The Internal Revenue Service Has Extended Its Estimated Federal Financial Management Improvement Act Remediation Date to November 2020

August 25, 2015

Reference Number: 2015-10-065

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THE INTERNAL REVENUE SERVICE HAS EXTENDED ITS ESTIMATED FEDERAL FINANCIAL MANAGEMENT IMPROVEMENT ACT REMEDIATION DATE TO NOVEMBER 2020

Highlights

Final Report issued on August 25, 2015

Highlights of Reference Number: 2015-10-065 to the Internal Revenue Service Chief Financial Officer.

IMPACT ON TAXPAYERS

The Federal Financial Management Improvement Act (FFMIA) remediation plan is a critical part of the IRS's efforts to bring its financial management systems into compliance with the FFMIA and to provide reliable and timely financial data. Complete and reliable financial information is critical to the IRS's ability to accurately report on the results of its operations to both internal and external stakeholders, including taxpayers.

WHY TIGTA DID THE AUDIT

The overall objectives of this review were to identify any instances of and reasons for missed intermediate target dates established in the IRS Fiscal Year 2014 FFMIA remediation plan and to determine whether the IRS has taken adequate corrective actions on prior audit findings related to the plan.

WHAT TIGTA FOUND

The Government Accountability Office reported in 2014 that the IRS's financial systems currently do not provide the accurate and complete transaction-level financial information necessary to enable the IRS to reliably classify and report unpaid tax assessment balances in accordance with Federal accounting standards. Since TIGTA's last report on IRS compliance with the FFMIA, the IRS has made progress in addressing aspects of its FFMIA material weakness, but revised its FFMIA compliance date from 2014 to 2020. Specifically, the IRS anticipates that it will be unable to fully address the unpaid tax assessments material weakness until implementation of the Customer Account Data Engine 2 Transition State 2 (CADE 2 TS2) release plan in November 2020. Although this system is critical to FFMIA implementation, the IRS does not list remediation steps for the CADE 2 TS2 in its remediation plan because it does not consider the CADE 2 TS2 a financial system. As previously recommended, TIGTA continues to believe that including implementation steps associated with the CADE 2 TS2 would improve the remediation plan.

While TIGTA has significant concerns about CADE 2 TS2 actions that are not included in the IRS's remediation plan, TIGTA found that the IRS did not miss any intermediate target dates for actions the IRS did include in its remediation plan. Also, the IRS included limited cost information in its remediation plans, and costs were not clearly linked to specific remediation actions.

WHAT TIGTA RECOMMENDED

TIGTA recommended that the Chief Financial Officer include in remediation plans detailed cost information associated with each corrective action. The IRS agreed with the recommendation and plans to include detailed cost estimates and link the actions to Government Accountability Office recommendations.

TREASURY INSPECTOR GENERAL
FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY

WASHINGTON, D.C. 20220

August 25, 2015

MEMORANDUM FOR CHIEF FINANCIAL OFFICER

FROM: Michael E. McKenney
Deputy Inspector General for Audit

SUBJECT: Final Audit Report – The Internal Revenue Service Has Extended Its Estimated Federal Financial Management Improvement Act Remediation Date to November 2020 (Audit # 201510005)

This report presents the results of our statutory review to identify any instances of and reasons for missed intermediate target dates established in the Internal Revenue Service's (IRS) Fiscal Year 2014 Federal Financial Management Improvement Act[1] remediation plan and to determine whether the IRS has taken adequate corrective actions on prior audit findings related to the plan. This review is included in our Fiscal Year 2015 Annual Audit Plan and addresses the major management challenge of Achieving Program Efficiencies and Cost Savings.

Management's complete response to the draft report is included as Appendix IV.

Copies of this report are also being sent to the IRS managers affected by the report recommendation. If you have any questions, please contact me or Gregory D. Kutz, Assistant Inspector General for Audit (Management Services and Exempt Organizations).

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[1] Pub. L. No. 104-208, 110 Stat. 3009.

