November 2002

GAO
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Highlights

Highlights of GAO-03-243, a report to the Secretary of the Treasury

FINANCIAL AUDIT

IRS'S FISCAL YEARS 2002 AND 2001 FINANCIAL STATEMENTS

Why GAO Did This Study

Because of the significance of IRS revenue collections to 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 IRS prepares are reliable, (2) IRS management maintained effective internal controls, and (3) IRS complies with selected provisions of significant laws and regulations and its financial systems comply with the Federal Financial Management Improvement Act (FFMIA).

What GAO Recommends

In prior audits, GAO made numerous recommendations to IRS to address issues raised again in this audit. GAO will continue to monitor IRS's progress in implementing the more than 60 recommendations that remain open as of the date of this report. IRS agreed with the vast majority of GAO's recommendations and recognizes that only by implementing a new, integrated financial system can it overcome many of its weaknesses. IRS agreed with the report's findings and cited a number of planned improvements and initiatives to address some of the problems GAO identified.

www.gao.gov/cgi-bin/getrpt?GAO-03-243.

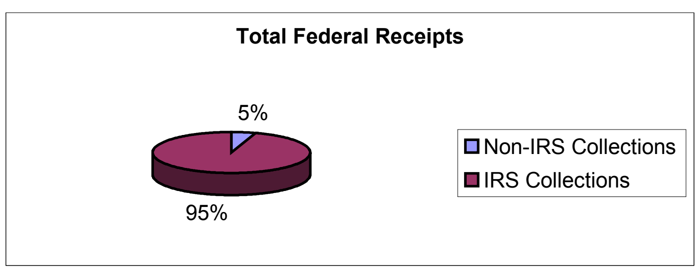
For a fuller understanding of GAO's opinion on IRS's 2002 financial statements, readers should refer to the complete audit report, available by clicking the link above, which includes information on audit objectives, scope, and methodology, as well as audit findings. For additional information, contact Steven J. Sebastian (202-512-3406).

What GAO Found

In GAO's opinion, IRS's fiscal year 2002 financial statements were fairly presented in all material respects. Because of serious financial systems and control weaknesses, however, IRS again had to rely extensively on various costly and resource-intensive processes to prepare its financial statements.

IRS made notable progress in a number of areas in fiscal year 2002, including addressing issues related to budgetary activity, accountability over property and equipment, and computer security. The agency also laid the groundwork for improvement in several other areas. Nevertheless, IRS continues to be challenged by many of the same issues reported each year since fiscal year 1992, when GAO began auditing IRS's financial statements. Serious problems continued to exist in the following five areas: (1) financial reporting, (2) unpaid tax assessments, (3) tax revenue and refunds, (4) property and equipment, and (5) computer security. Additionally, IRS was not always in compliance with laws concerning the structure of installment agreements IRS enters into with taxpayers and the timing of the release of federal tax liens.

One of the largest obstacles facing IRS management is the agency's lack of a financial management system capable of producing information needed for day-to-day decisions. Through compensating processes, extraordinary efforts, and some fundamental changes in how it processed transactions, maintained its records, and reported its financial results, IRS was able to issue its financial statements 6 weeks after the end of the fiscal year. Despite this, IRS's compensating processes and approaches cannot produce reliable, timely financial and cost-based performance information useful for ongoing decision making or fully address the financial management and operational issues that affect IRS's ability to fulfill its responsibilities as the nation's tax collector, largely because IRS's financial management systems do not comply with FFMIA.



Source: IRS.

IRS lacks an adequate, integrated financial system, although the agency is responsible for collecting nearly all federal receipts. IRS's fiscal year 2002 financial statements show that IRS programs collected more than $2 trillion in federal receipts; this constituted 95 percent of total federal receipts.