, compared to FY 2017. Nevertheless, appropriate case selection and effective field performance continue to positively affect the number of cases resulting in convictions and likely avoided a greater decrease in the rate. Consequently, CI's rate of conviction continues to be a strong indicator of investigative quality given it's one of the highest in Federal law enforcement. Since CI does not prosecute its own cases, it must depend on the ability of the DOJ to accept its cases for prosecution and to move such cases through the courts. CI management will continue its current efforts of appropriate and consistent contact with DOJ Tax Division and U.S. Attorney Offices regarding prosecutorial priorities and the appropriate movement of pipeline investigations to ensure a high rate of conviction.

Appendix E
Strategic Plan Measures

Strategic Goal	*Performance Measure*
Empower and enable all taxpayers to meet their tax obligations	**Enterprise Self-Assistance Participation Rate (ESAPR)** – Measures the percent of instances where a taxpayer uses one of the IRS's self-assistance service channels (i.e., automated calls, web services) versus needing support from an IRS employee (i.e., face-to-face, over the phone, via paper correspondence). **Progress towards Goal:** Through FY 2018 4th quarter, ESPAR was at 82.0% vs. 79.0% for the same period in FY 2017; total services provided increased by 16.8% while self-assistance services provided increased by 21.2%. Used as an indicator for FY 2018.
Protect the integrity of the tax system by encouraging compliance through administering and enforcing the tax code	**Time to Start** – Measures the percentage of total instances where IRS compliance enforcement divisions contact a noncompliant taxpayer within six months of receiving a taxpayer's return (or when a taxpayer should have filed their return but may not have). **Progress towards Goal:** Based on the Enforcement Revenue Information System data (FY 2014 – FY 2016), 57% of enforcement cases are started within six months of the return posting date. Measure is currently being updated with more recent data.
Collaborate with external partners proactively to improve tax administration	**Enhanced Partnership Strategy** – Meeting key milestones in the IRS's ability to maintain and create new partnerships with external stakeholders (e.g., tax preparer community, international compliance/cyber security experts, other government agencies). **Progress towards Goal:** FY 2018 key accomplishments include: held EITC Awareness Day; conducted Security Summits; the Office of Procurement hosted an Industry and Reverse Industry Day event; conducted Tax Forums; held Tax Forums; and established the Joint Chiefs of Global Tax Enforcement and International Tax & Financial Crimes Group to reduce offshore tax evasion.
Cultivate a well-equipped, diverse, flexible and engaged workforce	**Employee Engagement** – Percentage of employees that say they feel engaged in their work as measured by Office of Personnel Management's index of relevant questions from the Federal Employee Viewpoint Survey. **Progress towards Goal:** Developed an engagement action plan that focuses on nine FEVS questions to promote diversity, inclusion & flexible work-life options associated with the IRS Strategic Plan. Used as an indicator for FY 2018.
Advance data access, usability and analytics to inform decision making and improve operational outcomes	**Data Strategy** – Meeting key milestones related to the creation of a data strategy. **Progress towards Goal:** FY 2018 accomplishments included: developing an enterprise research plan; establishing a governance council; and establishing and updating a comprehensive catalog of data sources.

Appendix E
Strategic Plan Measures (Continued)

Drive increased agility, efficiency, effectiveness and security in IRS operations	**Aged Hardware Percentage** – Quantity of hardware in operation past its useful life as a share of total hardware in use. **Progress towards Goal**: Through FY 2018 4th quarter, the Percent of Aged Hardware was 45.5% vs. 52.3% for the same period in FY 2017. FY 2018 Target is 53.1%. The nearly 7 percentage point reduction was attributable to: increased focus, discipline and leadership engagement to improve delivery of aged hardware refresh activities; replacing the nearly 21,000 assets aging during FY 2018 to prevent growth in IRS aged hardware inventory; and, removing certain asset categories (fax machines, low-end printers and scanners) that are no longer being actively refreshed from the aged calculation to more accurately define the inventory that's reflective of risk to the Information Technology (IT) environment. IRS-IT leadership will continually monitor progress against FY 2019 aged hardware replacement targets monthly. **Efficient Space Utilization** – Ratio that measures overall rentable square footage per person (includes contractors). **Progress towards Goal:** The IRS continued to release excess office space through building closures and consolidations. Through FY 2018 4th quarter, the Rentable Sq. Ft. per Person was 301 vs. 297 for the same period in FY 2017. IRS released 492,110 sq. ft. of space in FY 2018, generating about $10.5 million in annual rent savings. The IRS expanded the number of offices that incorporate hoteling or shared workspace for employees and contractors who do not require full-time. Used as an indicator for FY 2018.

Appendix F
Management Challenges and High-Risk Areas

GAO Management Challenges and High-Risk Areas

The GAO updates its High Risk Report every two years at the start of each new Congress. The high-risk area below appears in the *High-Risk Series: Progress on Many High-Risk Areas, While Substantial Efforts Needed on Others* (GAO-17-317), published on February 15, 2017. In addition, the GAO identified three significant financial management challenges in its report, *Financial Audit IRS's Fiscal Years 2017 and 2016 Financial Statements* (GAO-18-165), published on November 9, 2017. The IRS remains dedicated to improving its financial management, internal controls, and information security, and has identified specific steps and actions to address these issues through its existing program activities.

GAO High-Risk Area

Enforcement of Tax Laws:
1. Improving tax compliance and addressing the tax gap
2. Refund fraud related to identity theft

Safeguarding Taxpayer Receipts and Associated Information
Summary of Major Issues: Prevent unauthorized access to IRS facilities, hard copy taxpayer receipts, and related sensitive information.
Actions Taken: Safeguarding taxpayer receipts and associated taxpayer information to prevent the loss of receipts or inappropriate disclosure or compromise of taxpayer information is among the IRS's most important and demanding responsibilities. In FY 2018, the IRS realigned the clean desk policy from Internal Revenue Manual (IRM) 10.2.13, Information Security, to IRM 10.5.1, Privacy Information Protection, to provide better oversight and increased collaboration between internal organizations in the protection of taxpayer information. The IRS updated its facility access policy to clarify the access requirements for contractor personnel from other agencies and detailed IRS employee/contractor responsibilities for escorting visitors. Additionally, the IRS established and offered the Contracting Officer's Representative (COR) Security Training course, which CORs will complete annually. **Actions Planned or Underway for FY 2019 and Beyond:** Although there have been significant strides in safeguarding taxpayer information and combatting unauthorized access, the IRS will continue to focus on mitigating this risk. The IRS plans to continue to review the appetite and tolerance for risk created by contractors who do not require staff-like access. The IRS will continue to provide the Contracting Officer's Representative Security Training course annually and work towards completing an online version of the training course.
Preventing and Detecting Fraudulent Refunds Based on Identity Theft
Summary of Major Issues: Effectively identify, design, and implement the most appropriate measures and internal controls for preventing and detecting identity theft-related refund fraud.
Actions Taken: The IRS continued its partnership with the Security Summit to implement measures to prevent and detect identity theft-related refund fraud. In FY 2018, the IRS used new data elements, including Security Summit variables, and integrated lessons learned from PY 2017 into the filters when processing returns. In addition, the earlier availability of Form W-2 and Form 1099 MISC data enhanced the IRS's defenses against identity theft and refund fraud. The IRS conducted systemic verification of information reported on taxpayers' returns against Form W 2 information and used the Form 1099 MISC data as a variable in the filtering process before issuing refunds. The IRS leveraged both filtering capabilities along with the PATH Act's refund hold requirement on all returns claiming EITC and/or ACTC to automate and expand the selection of potentially fraudulent returns. For

2018, the IRS held 9.4 million returns with $46.9 billion refunds until February 15 (as required by law) and identified about 340,000 PATH returns with potentially overstated income or withholding-related issues.

Actions Planned or Underway for FY 2019 and Beyond:

The IRS will continue engaging with the Security Summit to detect and prevent identity theft-related refund fraud and improve its filtering process to weed out fraudulent returns.

Implementing Patient Protection and Affordable Care Act Tax-Related Provisions

Summary of Major Issues: Improve the timeliness and accuracy of information provided by agencies and external partners and ensure processing of only valid and accurate payments.

Actions Taken:

To ensure processing of only valid and accurate PTC payments, the IRS conducted a detailed review both internally and with the CMS, which may result in an alternative recommendation that will allow the IRS to prevent PTC at-filing for non-citizens. The IRS is currently assessing the results of the review and the feasibility of this alternative approach. Should the alternative approach be approved, it will require process changes in the way health insurance marketplaces verify, notify, and report information to the IRS for individuals who failed to demonstrate they met the citizenship or lawful presence requirements when applying for insurance and APTC.

In addition, the IRS made efforts to assess PTC information accuracy. Through the IRS's National Research Program (NRP), the IRS gathered compliance data on net PTC for use in developing estimates of improper payments. IRS operations enacted safeguards (e.g., ACA Verification Service (AVS)) that prevent returns with an APTC/PTC reconciliation obligation from posting to the Masterfile during the pipeline process stage of tax filing season. The IRS also conducted post-filing compliance activities designed to address inaccuracies on filed ACA tax returns. Lastly, the IRS completed the remaining sample of tax year 2015 Applicable Large Employer Form 1095-C/1094-C nonfiler cases in October of 2017.

Actions Planned or Underway for FY 2019 and Beyond:

In FY 2019, the IRS will finalize the assessment and feasibility study of the potential alternative approach currently being reviewed, making programing and processing changes as needed. In addition, the IRS will continue to address challenges concerning timeliness and information accuracy by briefing health insurance marketplaces on process changes in the way they verify, notify, and report information to the IRS for those individuals who failed to prove they met the citizenship or lawful presence requirements. The IRS will also take internal steps to make the necessary programming and Form 1095-A changes in time for TY 2020 implementation.

The IRS also will estimate net PTC improper payments using NRP compliance data. Concurrent with gathering data on net PTC for the NRP sample returns, the IRS will be monitoring reconciliation and continuing with its filing and post-filing activities for all returns with APTC/PTC. The IRS will commence issuance of non-filer and stop filer letters for tax year 2016 Applicable Large Employers who appear to have Form 1095-C/1094-C filing requirements.

Appendix F

Management Challenges and High-Risk Areas (Continued)

TIGTA Management and Performance Challenges

The Reports Consolidation Act of 2000 requires that TIGTA summarize for inclusion in the annual Department of the Treasury Agency Financial Report its perspective on the most serious management and performance challenges confronting the IRS.

Each year, TIGTA evaluates IRS programs, operations, and management functions to identify the areas of highest vulnerability to the Nation's tax system and presents them to the IRS in a memorandum titled, *Management and Performance Challenges Facing the Internal Revenue Service.*

The IRS addresses these issues through new and existing program activities. Measures of these program activities show progress in addressing these management challenges. The below actions taken and actions planned address the management and performance challenges facing the IRS in FY 2018.

Security Over Taxpayer Data and Protection of IRS Resources
Summary of Major Issues: Promote measures protecting the confidentiality of taxpayer information.
Actions Taken: The IRS continued its work on several initiatives to protect the confidentiality of taxpayer information and IRS systems. This year, the IRS continued implementation of the Identity Assurance Strategy to address authentication needs. The authentication strategy outlines core objectives that reflect the most significant challenges and potential opportunities for future investment across channels and capability areas. Additionally, the IRS reviewed the current eAuthentication test plan and identified some inefficiencies, which the IRS addressed and released on March 9, 2018, and developed an action plan to ensure concentration on remaining issues preventing full implementation of network monitoring tools. The IRS also remains focused on ensuring the protection of data transfers to external partners. In FY 2018, the IRS reviewed and verified firewall rulesets and identified one rule as using non-secure File Transfer Protocol (FTP). Removal of that rule was recommended, implemented, and documented to help ensure use of applicable protocols to fully protect sensitive information during transmission. The IRS increased oversight of Plans of Action and Milestones (POA&M) to ensure preparation in accordance with IRS policy and reviewed current Interconnection Security Agreements (ISA). The IRS also updated IRM 10.8.55, Information Technology (IT) Security, Network Security Policy, to address security configurations for network devices to ensure protection against internal threats. **Actions Planned or Underway for FY 2019 and Beyond:** The IRS will continue implementing its Servicewide strategy that establishes consistent oversight of all authentication needs and ensures that the authentication processes meet Government Information Security Standards. The IRS continues to implement NIST SP 800-63-3 standards for applications protected by Secure Access. The IRS has developed a current state assessment of the existing Secure Access e-Authentication application and compared its functionality to that of the requirements in the NIST SP 800-63-3. During FY 2019, the IRS will determine business requirements and the related IT architecture needs to implement a new digital identity-compliant solution. In addition, the IRS will review the external file transfer firewall rulesets and remove those no longer needed. The IRS will establish a new group to track, review, and analyze existing processes as well as recommend changes to improve the security of the General Support System (GSS). In addition, the IRS will implement audit plans for the 12 previously reviewed systems and applications in the production computing environment. Finally, the IRS will also implement a compliance verification process to ensure comprehensive testing of configuration policies on the mainframe and incorporate new procedures into the Operations Application Auditing standard operating procedure, which delineates the

procedures for all application monitoring services. Implementation of these detailed procedures will facilitate the periodic review and analysis of audit records for its financial systems.

Identity Theft and Impersonation Fraud
Summary of Major Issues: Detect and prevent fraudulent tax refunds resulting from identity theft.
Actions Taken: Combatting fraud and identify theft for all taxpayers continues to be a priority for IRS. In FY 2018, the IRS added several new business return identity theft filters to expand business identity theft protections, allowing protection for more business taxpayers through the expansion of upfront filtering and modeling. Additionally, the IRS implemented programming to detect paper returns that report wages filed under an Individual Taxpayer Identification Number (ITIN) and updated IRM 3.12.3.5.9, Error Code 030 (CE) ITIN Filers With Form W-2, to provide procedures for "ITIN Filers with Form W-2," errors. The IRS continued to educate taxpayers about tax scams, issuing news releases with an emphasis on providing early alerts. When new scams emerged, IRS worked with Security Summit partners to assess the magnitude and, using listservs, warned taxpayers and other stakeholders and/or issued alerts to targeted users. **Actions Planned or Underway for FY 2019 and Beyond:** The IRS will continue to pursue opportunities to combat fraud and identity theft by expanding identity theft filters and authentication data elements to additional business returns. The IRS will identify conditions that prevent eligible accounts from receiving the identity theft marker when the potential misuse of an individual's Social Security Number (SSN) becomes evident and will determine the programming changes needed to ensure the proper placement of identity theft markers. The third annual Tax Security Awareness Week with IRS and Security Summit partners will occur in early December to raise taxpayer awareness about data security in advance of the holiday season.