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Abbreviations

CADE 2 TS2	Customer Account Data Engine 2 Transition State 2
FFMIA	Federal Financial Management Improvement Act
GAO	Government Accountability Office
IRS	Internal Revenue Service
TIGTA	Treasury Inspector General for Tax Administration

Background

The Federal Financial Management Improvement Act of 1996 (FFMIA)[1] was established to advance Federal financial management by ensuring that Federal financial management systems provide accurate, reliable, and timely financial management information to the Government's managers. Further, it requires that this disclosure be done on a basis that is uniform across the Federal Government from year to year by consistently using professionally accepted accounting standards. Specifically, FFMIA Section 803 (a) requires each agency to implement and maintain systems that comply substantially with:

On November 12, 2014, the Government Accountability Office reported that the Internal Revenue Service did not maintain effective internal controls over financial reporting as of September 30, 2014.

- Federal Government financial management systems requirements.
- Applicable Federal Government accounting standards.
- The United States Government Standard General Ledger[2] at the transaction level.

The FFMIA also requires financial statement auditors[3] to report on agency compliance with the three stated requirements as part of financial statement audit reports, and requires agency heads to determine, based on the audit report and other information, whether their financial management systems comply with the FFMIA requirements. If the agency does not comply, the agency is required to develop remediation plans that describe the resources, remedies, and intermediate target dates for achieving compliance and file the plans with the Office of Management and Budget. In addition, Section 804 (b) requires that the agency's Inspector General shall report to Congress instances of and reasons for missed target dates when an agency has not met the intermediate target dates established in the remediation plan.

In December 1993,[4] the Government Accountability Office (GAO) reported on significant financial management weaknesses that affected the Internal Revenue Service's (IRS) ability to account for unpaid tax assessments.[5] Because the GAO has reported noncompliance with the requirements of

[1] Pub. L. No. 104-208, 110 Stat. 3009.
[2] Provides a uniform Chart of Accounts and technical guidance to be used in standardizing Federal agency accounting.
[3] The Government Accountability Office is responsible for auditing the IRS's financial statements annually.
[4] GAO (formerly known as the General Accounting Office), GAO/AIMD-94-22, *Financial Management: Important IRS Revenue Information Is Unavailable or Unreliable* (Dec. 1993).
[5] An unpaid tax assessment is a legally enforceable claim against a taxpayer and consists of taxes, penalties, and interest that have not been collected or abated (a reduction in a tax assessment).

the FFMIA, primarily because of the weaknesses in unpaid tax assessments, the IRS has been required to prepare and maintain a remediation plan.

In November 2014,[6] the GAO reported that the IRS continues to have a material weakness in internal control over unpaid tax assessments.[7] However, the IRS has implemented numerous systems resulting in incremental improvements to its financial management systems. Many of these systems helped improve the IRS's ability to more accurately report financial information, but the overall material weakness[8] remains. In a July 2014 management report, the GAO closed a recommendation from 1998 because the IRS has implemented controls to effectively identify and eliminate, on an ongoing basis, duplicate assessments related to unpaid payroll taxes and trust fund recovery penalties[9] that have already been paid off.

This review was performed at the IRS Headquarters in Washington, D.C., in the office of the Chief Financial Officer during the period January through April 2015. We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. Detailed information on our audit objectives, scope, and methodology is presented in Appendix I. Major contributors to the report are listed in Appendix II.

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[6] GAO, GAO-15-173, *Financial Audit: IRS's Fiscal Years 2014 and 2013 Financial Statements* (Nov. 2014).
[7] GAO reported that the IRS's financial systems currently do not provide the accurate and complete transaction-level financial information necessary to enable the IRS to reliably classify and report unpaid tax assessment balances in accordance with Federal accounting standards.
[8] In December 2013, the GAO explained that a material weakness is a deficiency, or combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected, on a timely basis. A significant deficiency is a deficiency, or combination of deficiencies, in internal control that is less severe than a material weakness yet important enough to merit attention by those charged with governance. A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis.
[9] Sec. 6672(a) imposes a penalty on any person who is responsible for paying payroll taxes and willfully fails to do so. This is known as the trust fund recovery penalty. Typically, the trust fund recovery penalty equals the amount of money the employer withheld from employees' wages, *e.g.*, Social Security, Medicare, and income taxes, that was not remitted to the IRS.

