

**The Internal Revenue Service's Federal
Financial Management Improvement Act
Remediation Plan as of December 31, 2002**

March 2003

Reference Number: 2003-10-079

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.



DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

INSPECTOR GENERAL
for TAX
ADMINISTRATION

March 27, 2003

MEMORANDUM FOR CHIEF FINANCIAL OFFICER

Gordon C. Milbourn III

FROM: Gordon C. Milbourn III
Acting Deputy Inspector General for Audit

SUBJECT: Final Audit Report - The Internal Revenue Service's Federal
Financial Management Improvement Act Remediation Plan as of
December 31, 2002 (Audit # 200310003)

This report presents the results of our review of the Internal Revenue Service's (IRS) Federal Financial Management Improvement Act (FFMIA)¹ remediation plan. The overall objective of this review was to identify any instances of and reasons for missed intermediate target dates established in the IRS' FFMIA remediation plan. We also evaluated, in general, whether the IRS was meeting its responsibilities in fulfilling the intent of the FFMIA. The review was performed to meet our requirement under the FFMIA that states, in general, that each Inspector General shall report to the Congress instances and reasons when an agency has not met the intermediate target dates established in the remediation plan.

In summary, we did not identify any instances where the IRS did not meet established intermediate target dates contained in its FFMIA remediation plan. The IRS extended 18 intermediate target dates for actions scheduled for completion during Calendar Year 2002 and provided acceptable reasons in the remediation plan document. Also, the IRS, through the Department of the Treasury, properly obtained Office of Management and Budget concurrence for remedial actions with target dates that extend longer than 3 years from the initial reporting of the financial weakness. In addition, the IRS adequately addressed General Accounting Office recommendations meeting FFMIA criteria in the remediation plan.

We did identify, however, that some resources included in the remediation plan were not verifiable to supporting documentation, and that functional areas were not consistently reporting resources shown in the remediation plan. Accordingly, we

¹ Federal Financial Management Improvement Act of 1996, Pub. L. No. 104-208, 110 Stat. 3009.

recommended procedures be issued that include a process for verifying the resources included in the IRS' FFMIA remediation plan and that provide for consistent reporting of such resources by the responsible functions.

Management's Response: IRS management agreed with the recommendation presented in the report. The CFO has enhanced and approved reporting procedures to address the recommended resource issues. Further, the enhanced reporting instructions for resources were included with the March 14, 2003, remediation plan quarterly call memorandum. Management's complete response to the draft report is included as Appendix IV.

Copies of this report are also being sent to the IRS managers who are affected by the report recommendation. Please contact me at (202) 622-6510 if you have questions or Daniel R. Devlin, Assistant Inspector General for Audit (Headquarters Operations and Exempt Organizations Programs), at (202) 622-8500.

**The Internal Revenue Service's Federal Financial Management Improvement Act
Remediation Plan as of December 31, 2002**

Table of Contents

Background	Page 1
No Instances of Missed Target Dates Were Identified; Some Target Dates Were Extended.....	Page 2
Office of Management and Budget Concurrence Was Received for Target Dates Extending Longer Than 3 Years	Page 4
The Remediation Plan Addressed Applicable General Accounting Office Recommendations	Page 5
Remediation Plan Resources Were Not Always Verifiable to Supporting Documentation, and Reporting of Resources Was Inconsistent	Page 6
<u>Recommendation 1:</u>	Page 8
Appendix I – Detailed Objectives, Scope, and Methodology	Page 9
Appendix II – Major Contributors to This Report.....	Page 10
Appendix III – Report Distribution List	Page 11
Appendix IV – Management's Response to the Draft Report	Page 12

**The Internal Revenue Service's Federal Financial Management Improvement Act
Remediation Plan as of December 31, 2002**

Background

The Federal Financial Management Improvement Act of 1996 (FFMIA)¹ establishes in statute certain financial management systems requirements that were already established by Executive Branch policies. It was intended to advance Federal financial management by ensuring that Federal management systems can and do provide reliable, consistent disclosure of financial data. This 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, § 803 (a) of the FFMIA requires each agency to implement and maintain systems that comply substantially with:

- Federal financial management system requirements.
- Applicable Federal accounting standards.
- The Government Standard General Ledger at the transaction level.

