Status of the Implementation of the Federal Financial Management Improvement Act

July 26, 2019

Reference Number: 2019-10-051

This report has cleared the Treasury Inspector General for Tax Administration disclosure review process and information determined to be restricted from public release has been redacted from this document.

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STATUS OF THE IMPLEMENTATION OF THE FEDERAL FINANCIAL MANAGEMENT IMPROVEMENT ACT

Highlights

Final Report issued on July 26, 2019

Highlights of Reference Number: 2019-10-051 to the Commissioner of Internal Revenue.

IMPACT ON TAXPAYERS

The Federal Financial Management Improvement Act (FFMIA) remediation plan is an important 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 determine any instances of and reasons for missed intermediate target dates established in the IRS's September 30, 2018, FFMIA remediation plan and to determine whether the IRS has taken adequate corrective actions on TIGTA's prior audit findings related to the Fiscal Year 2017 remediation plan.

WHAT TIGTA FOUND

During Fiscal Year 2018, the IRS made progress addressing a long-standing material weakness in its internal controls over unpaid assessments. For example, the IRS completed four of the 12 open remediation actions related to internal control weaknesses. IRS management also approved the extension of one open remediation action to a future date. This open remediation action and seven other actions have expected completion dates between Fiscal Year 2019 and Fiscal Year 2021. In addition, the IRS also included all six open Government Accountability Office recommendations in its remediation plan as required. However, the IRS still does not include resource cost information for each corrective action in accordance with Federal and internal requirements.

In November 2018, the Government Accountability Office downgraded the IRS's material weakness over unpaid assessments to a significant deficiency due to the IRS's progress in addressing the control weaknesses that affect its financial reporting. Federal agencies with a material weakness over internal controls are required to report externally on the actions taken to address the weakness. While external reporting is no longer required, the Office of Management and Budget requires the IRS to internally assess its progress in addressing the significant deficiency over unpaid assessments.

WHAT TIGTA RECOMMENDED

TIGTA did not make any recommendations in this report.

TREASURY INSPECTOR GENERAL
FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY

WASHINGTON, D.C. 20220

July 26, 2019

MEMORANDUM FOR COMMISSIONER OF INTERNAL REVENUE

FROM: Michael E. McKenney
Deputy Inspector General for Audit

SUBJECT: Final Audit Report – Status of the Implementation of the Federal Financial Management Improvement Act (Audit # 201910002)

This report presents the results of our review to determine any instances of and reasons for missed intermediate target dates established in the Internal Revenue Service (IRS) September 30, 2018 (Fiscal Year 2018) Federal Financial Management Improvement Act[1] remediation plan and to determine whether the IRS has taken adequate corrective actions on the Treasury Inspector General for Tax Administration's prior audit findings related to the Fiscal Year 2017 remediation plan.[2] This review is included in our Fiscal Year 2019 Annual Audit Plan and addresses the major management challenge of Achieving Program Efficiencies and Cost Savings.

Management's complete response is included in Appendix IV.

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

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

[2] Treasury Inspector General for Tax Administration, Ref. No. 2018-10-044, *Status of the Implementation of the Federal Financial Management Improvement Act*, p. 4 (Aug. 2018).

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Abbreviations

FFMIA	Federal Financial Management Improvement Act
FY	Fiscal Year
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 help ensure that financial management systems provide accurate, reliable, and timely financial information to financial managers and Congress. Further, the FFMIA requires that the systems used for financial accounting are uniform across the Federal Government from year to year by consistently using accepted accounting standards. Specifically, FFMIA Section 803(a) requires each agency to implement and maintain systems that substantially comply with:

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

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

In June 1993, the Government Accountability Office (GAO) reported[4] that the Internal Revenue Service (IRS) had a material weakness in its internal controls over unpaid assessments. 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.[5] An unpaid assessment is an enforceable claim for which specific amounts are due and have been determined and the person(s) or entities from which a tax is due have been identified. Federal

[1] Pub. L. No. 104-208, 110 Stat. 3009.
[2] The U.S. Government Standard General Ledger 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 Internal Revenue Service's financial statements annually.
[4] GAO (formerly known as the General Accounting Office), GAO/Accounting and Information Management Division – 93-2, *Financial Audit: Examination of IRS' Fiscal Year 1992 Financial Statements* (June 30, 1993).
[5] 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.