Results of Review

The Remediation Date Has Been Extended to November 2020, but Certain Necessary Actions Are Not Listed in the Remediation Plan

The IRS has made progress in addressing certain aspects of its FFMIA material weakness, but it recently extended its anticipated FFMIA compliance date to November 2020. Specifically, the IRS anticipates it will be unable to fully address the unpaid tax assessments material weakness until Fiscal Year[10] 2021, when it estimates the Customer Account Data Engine 2 Transition State 2 (CADE 2 TS2) will be implemented. However, because the IRS continues to omit remediation steps associated with the CADE 2 TS2 in its FFMIA remediation plans, it is unclear whether the IRS has an analytical and supportable basis for the November 2020 estimated compliance date.

The IRS improved its controls over processing trust fund recovery penalties

The IRS has made progress in its controls related to payments received from taxpayers that were assessed a trust fund recovery penalty for failing to pay withheld income and employment taxes. In February 1998, the GAO reported that the IRS's systems precluded it from ensuring that all parties liable for certain assessments, such as trust fund recovery penalties, received credit for payments made on those assessments.[11] Specifically, payments made on unpaid payroll tax withholdings[12] for a failing company, which can be collectible from multiple individuals, were not always credited to each responsible party to reflect the reduction in their tax liability. However, in July 2014, the GAO reported that the IRS implemented controls to effectively identify and eliminate duplicate assessments related to unpaid payroll taxes and trust fund recovery penalties that have already been paid.[13]

The CADE 2 TS2 release plan date has been extended to November 2020

On September 24, 2014, the IRS revised its estimated CADE 2 TS2 release plan date from November 2014 to November 2020. This six-year extension has a major impact on the IRS's ability to comply with FFMIA requirements. Specifically, the IRS has consistently represented that CADE 2 TS2 is a key part of its plan to address its unpaid tax assessments material

[10] Any yearly accounting period, regardless of its relationship to a calendar year. The Federal Government's fiscal year begins on October 1 and ends on September 30.
[11] GAO, AIMD-98-77, *Financial Audit, Examination of the IRS' Fiscal Year 1997 Custodial Financial Statements* (Feb 1998).
[12] Payroll tax withholdings consist of individual income tax withholdings and employer and employee Social Security and Medicare tax.
[13] GAO, GAO-14-433R, *IRS Management Report* (July 2014).

weakness. According to IRS management, the CADE 2 TS2 is expected to provide better clarity and transparency of IRS accounts, which will lead to more accurate reporting of the IRS's unpaid tax assessments. However, management explained that the timely implementation of the CADE 2 TS2 is dependent upon funding and resource availability. For more information about the IRS's planning activities for the CADE 2 TS2, see the recently released Treasury Inspector General for Tax Administration (TIGTA) report.[14]

We previously recommended that the IRS include CADE 2 TS2 actions in its remediation plans because IRS management indicated that the system was a key part of its strategy for addressing its material weakness related to unpaid tax assessments.[15] The IRS disagreed with this recommendation, stating that because the IRS does not classify the CADE 2 TS2 as a financial system, it does not need to be included in FFMIA remediation plans. While the IRS's September 30, 2014, remediation plan explained that the CADE 2 TS2 is expected to resolve the material weakness by November 2020, the details of the CADE 2 TS2 implementation were not described in the plan. Due to the lack of details associated with CADE 2 TS2 implementation, the current IRS FFMIA remediation plan does not provide sufficient details to determine whether the new November 2020 date has any substantive support and is a reasonable estimate. The GAO recently issued a report[16] in which it also noted concerns about the IRS's remediation plan. Specifically, the GAO stated the plan lacks certain key elements, such as detailed actions that must be performed to resolve the deficiencies, parties responsible for taking specific actions, resource requirements, or incremental milestones so that interim actions and progress can be monitored and assessed. As a result of the importance of the CADE 2 TS2 to FFMIA implementation, we continue to believe that including implementation steps associated with the CADE 2 TS2 would improve the remediation plan.

