TREASURY INSPECTOR GENERAL FOR TAX ADMINISTRATION

Status of Implementation of the Federal Financial Management Improvement Act

April 30, 2014

Reference Number: 2014-10-026

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.

Phone Number / 202-622-6500
E-mail Address / TIGTACommunications@tigta.treas.gov
Website / http://www.treasury.gov/tigta

STATUS OF IMPLEMENTATION OF THE FEDERAL FINANCIAL MANAGEMENT IMPROVEMENT ACT

Highlights

Final Report issued on April 30, 2014

Highlights of Reference Number: 2014-10-026 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's Fiscal Year 2013 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 IRS has continued to take action on internal control weaknesses that affect its financial reporting. For example, the IRS closed seven of 11 open remediation actions during Fiscal Year 2013 and did not miss any intermediate target dates on its remediation plans related to the unpaid tax assessments material weakness. However, in December 2013, the Government Accountability Office reported that because of the material weakness in the IRS's internal controls over unpaid tax assessments and the associated system deficiencies, the IRS financial management systems did not comply with the Federal financial management systems requirements. The unpaid tax assessments material weakness affects the IRS's ability to accurately quantify the amount of unpaid tax assessments owed to the IRS.

IRS management advised TIGTA that they cannot determine when they will achieve compliance with the FFMIA because it is largely contingent on the implementation of the Customer Account Data Engine 2 (CADE 2). As TIGTA previously reported, the IRS has not included any specific details related to the CADE 2 in its remediation plan. Because the IRS has indicated that the CADE 2 is a key piece of its strategy to address its material weakness related to unpaid tax assessments, TIGTA continues to believe that CADE 2 implementation and associated cost estimates should be included in the remediation plan.

WHAT TIGTA RECOMMENDED

TIGTA did not make any recommendations in this report. However, a discussion draft of the report was provided to the IRS for review and comment. In its response, the IRS stated that it is planning to reassess the November 2014 closing date for the unpaid assessments material weakness once the scope for the CADE 2 Transition State 2 has been determined.

TREASURY INSPECTOR GENERAL
FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

April 30, 2014

MEMORANDUM FOR CHIEF FINANCIAL OFFICER

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

SUBJECT: Final Audit Report – Status of Implementation of the Federal Financial Management Improvement Act (Audit # 201410001)

This report presents the results of our review of the status of implementation of the Federal Financial Management Improvement Act. The overall objectives of this review were to identify any instances of and reasons for missed intermediate target dates established in the Internal Revenue Service's (IRS) Fiscal Year 2013 Federal Financial Management Improvement Act remediation plan and to determine whether the IRS has taken adequate corrective actions on our Fiscal Year 2012 audit findings related to the plan. This review is included in our Fiscal Year 2014 Annual Audit Plan and addresses the major management challenge of Achieving Program Efficiencies and Cost Savings.

The Treasury Inspector General for Tax Administration made no recommendations as a result of the work performed during this review. However, a discussion draft of the report was provided to the IRS for review and comment. Management's complete response is included as 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 Gregory Kutz, Assistant Inspector General for Audit (Management Services and Exempt Organizations).

Table of Contents

Background..Page 1

Results of Review ....Page 3

No Intermediate Target Dates Were Missed and Extension of Time
Was Approved ....Page 3

Unpaid Tax Assessments Material Weakness Remains a Challenge ....Page 4

Appendices

Appendix I – Detailed Objectives, Scope, and Methodology.......................Page 6

Appendix II – Major Contributors to This Report ....Page 8

Appendix III – Report Distribution List ....Page 9

Appendix IV – Management's Response to the Draft Report ....Page 10

Abbreviations

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

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, the Act required this disclosure should 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 December 2013, the Government Accountability Office continued to report that the Internal Revenue Service's internal controls over financial reporting are not effective.

- 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 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 and reasons when an agency has not met the intermediate target dates established in the remediation plan.

In December 1993, the Government Accountability Office (GAO) reported on significant financial management weaknesses[4] that impacted 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. 21, 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.

Over the last 20 years, 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[6] remains. 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, in GAO's December 2013 report, it reported that the IRS continues to have a material weakness related to its unpaid tax assessments on its financial statements, *e.g.*, unpaid tax assessments, which affects the IRS's ability to accurately quantify the amount of unpaid tax assessments.[7]

This review was performed at the IRS Headquarters in Washington, D.C., in the office of the Chief Financial Officer during the period October 2013 through March 2014. 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.

---

[6] In May 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.

[7] GAO, GAO-14-169, *Financial Audit: IRS's Fiscal Years 2013 and 2012 Financial Statements* (Dec. 12, 2013).

Results of Review

During Fiscal Year (FY)[8] 2013, the IRS continued to take action on internal control weaknesses that affect its financial reporting. For example, the IRS closed seven of 11 open remediation actions and did not miss any intermediate target dates on its remediation plans related to the unpaid tax assessments material weakness. However, IRS management advised us that they cannot determine when they will achieve compliance with the FFMIA because it is largely contingent on the implementation of the Customer Account Data Engine 2 (CADE 2) Transition State 2.[9]

As we have previously reported, the IRS has not included any specific details related to the CADE 2 in its remediation plans.[10] Also, because the IRS has encountered delays in implementing the CADE 2, it is unclear when it will be fully compliant with the FFMIA requirements. Because the IRS has indicated that the CADE 2 is a key piece of its strategy to address its material weakness related to unpaid tax assessments, we continue to believe CADE 2 implementation and associated cost estimates should be included in the remediation plan.

