



Highlights of [GAO-07-136](#), 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

In prior audits, GAO made numerous recommendations to IRS to address issues comprising the material weaknesses and reportable condition and compliance matters that persisted during fiscal year 2006. GAO will continue to monitor IRS's progress in implementing the 72 recommendations that remain open as of the date of this report. IRS agreed with the report's findings and that it fairly presents IRS's progress and challenges. IRS said it had made significant progress in addressing financial management issues and noted that it had a strong management team to continue improving financial management with an increased focus on internal controls and information security.

www.gao.gov/cgi-bin/getrpt?GAO-07-136.

To view the full product, including the scope and methodology, click on the link above. For more information, contact Steven J. Sebastian at (202) 512-3406 or sebastians@gao.gov.

FINANCIAL AUDIT

IRS's Fiscal Years 2006 and 2005 Financial Statements

What GAO Found

In GAO's opinion, IRS's fiscal years 2006 and 2005 financial statements are fairly presented in all material respects. Because of serious internal control and financial management systems deficiencies, IRS again had to rely extensively on resource-intensive compensating processes to prepare its financial statements. Because of these serious internal control and financial management 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 material in relation to the financial statements would be prevented or detected on a timely basis.

IRS has continued to make great strides in addressing its financial management challenges and has substantially mitigated several material weaknesses in its internal controls. IRS made significant progress in developing its cost accounting module, which was part of the first phase of the Integrated Financial System (IFS), implemented in fiscal year 2005. IRS also improved the reliability of its property and equipment records, and we no longer consider this issue to be a reportable condition. However, because of budgetary concerns and advances in automated financial management system technologies, IRS is no longer committed to the future releases of IFS that were once intended to resolve many of its most serious financial management issues, and is currently considering alternatives. IRS has not yet committed to an alternative approach nor has funding been appropriated. Additionally, IRS has not determined how to resolve issues related to the lack of integration between IFS and its tax processing systems. Consequently, 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. Although 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 reportable condition. In addition, IRS was not always in compliance with a 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 substantially comply with FFMIA requirements. These challenges adversely affect IRS's ability to fulfill its responsibilities as the nation's tax collector because it is unable to obtain comprehensive, timely, accurate, and useful information for day-to-day decision making. Solving IRS's financial management problems depends largely on the ultimate success of IRS's ongoing systems modernization efforts.