No Intermediate Target Dates Were Missed or Extended on Open Remediation Actions, but Cost Information Was Limited

While we have concerns about actions that are not included in the IRS's remediation plans, our review identified that the IRS did not miss any intermediate target dates for actions it did include in its remediation plans related to the unpaid tax assessments material weakness. However, cost information and links to open GAO recommendations were not clear in the IRS's remediation plans.

[14] TIGTA, Ref. No. 2015-20-031, *Planning Decisions for Customer Account Data Engine 2 Transition State 2 Should Be Effectively Linked to Actions Needed to Address the Internal Revenue Service's Financial Material Weakness* (May 2015).
[15] TIGTA, Ref. No. 2011-10-041, *Challenges Continue With Reporting Complete and Accurate Information in the Federal Financial Management Improvement Act Remediation Plan* (May 2011).
[16] GAO, GAO-15-480R, IRS Management Report (May 2015).

Intermediate target dates were met

As of September 30, 2014, the IRS completed four of five remediation actions and the remaining action was still open. Section 803(c)(3)(A) of the FFMIA states that an agency's remediation plan shall include intermediate target dates necessary to bring the agency's financial management systems into substantial compliance. For example, one of the remediation actions the IRS identified was to establish a new date to become compliant with the unpaid tax assessments material weakness identified by the GAO.

On September 24, 2014, the IRS's Management Controls Executive Steering Committee approved a new date of November 30, 2020, to resolve the material weakness. The remaining open action item stated that by June 30, 2015, the IRS would develop new action items for inclusion in the remediation plan based on the CADE 2 TS2.

Corrective actions in remediation plans had limited cost information and were not linked to specific GAO recommendations

During this review, we found that the IRS was unable to provide adequate documentation to support the resources, *e.g.*, costs, listed on its September 30, 2014, remediation plan. That plan listed costs incurred for Fiscal Year 2011 through Fiscal Year 2014, and the costs were grouped into four categories: Government salary, Government benefits, Travel, and Contractor. However, because the costs were not linked to specific remediation actions, we could not identify support for the expenditures.

The FFMIA requires that remediation plans should include the resources, remedies, and intermediate target dates necessary to bring the agency's financial management systems into substantial compliance. The FFMIA also requires agencies to include the estimated and actual resources needed to implement action plans (and requires that these resources be identified by fiscal year). In addition, the IRS's guidance requires that the responsible organization provide all costs to implement the recommendations and the dollar amount approved by project.

When we requested supporting documentation for the costs associated with each corrective action included in the Fiscal Year 2014 remediation plans, the IRS was unable to provide detailed information specifically associated with each corrective action. The IRS explained that its accounting system is not capable of assigning costs to specific tasks and, as a result, it is unable to provide detailed information about costs shown on the Fiscal Year 2014 remediation plans. Therefore, we could not determine the purpose of the cost and whether the costs were reasonable.

Further, the IRS listed all GAO recommendations related to the unpaid tax assessments material weakness in its remediation plans, but it did not include a complete description of the corrective action associated with each GAO recommendation. As a result, we were unable to determine whether the corrective actions listed in the IRS's Fiscal Year 2014 remediation plans were responsive to all of the GAO's recommendations. IRS guidelines[17] require the responsible office to identify in the remediation plans the related GAO recommendation for the action and to provide a concise but complete description of the action to be taken and the resources required for implementation of any action. Without detailed information, the IRS may not develop corrective actions that address all of the GAO's recommendations.

Recommendation

Recommendation 1: The Chief Financial Officer should include in remediation plans required detailed cost estimate information associated with each specific corrective action and link each action to GAO recommendations.

> ***Management's Response:*** The IRS agreed with this recommendation. The Chief Financial Officer agreed to include detailed cost estimates and link the actions in the plan to GAO recommendations. The Chief Financial Officer will determine what information is needed where corrective actions are not specific to a GAO recommendation or when resources are solely tied to use of existing staff.

[17] Internal Revenue Manual 1.4.2.13 (Dec 14, 2012).

Appendix I

Detailed Objectives, Scope, and Methodology

The overall objectives of this review were to determine any instances of and reasons for missed intermediate target dates established in the IRS's Fiscal Year[1] 2014 (September 30, 2014) FFMIA[2] remediation plan and to determine whether the IRS has taken adequate corrective actions on our Fiscal Year 2013 audit findings related to the FFMIA remediation plan. To accomplish our objectives, we:

I. Gained an understanding of the requirements of the FFMIA, including Office of Management and Budget and Department of the Treasury guidance.

