U.S. GOVERNMENT ACCOUNTABILITY OFFICE
441 G St. N.W.
Washington, DC 20548

Accessible Version

May 17, 2017
The Honorable John Koskinen
Commissioner of Internal Revenue

Management Report: Improvements Are Needed to Enhance the Internal Revenue Service's Internal Control over Financial Reporting

Dear Mr. Koskinen:

On November 10, 2016, we issued our report on our audit of the Internal Revenue Service's (IRS) fiscal years 2016 and 2015 financial statements,[1] which included our opinion that IRS's internal control over financial reporting was not effective as of September 30, 2016, because of a continuing material weakness in internal control over unpaid assessments.[2] The purpose of this report is to present (1) a new control deficiency related to the material weakness reported in our 2016 report and (2) other new control deficiencies that we identified during our fiscal year 2016 testing of IRS's controls, along with our recommended corrective actions related to all of these deficiencies.[3] This report also presents the status, as of September 30, 2016, of IRS's corrective actions taken to address our recommendations detailed in our previous management reports that remained open at the beginning of our fiscal year 2016 audit (see enc. I).[4] This report is intended for use by IRS management.

Results in Brief

During our audit of IRS's fiscal years 2016 and 2015 financial statements, we identified a new control deficiency involving changes to master file programs that contributed to IRS's continuing material weakness in internal control over unpaid assessments as of September 30, 2016.

We also identified other new deficiencies in IRS's internal control over financial reporting that although not considered material weaknesses or significant deficiencies,[5] nonetheless warrant IRS management's attention. These control deficiencies concern

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[1]GAO, *Financial Audit: IRS's Fiscal Years 2016 and 2015 Financial Statements*, GAO-17-140 (Washington, D.C.: Nov. 10, 2016).

[2]An unpaid assessment is a legally enforceable claim against a taxpayer and consists of taxes, penalties, and interest that have not been collected or abated (i.e., reduced by IRS). Internal Revenue Manual (IRM) § 1.34.1.2 (June 23, 2009).

[3]We plan to issue a separate report on the information security issues identified during our fiscal year 2016 audit, including the previously unresolved and new issues that collectively contributed to a significant deficiency in internal control over financial reporting systems as of September 30, 2016, along with associated new recommendations for corrective actions.

[4]GAO, *Management Report: Improvements Are Needed to Enhance the Internal Revenue Service's Internal Control over Financial Reporting*, GAO-16-457R (Washington, D.C.: May 18, 2016).

[5]A material weakness is a deficiency, or combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected, on a timely basis. A significant deficiency is a deficiency, or combination of

- Internal Revenue Manual (IRM) policies and procedures,[6]
- digital signatures on forms related to the authorization of manual refunds,
- assignment of user access rights in IRS's human resources information management system,
- review of the process for determining intragovernmental costs and costs with the public, and
- accuracy of asset disposal dates.

This report provides 2 recommendations pertaining to the new control deficiency that contributed to IRS's continuing material weakness in internal control over unpaid assessments and 8 recommendations related to the other identified control deficiencies, for a total of 10 new recommendations. These recommendations are intended to improve IRS's internal controls over its financial management and accountability of resources as well as to bring IRS into conformance with its own policies and *Standards for Internal Control in the Federal Government*.[7]

As of September 30, 2016, IRS had completed corrective action on 11 of the 42 recommendations from our prior financial audits that remained open at the beginning of our fiscal year 2016 audit. As a result, IRS currently has 41 GAO recommendations to address, which consist of the previous 31 open recommendations and the 10 new recommendations we are making in this report. Enclosure I provides details on the status of IRS's actions to address the open recommendations from our prior audits.

In commenting on a draft of this report, IRS stated that it is committed to implementing appropriate improvements to ensure that IRS maintains sound financial management practices. IRS agreed with the 10 new recommendations and described actions it has taken or planned to take to address each recommendation. IRS's comments are reprinted in their entirety in enclosure II.

Objectives, Scope, and Methodology

Our objectives were to evaluate IRS's internal control over financial reporting and to determine the status of IRS's corrective actions as of September 30, 2016, to address recommendations in our prior years' reports for which actions were not complete as of September 30, 2015.[8] This work was performed in connection with our audit of IRS's financial statements for the fiscal

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deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis.

