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Highlights

Highlights of GAO-13-120, a report to the Secretary of the Treasury

November 2012

FINANCIAL AUDIT

IRS's Fiscal Years 2012 and 2011 Financial Statements

Why GAO Did This Study

In accordance with the authority granted by the Chief Financial Officers Act of 1990, GAO annually audits the financial statements of IRS to determine whether (1) the financial statements are fairly presented and (2) IRS management maintained effective internal control over financial reporting. GAO also tests IRS's compliance with selected provisions of significant laws and regulations and its financial systems' compliance with FFMIA.

IRS's tax collection activities are significant to overall federal receipts, and the effectiveness of its financial management is of substantial interest to Congress and taxpayers.

What GAO Recommends

Based on prior financial statement audits, GAO made numerous recommendations to IRS to address internal control deficiencies. GAO will continue to monitor and will report separately on IRS's progress in implementing the recommendations that remain open, as well as any recommended actions to address the new internal control deficiencies identified in this year's audit.

In commenting on a draft of this report, IRS stated that it would continue to increase its focus on information security and internal controls while improving financial reporting.

View GAO-13-120. For more information, contact Cheryl E. Clark at (202) 512-3406 or clarkce@gao.gov.

What GAO Found

In GAO's opinion, the Internal Revenue Service's (IRS) fiscal years 2012 and 2011 financial statements are fairly presented in all material respects. However, in GAO's opinion, IRS did not maintain effective internal control over financial reporting as of September 30, 2012, because of a material weakness in internal control over unpaid tax assessments. In addition, GAO found that IRS's financial management systems were not in substantial compliance with Federal Financial Management Improvement Act of 1996 (FFMIA) requirements because of the systems issues underlying the material weakness. GAO also found no reportable instances of noncompliance in fiscal year 2012 with provisions of the laws and regulations it tested.

During fiscal year 2012, IRS continued to make important progress in addressing its deficiencies in internal control. Specifically, based on IRS's success in addressing numerous deficiencies in its information security controls over its financial reporting systems, GAO considers information security, previously reported as a long-standing material weakness, to be a significant deficiency that warrants the attention of those charged with governance of IRS. In addition, a significant reduction in the magnitude of manual refunds, coupled with the expiration of the First-time Homebuyer Credit program and resultant decrease in the number of related claims, led GAO to conclude that the deficiencies in internal control over refunds no longer constitute a significant deficiency. GAO also concluded that for the first time since fiscal year 1999, there was no reportable noncompliance by IRS with laws applicable to release of tax liens because of improvements IRS made in related processes.

The material weakness in internal control over unpaid tax assessments was primarily caused by financial system limitations and data entry errors that necessitated the use of a compensating statistical estimation process rather than the summation of individual account balances to determine the amount of taxes receivable, the most material asset on IRS's balance sheet. Serious control deficiencies over unpaid tax assessments are likely to continue to exist until IRS (1) significantly enhances or replaces the software applications it uses to maintain the subsidiary taxpayer information necessary to support its unpaid tax assessment amounts and (2) remedies the deficiencies that continue to result in significant errors in taxpayer accounts.

In addition to its internal control deficiencies, IRS faces significant ongoing financial management challenges arising from its continued need to safeguard the large volume of sensitive hard copy taxpayer receipts and related information and to address its exposure to significant improper refunds based on identity theft. Sustained management efforts will be necessary to maintain and build on the progress made to date and to fully address IRS's remaining internal controls and systems deficiencies as well as its financial management challenges.