Auditors are required to report on agency compliance with the three stated requirements as part of financial statement audit reports. Agency heads are required to determine, based on the audit report and other information, whether their financial management systems comply with the FFMIA. If the agency's financial system 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 (OMB).

In addition, § 804 (b) of the FFMIA requires that the Inspector General report to the Congress instances and reasons when an agency has not met the intermediate target dates established in the remediation plan.

In the last several years, the General Accounting Office (GAO) has reported numerous financial management weaknesses in its audits of the Internal Revenue Service's (IRS) annual financial statements and related assessments of internal control. Due to these weaknesses, the IRS is

¹ Federal Financial Management Improvement Act of 1996, Pub. L. No. 104-208, 110 Stat. 3009.

**The Internal Revenue Service's Federal Financial Management Improvement Act
Remediation Plan as of December 31, 2002**

noncompliant with the FFMIA and is required to prepare a remediation plan.

This review was performed at IRS National Headquarters in the office of the Chief Financial Officer (CFO), which is responsible for monitoring and implementing the remediation plan, during the period December 2002 through February 2003. The audit was conducted in accordance with *Government Auditing Standards*. Detailed information on our objectives, scope, and methodology is presented in Appendix I. Major contributors to the report are listed in Appendix II.

**No Instances of Missed Target
Dates Were Identified; Some
Target Dates Were Extended**

The IRS' December 31, 2002, remediation plan had established intermediate target dates for all but 1 of the 104 open remedial actions listed in the plan. The one remedial action, which concerns future year enhancements to the Integrated Financial System (IFS),² is being re-evaluated to identify the benefits that will be achieved through its implementation, as well as the sequencing of interim actions to accomplish the overall action. Approval of the completed re-evaluation and new sequencing is expected for the March 31, 2003, remediation plan update.

Our analysis of open remedial actions did not identify any instances where the IRS did not meet the established intermediate target dates contained in the remediation plan.

We compared the IRS' December 31, 2002, remediation plan to the prior 4 quarters' remediation plans, i.e., remediation plan activity during Calendar Year (CY) 2002. During that period, the IRS extended 18 of the 83 intermediate target dates on remedial actions that were due to be completed during CY 2002. These extensions ranged from 1 month to 19 months and averaged approximately 5 months beyond the original intermediate target dates. In addition, the IRS extended 12 intermediate target dates for remedial actions that had original completion dates after December 31, 2002. These

² The IFS will implement a commercial-off-the-shelf package, which is Joint Financial Management Improvement Program certified, and address the IRS' financial and revenue accounting, property, and procurement processes.

The Internal Revenue Service's Federal Financial Management Improvement Act Remediation Plan as of December 31, 2002

extensions ranged from 1 month to 7 months and averaged approximately 3 months beyond the original intermediate target dates.

The IRS provided acceptable reasons for the extensions within the remediation plan documents, including for some of the more significant extensions:

- Hiring and funding issues.
- Re-planning of major actions.
- Date changes to coincide with other major actions.
- Insufficient data gathered to fully analyze and close specific actions.
- Training issues.
- Internal re-organizations.

For the September 2002 remediation plan, the IRS made a decision to revise the plan's presentation to concentrate only on GAO recommendations that addressed financial management system weaknesses. Recommendations that address procedural or guidance weaknesses were not included in the revised plan. These recommendations would be monitored through the use of the Department of the Treasury's Joint Audit Management Enterprise System (JAMES).³

Because of this plan revision, we performed a reconciliation of prior recommendations to the recommendations included in the September 2002 plan using a crosswalk document provided by the IRS. All recommendations, except for eight, were found to be included verbatim in the revised plan. Five of the eight recommendations were crosswalked by the IRS to other similar recommendations that addressed the weakness and, therefore, were not included in the plan. The remaining three recommendations dealt with procedural issues and were, therefore, not specifically crosswalked by the IRS to recommendations contained in the plan. We

³ The JAMES is a Department of the Treasury database that monitors and tracks the progress of internal control issues and material weaknesses within the Department.

