Significant Progress Was Made in Achieving Compliance With the Federal Financial Management Improvement Act, but Unpaid Assessments Remain a Material Weakness

August 29, 2013

Reference Number: 2013-10-091

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SIGNIFICANT PROGRESS WAS MADE IN ACHIEVING COMPLIANCE WITH THE FEDERAL FINANCIAL MANAGEMENT IMPROVEMENT ACT, BUT UNPAID ASSESSMENTS REMAIN A MATERIAL WEAKNESS

Highlights

Final Report issued on August 29, 2013

Highlights of Reference Number: 2013-10-091 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. Overall, the IRS still faces challenges in its efforts to comply with the FFMIA. 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 report to Congress, as required by the FFMIA, any instances of and reasons for missed intermediate target dates established in the IRS's Fiscal Year 2012 and first quarter Fiscal Year 2013 FFMIA remediation plans, determine whether the IRS has taken adequate corrective actions on prior audit findings related to the plan, and document the history of the unpaid assessments material weakness that has been noted in IRS financial statements for more than a decade.

WHAT TIGTA FOUND

The IRS made significant progress in addressing previously identified remediation plan material weaknesses. For example, the Government Accountability Office reported the downgrade of the information security material weakness to a significant deficiency during the Fiscal Year 2012 financial statement audit, and the IRS removed it from the December 31, 2012, remediation plan. This material weakness was initially identified in the June 1993 Government Accountability Office report. In addition, the IRS met all intermediate target dates established in its remediation plan.

However, the material weaknesses related to unpaid assessments remain. In a previous report, TIGTA recommended that the IRS determine whether the planned November 2014 implementation of a key system, the Customer Account Data Engine 2, will fully address the unpaid assessments material weakness, and TIGTA recommended that the IRS update future remediation plans with a more accurate implementation date, if necessary. IRS management agreed with this recommendation and plans to reassess the November 2014 closing date for this material weakness once the scope for the Customer Account Data Engine 2 is determined. As a result, TIGTA will continue to monitor the IRS's progress in achieving compliance with the FFMIA.

WHAT TIGTA RECOMMENDED

Although TIGTA made no recommendations in this report, IRS officials were provided an opportunity to review the draft report. IRS management did not provide a formal response but agreed with the facts and conclusions presented.

TREASURY INSPECTOR GENERAL
FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY

WASHINGTON, D.C. 20220

August 29, 2013

MEMORANDUM FOR CHIEF FINANCIAL OFFICER

FROM: Michael E. McKenney
Acting Deputy Inspector General for Audit

SUBJECT: Final Audit Report – Significant Progress Was Made in Achieving Compliance With the Federal Financial Management Improvement Act, but Unpaid Assessments Remain a Material Weakness (Audit # 201310020)

This report presents the results of our review to report to Congress, as required by the Federal Financial Management Improvement Act (FFMIA),[1] any instances of and reasons for missed intermediate target dates established in the Internal Revenue Service's (IRS) Fiscal Year 2012 and first quarter Fiscal Year 2013 FFMIA remediation plans, determine whether the IRS has taken adequate corrective actions on our prior year's audit findings related to the FFMIA remediation plan, and document the history of the unpaid assessments material weakness that has been noted in the IRS's financial statements for more than a decade. This review is included in our Fiscal Year 2013 Annual Audit Plan and addresses the major management challenge area of Achieving Program Efficiencies and Cost Savings.

Although TIGTA made no recommendations in this report, IRS officials were provided an opportunity to review the draft report. IRS management did not provide a formal response but agreed with the facts and conclusions presented.

If you have any questions, please contact me or Gregory D. Kutz, Assistant Inspector General for Audit (Management Services and Exempt Organizations).

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

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Abbreviations

CADE 2	Customer Account Data Engine 2
FFMIA	Federal Financial Management Improvement Act
GAO	Government Accountability Office
IRS	Internal Revenue Service

Background

The Federal Financial Management Improvement Act (FFMIA) of 1996[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, the Act required 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:

As of May 2013, the Government Accountability Office continued to report that improvements are needed to enhance the Internal Revenue Service's internal controls.

- 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 required financial statement auditors[3] to report on agency compliance with the three stated requirements as part of financial statement audit reports, and 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, 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 Inspector General shall report to Congress instances and reasons when an agency has not met the intermediate target dates established in the remediation plan.

As of May 2013, the Government Accountability Office (GAO) continues to report[4] that improvements are needed to enhance the Internal Revenue Service's (IRS) internal controls. Because the GAO has reported noncompliance with the requirements of the FFMIA, the IRS has been required to prepare and maintain a remediation plan.

[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, GAO-13-420R, *Management Report: Improvements Are Needed to Enhance the Internal Revenue Service's Internal Controls* (May 13, 2013).