Providing Quality Taxpayer Service and Expanding Online Services
Summary of Major Issues: Improve taxpayer service and efficiency of operations.
Actions Taken: The IRS continues to focus on improving taxpayer service to taxpayers who were victims of identity theft. In FY 2018, the IRS provided requirements to modify Identity Protection Personal Identification Number (IP PIN) and notice programming to implement additional identity theft prevention processes. Additionally, the IRS finalized case resolution guidance, "The Taxpayer Treatment Guide," to ensure consistency by all IRS functions. The IRS continues to make significant strides to ensure that digital efforts are data-driven and customer focused, allowing taxpayers to interact with the IRS in ways that are responsive to top service needs. The IRS continued to make IRS.gov easier to navigate and more responsive for mobile devices, allowing taxpayers to access information more quickly and effectively. In FY 2018, the IRS launched a tool for the Taxpayer Protection Program that allows taxpayers to answer three questions to confirm their identity and validate suspected identity theft returns. The IRS also released an improved Tax-Exempt Organizations Search tool to allow users to search across several previously separate databases (Publication 78 data, Form 990-N filers, and organizations with revoked status) and view associated determination letters and copies of returns for many charities and non-profit entities. Beyond enhancing the customer experience, the IRS's digital tools are a significant source of efficient revenue collection for the government. These efforts not only increase the customer experience for taxpayers, but also allow the IRS to maximize its limited resources to better serve taxpayers who require one-on-one assistance. **Actions Planned or Underway for FY 2019 and Beyond:** The IRS will implement the modifications to the IP PIN and notice programming by placing a case resolution marker on the accounts of taxpayers who were victims of identity theft and generating an IP PIN. In FY 2019, the IRS will continue its focus on expanding new digital tools and improving existing tools to enhance the overall taxpayer experience and maximize limited resources.

Upgrading Tax Systems
Summary of Major Issues: Modernize IRS systems and develop and implement new information technology applications.
Actions Taken: The IRS continues to modernize its systems and develop and implement new technology applications. In FY 2018, the IRS increased focus on the aged infrastructure issue by creating a cross-functional team with regular leadership engagement. The team accomplished the following actions: • Redefined the measurement criteria for aged hardware to improve tracking precision, accuracy, and consistency; • Finalized FY 2018 aged hardware replacement targets that will prevent growth in the aged asset inventory; • Initiated work on a long-term plan that will deliver a proactive and sustainable operating model to enable top-down, multi-year planning, driven by operational risk assessment, IRS technology direction, and industry standards; • Combined three separate sustaining infrastructure documents into a comprehensive guidance document; and • Implemented systemic controls to prevent erroneous incident ticket time entries to the Knowledge Incident/Problem Service Asset Management (KISAM) system. The IRS made significant changes to the Integrated Production Model (IPM) system, including moving data to different software and hardware platforms. When these changes occurred, the IRS moved business ownership and security responsibilities of the IPM to the Big Data Analytics General Support System (BDA GSS). However, BDA GSS did not capture about 10 percent of security controls, which previously protected IPM system data. The IRS completed a full review and update to the Security Change Management Standard Operating Procedures to ensure it stipulates the requirement to follow the security change management process prior to the introduction of new information systems into the IRS infrastructure and for changes to existing information systems. Cloud computing holds tremendous potential for the IRS. The IRS formulated, socialized and published the enterprise-wide cloud strategy. This strategy identifies and formalizes the necessary personnel, process, technology, and methodology changes that will allow the IRS to strategically pursue, procure, deploy, and manage cloud services within the IRS. **Actions Planned or Underway for FY 2019 and Beyond:** In FY 2019, the IRS will continue to improve system performance and integrity by finalizing the FY 2019 aged hardware replacement targets that will reduce aged asset inventory and further stabilize the inventory of IRS aging infrastructure; complete development of the long-term plan; and operationalize recommendations started in FY 2018 to reduce the percentage of aged assets to 20-25 percent over the next three to five years as well as update processes/technology to ensure natural sustainability of this level of aged infrastructure. As part of its cloud strategy effort, the IRS will identify and recommend formalization of specific cloud inventory management processes. The IRS will also identify and recommend specific changes in project initiation processes having cloud impact and incorporate them into the enterprise life cycle (ELC) process, where appropriate.
Implementing Tax Law Changes
Summary of Major Issues: Implementing new tax laws.
Actions Taken: The IRS continues to face challenges each year in processing tax returns while implementing new tax laws and changes resulting from renewal of expired tax provisions. The IRS requested programming changes to perform automated checks to ensure taxpayers who do not meet eligibility requirements to receive or claim the HCTC do not receive eligibility indicators on their tax accounts.

The IRS also updated the Masterfile to correctly remove indicators for taxpayers who are 67 years of age or older or incarcerated.

The IRS developed processes to identify all American Opportunity Tax Credit (AOTC) claims for both missing Forms 1098-T, Tuition Statement, and claims that did not provide the institution's Employer Identification Number (EIN). Beginning with tax year 2016, the IRS initiated pre-refund audits on returns for which a student claimed the AOTC in the previous year and there was no Form 1098-T filed for the prior year. The IRS also identifies claims on original returns for which there is no 1098-T on record for potential audit.

The IRS worked to prevent erroneous notifications sent to individuals indicating that they had not filed the required tax return by comparing TINs in the error resolution suspense file before mailing letters to APTC payment recipients who were either non-filers or extension filers.

Actions Planned or Underway for FY 2019 and Beyond:

The IRS will continue efforts to improve information availability and compliance activities in FY 2019. The IRS will perform the requisite automated checks to ensure that taxpayers who do not meet eligibility requirements to receive or claim the HCTC do not receive eligibility indicators on their tax accounts and will verify tax year 2018 updates to Masterfile are complete and correct.

Beginning with tax year 2018, the IRS will implement math error authority for claims for which the educational institution's EIN is missing from Form 8863, Education Credits (American Opportunity and Lifetime Learning Credits), pending any budget constraints due to tax reform implementation.

Improving Tax Compliance

Summary of Major Issues: Improve compliance and fairness in the application of the tax laws.

Actions Taken:

The IRS continues to focus on improving compliance processes. The IRS increased Automated Substitute for Return Program (ASFR) case selections from 25,000 to 159,172 in FY 2018. In June 2018, the IRS streamlined systemic processing to reduce manual processing time. The IRS also reduced Delinquent Return Refund Hold selections.

The IRS has continued to focus on employers who have failed to pay employment taxes. In FY 2018, the IRS created an IRS YouTube video titled "Monitoring Your Outsourced Payroll Duties on EFTPS." In addition, Criminal Investigation Special Agents received employment tax training and initiated a cross-functional program where 49 employment tax cases that would have normally been referred to the Department of Justice (DOJ) Tax Division to begin the injunction process, instead were routed to the IRS's Fraud Program for review and referral for criminal investigation. Of the 49 cases, the Fraud Program referred 18 to the DOJ Tax Division, 12 of which the DOJ Tax Division accepted and filed Injunction Suits. The IRS continued to identify potential underreported taxes due to discrepancy cases resulting when employers' wage and withholding information does not match information reported on the employers' employment tax return. In FY 2018, the IRS held discussions with the Social Security Administration (SSA) about the number of SSA Combined Annual Wage Report (CAWR) cases referred for action to address potential underreported taxes cases.

Actions Planned or Underway for FY 2019 and Beyond:

In FY 2019, the IRS expects to increase ASFR case selection to 426,500 due to the new streamlined systemic processing and anticipated new hires. New systemic processing will provide the IRS with flexibility to determine quarterly Delinquent Return Refund Hold inventory volumes and new case modeling will improve high priority case selections.

In addition, the IRS will explore use of the Integrated Production Model to refine, enhance and automate the current Federal Tax Deposit (FTD) Alert X process for early interaction with employers.

In early FY 2019, the IRS will stand-up the Combined Annual Wage Report (CAWR) Unit at the Cincinnati Campus focusing on IRS CAWR cases. The IRS will also conduct a joint review of the CAWR program with

SSA, focusing on refining case referral criteria.

Reducing Fraudulent Claims and Improper Payments

Summary of Major Issues: Increase the ability to detect, prevent, and track fraudulent tax returns, improve assistance to victims of identity theft, and identify, measure, and reduce improper payments.

Actions Taken:

The IRS and Department of the Treasury jointly evaluated the merits of an end-to-end risk assessment process with CMS and Health and Human Services (HHS). The interagency workgroup concluded that a risk assessment process that evaluates APTC risk and PTC risk separately was the most appropriate approach. The IRS believes this structure is more advantageous because the specific responsibilities of CMS and IRS for APTC and PTC, respectively, provide a logical basis with which to evaluate the program risks. OMB approved this approach in FY 2016.

The IRS continues to take steps to combat identity theft and refund fraud. The earlier availability of Forms W-2 and Forms 1099-MISC information returns and the PATH Act's requirement to hold refunds on all returns claiming EITC and/or ACTC until February 15 enhanced the IRS's defenses against identity theft and refund fraud.

Actions Planned or Underway for FY 2019 and Beyond:

The IRS and CMS will continue to work together to understand the intricacies of the APTC and PTC programs and look for opportunities to strengthen controls and improve the ability to detect and prevent fraudulent and erroneous payments.

The IRS will expand filters and models used to identify identity theft at the time of filing and continue to submit a legislative proposal requesting additional EITC error correction authority as part of its annual budget submission.

Impact of Global Economy on Tax Administration

Summary of Major Issues: Increase the outreach efforts to foreign governments on cross border transactions.

Actions Taken:

In FY 2018, the IRS continued use of the Mutual Collection Assistance Request (MCAR) Program by providing its revenue officers with a training course titled "International Asset Identification and Collection." The IRS also issued an interim guidance memorandum which aided employees in determining when to withdraw an outbound MCAR and published an article in the SB/SE Technical Digest titled "Offshore Assets – Mutual Collection Assistance Request."

In FY 2018, the IRS improved its exchange of information capabilities by utilizing its Automatic Exchange of Information (AEOI) program, which receives monthly reports detailing incoming FATCA filings by authority and tax year. The AEOI program provides exam groups with FATCA information pertaining to taxpayers in the audit inventory. In addition, the AEOI tracks incoming traditional AEOI information by submission, and saves the information in SharePoint.

In FY 2018, the IRS expanded its use of the MCAR. The Exchange of Information (EOI) program office worked with five collection partners to ensure timely issuance of MCARs, establishing time frames for processing and implementing changes to the receipt, assignment, and reconciliation of MCARs. The EOI program office also developed frameworks to discuss open MCARs and resolution strategies with MCAR treaty partners. In addition, the National Archives approved the IRS's request for a record control schedule for closed MCAR cases.

In FY 2018, the IRS improved controls to ensure that nonresident aliens (NRA) are reporting rental income from their U.S. property properly. The IRS delivered a 50-minute presentation at Nationwide Tax Forums titled, "NRAs and U.S. Real Estate Investments," that explores the lifecycle of a nonresident alien's investment in U.S. real estate: initial purchase, ownership period, and sale. It also delves into the ownership period and discusses issues that arise if the nonresident alien rents the property to others. The IRS presented these materials at five

Nationwide Tax Forum locations: Atlanta, GA; National Harbor, MD; San Diego, CA; Chicago, IL and Orlando, FL.

Actions Planned or Underway for FY 2019 and Beyond:

The IRS will explore the use of the International Treasury Services system for MCAR foreign electronic payments and will revise IRM 5.21.7., Special Cases.

In FY 2019, the AEOI program office will develop training to teach compliance employees how to use FATCA data. Compliance employees will have direct access to FATCA data using the Business Objects Enterprise and the IRS will explore enhancing the Business Objects Enterprise reporting capabilities.

In FY 2019, the IRS will add a check box on the Form 1040NR return to indicate if the taxpayer has made an 871(d) election to treat rental income as Effectively Connected Income (ECI), which allows the taxpayer to deduct ordinary and necessary expenses from their income to arrive at the net taxable income. The IRS will continue to focus the compliance initiative on U.S. Real Property Investments of Foreign Individuals through outreach.

Protecting Taxpayer Rights

Summary of Major Issues: Apply the tax laws fairly.

Actions Taken:

In FY 2018, the IRS engaged external stakeholders in several activities to promote data protection and updated its internal processes and policies to minimize the potential mistreatment of taxpayers.

The IRS is conducting on-site and virtual operational reviews to ensure that PCA company employees abide by taxpayer rights and the provisions of the FAST Act. The IRS conducted ad-hoc reviews in March through May with a focus on payment arrangements. In addition, quality reviewers conduct reviews of PCA phone calls.

The IRS corrected all Collection Statute Expiration Date (CSED) errors identified by TIGTA during the FY 2017 Collection Due Process audit.

The IRS updated Internal Revenue Manual procedures, reminding employees to include all representative information with Notice of Federal Tax Lien requests.

The IRS continues efforts to improve the processes associated with the Bank Secrecy Act's anti-structuring provisions. In FY 2014, the IRS decided to stop the pursuit of seizures and forfeiture of funds associated solely with legal source structuring cases unless there were exceptional circumstances. Seizures or forfeitures under exceptional circumstances will require approval by field office senior leadership. The IRS mailed notices to about 1,800 property owners with forfeited assets pursuant to structuring violations for the years 2009 through 2016, advising them of the opportunity to petition for return of their previously seized and forfeited property. The notices also provided information on how to file a proper petition if the property owner chose to do so. All petition for remission claims related to these 1,800 notices have been processed and a final determination was made by either the IRS or Department of Justice in FY 2018.

Actions Planned or Underway for FY 2019 and Beyond:

The IRS will continue operational and ad-hoc reviews to ensure that PCA company employees abide by taxpayer rights and the provisions of the FAST Act.

The IRS will continue efforts to improve the processes associated with the Bank Secrecy Act's anti-structuring provisions. In 2019, the IRS will continue annual training for Task Force Officers assigned to Financial Crimes Task Forces, continue communication with field office senior leadership to ensure proper oversight on Title 31 investigations, and ensure senior field office leadership approves any potential Title 31 legal source income seizures with exceptional circumstances.

