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Highlights

Highlights of GAO-05-103, a report to the Secretary of the Treasury

November 2004

FINANCIAL AUDIT

IRS's Fiscal Years 2004 and 2003 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, (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 of 1996 (FFMIA).

What GAO Recommends

In prior audits, GAO made numerous recommendations to IRS to address issues that continued to persist during this year's financial audit. GAO will continue to monitor IRS's progress in implementing the 76 recommendations that remain open as of the date of this report. IRS agreed with the report's findings and noted that it fairly presented IRS's progress and remaining challenges. IRS cited a number of planned improvements and initiatives to address the matters raised. Finally, IRS noted that the agency had established a continuing commitment to improving financial management that would be further enhanced by implementation of its modernized financial management systems.

www.gao.gov/cgi-bin/getrpt?GAO-05-103.

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 year 2004 financial statements were fairly presented in all material respects. Because of continuing serious deficiencies in financial systems and internal control weaknesses, however, IRS again had to rely extensively on resource-intensive compensating processes to prepare its financial statements. Due to these serious deficiencies and internal control weaknesses, in GAO's opinion, IRS did not 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.

For the third consecutive year, IRS was able to meet an accelerated financial reporting date, an accomplishment all the more notable because IRS was simultaneously working to implement new financial management systems. IRS also continued to make progress in its efforts to address its weakness in controls over property and equipment and hard-copy taxpayer receipts and data. However, GAO continues to consider issues related to IRS's controls over financial reporting, management of unpaid assessments, and collection of revenue and issuance of tax refunds to be material weaknesses. GAO also continues to consider issues related to information security to be a material weakness. In addition, IRS was not always in compliance with laws concerning the timely release of tax liens and the structure of installment agreements it enters into with taxpayers. Recently enacted legislation modifying the legal requirements regarding the structuring of installment agreements will resolve this compliance issue for future audits.

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. 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. IRS is installing a new financial management system intended to resolve many of these problems and is presently implementing the first phase of a major component of the system—the Integrated Financial System (IFS). IRS's effort to bring IFS online has experienced significant problems and delays, however, and if IRS should encounter difficulties with the first phase of IFS, the integrity of IRS's financial records could be affected. Additionally, the continued and serious weaknesses in information security have significant implications for the reliability of financial management information produced by the new financial management systems being implemented.