accounting standards classify unpaid assessments into one of the following three categories for reporting purposes: Federal taxes receivable, compliance assessments, and write-offs.[6]

The IRS explained that this weakness stemmed from financial system limitations and errors in taxpayer accounts that rendered the IRS's systems unable to distinguish between taxes receivable, compliance assessments, and write-offs for proper financial reporting. Due to the long-standing noncompliance with the requirements of the FFMIA, the IRS was required to prepare and maintain a remediation plan that lists the IRS's planned corrective actions to address the material weakness.

Each year, the GAO evaluates whether the IRS's financial statements are fairly presented and whether IRS management maintained effective internal control over financial reporting. If the GAO finds additional internal control deficiencies in unpaid assessments, it may make additional recommendations.

The GAO also evaluates the IRS's corrective actions to address open recommendations. If the GAO determines that the actions address previously identified internal control deficiencies, it will close the related open recommendations. In May 2018, the GAO closed one recommendation and issued two new recommendations related to the unpaid assessments material weakness.[7] The new recommendations required the IRS to take the following actions:

- Research and determine why the IRS's existing policies and procedures intended to timely follow up on, resolve, and record unpostable transactions were not fully effective in achieving these objectives.
- Based on the IRS's research and determination, design and implement the corrective actions necessary to reasonably assure that the IRS effectively resolves and records unpostable transactions in a timely manner, including establishing clearly defined time frames in the IRS's internal manual by which the IRS operating divisions should correct unpostable transactions and appropriate related oversight and review processes.

The FFMIA remediation plan is an important 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.

[6] Federal taxes receivable are taxes due from taxpayers for which the 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 for which 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 the IRS does not expect further collections because of factors such as the taxpayer's death, bankruptcy, or insolvency.
[7] GAO, GAO-18-393R, *Management Report: Improvements Are Needed to Enhance the Internal Revenue Service's Internal Control Over Financial Reporting* (May 2018).

This review was performed with information obtained from the Unpaid Assessments and Analysis Division in the IRS Chief Financial Officer's Custodial Financial Management function in Washington, D.C., during the period November 2018 through April 2019. 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.

Results of Review

Most Remediation Plan Requirements Were Met; However, Cost Information Is Still Lacking

Section 803(c)(3)(A) of the FFMIA requires agencies to include in their remediation plan intermediate target dates necessary to bring the agency's financial management system into substantial compliance. The Treasury Inspector General for Tax Administration (TIGTA) determined that the IRS established intermediate target dates in its Fiscal Year (FY)[8] 2018 quarterly remediation plan as required and met the target dates for all but one of the remediation actions. IRS management properly approved the extension of the remaining action's target date.[9] As of September 30, 2018, the IRS had completed four of the 12 open remediation actions related to the unpaid assessments material weakness in its FY 2018 quarterly remediation plans. The remaining eight open remediation actions have expected completion dates between FY 2019 and FY 2021. In addition, the IRS included all six open GAO recommendations related to unpaid assessments in its quarterly remediation plans as required. However, the IRS did not comply with Federal and internal requirements to include resource cost information for each corrective action.

The FFMIA requires that remediation plans include the resources, remedies, and intermediate target dates necessary to bring the agency's financial management systems into substantial compliance. The Office of Management and Budget requires that an agency's corrective action plan must indicate the types of resources needed to correct the control deficiency (*e.g.*, additional personnel, contract support, training), including nonfinancial resources, such as senior leadership support. In addition, IRS guidance requires that the responsible organization provide all costs, including estimates, to implement the recommendations and the dollar amount approved by project. We found that none of the eight open corrective actions in the IRS's September 30, 2018, remediation plan had detailed costs listed.