**The Internal Revenue Service's Federal Financial Management Improvement Act
Remediation Plan as of December 31, 2002**

**Office of Management and
Budget Concurrence Was
Received for Target Dates
Extending Longer Than 3 Years**

confirmed with IRS officials that these three recommendations were not in the plan and verified that they were being monitored through the JAMES.

The FFMIA requires that a remediation plan bring an agency's financial management systems into substantial compliance no later than 3 years after the date a determination is made that the financial management systems do not comply with the requirements of the FFMIA unless the agency, with concurrence of the Director of OMB:

- Determines that the agency's financial management systems cannot comply with the requirements within 3 years.
- Specifies the most feasible date to bring the agency's financial management systems into compliance with the requirements.
- Designates an agency official who shall be responsible for bringing the agency's financial management systems into compliance with the requirements.

Of the 104 open remedial actions contained in the IRS' December 31, 2002, remediation plan, 102 actions have intermediate target dates that extend longer than 3 years from the original reporting of the financial weakness. A significant number of the open remedial actions relate to implementation of four major IRS system projects and improvements concerning physical and computer security. The four projects include:

- The IFS, which is scheduled to be implemented in three releases. The first release is due in October 2003, the second release is due in March 2005, and the third release date has yet to be determined. These actions address, in general, GAO recommendations made since August 1993.
- The Custodial Accounting Project (CAP),⁴ which is scheduled to be implemented in three releases. The first

⁴ The CAP is an integrated information system to analyze and report on taxpayer account and return data.

The Internal Revenue Service's Federal Financial Management Improvement Act Remediation Plan as of December 31, 2002

release is due in November 2003, the second release is due in April 2005, and the third release is due in November 2006. These actions address, in general, GAO recommendations made since October 1998.

- The Automated Trust Fund Recovery (ATFR)⁵ System, which is scheduled to be implemented in March 2005 and addresses a GAO recommendation made in October 1998.
- The Complex Interest Quality Measurement System (CIQMS),⁶ which is scheduled to be implemented in July 2003 and addresses a GAO recommendation made in December 1993.

The security remedial actions are scheduled to be implemented in stages, with the final implementation scheduled for September 2003. These actions address, in general, GAO recommendations made as far back as 1999.

On March 30, 2001, the Department of the Treasury obtained OMB concurrence for time extensions relating to the IRS' remedial actions in excess of 3 years from the initial reporting of the financial weakness. As part of the concurrence, quarterly status review sessions have been held with the OMB on the progress being made to complete the identified remedial actions. In addition, because the CAP implementation schedule was extensively revised, IRS officials briefed OMB representatives on the changes in December 2002.

The Remediation Plan Addressed Applicable General Accounting Office Recommendations

On January 4, 2001, the OMB issued revised implementation guidance for the FFMIA. The revised guidance states that Federal agencies must comply, and agency auditors must report whether the agency's financial management systems substantially comply, with applicable Federal financial management systems requirements, applicable Federal accounting standards, and the

⁵ The ATFR System provides the capability to systematically upload penalty assessments from IRS area offices and cross-reference the payments received for assessments.

⁶ The CIQMS is a review process to reduce errors in calculating interest, along with a database to measure the accuracy rate.

**The Internal Revenue Service's Federal Financial Management Improvement Act
Remediation Plan as of December 31, 2002**

Government Standard General Ledger. The Federal Accounting Standards Advisory Board standards, incorporated into OMB Bulletin, *Form and Content*, are the applicable accounting standards for the Federal Government. OMB Circular A-127, *Financial Management Systems*, is the source of Federal financial management systems requirements.

Since the preparation of the IRS' December 31, 2001, remediation plan, the GAO reported 16 financial management recommendations resulting from its Fiscal Year (FY) 2001 IRS financial statement audit.⁷ We believe that 3 of these 16 recommendations met the current OMB guidance for inclusion in the IRS' remediation plan. These recommendations included developing procedures to reduce the likelihood of invalid property records, ensure requisition and procurement numbers are accurately recorded, and record software licenses in the property records.