Achieving Program Efficiencies and Cost Savings
Summary of Major Issues: Improve program effectiveness and reduce costs.
Actions Taken: The IRS took steps to detect and prevent employee salary overpayments or underpayments by taking corrective personnel actions to address the cases identified. The IRS completed second level reviews of high-risk accounts and used the results of these reviews as well as recommendations from audits, internal reviews and other sources to simplify pay policy and/or training. The IRS will evaluate prior performance and conduct issues during the rehiring process. The IRS updated hiring policies to ensure the selecting official reviews derogatory performance and conduct information on former IRS employees who apply through the external hiring process - regardless of the age of that information - to prevent inappropriate rehires. The guidance requires the selecting official to document fully any decision to select a former employee with prior conduct or performance issues and provide a justification to the IRS Human Capital Officer for rehiring former employees with prior performance and/or conduct issues. The new guidance also mandates the Business Commissioner and IRS Human Capital Officer's concurrence when selecting officials wish to rehire an external applicant with prior conduct or performance issues. The IRS also obtained OPM guidance on when to refer applicants for potential falsification of information on their application materials and revised the its guidance to ensure the referral of applicants to OPM if any material falsification is identified during the suitability screening process. Furthermore, the IRS updated its policy to consider applicants with "currently not collectible" (CNC) tax obligations as noncompliant with tax filing and payment requirements for the purposes of determining suitability for employment with the IRS. In FY 2018, the IRS deployed the new enterprise email solution that enables the IRS to comply with Federal records management requirements, including the ability to organize and maintain the records in a usable format to facilitate their use when and where needed as well as ensure their preservation throughout their authorized retention period. The IRS improved the strategy for ASFR casework with funding for new hires, which enabled the IRS to increase case selections to include all high dollar cases. The IRS also conducted a Test and Learn strategy that will provide better methods for selecting high-dollar cases and provide the optimal threshold for Refund Hold selections. The IRS implemented efforts to maintain standard pricing and terms and conditions for its software acquisitions. In FY 2018, the IRS compiled a baseline inventory of software licenses to improve software license management as required by recent laws and regulations. The IRS developed the charter for a program office with responsibility for software asset management (SAM) across the Service, created a software request portal that restructures the server software request process, implemented a monthly reporting dashboard to identify license discrepancies and significant changes in deployment data, and consolidated major software supplier contract entitlement data as a preliminary enterprise software license management repository. **Actions Planned or Underway for FY 2019 and Beyond:** The IRS will monitor the new hiring process to ensure consistency in application, quality of documentation, defensibility, and compliance with the uniform guidelines. In FY 2019, the IRS will test new modeling for potential changes to ASFR case selections. The IRS will also increase individual return delinquency cases, which will expand the pool of new inventory. In addition, the IRS will analyze the results of the change from its current wider range selection methodology to a selection methodology based on the cases that have the highest potential for compliance impact and adjust selection criteria as warranted. The IRS also will develop and implement a multi-year test plan to measure compliance levels for cases excluded from notice generation. In FY 2019, the IRS will continue to uphold standard pricing and terms and conditions for its software acquisitions by establishing a Software Asset Management (SAM) Program Office with appropriate authority

consistent with the charter; implementing a specialized SAM tool as a central license entitlement, deployment, reconciliation and reporting repository; improving the Procurement for the Public Sector (PPS) system data model to better capture license purchases, entitlement and deployment traceability; improving deployment data capture through deployment of improved inventory management and discovery tools across the Service; and implementing an outcome-based SAM approach that will provide information as required by recent laws and regulations.

Financial Statements

Principal Financial Statements

The principal financial statements have been prepared to report the financial position and results of operations of the Internal Revenue Service, pursuant to the requirements of the *Chief Financial Officers Act of 1990* (Public Law 101-576), the *Government Management Reform Act of 1994,* and the Office of Management and Budget Circular No. A-136, *Financial Reporting Requirements*. The responsibility for the integrity of the financial information included in these statements rests with the management of the IRS. The audit of the IRS principal financial statements was performed by the Government Accountability Office.

The IRS principal financial statements for fiscal years 2018 and 2017 are as follows:

- The **Balance Sheets** present the assets, liabilities, and net position.
- The **Statements of Net Cost** present the net cost of operations by program. It includes the gross costs less any exchange revenue earned from activities.
- The **Statements of Changes in Net Position** present the change in net position resulting from the net cost of operations, budgetary financing sources other than exchange revenues, and other financing sources.
- The **Statements of Budgetary Resources** present the budgetary resources; the status of those resources; and the agency outlays, net. Additional detail by major budget accounts is available in the Required Supplementary Information section.
- The **Statements of Custodial Activity** present the sources and disposition of non-exchange federal tax revenues collected and refunds disbursed.

Internal Revenue Service
Balance Sheets
As of September 30, 2018 and 2017

(In Millions)

	2018	2017
Assets		
Intragovernmental		
Fund balance with Treasury (Note 2)	$ 3,206	$ 2,603
Due from General Fund of the U.S. Government (Note 6)	2,974	3,061
Other assets (Note 3)	42	16
Total intragovernmental	**6,222**	**5,680**
Cash and other monetary assets (Notes 4, 6)	536	493
Federal taxes receivable, net (Notes 5, 6)	58,000	52,000
General property and equipment, net (Note 7)	1,976	2,078
Other assets (Note 3)	13	13
Total assets	**$ 66,747**	**$ 60,264**
Liabilities		
Intragovernmental		
Due to General Fund of the U.S. Government	$ 58,219	$ 52,000
Other liabilities (Note 8)	166	173
Total intragovernmental	**58,385**	**52,173**
Federal tax refunds payable	2,974	3,062
Other liabilities (Note 8)	1,931	1,898
Total liabilities	**63,290**	**57,133**
Net position		
Unexpended appropriations	1,765	1,513
Cumulative results of operations	1,692	1,618
Total net position	**3,457**	**3,131**
Total liabilities and net position	**$ 66,747**	**$ 60,264**

The accompanying notes are an integral part of these statements.

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Internal Revenue Service
Statements of Net Cost
For the Years Ended September 30, 2018 and 2017

(In Millions)

	2018	2017
Program		
Taxpayer Assistance and Education		
Gross cost	$ 531	$ 544
Earned revenue	(3)	(2)
Net cost of program	**528**	**542**
Filing and Account Services		
Gross cost	4,685	4,334
Earned revenue	(148)	(149)
Net cost of program	**4,537**	**4,185**
Compliance		
Gross cost	7,856	7,701
Earned revenue	(416)	(418)
Net cost of program	**7,440**	**7,283**
Administration of Tax Credit Programs		
Gross cost	137	138
Earned revenue	-	-
Net cost of program	**137**	**138**
Net cost of operations	**$ 12,642**	**$ 12,148**

The accompanying notes are an integral part of these statements.

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Internal Revenue Service
Statements of Changes in Net Position
For the Years Ended September 30, 2018 and 2017

(In Millions)

	2018		2017	
	Unexpended Appropriations	Cumulative Results of Operations	Unexpended Appropriations	Cumulative Results of Operations
Beginning balances	$ 1,513	$ 1,618	$ 1,587	$ 1,405
Budgetary financing sources				
Appropriations received	11,431		11,235	
Transfers in/out without reimbursement	-	63	-	18
Other adjustments	(94)		(104)	
Appropriations used	(11,085)	11,085	(11,205)	11,205
Other financing sources				
Imputed financing		1,577		1,159
Transfers in/out without reimbursement		-		-
Transfers to General Fund of the U.S. Government		(9)		(21)
Total financing sources	252	12,716	(74)	12,361
Net cost of operations		(12,642)		(12,148)
Net change	252	74	(74)	213
Ending balances	$ 1,765	$ 1,692	$ 1,513	$ 1,618

The accompanying notes are an integral part of these statements.

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Internal Revenue Service
Statements of Budgetary Resources
For the Years Ended September 30, 2018 and 2017

(In Millions)

	2018	2017
Budgetary resources		
Unobligated balance brought forward, October 1	$ 1,058	$ 949
Recoveries of prior year unpaid obligations	58	106
Other changes in unobligated balance	(57)	(48)
Unobligated balance from prior year budget authority, net	1,059	1,007
Appropriations (discretionary and mandatory)	11,854	11,631
Spending authority from offsetting collections (discretionary and mandatory)	196	165
Total budgetary resources	**$ 13,109**	**$ 12,803**
Status of budgetary resources		
New obligations and upward adjustments (total) (Note 12)	$ 11,976	$ 11,745
Unobligated balance, end of year		
Apportioned, unexpired accounts	730	530
Exempt from apportionment, unexpired accounts	7	7
Unapportioned, unexpired accounts	167	238
Unexpired unobligated balance, end of year	904	775
Expired unobligated balance, end of year	229	283
Unobligated balance, end of year (total)	1,133	1,058
Total budgetary resources	**$ 13,109**	**$ 12,803**
Outlays, net		
Outlays, net (total) (discretionary and mandatory)	$ 11,379	$ 11,505
Distributed offsetting receipts	(382)	(362)
Agency outlays, net (discretionary and mandatory)	**$ 10,997**	**$ 11,143**

The accompanying notes are an integral part of these statements.

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Internal Revenue Service
Statements of Custodial Activity
For the Years Ended September 30, 2018 and 2017

(In Billions)

	2018	2017
Revenue activity		
Collections of federal tax revenue (Note 13)		
Individual income, FICA/SECA, and other	$ 3,090	$ 2,976
Corporate income	263	339
Excise	73	64
Estate and gift	24	24
Railroad retirement	6	6
Federal unemployment	9	8
Total collections of federal tax revenue	**3,465**	**3,417**
Increase in federal taxes receivable, net	6	3
Total federal tax revenue	**$ 3,471**	**$ 3,420**
Distribution of federal tax revenue to General Fund of the U.S. Government	**$ 3,465**	**$ 3,417**
Increase in amount due to General Fund of the U.S. Government	6	3
Total disposition of federal tax revenue	**3,471**	**3,420**
Net federal revenue activity	**$ -**	**$ -**
Federal tax refund and outlay activities		
Total refunds of federal taxes and outlays (Note 14)	$ 464	$ 437
Appropriations used for refund of federal taxes and outlays	(464)	(437)
Net federal tax refund and outlay activities	**$ -**	**$ -**

The accompanying notes are an integral part of these statements.

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INTERNAL REVENUE SERVICE

Notes to the Financial Statements

For the Years Ended September 30, 2018 and 2017

Note 1. Summary of Significant Accounting Policies

A. Reporting Entity

The Internal Revenue Service (IRS) is a bureau of the United States (U.S.) Department of the Treasury (Treasury). The IRS originated in 1862, when Congress established the Office of the Commissioner of the Internal Revenue. The IRS administers the nation's tax laws and annually collects over 90 percent of the revenues funding the Federal Government. Numerous organizational divisions and major programs within the IRS contribute to this achievement.

Operating Divisions
The IRS has four operating divisions:

- Wage and Investment provides customer support, submission processing, and compliance activities with respect to individuals with wage and investment income;
- Small Business and Self-Employed administers compliance activities for small businesses, self-employed individuals, and others with income from sources other than wages;
- Tax Exempt and Government Entities oversees and assists employee plans, tax exempt organizations, and government entities in complying with tax laws and regulations; and
- Large Business and International serves corporations, subchapter S corporations and partnerships with assets greater than $10 million; which deal with complicated issues involving tax law and accounting principles, and conduct business in an expanding global environment.

Functional Divisions
Five functional divisions within the IRS provide enforcement services supporting both internal and external operations:

- Appeals
- Criminal Investigation
- Communications & Liaison
- Taxpayer Advocate Service
- Office of Chief Counsel

The National Taxpayer Advocate reports directly to Congress and the IRS Chief Counsel reports to the Secretary of the Treasury.

Support Divisions
Nine support divisions provide shared services support to all of the IRS organizations:

- Information Technology
- Agency-Wide Shared Services
- Stewardship
- Wage & Investment - Stewardship
- Executive Leadership and Direction
- Privacy, Governmental Liaison and Disclosure
- Human Capital Office
- Human Capital Office Corporate Programs
- Chief Financial Officer

Major Programs
The IRS has four major programs (further discussed in Note 1.J., Program Costs):

- Taxpayer Assistance and Education
- Filing and Account Services
- Compliance
- Administration of Tax Credit Programs

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INTERNAL REVENUE SERVICE

Notes to the Financial Statements

For the Years Ended September 30, 2018 and 2017

B. Basis of Accounting and Presentation

The financial statements have been prepared from the accounting records of the IRS in conformity with accounting principles generally accepted in the U.S. and in accordance with the Office of Management and Budget (OMB) Circular No. A-136, *Financial Reporting Requirements*. Accounting principles generally accepted for federal entities are the standards prescribed by the Federal Accounting Standards Advisory Board, which is the official body for setting accounting standards of the Federal Government.

These comparative financial statements and related notes consist of the Balance Sheet, the Statement of Net Cost, the Statement of Changes in Net Position, the Statement of Budgetary Resources (SBR), and the Statement of Custodial Activity (SCA).

The accounting structure of federal agencies is designed to reflect both accrual and budgetary accounting transactions. Under the accrual method of accounting, revenues are recognized when earned and expenses are recognized when incurred, without regard to receipt or payment of cash. Budgetary accounting facilitates compliance with legal constraints and controls over the use of federal funds. The SCA is presented on the modified cash basis of accounting. Under this method, cash collections and transfers to the General Fund of the U.S. Government are reported on a cash basis. The collections and transfers are adjusted on the face of the statement for the net change in taxes receivable, producing modified cash basis balances.

Certain assets, liabilities, earned revenues, and costs have been classified as intragovernmental throughout the financial statements and notes. Intragovernmental is defined as transactions made between two reporting entities within the Federal Government.

C. Fund Balance with Treasury

The fund balance with Treasury is the aggregate of funds in the accounts of the IRS, primarily appropriated funds, from which the IRS is authorized to make expenditures and pay liabilities.

The status of fund balance with Treasury represents amounts obligated and unobligated. The obligated balances not yet disbursed represent the unpaid funds with budgetary obligations. Unobligated balances, available represent amounts in unexpired appropriations as of the end of the current fiscal year. Unobligated balances become available when apportioned by the OMB. Unobligated balances, unavailable represent amounts in expired appropriations and amounts not apportioned for obligation as of the end of the current fiscal year.

D. Other Assets

Accounts receivable consist of amounts due to the IRS from the public and from federal agencies. Accounts receivable are recorded and reimbursable revenues are recognized as the services are performed and costs are incurred. The allowance for uncollectible accounts is based on an annual review of groups of accounts by age for accounts receivable balances older than one year. Receivables include an expenditure transfer receivable from the Treasury Forfeiture Fund for the repayment of costs incurred in criminal investigations related to seizure and forfeitures.

Advances to the public represent cash outlays for criminal investigations and employee travel.

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INTERNAL REVENUE SERVICE

Notes to the Financial Statements

For the Years Ended September 30, 2018 and 2017

Forfeited property held for sale is acquired as a result of forfeiture proceedings or foreclosure sales to satisfy a tax liability. The Federal Tax Lien Revolving Fund, established in accordance with Title 26 United States Code (USC), Section 7810, is used to redeem real property foreclosed upon by a holder of a lien. The IRS may sell the property, reimburse the revolving fund in an amount equal to the redemption, and apply the net proceeds to the outstanding tax obligation.

E. Cash and Other Monetary Assets

Imprest funds are maintained by headquarters and field offices in commercial bank accounts. Other monetary assets consist primarily of offers-in-compromise, voluntary deposits received from taxpayers pending application of the funds to unpaid tax assessments, and seized monies pending the results of criminal investigations.