We are not making recommendations in this report because we previously recommended that the IRS Chief Financial Officer include detailed cost estimate information for each corrective action in the IRS's quarterly remediation plan.[10] Instead, the IRS indicated in its quarterly remediation plans that the resources for the corrective actions were nonsystem costs that were absorbed by normal business practices. As such, we continue to identify corrective actions for which actual

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[8] 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.
[9] The target due date was extended twice.
[10] TIGTA, Ref. No. 2015-10-065, *The Internal Revenue Service Has Extended Its Estimated Federal Financial Management Improvement Act Remediation Date to November 2020* (Aug. 2015).

or estimated costs should have been listed but were not. For example, the IRS should include the estimated cost to obtain assistance from data or subject matter experts when it knows such services will be needed. Without listing the required resources to implement proposed or complete corrective actions, the IRS is not fully meeting the requirements of the FFMIA.

The GAO downgraded the internal control deficiencies in unpaid assessments to a significant deficiency

During FY 2018, the GAO found that the IRS made progress in addressing a long-standing material weakness in its internal controls over unpaid assessments. In November 2018, the GAO downgraded the IRS's long-standing material weakness in its internal controls over unpaid assessments to a significant deficiency.[11] The GAO explained in its report[12] that the IRS continued to improve internal controls over the management and reporting of unpaid assessments by:

- Implementing recommendations made by an internal task force to address related data quality concerns.
- Implementing several programming changes to systemically classify unpaid assessments more accurately.
- Enhancing its estimation process by revising sampling parameters to improve the reliability of its resulting statistical estimates of reported unpaid assessments balances.
- Adding additional levels of management review, which improved the effectiveness of the IRS's FY 2018 analyses of taxes receivable used as a basis for the estimate reported on its balance sheet and disclosures.

Based on the cumulative effects of these and other efforts, the GAO concluded that the remaining unpaid assessments deficiencies no longer represent a material weakness.

Federal agencies with a material weakness over internal controls are required to report externally on the actions taken to address the weakness.[13] However, the GAO stated that the remaining internal control deficiencies in unpaid assessments (*i.e.*, ongoing financial system limitations and errors in taxpayer accounts) are important enough to merit continued attention. For example, the GAO stated that the IRS's continued use of a manual estimation process to determine the amount of unpaid assessments does not provide readily available, reliable information throughout the

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[11] 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.
[12] GAO, GAO-19-150, *Financial Audit: IRS's Fiscal Years 2018 and 2017 Financial Statements* (Nov. 2018).
[13] The Office of Management and Budget Circular No. A-123, *Management's Responsibility for Enterprise Risk Management and Internal Control* (July 15, 2016).

year to support informed management decision-making. Moreover, the Office of Management and Budget requires that the IRS internally assess its progress in addressing the significant deficiency over unpaid assessments.

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 September 30, 2018 (FY 2018)[1] FFMIA[2] remediation plan and to determine whether the IRS has taken adequate corrective actions on TIGTA's prior audit findings related to the FY 2017 FFMIA remediation plan.[3] 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 for compliance with the Act.

II. Determined whether the IRS's September 30, 2018, remediation plan was consistent with GAO recommendations from the IRS's FYs 2018 and 2017 financial audits and related financial management reports.

III. Determined whether the IRS missed any intermediate target dates established in its remediation plan and whether any intermediate target dates were extended without sufficient documentation to support the revised dates.

IV. Determined whether the IRS had taken adequate corrective actions on our prior audit findings related to the FY 2017 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 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.

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[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.
[3] TIGTA, Ref. No. 2018-10-044, *Status of the Implementation of the Federal Financial Management Improvement Act*, p. 4 (Aug. 2018).

Appendix II

Major Contributors to This Report

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Appendix III

Report Distribution List

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Appendix IV

Management's Response to the Draft Report

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

CHIEF FINANCIAL OFFICER

July 12, 2019

MEMORANDUM FOR MICHAEL E. MCKENNEY
DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: Charles A. Messing
Deputy Associate CFO for Custodial Financial Management

SUBJECT: Draft Audit Report - Status of the Implementation of the Federal Financial Management Improvement Act (Audit # 201910002)

Thank you for the opportunity to respond to this draft audit report. We appreciate TIGTA's recognition of progress made by us on the IRS's September 30, 2018 FFMIA Remediation Plan. Due to the Government Accountability Office downgrading the IRS's material weakness over unpaid assessments to a significant deficiency in November 2018, the IRS closed this remediation plan.