No Intermediate Target Dates Were Missed and Extension of Time Was Approved

Our review identified that the IRS did not miss any intermediate target dates on its remediation plans related to the unpaid tax assessments material weakness. At the end of FY 2013, the IRS completed seven of 11 remediation actions and the remaining four actions were still open. All four of the open actions were associated with improvements to the unpaid tax assessments material weakness.

The FFMIA requirements state there is a three-year time period for an agency's remediation plan to bring its financial management systems into substantial compliance.[11] However, there are provisions to allow an agency to receive an extension of time. The target dates for the four open remediation actions were extended more than three years from the initial determination that IRS financial management systems were not in substantial compliance with the FFMIA. As required,

---

[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 CADE 2 is part of the IRS's modernization efforts. CADE 2 Transition State 2 planned scope focuses, in part, on resolving financial material weaknesses.
[10] 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).
[11] Pub. L. No. 104-208, 110 Stat. 3009.

the IRS, through the Department of the Treasury, properly obtained Office of Management and Budget concurrence to extend its corrective actions beyond the three-year limitation.

Unpaid Tax Assessments Material Weakness Remains a Challenge

According to IRS management, the CADE 2 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, the IRS has encountered challenges in implementing the CADE 2. The IRS had planned to implement the CADE 2 by November 2014, but we were advised that date is no longer achievable. IRS management stated that several factors have delayed the CADE 2 implementation including the Government shutdown, the Affordable Care Act implementation, and budget shortfalls. The IRS could not determine when the CADE 2 would be functional, but planned to determine a new implementation date during a strategy meeting which is scheduled for September 2014.

During this review, we also noted the IRS continues to omit remediation plan actions and cost estimates for the CADE 2 to address the material weakness of unpaid tax assessments. We previously recommended that the IRS include CADE 2 actions in its remediation plans.[12] However, IRS management stated that the FFMIA remediation plan was created to address the actions required for their financial systems, and they believe that the CADE 2 is not a financial system; rather, it is a Business Systems Modernization project used to modernize the IRS tax system for individual taxpayer account data. However, we continue to believe that including additional remediation plan steps associated with CADE 2 implementation in the current remediation plan will increase the likelihood of the IRS addressing the material weakness relating to unpaid tax assessments.

The GAO continues to report that internal controls over financial reporting are not effective

While reviewing the IRS's 2012 and 2013 financial statements, the GAO reported that the IRS's internal controls over financial reporting were not effective.[13] The GAO found that the IRS was unable to rely on its general ledger and underlying subsidiary ledgers for tracing reported taxes receivable to supporting transactions and was unable to effectively prevent or detect and correct errors in taxpayer accounts. Because of these issues, the GAO reported that the IRS has a material weakness related to its unpaid tax assessments on its financial statements. The unpaid tax assessments material weakness affects the IRS's ability to accurately quantify the amount of unpaid tax assessments owed to the IRS.

---

[12] 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).
[13] GAO, GAO-14-169, *Financial Audit: IRS's Fiscal Years 2013 and 2012 Financial Statement* (Dec. 12, 2013).

In addition, the GAO reported that the IRS's controls over its process for estimating the balances of unpaid tax assessments were not effective to ensure the 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 systems that were not designed to provide timely transaction level information. Therefore, the Treasury Inspector General for Tax Administration will continue to monitor the IRS's progress in achieving compliance with the FFMIA but is not making new recommendations at this time.

Appendix I

Detailed Objectives, Scope, and Methodology

The overall objectives of this review were to identify any instances of and reasons for missed intermediate target dates established in the IRS's FY 2013 FFMIA remediation plan and to determine whether the IRS has taken adequate corrective actions on our FY 2012 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, 2013, 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 remedial actions extending more than three years.

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

   B. Identified any intermediate target dates extending more than three years since 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 FY 2012 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 our audit.

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

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.

Appendix II

Major Contributors to This Report

Gregory 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
Mary F. Herberger, Senior Auditor

Appendix III

Report Distribution List

Commissioner C
Office of the Commissioner – Attn: Chief of Staff C
Deputy Commissioner for Operations Support OS
Chief Technology Officer OS:CTO
Deputy Chief Financial Officer OS:CFO
Associate Chief Financial Officer for Corporate Planning and Internal Controls OS:CFO:CPIC
Chief Counsel CC
National Taxpayer Advocate TA
Director, Office of Legislative Affairs CL:LA
Director, Office of Program Evaluation and Risk Analysis RAS:O
Office Of Internal Control OS:CFO:CPIC:IC
Audit Liaisons:
    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

CHIEF FINANCIAL OFFICER

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

April 8, 2014

MEMORANDUM FOR GREGORY D. KUTZ
ASSISTANT INSPECTOR GENERAL FOR AUDIT
(Management Services and Exempt Organizations)

FROM: Robin L. Canady
Chief Financial Officer

SUBJECT: Discussion Draft Audit Report – Status of Implementation of the Federal Financial Management Improvement Act (Audit # 201410001)

We have reviewed the discussion draft report titled, "*Status of Implementation of the Federal Financial Management Improvement Act.*" We appreciate your acknowledgement of the progress IRS has made in addressing previously identified remediation plan material weaknesses.

The IRS will reassess the November 2014 closing date for the unpaid assessments material weakness once the scope for Customer Account Data Engine 2 (CADE 2) Transition State 2 (TS2) has been determined. As indicated in your report, the current goal is to establish a new CADE 2 TS2 implementation date by September 2014.

If you have any questions, please contact me at (202) 317-6400, or a member of your staff may contact John Pekarik, Acting Associate Chief Financial Officer, Corporate Planning and Internal Control, at (202) 317-4038.