F. Federal Taxes Receivable, Net and Due to General Fund of the U.S. Government

Federal taxes receivable, net, and the corresponding liability, Due to General Fund of the U.S. Government, are not accrued until related tax returns are filed or assessments are made by the IRS and agreed to by either the taxpayer or the court. Accruals are made to reflect penalties and interest on taxes receivable through the balance sheet date.

Taxes receivable consist of unpaid assessments (taxes and associated penalties and interest) due from taxpayers. The existence of a receivable is supported by a taxpayer agreement, such as filing of a tax return without sufficient payment, or a court ruling in favor of the IRS. The allowance reflects an estimate of the portion of total taxes receivable deemed to be uncollectible.

Compliance assessments are unpaid assessments which neither the taxpayer nor a court has affirmed is owed to the Federal Government. Examples include assessments resulting from an IRS audit or examination in which the taxpayer does not agree with the results. Write-offs consist of unpaid assessments for which the IRS does not expect further collections due to factors such as taxpayers' bankruptcy, insolvency, or death. Compliance assessments and write-offs are not reported on the balance sheet. Statutory provisions authorize the IRS to collect on unpaid assessments for a specific statutory timeframe. In order to pursue collections and account for collection efforts, the IRS maintains unpaid assessment accounts in the financial records until the statute for collection expires.

Tax Assessments

Under the Internal Revenue Code (IRC) §6201, the Secretary of the Treasury is authorized and required to make inquiries, determinations, and assessments of all taxes imposed and accrued under any internal revenue law, which have not been duly paid, including interest, additions to the tax, and assessable penalties. The Secretary has delegated this authority to the Commissioner of the IRS. Unpaid assessments result from taxpayers filing returns without sufficient payments and from the enforcement programs of the IRS, such as examination, under-reporter, substitute for return, and combined annual wage reporting.

Abatements

IRC §6404 authorizes the Commissioner of the IRS to abate certain paid or unpaid portions of assessed taxes, interest, and penalties. Abatements occur for a number of reasons and are a standard part of the tax administration process. Abatements may be allowed for qualifying corporations

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INTERNAL REVENUE SERVICE

Notes to the Financial Statements

For the Years Ended September 30, 2018 and 2017

claiming net operating losses that create a credit when carried back and applied against a prior year's tax liability. Additionally, abatements can correct previous assessments from enforcement programs, eliminate taxes discharged in bankruptcy, reduce or eliminate taxes encompassed in offers-in-compromise, eliminate penalty assessments for reasonable cause, eliminate contested assessments caused by mathematical or clerical errors, and eliminate assessments contested after the liability has been satisfied. Abatements may result in claims for refunds or reductions of the unpaid assessed amounts.

G. General Property and Equipment

General property and equipment is recorded at historical cost. It consists of tangible assets and software. The IRS depreciates property and equipment on a straight line basis over its estimated useful life. Except for leases meeting the 75 percent useful life and/or 90 percent of net present value (NPV) criteria, the IRS records a half-year of depreciation in the first year and the final year for all property and equipment. The IRS depreciates leases meeting the 75 percent useful life and/or 90 percent of NPV criteria over the life of the leases, with no use of a half-year convention. Disposals are recorded when deemed material.

In fiscal year (FY) 2018, the IRS changed its capitalization threshold for telecommunications Information Technology (IT) equipment by implementing a threshold of $50 thousand or greater. Prior to FY 2018, this category was capitalized regardless of cost. Additionally, in FY 2018, the IRS changed its process of capitalizing leasehold improvements to construction in progress when projects have not yet been completed. Prior to FY 2018, leasehold improvements were capitalized and amortized when the services were received and accepted.

The IRS capitalization policy for property and equipment by asset class and threshold:

Asset Class	Capitalization Threshold
IT equipment	Bulk cost of $50 thousand or greater.
Non-IT equipment	Assets with bulk cost of $50 thousand or greater and the individual cost is $5 thousand or greater.
Furniture	No threshold.
Investigative equipment	Bulk cost of $50 thousand or greater.
Vehicles	No threshold.
Major systems	Projects with costs of $20 million or greater.
Internal use software	Projects with an estimated cost of greater than or equal to $10 million per year or greater than or equal to $50 million over the life cycle.
Leasehold improvements (LHI)	Improvements with bulk cost of $50 thousand or greater.
Assets under capital lease	Assets with bulk cost of $50 thousand or greater.

Prior to the implementation of Statement of Federal Financial Accounting Standards (SFFAS) No. 10, *Accounting for Internal Use Software*, Major systems was an asset class established to account for large-scale computer systems. These assets are fully depreciated, but still used in the IRS's daily operations and are reported on the financial statements.

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INTERNAL REVENUE SERVICE

Notes to the Financial Statements

For the Years Ended September 30, 2018 and 2017

Internal use software captures the costs of major Business Systems Modernization (BSM) projects in accordance with SFFAS No. 10. It encompasses software design, development, and testing of projects adding significant new functionality and long-term benefits. Costs for developing internal use software are accumulated in work in process until final acceptance and testing are successfully completed. When the software is completed and placed into service, the costs are transferred to amortizable property.

H. Federal Tax Refunds Payable and Due from General Fund of the U.S. Government

Federal tax refunds payable is comprised of measurable and legally payable amounts due to taxpayers under established refund processes of the IRS. It is a fully funded liability offset by a corresponding asset, Due from General Fund of the U.S. Government. The IRS records an amount Due from General Fund of the U.S. Government to designate approved funding to pay year-end tax refund liabilities to taxpayers.

I. Financing Sources and Revenues

Appropriations Received

The IRS receives the majority of its funding through annual, multi-year, and no-year appropriations available for use within statutory limits for operating and capital expenditures. Appropriations are recognized as budgetary financing sources when the related expenses are incurred.

Appropriations

The major budget accounts are:

- Taxpayer Services
- Enforcement
- Operations Support
- Other

Taxpayer Services provides funds for the direct costs of the Taxpayer Assistance and Education and the Filing and Account Services Programs discussed in Note 1.J., Program Costs.

Enforcement provides resources for the direct costs of the Compliance Program discussed in Note 1.J., Program Costs. Additionally, it funds the direct costs of administering the Earned Income Tax Credit Program (EITC).

Operations Support funds the indirect costs of all programs. Activities include executive planning and direction; shared service support for facilities, rent, utilities, and security; procurement; printing; postage; headquarters' activities such as strategic planning, finance, and human resources; research and statistics of income; and information systems, data processing, and telecommunication.

The IRS administers various tax provisions in the *Patient Protection and Affordable Care Act of 2010* (PPACA). The administrative costs are funded in the three major budget accounts: Taxpayer Services, Enforcement, and Operations Support.

Other primarily consists of the BSM appropriation, which provides resources for the planning and capital asset acquisition of information technology to modernize the business systems. Additionally, BSM is obligated pursuant to an expenditure plan submitted to Congress.

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INTERNAL REVENUE SERVICE

Notes to the Financial Statements

For the Years Ended September 30, 2018 and 2017

Exchange Revenues
Exchange revenues recognized by the IRS represent reimbursements and user fees. Reimbursements are recognized as the result of costs incurred for services performed for federal agencies or the public under reimbursable agreements. User fees are derived from transactions with the public and are generally recognized when collected.

Imputed Financing Sources
Other financing sources include imputed financing sources to offset the imputed costs recognized for goods or services received from other federal agencies without reimbursement from the IRS. The imputed costs are pension and other benefit costs administered by the Office of Personnel Management (OPM), costs of processing payments and collections by the Bureau of the Fiscal Service, costs of providing training by the Federal Law Enforcement Training Center, and legal judgments paid by the Treasury Judgment Fund.

J. Program Costs

Taxpayer Assistance and Education provides services to assist taxpayers with tax return preparation. Primary activities include tax law interpretations, developing and disseminating tax forms and publications, researching customer needs and establishing partnerships with stakeholder groups, and taxpayer advocacy. In addition, these programs continue to emphasize taxpayer education, outreach, and enhancing pre-filing taxpayer support through electronic media. Earned revenues include reimbursable revenues from services provided.

Filing and Account Services provides resources and support services to taxpayers with filing returns or paying taxes, and for the issuance of refunds and maintenance of taxpayer accounts. Program activities include providing assistance, education, and compliance services to taxpayers through telephone, correspondence, and electronic means to resolve account and notice inquiries. Earned revenues include user fees from photocopies, U.S. Residency Certification and Income Verification Express Service, and reimbursable revenues from services provided.

Compliance administers compliance activities after a return is filed to identify and correct possible errors or underpayments. This program includes examination and collection programs, which ensure proper payment and tax reporting; criminal investigation programs to uncover violations of internal revenue tax laws and other financial crimes; the development and printing of published IRS guidance materials; and support of taxpayers for pre-filing agreements, determination letters, and advance pricing agreements. It also includes specialty program examinations, international collections, and international examinations. Earned revenues are primarily from user fees for installment agreements, letter rulings and determinations, offers-in-compromise and enrollment programs, Advance Pricing and Mutual Agreement, and reimbursable revenues from services provided.

Administration of Tax Credit Programs primarily administers the EITC program, which works closely with internal and external stakeholders through expanded customer service and public outreach, enforcement, and research efforts to increase the number of eligible taxpayers who claim the EITC and to reduce the number of EITC claims paid in error. The EITC payments actually refunded to individuals or credited against tax liabilities are not included in program costs.

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INTERNAL REVENUE SERVICE

Notes to the Financial Statements

For the Years Ended September 30, 2018 and 2017

K. Custodial Activity

Non-exchange Revenues
The IRS collects custodial non-exchange revenues for taxes levied against taxpayers for: individual and corporate income, Federal Insurance Contributions Act (FICA) and Self-Employment Contributions Act (SECA), excise, estate, gift, railroad retirement, and federal unemployment taxes. These collections are not available to the IRS for obligation or expenditure and are recognized as custodial revenues when collected. The sources of federal tax revenue and their distribution to the General Fund of the U.S. Government are reported on the SCA.

Permanent Indefinite Appropriations
The IRS was granted permanent and indefinite budgetary authority through legislation to disburse tax refund principal and related interest as they become due. The permanent and indefinite appropriations are not subject to budgetary ceilings set by Congress during the annual appropriation process.

Refunds due to taxpayers are reported as Federal tax refunds payable on the Balance Sheet. The IRS records an offsetting asset, Due from General Fund of the U.S. Government, to reflect the year-end budget authority to pay this liability.

Disbursements for tax refunds, refundable tax credits and related interest, reported on the SCA, are offset by appropriations used for refunds. Disbursements for refunds are not a cost to the IRS, but rather a cost to the Federal Government as a whole.

L. Funds from Dedicated Collections

In accordance with SFFAS No. 43, *Funds from Dedicated Collections: Amending Statement of Federal Financial Accounting Standards 27, Identifying and Reporting Earmarked Funds*, Funds from Dedicated Collections are financed by specifically identified revenues, which remain available over time. These specifically identified revenues are required by statute to be used for designated activities, benefits or purposes, and must be accounted for separately from the Federal Government's general revenues.

The Federal Tax Lien Revolving Fund (20X4413) was established pursuant to section 112(a) of the *Federal Tax Lien Act of 1966*, to serve as the source of financing for the redemption of real property by the United States.

Established under the *American Jobs Creation Act of 2004,* the Private Collection Agent Program (20X5510) ended in March 2009. The remaining unobligated funds were retained by the IRS. The *Fixing America's Surface Transportation Act*, Public Law 114-94, enacted in December 2015, amended Title 26 United States Code, Section 6306, requiring the IRS to contract with private collection agencies for the collection of delinquent taxes. The delinquent taxes have (1) been removed from the IRS's active inventory due to a lack of resources or inability to find the taxpayer; (2) passed more than one-third of the applicable limitation period and no IRS employee has been assigned to the debt; or (3) been assigned for collection, but more than a year has passed without interaction with the taxpayer for the purpose of increasing the probability of collection. The Private Collection Agent Program (20X5510) is allowed to expend retained funds for qualified tax collection contracts and collection enforcement activities. The Special Compliance Personnel Program Account (20X5622) requires the hiring, training, and employment of personnel in compliance with Section 6307.

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INTERNAL REVENUE SERVICE

Notes to the Financial Statements

For the Years Ended September 30, 2018 and 2017

M. Allocation Transfers

The IRS is a party to allocation transfers with other federal agencies as both a transferring (parent) entity and a receiving (child) entity. Allocation transfers are legal delegations by one department of its authority to obligate budget authority and outlay funds to another department. A separate fund account (allocation account) is created in the U.S. Treasury as a subset of the parent fund account for tracking and reporting purposes. All allocation transfers of balances are credited to this account, and subsequent obligations and outlays incurred by the child entity are charged to this allocation account as they execute the delegated activity on behalf of the parent. Financial activity related to these allocation transfers is reported in the financial statements of the parent entity, from which the underlying legislative authority, appropriations, and budget apportionments are derived. The IRS allocates funds, as the parent, to the U.S. Department of Health and Human Services (HHS). Additionally, the IRS receives allocation transfers, as the child, from the U.S. Department of Transportation's Federal Highway Administration and HHS.

N. Fiduciary Activities

Fiduciary activities are the collection or receipt, and the management, protection, accounting, investment, and disposition by the Federal Government of cash or other assets in which non-federal individuals or entities have an ownership interest the Federal Government must uphold.

The IRS fiduciary activities include the net collections for a taxable year from U.S. military and federal employees working in the U.S. territories of the Northern Mariana Islands, the U.S. Virgin Islands, Guam, and American Samoa. These fiduciary assets are not assets of the IRS.

O. Employee Compensation and Benefits

Accrued Annual, Sick, and Other Leave
Annual and compensatory leave is expensed with an offsetting liability as it is earned, and the liability is reduced as leave is taken. Each year, the IRS adjusts the balance in the accrued annual leave liability account to reflect current pay rates. To the extent current or prior year appropriations are not available to fund annual and compensatory leave earned but not taken, funding is obtained from future financing sources. Sick leave and other types of non-vested leave are expensed as taken.

Employee Health and Life Insurance Benefits
Employees are eligible to participate in the Federal Employees Health Benefit Program (FEHB) and Federal Employees' Group Life Insurance Program (FEGLI). The FEHB offers a wide variety of group plans and coverage. The coverage is available to employees, retirees, and their eligible family members. The cost for each plan varies and is shared between the IRS and the employee. An employee participating in the FEGLI program can obtain basic term life insurance, with the employee paying two-thirds of the cost and the IRS paying one-third. Additional coverage is optional, to be paid fully by the employee. The basic life coverage may continue into retirement if certain requirements are met. The IRS recognizes the full cost of providing these benefits.