Since Calendar Year 1993, the IRS has made substantial efforts to address the unpaid assessments[5] material weakness. In the last 20 years, the IRS has proposed, developed, and implemented numerous systems in an attempt to address this material weakness. Many of these systems helped improve the IRS's ability to more accurately report financial information, but the overall material weakness remains. Beginning in December 1993,[6] the GAO reported on significant financial management weaknesses that affected the IRS's ability to account for unpaid assessments. The GAO found that the IRS was, and still is as of Fiscal Year[7] 2012, unable to rely on its general ledger and underlying subsidiary ledgers for tracing reported taxes receivable to supporting transactions, and is unable to effectively prevent, or detect and correct, errors in taxpayer accounts. The unpaid assessments material weakness[8] affects the IRS's ability to accurately quantify the amount of unpaid assessments owed to the IRS.

Over the last 15 years, the IRS has implemented numerous systems, which has resulted in incremental improvements to its financial management systems. In January 2010, the IRS implemented a new accounting system, the Redesign Revenue Accounting Control System, which allowed the IRS to post transactions in compliance with Federal Government requirements, support traceability for revenue transactions, and further assist the IRS in becoming compliant with the FFMIA. However, despite system improvements, the IRS does not believe it will become fully compliant with the FFMIA and address the material weakness related to unpaid assessments until approximately November 2014, pending successful implementation of Transition State 2 of the Customer Account Data Engine 2 (CADE 2). In our Fiscal Year 2012 FFMIA review, we determined that the November 2014 implementation date was not likely to be met, and IRS management agreed to provide a more realistic date.[9]

This review was performed at the IRS National Headquarters in the office of the Chief Financial Officer in Washington, D.C., during the period January through July 2013. 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

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[5] 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 (a reduction in a tax assessment).

[6] GAO (formerly known as the General Accounting Office), GAO/AIMD-94-22, *Financial Management: Important IRS Revenue Information Is Unavailable or Unreliable* (Dec. 12, 1993).

[7] A 12-consecutive-month period ending on the last day of any month. The Federal Government's fiscal year begins on October 1 and ends on September 30.

[8] According to the GAO, 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] Treasury Inspector General for Tax Administration, Ref. No. 2012-10-069, *The Remediation Plan Still Does Not Contain All the Necessary Actions to Address the Unpaid Assessments* (Jul. 2012).

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

The IRS made significant progress to address previously identified remediation plan material weaknesses. For example, the GAO reported the downgrade of the information security material weakness to a significant deficiency during the Fiscal Year 2012 financial statement audit, and the IRS removed it from the December 31, 2012, remediation plan. This deficiency was first identified in the June 1993 GAO report.[10] This was one of two material weaknesses that resulted in the IRS not being in compliance with the FFMIA. However, the IRS continues to face challenges in mitigating the unpaid assessments material weakness. As we previously reported, the IRS has not included any specific details related to the CADE 2 in its remediation plans.[11] Because the IRS has indicated that the CADE 2 is the key piece of its strategy to address its unpaid assessments material weakness associated with individual accounts, we continue to believe that CADE 2 remediation plan actions and cost estimates should be included in the remediation plan. The IRS expects that once the CADE 2 Transition State 2 is fully implemented and the financial systems have been fully leveraged with all available information, this material weakness will be closed. Until the IRS updates its FFMIA remediation plan with sufficient actions to address the unpaid assessments material weakness, we will be unable to assess its overall progress in resolving the unpaid assessments material weakness.

No Intermediate Target Dates Were Extended on Open Remediation Actions

We determined that the IRS's December 31, 2012, FFMIA remediation plan was consistent with GAO recommendations from prior IRS financial audits and related financial management reports. In its December 31, 2012, remediation plan, the IRS reported that it completed two remediation actions and removed 11 actions associated with the information security material weakness which was downgraded, leaving seven open remediation actions. All of these open actions were associated with the unpaid assessments material weakness.

Each of the seven open remediation actions had an intermediate target date that extended more than three years from the initial determination that IRS financial management systems were not in substantial compliance with the FFMIA. As required, the IRS obtained concurrence from the Office of Management and Budget to extend corrective actions beyond the three-year limitation.

[10] GAO (formerly known as the General Accounting Office), GAO/AIMD-93-2, *Examination of IRS' Fiscal Year 1992 Financial Statements* (June 30, 1993).
[11] Treasury Inspector General for Tax Administration, Ref. No. 2011-10-041, *Challenges Continue With Reporting Complete and Accurate Information in the Federal Financial Management Improvement Act Remediation Plan* (May 2011).

Our review of the seven open remediation actions related to the unpaid assessments material weakness found that the IRS did not miss any intermediate target dates.

