



Highlights of [GAO-08-166](#), a report to the Secretary of the Treasury

## Why GAO Did This Study

Because of the significance of Internal Revenue Service (IRS) collections to overall federal receipts and, in turn, to the consolidated financial statements of the U.S. government, which GAO is required to audit, and Congress's interest in financial management at IRS, GAO audits IRS's financial statements annually to determine whether (1) the financial statements are reliable, and (2) IRS management maintained effective internal controls. 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).

## What GAO Recommends

Based on prior audits, GAO made numerous recommendations to IRS to address the internal control and compliance issues that persisted during fiscal year 2007. GAO will continue to monitor IRS's progress in implementing the 144 recommendations that remain open as of the date of this report, of which 69 relate to the material weakness in information security.

IRS agreed with the report's findings and noted that it fairly presented IRS's progress and challenges. IRS noted that improving information security continues to be a priority, and that it has a solid management team in place to address remaining financial management challenges.

For a fuller understanding of GAO's opinion on IRS's fiscal years 2007 and 2006 financial statements, readers should refer to the complete audit report, available by clicking on [GAO-08-166](#), which includes information on audit objectives, scope, and methodology. For more information, contact Steven J. Sebastian, (202) 512-3406, [sebastians@gao.gov](mailto:sebastians@gao.gov).

## FINANCIAL AUDIT

### IRS's Fiscal Years 2007 and 2006 Financial Statements

#### What GAO Found

In GAO's opinion, IRS's fiscal years 2007 and 2006 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 rely on resource-intensive compensating processes to prepare its financial statements. Because of these and other deficiencies, IRS did not, in GAO's opinion, maintain effective internal controls over financial reporting (including safeguarding of assets) or compliance with laws and regulations, and thus did not provide reasonable assurance that losses, misstatements, and noncompliance with laws and regulations material in relation to the financial statements would be prevented or detected on a timely basis.

IRS has continued to make significant strides in addressing its financial management challenges and has substantially mitigated several material weaknesses in its internal controls. For example, IRS (1) enhanced its reporting of tax receipts and accelerated its certification of excise tax receipts to recipient trust funds, (2) issued its first cost accounting policy to serve as guidance for costing its services and activities, (3) enhanced its use of available information to better target collection efforts on outstanding tax debt and reduce the risk of improper refund disbursements, and (4) made progress in establishing the framework for implementing a subsidiary ledger for its tax administration activities. However, IRS's ability to fully address its remaining financial management issues largely depends on addressing the limitations of its automated systems used to process tax-related activities. IRS has also not determined how to apply the cost information that resides in its core general ledger system for non-tax activities to the activities processed by its separate tax processing systems. Thus, it is unclear how or when these issues will be resolved. GAO continues to consider issues related to IRS's controls over financial reporting, management of unpaid assessments, collection of revenue and issuance of tax refunds, and information security to be material weaknesses. Additionally, while IRS continued to make progress in addressing weaknesses in controls over hard-copy taxpayer receipts and data, GAO concluded that remaining issues related to this activity constituted a significant deficiency. Also, GAO found that IRS was not always in compliance with the law concerning the timely release of tax liens.

IRS management faces serious challenges from its continued use of obsolete financial management systems that do not conform to the requirements of FFMIA. These challenges adversely affect IRS's ability to fulfill its responsibilities as the nation's tax collector because it is unable to routinely obtain comprehensive, timely, accurate, and useful information for day-to-day decision making. In addition, as IRS continues to progress toward ever more automated financial management processes, the presence of material weaknesses in controls over these systems, especially in the area of information security, could have serious implications for our ability to determine whether IRS's financial statements are fairly stated.