Federal Employees' Compensation Act
The Federal Employees' Compensation Act (FECA) provides income and medical cost protection to covered federal civilian employees injured on the job, to employees who have incurred work-related occupational diseases, and to beneficiaries of employees whose deaths were attributed to job-related

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injuries or occupational diseases. The FECA program is administered by the U.S. Department of Labor (DOL), which pays valid claims and subsequently seeks reimbursement for claims paid. Accrued FECA liability represents amounts due to the DOL for claims paid on behalf of the IRS. Actuarial FECA liability represents the liability for future workers' compensation benefits, which includes the expected liability for death, disability, medical, and miscellaneous costs for approved cases. The DOL estimates the liability for future payments as a result of past events.

Employee Pension Benefits

The IRS recognizes the full costs of its employees' pension benefits. The liabilities associated with these costs are reported by the OPM, who administers the plans. Eligibility of employees to participate in the Civil Service Retirement System (CSRS) or the Federal Employees Retirement System (FERS) is based on their hire date with the Federal Government, and the IRS contributes a percentage of an employee's basic pay toward the employee's retirement plan.

EMPLOYEE PENSION BENEFIT CONTRIBUTION RATES

	Category	Employee	Agency
CSRS Rates	Regular	7.0%	7.0%
	Law Enforcement Officers	7.5%	7.5%
FERS Rates	Regular	0.8%	13.7%
Hired prior to January 1, 2013	Law Enforcement Officers	1.3%	30.1%
FERS – Revised Annuity Rate	Regular	3.1%	11.9%
Hired January 1, 2013 - December 31, 2013	Law Enforcement Officers	3.6%	28.4%
FERS – Further Revised Annuity Rate	Regular	4.4%	11.9%
Hired January 1, 2014 or later	Law Enforcement Officers	4.9%	28.4%

Employees covered by either CSRS or FERS are also eligible to contribute to the Thrift Savings Plan (TSP), a defined contribution plan. A TSP account is automatically established for employees participating in FERS, and the IRS makes a mandatory contribution to this plan equal to one percent of an employee's compensation. Additionally, the IRS matches up to four percent of the compensation for FERS-eligible employees contributing to their TSP accounts. No TSP matching contributions are made for employees participating in the CSRS.

P. Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions related to the reporting of assets, liabilities, revenues, expenses, and the disclosure of contingent liabilities. Actual results could differ from those estimates.

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Note 2. Fund Balance with Treasury

(In Millions)	2018	2017
Fund balance with Treasury	**$ 3,206**	**$ 2,603**

(In Millions)	2018	2017
Unobligated balances		
Available	$ 737	$ 537
Unavailable	396	521
Obligated balance not yet disbursed	1,853	1,548
Non-budgetary and other FBWT	220	(3)
Status of fund balance with Treasury	**$ 3,206**	**$ 2,603**

Note 3. Other Assets

	2018		2017	
(In Millions)	Intra-governmental	With the Public	Intra-governmental	With the Public
Accounts receivable, net	$ 42	$ 5	$ 16	$ 7
Advances	-	8	-	6
Other assets	**$ 42**	**$ 13**	**$ 16**	**$ 13**

Note 4. Cash and Other Monetary Assets

(In Millions)	2018	2017
Imprest fund	$ 3	$ 4
Other monetary assets	533	489
Cash and other monetary assets	**$ 536**	**$ 493**

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Notes to the Financial Statements

For the Years Ended September 30, 2018 and 2017

Note 5. Federal Taxes Receivable, Net and Due to General Fund of the U.S. Government

(In Billions)	2018	2017
Federal taxes receivable	$ 218	$ 197
Allowance for uncollectible taxes receivable	(160)	(145)
Federal taxes receivable, net and Due to General Fund of the U.S. Government	**$ 58**	**$ 52**

Federal taxes receivable consists primarily of tax assessments, penalties, and interest not paid or abated, which were agreed to by the taxpayer and the IRS or upheld by the courts. The Allowance for uncollectible taxes receivable represents the difference between the gross Federal taxes receivable and the portion estimated to be collectible based on projections of collectability from a statistical sample of taxes receivable. Federal taxes receivable, net is the portion of gross Federal taxes receivable estimated to be collectible, and Due to General Fund of the U.S. Government is the offsetting liability to be transferred when collected.

For conservative financial reporting purposes, the IRS changed its FY 2018 estimation methodology from prior years. The $58 billion in taxes receivable, net represents the amount of taxes receivable estimated to be collectible as of September 30, 2018. To derive the estimated collectability rate applied to gross Federal taxes receivable, the IRS utilized the 2018 sample collectible point estimate of $37 billion (+/- $6.5 billion) and, to normalize the effect of significant changes in this rate from year to year, the IRS averaged the collectible rates from the three most current years. In FY 2017, the $52 billion in taxes receivable, net derived from the 2017 collectible point estimate of $46 billion (+/- 7.2 billion) using the prior years' methodology.

The Federal taxes receivable balance as of September 30, 2018, includes $12 billion from Branded Prescription Drug Fees, Insurance Provider Fees, and the non-delinquent IRC §965(h) tax which are fully collectible based on the collection history and the type of taxpayer. The non-delinquent IRC §965(h) component refers to taxpayers who elected to pay their 965 tax on an eight-year installment schedule. As of September 30, 2017, there was $2 billion in Federal taxes receivable from Branded Prescription Drug Fees. Due to a legislative moratorium within the *Consolidated Appropriations Act of 2016*, no Insurance Provider Fees were collected in FY 2017.

Note 6. Non-entity Assets

	2018		2017	
(In Millions)	Intra-governmental	With the Public	Intra-governmental	With the Public
Due from General Fund of the U.S. Government	$ 2,974	$ -	$ 3,061	$ -
Federal taxes receivable, net	-	58,000	-	52,000
Other monetary assets	-	533	-	489
Non-entity assets	**$ 2,974**	**$ 58,533**	**$ 3,061**	**$ 52,489**

Non-entity assets are not available for use by the IRS. Federal taxes receivable, net is collected for the U.S. Government, but the IRS does not have the authority to spend them.

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Notes to the Financial Statements

For the Years Ended September 30, 2018 and 2017

Note 7. General Property and Equipment, Net

(In Millions)	Useful Life (Years)	Cost	Accumulated Depreciation	2018 Net Book Value	2017 Net Book Value
IT equipment	3 to 7	$ 1,251	$ (858)	$ 393	$ 395
Internal use software	2 to 15	2,908	(1,680)	1,228	1,357
Leasehold improvements (LHI)	2 to 10	239	(153)	86	95
Major systems	7	221	(221)	-	-
Internal use software - work in process		193	-	193	165
Vehicles	5	4	(4)	-	1
Furniture and non-IT equipment	8 and 10	177	(127)	50	56
Assets under capital lease	4.5 to 8	29	(12)	17	9
Investigative equipment	10	4	(3)	1	-
LHI construction in progress		8	-	8	-
Property and equipment		**$ 5,034**	**$ (3,058)**	**$ 1,976**	**$ 2,078**

The Cost column represents the historical cost of property and equipment, net of disposals. The cost basis for FY 2018 and FY 2017 is $5,034 million and $4,874 million, respectively. Accumulated depreciation for FY 2018 and FY 2017 is $3,058 million and $2,796 million, respectively.

Internal use software projects (deployed and work in process) include:

- Account Management Services (AMS) provides the applications to monitor and interface with taxpayers, issue enhanced notices, and deliver improved customer support and functionality.
- Customer Account Data Engine 2 (CADE 2) is leveraging existing systems and new development to implement a single data-centric solution, which provides daily processing of individual taxpayer accounts.
- Enterprise Case Management (ECM) will provide an enterprise solution for performing case management functions using a common infrastructure platform and common services.
- Foreign Account Tax Compliance Act (FATCA) is a system to enable foreign financial institutions to report information to the IRS about financial accounts held by U.S. taxpayers or foreign entities in which U.S. taxpayers hold a substantial ownership interest.
- Information Reporting and Document Matching (IRDM) is a business document matching program designed to increase voluntary compliance and accurate reporting of income through the use of third party information reporting data.
- Integrated Financial System (IFS) is the administrative financial system.
- Integrated Procurement System (IPS) was replaced with Procurement for Public Sector.
- Knowledge Incident/Problem Service Asset Management (KISAM) is the asset and problem management system.
- Modernized e-file (MeF) is an electronic filing system for tax returns.
- PPACA are the systems to support tax administration responsibilities.
- Return Review Program (RRP) is an automated system designed to maximize fraud detection at the time tax returns are filed.
- Web Applications (Web Apps) is a program to improve the taxpayer's online experience, provide secure digital communications, and add more interactive capabilities to existing web self-service products.

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Notes to the Financial Statements

For the Years Ended September 30, 2018 and 2017

Work in Process Internal Use Software

(In Millions)	2018	2017
CADE 2	$ 160	$ 96
RRP	14	44
Web Apps	2	-
FATCA	-	7
ECM	17	18
Work in process internal use software	**$ 193**	**$ 165**

Deployed Internal Use Software

(In Millions)	Cost	Accumulated Depreciation	2018 Net Book Value	2017 Net Book Value
AMS	$ 78	$ (49)	$ 29	$ 34
CADE 2	347	(259)	88	130
FATCA	316	(119)	197	211
IRDM	59	(50)	9	17
IFS	167	(163)	4	7
IPS	-	-	-	3
KISAM	6	(6)	-	-
MeF	405	(364)	41	62
PPACA	995	(310)	685	786
RRP	175	(57)	118	74
Web Apps	67	(10)	57	33
Other	293	(293)	-	-
Deployed internal use software	**$ 2,908**	**$ (1,680)**	**$ 1,228**	**$ 1,357**

Other deployed internal use software projects fully depreciated, include:

- Customer Communications is a customer service telephone system.
- Custodial Detail Database (CDDB), the subsidiary ledger for Redesigned Revenue Accounting Control System (RRACS), provides the functionality needed for custodial financial management and reporting.
- E-Services is a system of web-based products and services for tax practitioners and the public.
- Enterprise Systems Management (ESM) is an infrastructure system allowing remote monitoring and network management.
- Internet Refund Fact of Filing allows taxpayers to review the status of their refund.
- RRACS adds enhancements to financial reporting of taxpayer receipts and adds traceability between summary records and the detailed subsidiary ledger (CDDB).
- Security and Technology Infrastructure Release (STIR) is the infrastructure for information technology security.

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Notes to the Financial Statements

For the Years Ended September 30, 2018 and 2017

Note 8. Liabilities

Other Liabilities

(In Millions)	2018 Current	2018 Non-Current	2018 Total
Intragovernmental			
Accrued payroll and benefits	$ 72	$ -	$ 72
Accrued FECA liability	39	48	87
Accrued expenses	6	-	6
Capital lease liabilities	-	1	1
Other liabilities	**$ 117**	**$ 49**	**$ 166**
With the Public			
Accrued annual leave	$ 472	$ -	$ 472
Actuarial FECA liability	-	456	456
Accrued payroll and benefits	240	-	240
Accrued expenses	199	-	199
Liability for deposit funds and clearing accounts	533	-	533
Accounts payable	14	-	14
Capital lease liabilities	3	10	13
Energy savings performance liability	1	3	4
Other liabilities	**$ 1,462**	**$ 469**	**$ 1,931**

(In Millions)	2017 Current	2017 Non-Current	2017 Total
Intragovernmental			
Accrued payroll and benefits	$ 72	$ -	$ 72
Accrued FECA liability	41	49	90
Accrued expenses	10	-	10
Capital lease liabilities	1	-	1
Other liabilities	**$ 124**	**$ 49**	**$ 173**
With the Public			
Accrued annual leave	$ 475	$ -	$ 475
Actuarial FECA liability	-	466	466
Accrued payroll and benefits	242	-	242
Accrued expenses	218	-	218
Liability for deposit funds and clearing accounts	489	-	489
Accounts payable	3	-	3
Energy savings performance liability	1	4	5
Other liabilities	**$ 1,428**	**$ 470**	**$ 1,898**

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Notes to the Financial Statements

For the Years Ended September 30, 2018 and 2017

Liabilities Not Covered by Budgetary Resources

(In Millions)	2018	2017
Intragovernmental		
Accrued FECA liability	$ 87	$ 90
Capital lease liabilities	1	1
Intragovernmental	**88**	**91**
With the public		
Accrued annual leave	472	475
Actuarial FECA liability	456	466
Energy savings performance liability	4	5
With the public	**932**	**946**
Liabilities not covered by budgetary resources	1,020	1,037
Liabilities covered by budgetary resources	61,737	55,607
Liabilities not requiring budgetary resources	533	489
Liabilities	**$ 63,290**	**$ 57,133**

Liabilities not covered by budgetary resources result from the receipt of goods and services, or occurrence of eligible events in the current or prior periods, for which revenue to pay the liabilities has not been made available through appropriations of the IRS.

Note 9. Leases

Capital Leases

The IRS leases IT telecommunications equipment for toll free call centers, and currently has a two-year lease and two seven-year leases. There are no future payments due for the equipment under these active leases. The liability for the two-year lease was paid in FY 2012, and title for the equipment remains with the vendor. The liability for the two seven-year leases was paid in FY 2011 at the beginning of the leases.

In 2017 the IRS leased multifunctional printing devices in a lease-to-own agreement. The final payment was made in early FY 2018.

In FY 2018 the IRS entered into a software license agreement for five years with perpetual use rights to the licenses.

The IRS has a lease with the General Services Administration (GSA) for vehicles used for enforcement and leases for furniture. The vehicles are being leased over a period of three to five years. The furniture is being leased over a period of five years.

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Notes to the Financial Statements

For the Years Ended September 30, 2018 and 2017

Summary of Assets Under Capital Lease:

(In Millions) Capital Lease Category	2018	2017
Telecom equipment	$ 8	$ 8
Non-IT equipment	-	8
Software license agreement	17	-
Vehicles	1	4
Furniture	2	1
Accumulated depreciation	(11)	(12)
Assets under capital lease, net	**$ 17**	**$ 9**

Future minimum payments due are as follows:

(In Millions) Fiscal Year	2018 Intra-governmental	With the Public	Total
2019	$ -	$ 3	$ 3
2020	1	4	5
2021	-	3	3
2022	-	3	3
After 2022	-	-	-
Capital lease liabilities	**$ 1**	**$ 13**	**$ 14**
Capital lease liabilities not covered by budgetary resources			**$ 1**
Capital lease liabilities covered by budgetary resources			**$ 13**

Operating Leases

The IRS leases office space from GSA and commercial entities under non-cancelable operating leases with lease terms from 2 to 30 years. This includes all GSA occupancy agreements the IRS determined to be non-cancelable. Future lease payments under non-cancelable leases of office spaces are presented below.

(In Millions) Fiscal Year	2018 Intra-governmental	With the Public	Total
2019	$ 146	$ 9	$ 155
2020	134	1	135
2021	129	-	129
2022	72	-	72
2023	60	-	60
After 2023	322	-	322
Future lease payments	**$ 863**	**$ 10**	**$ 873**

Additionally, the IRS has annual operating leases with the GSA for office space and vehicles, and with commercial entities for equipment and software licenses. These leases may be canceled or renewed on an annual basis at the option of the IRS. They do not impose binding commitments on the IRS for future rental payments on leases with terms longer than one year.