Our analysis showed that none of the three recommendations were specifically included in the IRS' December 31, 2002, remediation plan. IRS officials informed us that these recommendations were not included since they believed that remedial actions already in the plan would address these recommendations as well. After further review of the property management section of the remediation plan and the corresponding IFS requirements package, we concur that remedial actions do exist that should address the three issues identified by the GAO.

The IRS' December 31, 2002, remediation plan listed 104 open remedial actions that were categorized into 9 major implementation areas. All but two major areas had resources identified in the plan. These two areas, which concern the implementation of the IFS, are being re-evaluated to identify the benefits that will be achieved through its implementation, as well as the sequencing of interim actions to accomplish the overall action. Approval of the completed re-evaluation and new sequencing is expected for the March 31, 2003, remediation plan update.

**Remediation Plan Resources
Were Not Always Verifiable to
Supporting Documentation, and
Reporting of Resources Was
Inconsistent**

⁷ *Management Report: Improvements Needed in IRS's Accounting Procedures and Internal Controls* (GAO-02-746R, dated July 2002).

**The Internal Revenue Service's Federal Financial Management Improvement Act
Remediation Plan as of December 31, 2002**

During our verification process, we were able to verify all estimated resources for FY 2003 to the draft FY 2003 Business Systems Modernization Office (BSMO) Expenditure Plan or other IRS budgetary documents, except for the ATFR System project. The reported resource estimate for this project was \$59,000 more than the amount shown in the supporting documentation (\$774,000 - \$715,000). The IRS was aware of this difference and will update the remediation plan for the next quarter.

In addition, we identified the following non-FY 2003 differences between the December 31, 2002, remediation plan and supporting documentation provided by the IRS:

- The ATFR System project resource estimate for FYs 2004 and 2005 was \$18,336 more than that shown in the draft ATFR Streamlined Business Case document (\$1,618,336 - \$1,600,000).
- The IFS project resource estimate for FY 2001 was \$400,000 more than that shown in the BSMO Expenditure Plan (\$8,600,000 - \$8,200,000).
- The CAP resource estimate for FYs 2000 through 2002 was \$1,126,000 more than that shown in the BSMO Expenditure Plan (\$66,500,000 - \$65,374,000).
- The CIQMS project resource estimate was 7 Full-Time Equivalent (FTE)⁸ more than that shown in the Request for Organizational Change document (55 FTEs - 48 FTEs).
- The security improvement resource estimate was \$489,000 and 2 FTEs less than that shown in the cost documentation provided (\$3,240,000 - \$3,729,000 and 45 FTEs - 47 FTEs).

In addition to the above, we identified one project, the ATFR System, which was reporting costs that were inconsistent with those of the other projects within the

⁸ An FTE is a measure of labor hours. One FTE is equal to 8 hours multiplied by the number of compensable days in a particular fiscal year. For FY 2003, 1 FTE is equal to 2,088 staff hours.

**The Internal Revenue Service's Federal Financial Management Improvement Act
Remediation Plan as of December 31, 2002**

remediation plan. The ATFR project reported only estimated resources for contract costs, while other projects (e.g., the IFS and the CAP) reported full implementation costs, including IRS costs for salaries, travel, and other costs associated with the projects.

The CFO does not have procedures that describe a process to verify information in the remediation plan or to specify the information needed to support resource commitments provided by the responsible functions. Unverifiable and inconsistent reporting of project resource estimates could mislead users of the remediation plan when making financial management decisions.

Recommendation

1. The CFO should issue procedures that include a process for verifying the resources included in its FFMIA remediation plan and that provide for consistent reporting of such resources by the responsible functions.

Management's Response: The CFO has enhanced and approved its reporting procedures to address the recommended resource issues. The CFO also included enhanced reporting instructions for resources with the remediation plan quarterly call memorandum, dated March 14, 2003.

