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Highlights

Highlights of GAO-06-137, a report to the Secretary of the Treasury

November 2005

FINANCIAL AUDIT

IRS's Fiscal Years 2005 and 2004 Financial Statements

Why GAO Did This Study

Because of the significance of Internal Revenue Service (IRS) 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 and (2) IRS management maintained effective internal controls. We also test IRS's compliance with selected provisions of significant laws and regulations and its financial management systems' compliance with the Federal Financial Management Improvement Act of 1996 (FFMIA).

What GAO Recommends

In prior audits, GAO made recommendations to IRS to address issues that continued to persist during this year's audit. GAO will monitor IRS's progress in implementing the 84 recommendations that remain open as of the date of this report. IRS agreed with the report's findings, noting that it fairly presented IRS's progress and challenges. IRS cited its implementation of the first phase of its new financial systems and its planned initiatives to address its financial management challenges. IRS noted that it had established a strong commitment to improve financial management and to aggressively pursue process and systems improvements.

www.gao.gov/cgi-bin/getrpt?GAO-06-137.

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.

What GAO Found

In GAO's opinion, IRS's fiscal years 2005 and 2004 financial statements were fairly presented in all material respects. Because of serious internal control and financial management systems deficiencies, however, IRS again had to rely extensively on resource-intensive compensating processes to prepare its financial statements. Due to 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. In fiscal year 2005, IRS successfully implemented the first phase, or release, of its new Integrated Financial System (IFS), which is intended to replace the outdated financial management systems IRS used in recent years to process and report administrative (nontax) transactions. This first phase of IFS provides for improved audit trails and more timely information for such activities and transactions as travel, purchases of goods and services, and budgetary activities. In addition, IRS continued to make progress in its efforts to address its weaknesses in controls over hard-copy taxpayer receipts and data and over property and equipment. However, 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. In addition, IRS was not always in compliance with a law concerning the timely release of tax liens.

IRS's most serious financial management weaknesses are rooted in its continued reliance on outdated automated systems. The lack of a sound financial management system that can produce timely, accurate, and useful information needed for day-to-day decisions continues to present a serious challenge to IRS management. While implementation of the first phase of IFS during fiscal year 2005 was noteworthy, it is still several years away from achieving its full potential, which is contingent on future system releases and development of a means to integrate the new system with the systems IRS uses to support its tax administration activities. IRS's present financial management systems, which do not substantially comply with FFMIA, inhibit IRS's ability to address the financial management and operational issues that affect its ability to fulfill its responsibilities as the nation's tax collector. Further, the continued and serious weaknesses in information security have significant implications for the reliability of information produced by the new financial management system being implemented. Solving IRS's financial management problems depends largely on the ultimate success of IRS's ongoing systems modernization effort.