II. Determined whether the IRS's September 30, 2014, remediation plan was consistent with GAO recommendations from prior IRS's financial audits and related financial management reports.

III. Determined whether: 1) the IRS missed any intermediate target dates established in its remediation plan, 2) intermediate target dates were extended without sufficient documentation to support the revised dates, and 3) proper approval was obtained for remedial actions extending more than three years.

   A. Verified that remedial actions have intermediate target dates established.

   B. Identified instances when the IRS has not met the intermediate target dates or changed target dates between January and September 2014.

   C. Identified intermediate target dates extending more than three years after the noncompliance issue was first identified in a financial statement audit and associated FFMIA compliance report by the GAO.

IV. Determined whether the IRS had taken adequate corrective actions on our Fiscal Year 2013 audit findings related to the FFMIA remediation plan.

Internal controls methodology

Internal controls relate to management's plans, methods, and procedures used to meet their mission, goals, and objectives. Internal controls include the processes and procedures for planning, organizing, directing, and controlling program operations. They include the systems for measuring, reporting, and monitoring program performance. We determined that the

[1] Any yearly accounting period, regardless of its relationship to a calendar year. The Federal Government's fiscal year begins on October 1 and ends on September 30.
[2] Pub. L. No. 104-208, 110 Stat. 3009.

following internal controls were relevant to our audit objectives: the IRS's policies, procedures, and practices for tracking remediation actions implemented due to identified material weaknesses. We evaluated these controls by interviewing management and reviewing applicable documentation.

Appendix II

Major Contributors to This Report

Gregory D. Kutz, Assistant Inspector General for Audit (Management Services and Exempt Organizations)
Jonathan T. Meyer, Director
Janice M. Pryor, Audit Manager
Ahmed M. Tobaa, Lead Auditor
Donald J. Martineau, Auditor

Appendix III

Report Distribution List

Commissioner C
Office of the Commissioner – Attn: Chief of Staff C
Deputy Commissioner for Operations Support OS
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Deputy Chief Financial Officer OS:CFO
Associate Chief Financial Officer for Corporate Planning and Internal Controls OS:CFO:CPIC
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    Deputy Commissioner for Operations Support OS
    Chief Financial Officer OS:CFO
    Chief Technology Officer OS:CTO

Appendix IV

Management's Response to the Draft Report

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

CHIEF FINANCIAL OFFICER

August 5, 2015

MEMORANDUM FOR MICHAEL E. MCKENNEY
DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: Robin L. Canady
Chief Financial Officer

SUBJECT: Draft Audit Report – The Internal Revenue Service Has Extended Its Estimated Federal Financial Management Improvement Act Remediation Date to November 2020 (Audit # 201510005)

Thank you for the opportunity to review the draft audit report titled, "The Internal Revenue Service Has Extended Its Estimated Federal Financial Management Improvement Act Remediation Date to November 2020."

I was pleased your audit report acknowledged that IRS did not miss any intermediate target dates for actions IRS included in its remediation plans related to the unpaid tax assessments material weakness.

Below is the IRS's comment on TIGTA's recommendation for the audit performed.

Recommendation #1: The Chief Financial Officer should include in remediation plans required detailed cost estimate information associated with each specific corrective action and link each action to GAO recommendations.

Management's Response: IRS agrees with this recommendation. The Chief Financial Officer (CFO) agrees to include detailed cost estimates and link the actions that are applicable to GAO recommendations, outside of CADE 2 development actions. The CFO will determine what information is needed where corrective actions are not specific to a GAO recommendation or when resources are solely tied to use of existing staff.

IMPLEMENTATION DATE: 11/20/15

RESPONSIBLE OFFICIAL: Chief Financial Officer

CORRECTIVE ACTION MONITORING PLAN: Remediation Plan

If you have any questions, please contact me at (202) 317-6400, or a member of your staff may contact John Pekarik, Associate Chief Financial Officer for Corporate Planning and Internal Control, at (202) 803-9151.