Detailed Objectives, Scope, and Methodology

The overall objective of this review was to identify any instances of and reasons for missed intermediate target dates established in the Internal Revenue Service's (IRS) Federal Financial Management Improvement Act of 1996 (FFMIA)¹ remediation plan. We also evaluated, in general, whether the IRS was meeting its responsibilities in fulfilling the intent of the FFMIA. 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 for compliance with the Act.
- II. Determined whether the IRS' remediation plan contained applicable General Accounting Office recommendations from prior IRS financial statement audit 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 date, and 3) proper approval was obtained for remedial actions extending longer than 3 years.
- IV. Determined whether the IRS' remediation plan had established resource needs for remedial actions and the resources presented were consistent with other IRS modernization resource budgets.

¹ Federal Financial Management Improvement Act of 1996, Pub. L. No. 104-208, 110 Stat. 3009.

Major Contributors to This Report

Daniel R. Devlin, Assistant Inspector General for Audit (Headquarters Operations and Exempt Organizations Programs)

John Wright, Director

Thomas Brunetto, Audit Manager

Chinita Coates, Auditor

Bobbie Draudt, Auditor

Report Distribution List

Acting Commissioner N:C
Deputy Chief Financial Officer N:CFO
Director, Assistance and Review N:CFO:AR
Chief Counsel CC
National Taxpayer Advocate TA
Director, Legislative Affairs CL:LA
Director, Office of Program Evaluation and Risk Analysis N:ADC:R:O
Office of Management Controls N:CFO:AR:M
Audit Liaison: Chief Financial Officer N:CFO

The Internal Revenue Service's Federal Financial Management Improvement Act
Remediation Plan as of December 31, 2002

Appendix IV

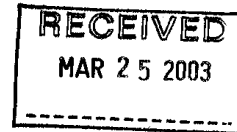
Management's Response to the Draft Report



CHIEF FINANCIAL OFFICER

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

March 24, 2003



MEMORANDUM FOR ACTING DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: W. Todd Grams *WJTB*
Chief Financial Officer

SUBJECT: Response to Draft Audit Report – Internal Revenue Service's
Federal Financial Management Improvement Act Remediation
Plan as of December 31, 2002 (Audit # 200310003)

We reviewed your draft report on IRS' Federal Financial Management Improvement Act (FFMIA) remediation plan. We agree with your recommendation to issue procedures to verify the resources in the FFMIA remediation plan and to provide for consistent reporting of these resources by the responsible functions.

We have distributed a revised procedural guide to the appropriate functions. Additionally, we will continue to seek ways to improve the quality and utility of our remediation plan, not only to meet the legislative mandate, but to establish a workable plan for attaining FFMIA-compliant systems throughout our organization. Our response to your finding and recommendation is attached.

If you have any questions, please contact me at 202.622.6400, or have a member of your staff contact Elaine Munroe, Acting Director, Assistance and Review, at 202.435.5373.

Attachment

The Internal Revenue Service's Federal Financial Management Improvement Act
Remediation Plan as of December 31, 2002

Attachment

**Response to
Draft Audit Report – Internal Revenue Service's
Federal Financial Management Improvement Act
Remediation Plan as of December 31, 2002
Audit #200310003**

Finding: Remediation plan resources were not always verifiable to supporting documentation and reporting of resources was inconsistent.

Recommendation: The CFO should issue procedures that include a process for verifying the resources included in its FFMIA remediation plan and that provide for consistent reporting of such resources by the responsible functions.

Assessment of Cause: The remediation plan is an evolving document as we continue to enhance our procedures and develop more meaningful action plans to make our financial systems and processes compliant with FFMIA.

Corrective Action: The CFO has enhanced and approved its reporting procedures to address the recommended resource issues. We also included enhanced reporting instructions for resources with the remediation plan quarterly call memorandum, dated March 14, 2003.

Implementation Date: March 20, 2003

Responsible Official: Chief Financial Officer

Corrective Action Monitoring Plan: The Office of Management Controls will review and validate all status updates for the remediation plan to ensure compliance with reporting procedures.