

Why GAO Did This Study

In accordance with authority granted by the Chief Financial Officers Act of 1990, GAO annually audits the financial statements of the Internal Revenue Service (IRS) 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 significant laws and regulations and its financial systems' compliance with the Federal Financial Management Improvement Act of 1996 (FFMIA). IRS's tax collection activities are significant to overall federal receipts, and its financial management is of substantial interest to Congress.

What GAO Recommends

In prior financial statement audits, GAO made numerous recommendations to IRS to address internal control and compliance issues. Many of these issues continued to persist during fiscal year 2011. GAO will continue to monitor and will report separately on IRS's progress in implementing the 182 recommendations that remain open as of the date of this report. GAO will report separately on recommended actions to address new deficiencies identified in this year's audit.

In commenting on a draft of this report, IRS stated that it would continue to increase its focus on information security and internal control while improving financial reporting.

FINANCIAL AUDIT

IRS's Fiscal Years 2011 and 2010 Financial Statements

What GAO Found

In GAO's opinion, IRS's fiscal years 2011 and 2010 financial statements are fairly presented in all material respects. However, serious internal control and financial management systems deficiencies continued to make it necessary for IRS to use resource-intensive compensating processes to prepare its balance sheet. Because of these and other internal control, compliance, and system-related deficiencies, IRS did not, in GAO's opinion, maintain effective internal control over financial reporting as of September 30, 2011, and thus did not have reasonable assurance that losses and misstatements material to the financial statements would be prevented or detected and corrected timely.

During fiscal year 2011, IRS continued to make strides in addressing its deficiencies in internal control. For example, to address its information security deficiencies, IRS formed cross-functional working groups to identify and remediate specific at-risk information security control areas and made improvements in several system-level information security controls.

However, deficiencies remain concerning (1) material weaknesses in internal control over unpaid tax assessments and information security, (2) a significant deficiency in its internal control over tax refund disbursements, (3) a noncompliance with the law concerning the timely release of tax liens, and (4) financial management systems' lack of substantial compliance with FFMIA requirements. The continuing material weakness in internal control over unpaid tax assessments results primarily from IRS's reliance on financial management systems that do not substantially comply with FFMIA requirements and that affect IRS's ability to produce reliable financial statements without significant compensating procedures. IRS's continued material weakness in information security controls limit IRS's ability to provide reasonable assurance that (1) the financial statements are fairly presented; (2) financial management information relied on to support day-to-day decision making is current, complete, and accurate; and (3) proprietary information processed by these automated systems is appropriately safeguarded. These issues increase the risk of inappropriate access, alteration, or abuse of proprietary IRS programs and electronic data and taxpayer information.

Further, during fiscal year 2011, IRS continued to face management challenges in developing and institutionalizing the use of financial management information, specifically cost- and revenue-based, outcome oriented performance information, to assist it in making operational decisions and measuring the effectiveness of its programs. Sustained management efforts will be necessary to build on the progress made to date and to fully address IRS's remaining internal control, compliance, and systems deficiencies and remaining financial management challenges.