INTERNAL REVENUE SERVICE

Notes to the Financial Statements

For the Years Ended September 30, 2018 and 2017

Note 10. Commitments and Contingencies

The IRS is a party to legal actions whose outcome, if unfavorable, could materially affect the financial statements. As of September 30, 2018, and 2017, there were no estimated contingent liabilities arising from these actions.

For some of the legal actions to which the IRS is a party, management and legal counsel cannot determine the likelihood of an unfavorable outcome nor can any related loss be reasonably estimated. The IRS does not accrue for possible losses related to cases where the potential loss cannot be estimated or the likelihood of an unfavorable outcome is less than probable. As of September 30, 2018, and 2017, there are two cases and five cases, respectively, for which management and legal counsel are unable to determine the likelihood of an unfavorable outcome or establish a range of potential losses. Additionally, for some of the legal actions, management and legal counsel have determined the likelihood of an unfavorable outcome is remote.

As of September 30, 2018, and 2017, the IRS does not have contractual commitments for payments on obligations related to canceled appropriations or contractual arrangements for which the IRS has not recognized liabilities for goods and services provided.

Note 11. Undelivered Orders at the End of the Period

	2018		
(In Millions)	Intra-governmental	With the Public	Total
Unpaid	$ 122	$ 1,241	$ 1,363
Paid	-	9	9
Undelivered orders at the end of the period	**$ 122**	**$ 1,250**	**$ 1,372**

	2017		
(In Millions)	Intra-governmental	With the Public	Total
Unpaid	$ 76	$ 955	$ 1,031
Paid	-	6	6
Undelivered orders at the end of the period	**$ 76**	**$ 961**	**$ 1,037**

Undelivered orders are the value of goods and services ordered and obligated, but not yet received. This amount includes any prepaid or advanced orders for which delivery or performance has not yet occurred.

INTERNAL REVENUE SERVICE

Notes to the Financial Statements

For the Years Ended September 30, 2018 and 2017

Note 12. Statement of Budgetary Resources

New Obligations and Upward Adjustments

(In Millions)	2018	2017
Category B		
Direct	$ 11,805	$ 11,593
Reimbursable	171	152
New obligations and upward adjustments	**$ 11,976**	**$ 11,745**

Category B apportionments distribute budgetary resources by activities or programs and are restricted by purpose for which obligations can be incurred.

Explanation of Differences Between the FY 2017 Statement of Budgetary Resources and the *FY 2019 Budget of the United States Government*

(In Millions)	Budgetary Resources	New Obligations and Upward Adjustments	Distributed Offsetting Receipts	Outlays, Net
Statement of Budgetary Resources	$ 12,803	$ 11,745	$ 362	$ 11,505
Not included on the *Budget of the United States Government*				
Expired funds	(345)	-	-	-
Offsetting receipts	-	-	(362)	-
Not included on the Statement of Budgetary Resources				
Refundable tax credits, interest refunds to taxpayers, and other outlays	134,493	134,493	-	128,008
Informant payments	22	22	-	22
Other	(2)	2	-	2
Budget of the United States Government	**$ 146,971**	**$ 146,262**	**$ -**	**$ 139,537**

The *FY 2020 Budget of the United States Government* presenting the actual amounts for the year ended September 30, 2018 has not been published as of the issue date of these financial statements and will be available at a future date. A reconciliation of the FY 2017 SBR and the FY 2017 actual amounts in the *FY 2019 Appendix, Budget of the United States Government* for budgetary resources, new obligations and upward adjustments, distributed offsetting receipts, and outlays, net is presented above.

Refundable tax credits, interest refunds, other outlays and Informant payments total $134.5 billion in appropriations. These appropriations primarily consist of EITC, Premium Tax Credit, and Child Tax Credit and are reported with refunds on the SCA and are not reported on the SBR.

INTERNAL REVENUE SERVICE

Notes to the Financial Statements

For the Years Ended September 30, 2018 and 2017

Note 13. Collections of Federal Tax Revenue

(In Billions)	Tax Year 2018		Tax Year 2017	Tax Year 2016	Tax Year Prior Years	Collections Received FY 2018	Collections Received FY 2017
Individual income, FICA/SECA, and other	$ 1,932	*	$ 1,097	$ 34	$ 27	$ 3,090	$ 2,976
Corporate income	150	**	100	2	11	263	339
Excise	54		19	-	-	73	64
Estate and gift	-		21	1	2	24	24
Railroad retirement	5		1	-	-	6	6
Federal unemployment	5		4	-	-	9	8
Collections of federal tax revenue	**$ 2,146**		**$ 1,242**	**$ 37**	**$ 40**	**$ 3,465**	**$ 3,417**

* Includes other collections of $251 million.
** Includes tax year 2019 corporate income tax receipts of $7 billion.

Note 14. Federal Tax Refund and Outlay Activities

(In Billions)	Tax Year 2018	Tax Year 2017	Tax Year 2016	Tax Year Prior Years	Refunds and Outlays FY 2018	Refunds and Outlays FY 2017
Individual income, FICA/SECA, and other	$ 55	$ 308	$ 30	$ 9	$ 402	$ 389
Corporate income	5	26	9	20	60	45
Excise	-	-	-	1	1	2
Estate and gift	-	-	1	-	1	1
Federal tax refund and outlay activities	**$ 60**	**$ 334**	**$ 40**	**$ 30**	**$ 464**	**$ 437**

Federal tax refunds and outlays include overpayments from taxpayers; payments for the various refundable credits, including EITC and the Premium Tax Credit; and other payments, including the Cost Sharing Reduction (CSR), Basic Health Program, and the State Innovation Waiver Program under the PPACA. On October 12, 2017, an executive order was issued to discontinue CSR payments effective October 1, 2017. The State Innovation Waiver Program is a new outlay for FY 2018.

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INTERNAL REVENUE SERVICE

Notes to the Financial Statements

For the Years Ended September 30, 2018 and 2017

Note 15. Fiduciary Activities

(In Millions)	2018 20X6737	20X6738	20X6740	20X6741	Total
Fiduciary net assets, beginning of year	$ -	$ 9	$ -	$ -	$ 9
Contributions	9	19	260	10	298
Disbursements to and on behalf of beneficiaries	(9)	(20)	(260)	(10)	(299)
Decrease in fiduciary net assets	-	(1)	-	-	(1)
Fiduciary net assets, end of year	**$ -**	**$ 8**	**$ -**	**$ -**	**$ 8**

(In Millions)	2017 20X6737	20X6738	20X6740	20X6741	Total
Fiduciary net assets, beginning of year	$ -	$ 19	$ -	$ -	$ 19
Contributions	9	10	23	13	55
Disbursements to and on behalf of beneficiaries	(9)	(20)	(23)	(13)	(65)
Decrease in fiduciary net assets	-	(10)	-	-	(10)
Fiduciary net assets, end of year	**$ -**	**$ 9**	**$ -**	**$ -**	**$ 9**

In fiduciary fund 20X6738, the fiduciary net assets, end of year balances are pending a tax matter resolution.

In accordance with the SFFAS No. 31, *Accounting for Fiduciary Activities,* fiduciary cash and other assets are not assets of the Federal Government. The IRS has four fiduciary funds not reported on the balance sheet:

- Internal Revenue Collections for Northern Mariana Islands 20X6737
- Coverover Withholdings – U.S. Virgin Islands 20X6738
- Coverover Withholdings – Guam 20X6740
- Coverover Withholdings – American Samoa 20X6741

IRC §7654 governs the tax coordination between the governments of the United States and the U.S. territories of the Northern Mariana Islands, the U.S. Virgin Islands, Guam, and American Samoa.

The collections of federal income taxes withheld from U.S. military and federal employees working in these U.S. territories are maintained in fiduciary funds of the IRS. The disbursements of these collections to these U.S. territory governments represent the transfer of the individual tax liability for a taxable year.

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INTERNAL REVENUE SERVICE

Notes to the Financial Statements

For the Years Ended September 30, 2018 and 2017

Note 16. Reconciliation of Net Cost of Operations to Budget

(In Millions)	2018	2017
Resources used to finance activities:		
New obligations and upward adjustments	$ 11,976	$ 11,745
Spending authority from offsetting collections and recoveries	(292)	(327)
Distributed offsetting receipts	(382)	(362)
Transfers to General Fund of the U.S. Government	(9)	(21)
Imputed financing	1,577	1,159
Transfers in/out without reimbursement	-	-
	12,870	12,194
Resources that do not fund net cost of operations:		
Changes in goods, services and benefits ordered but not yet received or (provided)	(335)	65
Costs capitalized on the balance sheet	(145)	(199)
Other	26	15
	(454)	(119)
Costs that do not require resources in current period:		
Depreciation and amortization	419	392
Decrease in unfunded liabilities	(17)	(13)
Revaluation of assets and liabilities	11	8
Other	(187)	(314)
	226	73
Net cost of operations	$ 12,642	$ 12,148

In accordance with the SFFAS No. 7, *Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting*, the budgetary resources obligated during the period for the programs and operations of the IRS must be reconciled to the net cost of operations. Budgetary accounting reports the obligations and outlays of financial resources to acquire or provide goods and services. The accrual basis of accounting reports the net cost of resources used.

Required Supplementary Information

INTERNAL REVENUE SERVICE

Required Supplementary Information - Unaudited

For the Years Ended September 30, 2018 and 2017

Schedule of Budgetary Resources by Major Budget Accounts

(In Millions)	2018 Taxpayer Services	Enforcement	Operations Support	Other	Total
Budgetary resources					
Unobligated balance brought forward, October 1	$ 90	$ 95	$ 258	$ 615	$ 1,058
Recoveries of prior year unpaid obligations	6	11	37	4	58
Other changes in unobligated balance	(33)	(9)	171	(186)	(57)
Unobligated balance from prior year budget authority, net	63	97	466	433	1,059
Appropriations (discretionary & mandatory)	2,513	4,627	4,198	516	11,854
Spending authority from offsetting collections (discretionary & mandatory)	70	57	69	-	196
Total budgetary resources	**$ 2,646**	**$ 4,781**	**$ 4,733**	**$ 949**	**$ 13,109**
Status of budgetary resources					
New obligations and upward adjustments (total)	$ 2,582	$ 4,717	$ 4,408	$ 269	$ 11,976
Unobligated balance, end of year					
Apportioned, unexpired accounts	24	15	193	498	730
Exempt from apportionment, unexpired accounts	-	-	-	7	7
Unapportioned, unexpired accounts	-	-	-	167	167
Unexpired unobligated balance, end of year	24	15	193	672	904
Expired unobligated balance, end of year	40	49	132	8	229
Unobligated balance, end of year (total)	64	64	325	680	1,133
Total budgetary resources	**$ 2,646**	**$ 4,781**	**$ 4,733**	**$ 949**	**$ 13,109**
Outlays, net					
Outlays, net (total) (discretionary & mandatory)	$ 2,469	$ 4,582	$ 4,061	$ 267	$ 11,379
Distributed offsetting receipts	-	-	-	(382)	(382)
Agency outlays, net (discretionary & mandatory)	**$ 2,469**	**$ 4,582**	**$ 4,061**	**$ (115)**	**$ 10,997**

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INTERNAL REVENUE SERVICE

Required Supplementary Information - Unaudited

For the Years Ended September 30, 2018 and 2017

Schedule of Budgetary Resources by Major Budget Accounts (continued)

	2017				
(In Millions)	Taxpayer Services	Enforcement	Operations Support	Other	Total
Budgetary resources					
Unobligated balance brought forward, October 1	$ 63	$ 136	$ 298	$ 452	$ 949
Recoveries of prior year unpaid obligations	6	17	78	5	106
Other changes in unobligated balance	3	9	51	(111)	(48)
Unobligated balance from prior year budget authority, net	72	162	427	346	1,007
Appropriations (discretionary & mandatory)	2,460	4,640	3,942	589	11,631
Spending authority from offsetting collections (discretionary & mandatory)	62	47	55	1	165
Total budgetary resources	**$ 2,594**	**$ 4,849**	**$ 4,424**	**$ 936**	**$ 12,803**
Status of budgetary resources					
New obligations and upward adjustments (total)	$ 2,504	$ 4,754	$ 4,166	$ 321	$ 11,745
Unobligated balance, end of year					
Apportioned, unexpired accounts	49	29	90	362	530
Exempt from apportionment, unexpired accounts	-	-	-	7	7
Unapportioned, unexpired accounts	-	-	-	238	238
Unexpired unobligated balance, end of year	49	29	90	607	775
Expired unobligated balance, end of year	41	66	168	8	283
Unobligated balance, end of year (total)	90	95	258	615	1,058
Total budgetary resources	**$ 2,594**	**$ 4,849**	**$ 4,424**	**$ 936**	**$ 12,803**
Outlays, net					
Outlays, net (total) (discretionary & mandatory)	$ 2,400	$ 4,642	$ 4,036	$ 427	$ 11,505
Distributed offsetting receipts	-	-	-	(362)	(362)
Agency outlays, net (discretionary & mandatory)	**$ 2,400**	**$ 4,642**	**$ 4,036**	**$ 65**	**$ 11,143**

Other Claims for Refunds

Management has estimated amounts that may be paid out as other claims for tax refunds. This estimate represents an amount (principal and interest), which may be paid for claims pending judicial review by the federal courts or, internally, by Appeals. In fiscal year (FY) 2018, the total estimated payout (including principal and interest) for claims pending judicial review by the federal courts is $11.1 billion and by Appeals is $1.8 billion. In FY 2017, the total estimated payout (including principal and interest) for claims pending judicial review by the federal courts was $8.2 billion and by Appeals was $2.2 billion. To the extent judgments against the government in these cases prompt other similarly situated taxpayers to file similar refund claims; these amounts could become significantly greater.

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INTERNAL REVENUE SERVICE

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For the Years Ended September 30, 2018 and 2017

Federal Taxes Receivable, Net

In accordance with the Statements of Federal Financial Accounting Standards No. 7, *Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting*, some unpaid assessments do not meet the criteria for financial statement recognition as discussed in Note 1.F., Federal Taxes Receivable, Net and Due to General Fund of the U.S. Government. Although compliance assessments and write-offs are not considered receivables under federal accounting standards, they represent legally enforceable claims of the IRS acting on behalf of the Federal Government. There is, however, a significant difference in the collection potential of these categories.