The Unpaid Assessments Material Weakness Remains

The IRS continues to not include remediation plan actions or cost estimates for the CADE 2 to address the material weakness of unpaid assessments associated with individual accounts. As of December 31, 2012, the Chief Financial Officer is working with IRS business units to determine when the IRS financial systems[12] will begin to be available in the CADE 2 so that actions can be added to the remediation plan for making changes to the financial systems. According to the IRS, it expects that the unpaid assessments material weakness will not be closed until changes are made to financial systems and the CADE 2 Transition State 2 is fully implemented. The IRS expects to implement the CADE 2 Transition State 2 by November 2014 and, therefore, the IRS plans to fully address its unpaid assessments material weakness after that date.

Management also stated that the FFMIA remediation plan was created to address the actions required for IRS financial systems and believes that the CADE 2 is not a financial system; rather, it is a Business System Modernization project used to modernize the IRS tax system for individual taxpayer account data. We continue to believe that including additional information in the remediation plan will increase the likelihood of the IRS addressing the unpaid assessments material weakness, and we previously recommended that the IRS should include CADE 2 actions in remediation plans.[13]

In addition, in May 2013, the GAO reported[14] that the IRS's controls over its process for estimating the balances of Federal taxes receivable and other unpaid assessments were not effectively implemented to ensure proper accounting classification and dollar amounts. This deficiency increases the risk that a material misstatement of the IRS's financial statements may not be prevented, or detected and corrected, on a timely basis. The GAO noted that the deficiencies are primarily caused by the IRS's continued reliance on software applications that were not designed to provide accurate, complete, and timely transaction level information. Therefore, the GAO continues to consider the internal control over unpaid assessments a material weakness.

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[12] Custodial Detail Data Base and Redesign Revenue Accounting Control System.

[13] Treasury Inspector General for Tax Administration, Ref. No. 2011-10-041, *Challenges Continue With Reporting Complete and Accurate Information in the Federal Financial Management Improvement Act Remediation Plan* (May 2011).

[14] GAO, GAO-13-420R, *Management Report: Improvements Are Needed to Enhance the Internal Revenue Service's Internal Controls* (May 13, 2013).

The Treasury Inspector General for Tax Administration recommended in a previous report[15] that the IRS determine whether the November 2014 implementation of the CADE 2 that fully addresses the unpaid assessments material weakness is still achievable and update future remediation plans with a more accurate date, if necessary. IRS management agreed with this recommendation and plans to reassess the November 2014 closing date for this material weakness once the scope for the CADE 2 Transition State 2 is determined. In addition, management informed us they are working toward achieving compliance with the FFMIA and their goal is to establish a new CADE 2 Transition State 2 implementation date by March 31, 2014. As a result, the Treasury Inspector General for Tax Administration will continue to monitor the IRS's progress in achieving compliance with the FFMIA and is not making a recommendation at this time.

[15] Treasury Inspector General for Tax Administration, Ref. No. 2012-10-069, *The Remediation Plan Still Does Not Contain All the Necessary Actions to Address the Unpaid Assessments Material Weakness* (Jul. 2012).

Appendix I

Detailed Objectives, Scope, and Methodology

The overall objectives of this review were to report to Congress, as required by the FFMIA,[1] any instances of and reasons for missed intermediate target dates established in the IRS's Fiscal Year[2] 2012 and first quarter Fiscal Year 2013 FFMIA remediation plans, determine whether the IRS has taken adequate corrective actions on prior audit findings related to the plan, and document the history of the unpaid assessments material weakness that has been noted in IRS financial statements for more than a decade. To accomplish our objectives, we:

I. Researched the requirements of the FFMIA, including Office of Management and Budget and Department of the Treasury guidance for the IRS's compliance with it.

II. Determined whether the IRS's remediation plan was consistent with GAO recommendations from prior IRS 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 remediation actions extending more than three years.

   A. Verified that all remediation actions have intermediate target dates established.

   B. Determined the facts and time frames associated with the existing material weakness to document how long the material weakness has been outstanding and the facts surrounding remediation actions planned and taken by the IRS since the material weakness was first identified.

IV. Determined whether the IRS had taken adequate corrective actions on prior reported audit findings related to the FFMIA remediation plan.

   A. Identified the prior year's Treasury Inspector General for Tax Administration audit findings and corresponding management responses concerning corrective actions that should have been completed by the time of this year's audit.[3]

   B. Confirmed through discussions and observations that actions had been completed.

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[1] Pub. L. No. 104-208, 110 Stat. 3009.
[2] A 12-consecutive-month period ending on the last day of any month. The Federal Government's fiscal year begins on October 1 and ends on September 30.
[3] Treasury Inspector General for Tax Administration, Ref. No. 2012-10-069, *The Remediation Plan Still Does Not Contain All the Necessary Actions to Address the Unpaid Assessments Material Weakness* (Jul. 2012).

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 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.

Appendix II

Major Contributors to This Report

Gregory D. Kutz, Assistant Inspector General for Audit (Management Services and Exempt Organizations)
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Appendix III

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