The components of the total unpaid assessments and derivation of net Federal taxes receivable were as follows:

(In Billions)	2018	2017
Total unpaid assessments	$ 398	$ 382
Compliance assessments	(65)	(74)
Write-offs	(115)	(111)
Gross federal taxes receivables	218	197
Allowance for uncollectible taxes receivable	(160)	(145)
Federal taxes receivable, net	**$ 58**	**$ 52**

Total unpaid assessments include $12 billion of Branded Prescription Drug Fees, Insurance Provider Fees and the non-delinquent IRC §965(h) tax which are fully collectible based on the collection history and the type of taxpayer. The non-delinquent IRC §965(h) component refers to taxpayers who elected to pay their 965 tax on an eight-year installment schedule. For conservative financial reporting purposes, the IRS changed its estimation methodology in FY 2018 (see Note 5). As of September 30, 2017, there was $2 billion in Federal taxes receivable from Branded Prescription Drug Fees. Due to a legislative moratorium within the *Consolidated Appropriations Act 2016*, no Insurance Provider Fees were collected in FY 2017.

To eliminate double-counting, the compliance assessments reported above exclude trust fund recovery penalties assessed against officers and directors of businesses involved in the non-remittance of federal taxes withheld from their employees. These penalties totaled approximately $1 billion as of September 30, 2018 and 2017, respectively. The related unpaid assessments of those businesses are reported as taxes receivable or write-offs, but the IRS may also recover portions of those businesses' unpaid assessments from any and all individual officers and directors against whom a trust fund recovery penalty is assessed.

The IRS cannot reasonably estimate the allowance for uncollectible amounts pertaining to its compliance assessments, and thus cannot determine their net realizable value or the value of the pre-assessment work in process.

INTERNAL REVENUE SERVICE

Other Information - Unaudited

For the Years Ended September 30, 2018 and 2017

Refundable Tax Credits and Other Outlays

Refundable Tax Credits

To offer tax relief to targeted individuals and businesses, Congress has provided assistance 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 non-refundable credits. Refundable credits, 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 amount of the credit, regardless of the underlying tax liability.

The following overview summarizes the refundable credits the IRS administers and pays. This overview describes refundable credits in existence for many years, and those created more recently by Congress, including those enacted as part of the *American Recovery and Reinvestment Act of 2009* (ARRA) and the *Patient Protection and Affordable Care Act of 2010* (PPACA).

Earned Income Tax Credit

The Earned Income Tax Credit (EITC) is a refundable tax credit for low to moderate income working individuals and families. Congress originally approved the tax credit legislation in 1975, in part, to offset the burden of social security taxes and to provide an incentive to work. To qualify, taxpayers must meet certain requirements and file a tax return, even if they did not have sufficient income to meet regular tax return filing requirements.

Premium Tax Credit

Starting January 1, 2014, persons who purchase health insurance coverage through the Health Insurance Marketplace may be eligible for the premium tax credit. In general, a person is eligible for the credit if they (a) buy health insurance through the Marketplace, (b) are ineligible for coverage through an employer or government plan, (c) are within certain income limits, (d) do not file a Married Filing Separately tax return (unless they meet specific criteria that allow certain victims of domestic abuse to claim the premium tax credit using the Married Filing Separately filing status for the 2014 calendar year), and (e) cannot be claimed as a dependent by another person. Eligible individuals may elect to have some or all of their estimated credit paid in advance directly to their insurance company to lower the amount they must pay out-of-pocket for their monthly premiums or they may elect to receive all of the credit when they file their tax return. Each person who receives the benefit of a credit advance or who wishes to claim the credit must file an income tax return.

Additional Child Tax Credit

The Additional Child Tax Credit is a special credit for taxpayers who work, have earnings below an established ceiling, and have a qualifying child. The Child Tax Credit is limited to the taxpayer's tax liability and is a nonrefundable tax credit. However, certain individuals who receive less than the full amount of the Child Tax Credit may qualify for the "Additional" Child Tax Credit. Under this credit, subject to additional criteria, the taxpayer may receive the full credit amount even if such amount exceeds the taxpayer's tax liability. Consequently, the Additional Child Tax Credit is categorized as a refundable tax credit. This refundable credit, set to expire at the end of 2012, was extended through December 2017, by the *American Taxpayer Relief Act of 2012*.

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For the Years Ended September 30, 2018 and 2017

Build America and Recovery Zone Bonds

Build America Bonds (BABs) are a financing tool for state and local governments. The bonds, which allow a new direct federal payment subsidy, are taxable bonds issued by state and local governments to give them access to the conventional corporate debt markets. At the election of the state and local governments, the U.S. Department of Treasury (Treasury) will make a direct payment to the state or local governmental issuer in an amount equal to 35 percent of the interest payment on the BABs. This federal subsidy payment provides state and local governments lower net borrowing costs and allows them to reach more sources of borrowing than they can with more traditional tax-exempt or tax credit bonds.

Created by the ARRA, Recovery Zone Bonds are targeted to areas particularly affected by job losses and help local governments obtain financing for much needed economic development projects, such as public infrastructure development.

Qualified Zone Academy Bonds and Qualified School Construction Bonds

Congress created Qualified Zone Academy Bonds and Qualified School Construction Bonds to help schools raise funds to renovate and repair buildings, invest in equipment and current technology, develop more challenging curricula, and train teachers. The tax credit portion of these bonds depends on the issuance date of the bonds, the number of bonds outstanding, and the time remaining until their redemption.

Qualified Energy Conservation Bonds and New Clean Renewable Energy Bonds

Qualified Energy Conservation Bonds (QECB) may be issued by state, local, and tribal governments to finance qualified energy conservation projects. A minimum of 70 percent of a state's allocation must be used for governmental purposes, and the remainder may be used to finance private activity projects. QECBs were originally structured as tax credit bonds. However, the March 2010 *Hiring Incentives to Restore Employment* (HIRE) *Act* (H.R. 2847 (Sec. 301)) changed QECB from tax credit bonds to direct subsidy bonds similar to BABs. The QECB issuer pays the investor a taxable coupon and receives a rebate from Treasury.

New Clean Renewable Energy Bonds (CREBs) may be issued by public power utilities, electric cooperatives, government entities (states, cities, counties, territories, Indian tribal governments), and certain lenders to finance renewable energy projects. CREBs were originally structured as tax credit bonds. However, the March 2010 HIRE Act (H.R. 2847 (Sec. 301)) changed CREBs from tax credit bonds to direct subsidy bonds similar to BABs. The issuer pays the investor a taxable coupon and receives a rebate from Treasury.

American Opportunity Tax Credit

The American Opportunity Tax Credit modifies the existing Hope Credit. The credit was extended to apply for tax years through 2017 by the *American Taxpayer Relief Act of 2012*. This tax credit makes the Hope Credit available to a broader range of taxpayers, including many with higher incomes and those who owe no tax. Additionally, it adds required course materials to the list of qualifying expenses and allows the credit to be claimed for four post-secondary education years instead of two. Many of those eligible will qualify for the maximum annual credit of $2,500 per student.

INTERNAL REVENUE SERVICE

Other Information - Unaudited

For the Years Ended September 30, 2018 and 2017

Corporate Alternative Minimum Tax Credit

Internal Revenue Code (IRC) §168(k)(4) allows a taxpayer to elect to claim a refundable credit for certain unused research credits in lieu of the special depreciation allowance for eligible property.

Health Coverage Tax Credit

The federal Health Coverage Tax Credit (HCTC) was created by the *Trade Act of 2002* to help certain displaced workers and certain retirees pay for health insurance. Generally, those eligible to claim the credit fall into one of two categories: 1) trade-impacted workers who have lost their jobs because of increased imports or a shift in production to another country and are classified as Trade Adjustment Assistance (TAA) or Alternative Trade Adjustment Assistance (ATAA) and, 2) individuals whose pensions are being paid by the Pension Benefit Guaranty Corporation (PBGC), are at least 55 years of age and not entitled to Medicare.

The *Trade Preferences Extension Act of 2015* (Public Law 114-27) extended and modified the expired HCTC. Previously, those eligible for the HCTC could claim the credit against the premiums they paid for certain health insurance coverage through 2013. The HCTC can now be claimed for coverage through 2019. Eligible participants are responsible for paying 27.5 percent of their insurance premium while the IRS is responsible for paying the remaining 72.5 percent.

In general, eligible taxpayers will claim the HCTC for 2016 when they file their federal income tax returns in 2017. However, the IRS implemented a limited interim process for making advance monthly payments in the summer of 2016. This process was only available to individuals for months they were enrolled in qualified health coverage and working with their Health Plan Administrator or a Third-Party Administrator that was willing to meet certain IRS requirements and enter into a Memorandum of Understanding (MOU) with the IRS.

Payments for Disaster Related Tax Relief

On September 29, 2017, the President of the United States of America signed into law H.R. 3823, known as the *Disaster Tax Relief and Airport and Airway Extension Act of 2017* (the Act), which provides a series of relief measures for zones and areas affected by hurricanes Harvey, Irma and Maria, among other matters. Pursuant to Section 504(d)(1)(B) of the Act, the Secretary of the Treasury shall pay to Puerto Rico amounts estimated by the Secretary of the Treasury as being equal to the aggregate benefits that would have been provided to residents of Puerto Rico by reason of the provisions of Title V of the Act if a mirror code tax system had been in effect in Puerto Rico.

Small Business Health Insurance Tax Credit

Certain small employers are eligible for a tax credit, provided they contribute a uniform percentage of at least 50 percent toward their employees' health insurance. For nonprofit (tax-exempt) organizations, the credit cannot exceed the total amount of income and Medicare tax (i.e., hospital insurance) withholdings the employer must make and the related employer share of Medicare tax on employees' wages.

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For the Years Ended September 30, 2018 and 2017

Other Outlays

Cost Sharing Reduction

In addition to the premium tax credit, individuals who purchased a qualified health care plan through the Marketplace could qualify for Cost Sharing Reductions (CSR) based on their family income. This lowered the amount they had to pay for out-of-pocket costs such as deductibles, coinsurance, and copayments. Unlike the premium tax credit, these subsidies were not tax credits and were not reported on the recipient's income tax return. The CSR program was administered jointly by the U.S. Department of Health and Human Services and the IRS. These CSR payments were outlays of the Federal Government.

On October 10, 2017, the Attorney General issued a formal legal opinion on the permanent, indefinite appropriation for refunding internal revenue collections, 31 U.S.C. §1324, indicating the appropriation is not available to fund the CSR payments authorized by section 1302 of the Affordable Care Act, 42 U.S.C. §18071. Considering the Attorney General's opinion, the Acting Secretary of HHS issued a directive on October 11th prohibiting CSR payments, and on October 12th an executive order was issued to discontinue CSR payments effective October 1, 2017.

Basic Health Program

Section 1331 of the PPACA gives states the option of creating a health benefits coverage program for low-income residents who would otherwise be eligible to purchase coverage through the Health Insurance Marketplace. The Basic Health Program (BHP) gives states the ability to provide more affordable coverage for these low-income residents and improve continuity of care for people whose income fluctuates above and below Medicaid and Children's Health Insurance Program levels. These subsidies, which are Federal Government outlays, are not tax credits and are not reported on the recipient's income tax return. In addition, the CSR portion of the BHP was terminated and no further quarterly payments were disbursed in FY 2018.

State Innovation Waiver Program

Starting January 1, 2017, the states can apply for a waiver under Section 1332 of the Affordable Care Act. The waivers will enable the states to implement innovative ways for providing access to quality health care to their residents. The coverage must be at least as comprehensive and affordable as would be provided absent the waiver. In addition, the states must extend coverage to a comparable number of residents as would be provided coverage absent a waiver and must not increase the federal deficit. Pass through funding is the foundation of the waivers, which will grant the states the equivalent of the forgone financial assistance they otherwise would receive absent the waiver, such as the Premium Tax Credit (IRC §36B), and the Small Business Health Tax Credit (IRC §45R).

Interest on Tax Refunds

The IRS pays interest on refunds sent later than 45 days from the filing deadline of the return. Additionally, interest is generally paid on amended returns that result in a refund. Returns that have been examined and show an overpayment also result in the payment of interest. The interest rate on overpayments is adjusted quarterly.

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For the Years Ended September 30, 2018 and 2017

Payments of refundable tax credits in excess of tax liabilities and other outlays in FY 2018 and FY 2017 are shown below.

(In Millions)	2018	2017
Earned Income Tax Credit	$ 58,640	$ 59,749
Premium Tax Credit*	41,694	28,544
Additional Child Tax Credit	18,597	19,408
Build America and Recovery Zone Bonds	3,539	3,629
Qualified Zone Academy Bonds	57	52
Qualified School Construction Bonds	680	673
Qualified Energy Conservation Bonds	40	40
New Clean Renewable Energy Bonds	46	40
American Opportunity Tax Credit	3,102	3,469
Corporate Alternative Minimum Tax Credit	1,120	626
Health Coverage Tax Credit	27	25
Payments for Disaster Related Tax Relief	250	-
Small Business Health Insurance Tax Credit	1	7
Cost Sharing Reduction**	(507)	6,270
Basic Health Program	4,750	4,330
State Innovation Waiver Program	26	-
Interest on Tax Refunds	1,551	1,148
Refundable tax credits and other outlays	**$ 133,613**	**$ 128,010**

*Includes advanced amounts for the Premium Tax Credit. Beginning in FY 2015, preliminary outlay amounts are adjusted upward or downward based on information from tax returns. In FY 2018 and FY 2017, total Premium Tax Credit advances disbursed by the Center for Medicare and Medicaid Services totaled $49,340 and $35,028, respectively. The FY 2018 and FY 2017 advanced amounts were adjusted downward based on tax return information.

**Negative amount represents funds CMS recovered from insurance companies.

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For the Years Ended September 30, 2018 and 2017

Social Security and Medicare Taxes

The Federal Insurance Contributions Act (FICA) provides for a federal system of old-age, survivors, disability, and hospital insurance benefits. Payments to trust funds established for these programs are financed by payroll taxes on employee wages and tips, employers' matching payments, and a tax on self-employment income.

A portion of FICA benefits involves old-age, survivors, and disability payments. These benefits are funded by the social security tax, which is currently 6.2 percent of wages and tips up to $128,400, and an employer matching amount of 6.2 percent, bringing the total rate to 12.4 percent for calendar year 2018. In calendar year 2017, the rate was 6.2 percent of wages and tips up to $127,200 and an employer matching amount of 6.2 percent, bringing the total rate to 12.4 percent. These benefits are also funded by a self-employment tax of 12.4 percent on self-employment income up to $128,400 and $127,200 for calendar years 2018 and 2017, respectively. Remaining benefits under FICA pertain to hospital benefits (referred to as Medicare) and are funded by a separate 1.45 percent tax on all wages and tips (there is no wage limit) and the employer matching contribution of 1.45 percent, for a total of 2.9 percent. Self-employed individuals pay a Medicare tax of 2.9 percent on all self-employment income. Beginning in 2013, an additional Medicare tax of 0.9 percent was collected on earned individual income of more than $200,000 and $250,000 for married couples filing jointly. Social security taxes collected by the IRS were approximately $863 billion and $859 billion in FY 2018 and FY 2017, respectively. Medicare taxes collected by the IRS were approximately $262 billion and $257 billion in FY 2018 and FY 2017, respectively. Social security taxes and Medicare taxes are included in the Individual income, FICA/SECA, and other financial statement line on the Statement of Custodial Activity.

Tax Expenditures

The *Congressional Budget and Impoundment Control Act of 1974* (Public Law 93-344) defines tax expenditures as "revenue losses attributable to provisions of the Federal tax laws which allow a special exclusion, exemption, or deduction from gross income or which provide a special credit, a preferential rate of tax, or a deferral of tax liability." Tax expenditures are the foregone federal revenue resulting from deductions and credits provided in the Internal Revenue Code. Since tax expenditures directly affect funds available for government operations, decisions to forego federal revenue are as important as decisions to spend federal revenue.

While the term "revenue losses" is used in the statutory definition, tax expenditures have traditionally been measured as reductions in federal tax revenues relative to normal baseline provisions of an individual and corporate income tax system, which were properly approved and authorized by the Congress to accomplish identified policy objectives, recognizing that federal tax revenues would be reduced.

In accordance with Statement of Federal Financial Accounting Standards 52, *Tax Expenditures*, narrative disclosures and information regarding tax expenditures are reported in the consolidated *Financial Report of the U.S. Government*. Such disclosures do not apply to the financial statements of component reporting entities such as the IRS. Tax expenditures also do not affect the reporting in the *Budget of the U.S. Government* or any other special purpose report.

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Tax Gap and Tax Burden

Tax Gap

The gross tax gap is the amount of true tax liability for a given tax year not paid voluntarily and/or timely. The most recent estimate of the gross tax gap is $458 billion. Unlike prior tax gap estimates that pertain to a single tax year, these estimates reflect an average compliance rate and average annual tax gap for the tax years 2008 - 2010. This approach was selected as it provides more reliable tax gap estimates by category and source of noncompliance.

There are three primary sources of noncompliance:

(1) nonfiling tax gap (the tax not paid on time by those who do not file required returns on time);
(2) underreporting tax gap (the net understatement of tax on timely filed returns); and
(3) underpayment tax gap (the amount of tax reported on timely filed returns not paid on time).

The estimated noncompliance of each of these components is $32 billion for nonfiling, $387 billion for underreporting, and $39 billion for underpayments. Additionally, the gross tax gap can be grouped by type of tax, as follows:

- $319 billion for individual income tax,
- $ 44 billion for corporation income tax,
- $ 91 billion for employment tax, and
- $ 4 billion for combined estate and excise tax.

The net tax gap is the gross tax gap less tax subsequently collected for a tax year either voluntarily or from IRS administrative and enforcement activities. As a result, the net tax gap is the portion of the gross tax gap that will not be paid. The portion of gross tax gap to eventually be collected is estimated to be $52 billion, resulting in a net tax gap of $406 billion. The estimated net tax gap by type of tax is:

- $291 billion for individual income tax,
- $ 35 billion for corporation income tax,
- $ 79 billion for employment tax, and
- $ 1 billion for combined estate and excise tax.

Tax Burden

The IRC provides for progressive rates of tax, whereby higher incomes are generally subject to higher rates of tax. The following pages present in both graph and table format various income levels and tax liability levels reported by individuals and corporations (that is, these amounts do not account for tax burdens that taxpayers do not report on their returns). This information is the most recent available for individuals (tax year 2016) and corporations (tax year 2015). The graphs and charts are representative of more detailed data and analyses available from the IRS Statistics of Income Office.

For individuals, the information illustrates, in both percentage and dollar terms, the tax burden that taxpayers bear by varying levels of Adjusted Gross Income (AGI). The corporate information illustrates, for varying corporate asset categories, the tax burden borne by these entities as a percentage of taxable income.

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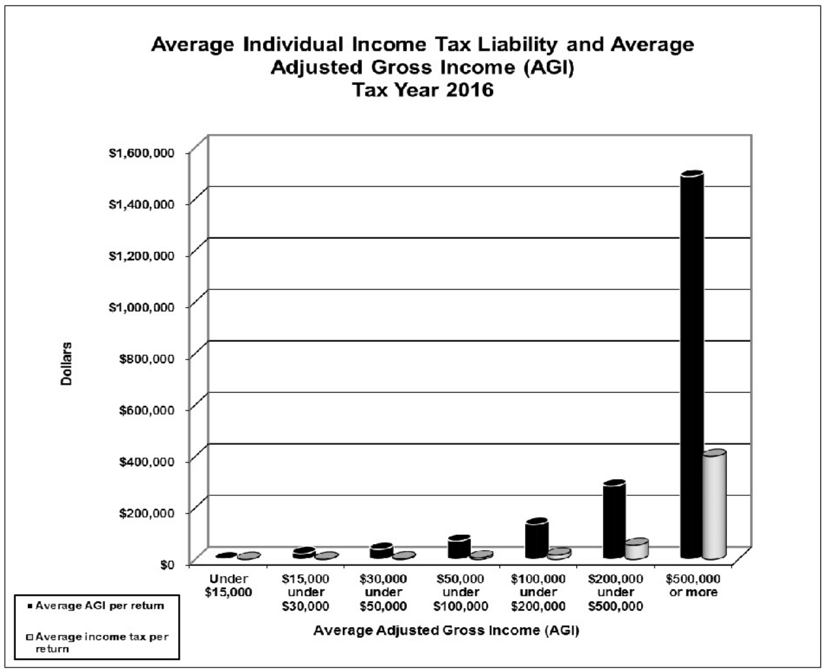
For the Years Ended September 30, 2018 and 2017



Adjusted gross income (AGI).	Number of taxable returns (in thousands)	AGI (in millions)	Total income tax (in millions)	Average AGI per return (in whole dollars)	Average income tax per return (in whole dollars)	Income tax as a percentage of AGI
Under $15,000	34,916	$ 55,654	$ 1,903	$ 1,594	$ 55	3.4%
$15,000 under $30,000	29,646	655,110	18,587	$ 22,098	$ 627	2.8%
$30,000 under $50,000	26,753	1,047,405	58,168	$ 39,151	$ 2,174	5.6%
$50,000 under $100,000	33,199	2,367,475	209,856	$ 71,312	$ 6,321	8.9%
$100,000 under $200,000	18,858	2,552,481	321,564	$ 135,353	$ 17,052	12.6%
$200,000 under $500,000	5,583	1,588,349	308,249	$ 284,497	$ 55,212	19.4%
$500,000 or more	1,318	1,959,465	527,721	$ 1,486,696	$ 400,395	26.9%
Totals	**150,273**	**$ 10,225,939**	**$ 1,446,048**			

(All figures are estimates and based on samples provided by the Statistics of Income Office.)

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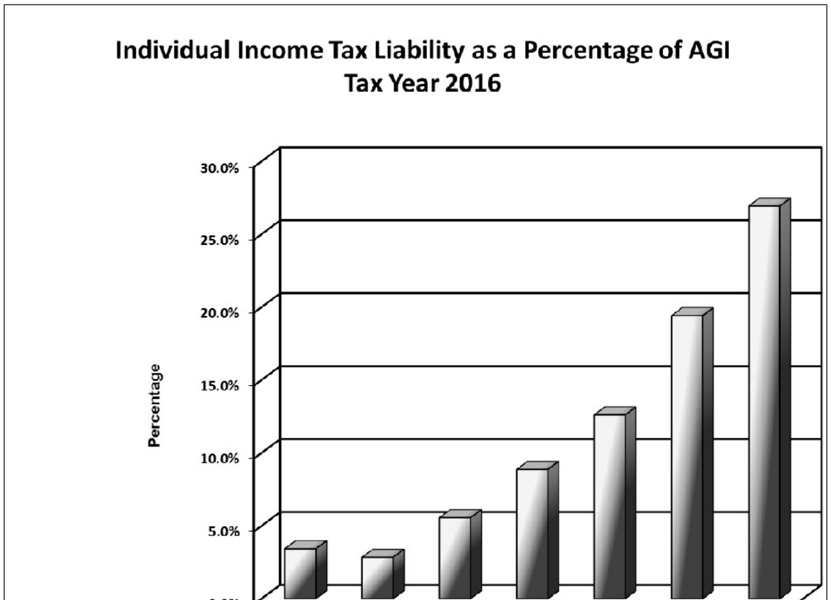
For the Years Ended September 30, 2018 and 2017



	Under $15,000	$15,000 under $30,000	$30,000 under $50,000	$50,000 under $100,000	$100,000 under $200,000	$200,000 under $500,000	$500,000 or more
Income tax as a percentage of AGI	3.4%	2.8%	5.6%	8.9%	12.6%	19.4%	26.9%

(All figures are estimates and based on samples provided by the Statistics of Income Office.)

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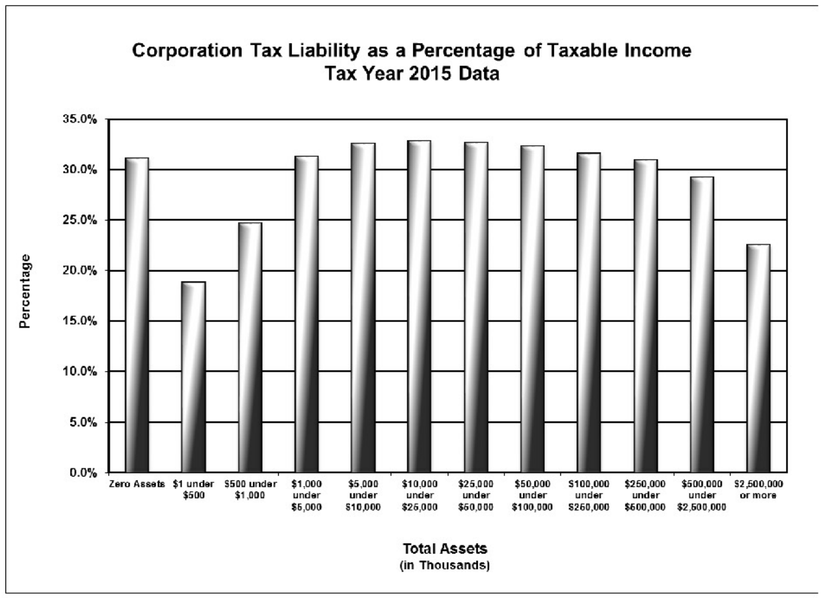
For the Years Ended September 30, 2018 and 2017



Total Assets (in thousands)	Income subject to tax (in millions)	Total income tax after credits (in millions)	Percentage of income tax after credits to taxable income
Zero Assets	$ 21,291	$ 6,627	31.1%
$1 under $500	8,606	1,619	18.8%
$500 under $1,000	3,942	974	24.7%
$1,000 under $5,000	13,667	4,273	31.3%
$5,000 under $10,000	8,581	2,793	32.5%
$10,000 under $25,000	13,120	4,306	32.8%
$25,000 under $50,000	12,890	4,210	32.7%
$50,000 under $100,000	15,296	4,948	32.3%
$100,000 under $250,000	25,377	8,017	31.6%
$250,000 under $500,000	27,404	8,477	30.9%
$500,000 under $2,500,000	110,454	32,281	29.2%
$2,500,000 or more	1,114,453	251,097	22.5%
Totals	**$ 1,375,081**	**$ 329,622**	

(All figures are estimates and based on samples provided by the Statistics of Income Office.)

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Appendix I: Management's Report on Internal Control over Financial Reporting

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

COMMISSIONER

November 8, 2018

Ms. Cheryl E. Clark
Director, Financial Management and Assurance
U.S. Government Accountability Office
441 G Street, NW, Room 5474
Washington, DC 20548

Dear Ms. Clark:

The Internal Revenue Service's (IRS) internal control over financial reporting is a process effected by those charged with governance and management, as well as other personnel with related responsibilities. The objectives of this process 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 provisions of applicable laws, including those governing the use of budget authority, regulations, contracts, and grant agreements, noncompliance with which could have a material effect on the financial statements.

IRS management is responsible for maintaining effective internal control over financial reporting, including the design, implementation, and maintenance of internal controls relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error. IRS management evaluated the effectiveness of the IRS's internal control over financial reporting as of September 30, 2018, based on the criteria established under 31 U.S.C. 3512(c), (d) (commonly known as the Federal Managers' Financial Integrity Act).

Based on that evaluation, we conclude that as of September 30, 2018, the IRS has two significant deficiencies in its internal control over financial reporting, for unpaid assessments and financial reporting systems. The IRS considers the previously reported unpaid assessment material weakness to now be a significant deficiency due to improved internal controls over its estimation process and data quality for the total amount of taxes receivable. The improved controls have allowed the IRS to reduce the error rate for book value adjustments on taxes receivable from 30 percent in FY 2000 to less than 5 percent in FY 2018. More recently, the IRS implemented two significant systemic enhancements that corrected known financial classification errors. Finally, the IRS has improved and documented the review process used to avoid material misstatements. On this basis, management provides unmodified assurance that as of September 30, 2018, the IRS's internal control over financial reporting was effective.

Charles P. Rettig Commissioner of Internal Revenue	November 8, 2018 Date
Jeffrey J. Tribiano Deputy Commissioner, Operations Support	November 8, 2018 Date
Ursula S. Gillis Chief Financial Officer	November 8, 2018 Date

Appendix II: Comments from the Internal Revenue Service

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

COMMISSIONER

November 2, 2018

Ms. Cheryl E. Clark
Director
Financial Management and Assurance
U.S. Government Accountability Office
441 G Street, NW, Room 5474
Washington, DC 20548

Dear Ms. Clark:

Thank you for the opportunity to comment on the draft report titled, Financial Audit: IRS's Fiscal Years 2018 and 2017 Financial Statements. We are pleased that the Internal Revenue Service (IRS) received an unmodified opinion on its combined financial statements. The unmodified opinion demonstrates that the IRS accurately accounts for approximately $3.5 trillion in tax revenue receipts, $464 billion in tax refunds and $11 billion in IRS appropriated funds.

We appreciate the Government Accountability Office (GAO) recognizing our efforts to improve internal controls over the management and reporting of unpaid assessments (UA), implement several programming changes to systemically classify UAs more accurately and enhance our estimation process, which resulted in the downgrade of UA from a material weakness to a significant deficiency. This downgrade is a milestone accomplishment and represents many years of diligent work and dedication that involved improving data quality, making system enhancements and strengthening internal controls. We also completed the implementation of our Integrated Financial System's asset accounting and procurement modules, which will eliminate related security deficiencies and improve the accuracy of reported balances.

I want to recognize the GAO's support throughout the audit. While challenges remain, the IRS has established its ability to produce accurate and reliable financial statements consistently. We have a solid management team dedicated to promoting the highest standard of financial management and we continue to increase our focus on information security and internal controls. We look forward to working with the GAO in our efforts to continue to improve controls over financial reporting.

Sincerely,

Charles P. Rettig

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