[6]The IRM is IRS's primary, official compilation of instructions to staff that relate to the administration and operations of the IRS. IRM § 1.11.2, *Internal Revenue Manual Process* (Sept. 21, 2015). Some IRM sections may have been revised or updated since our audit. For the purposes of this report, we are using the IRM in effect during the audit.

[7]GAO, *Standards for Internal Control in the Federal Government*, GAO-14-704G (Washington, D.C.: September 2014), contains the internal control standards to be followed by executive agencies in establishing and maintaining systems of internal control as required by 31 U.S.C. § 3512 (c), (d) (commonly referred to as the Federal Managers' Financial Integrity Act).

[8]An entity's internal control over financial reporting is a process effected by those charged with governance, management, and other personnel, the objectives of which are to provide reasonable assurance that (1) transactions are properly recorded, processed, and summarized to permit the preparation of financial statements in accordance with U.S. generally accepted accounting principles, and assets are safeguarded against loss from unauthorized acquisition, use, or disposition, and (2) transactions are executed in accordance with provisions of applicable laws, including those governing the use of budget authority, regulations, contracts, and grant agreements, noncompliance with which could have a material effect on the financial statements.

years ended September 30, 2016, and 2015, for the purpose of supporting our opinion on whether effective internal control over financial reporting was maintained, in all material respects. We designed our audit procedures to test relevant controls, including those for proper authorization, execution, accounting, and reporting of transactions and for the safeguarding of assets and taxpayer information. In conducting the audit, we reviewed applicable IRS policies and procedures, observed operations, tested statistical and nonstatistical samples of transactions, examined relevant documents and records, and interviewed IRS management and staff.

During the course of our work, we communicated our findings to IRS management. We performed our audit in accordance with U.S. generally accepted government auditing standards. We believe that our audit provides a reasonable basis for our findings and recommendations in this report.

Internal Control Deficiencies Identified in Our Fiscal Year 2016 Audit

We identified the following new internal control deficiency during our fiscal year 2016 audit that contributed to the continuing material weakness in IRS's internal control over unpaid assessments.

Changes to Master File Programs

IRS's master files contain the detailed records of taxpayer accounts,[9] and IRS uses this information for tax administration and to support information reported in its financial statements. IRS's operating divisions are responsible for activities relating to tax administration and operations,[10] such as assessing penalties against taxpayers for failing to timely file or pay taxes and recording such assessments on the taxpayers' master file accounts. IRS's Information Technology (IT) organization is responsible for maintaining IRS's systems and making any programming changes requested by the operating divisions. The Chief Financial Officer (CFO) organization relies on and uses the information from IRS's master files to produce IRS's financial statements. IRS uses a combination of manual and automated processes to record certain transactions into the master files. Among numerous activities, the master file programs automatically calculate and record certain transactions and related amounts to taxpayer accounts based on other information existing in the accounts.

Condition. During fiscal year 2016, we found that IRS made changes to its master file programs without coordinating with or communicating the changes to the CFO organization and affected staff, and without thoroughly testing these changes to reasonably assure that they yielded expected results. Specifically, we found that when IRS implemented procedural changes to automate the recording of abatements[11] for specific failure-to-file penalty assessments in its

[9]IRS uses several master file information systems, the most significant of which are the Business Master File, which contains tax records of corporations and other businesses, and the Individual Master File, which contains tax records of individual taxpayers.

[10]IRS's organizational structure is divided into two primary groups: Services and Enforcement and Operations Support. Services and Enforcement oversees operating divisions responsible for serving taxpayers. Operations Support oversees support functions facilitating IRS's business practices and includes the Information Technology organization and the Chief Financial Officer organization. IRM § 1.1.1.4, *Structure of the IRS* (June 2, 2015).

[11]Pursuant to 26 U.S.C. § 6404, IRS has the authority to abate the unpaid portion of tax assessments under certain conditions. IRS records tax abatements to reduce previously recorded tax assessments based on taxpayer disagreements, to remove assessments that have reached their statutory collection expiration dates, or to correct IRS errors.

Business Master File (BMF),[12] neither the responsible operating division nor the IT organization coordinated the BMF programming changes with the CFO organization. Furthermore, the responsible operating division did not timely notify staff charged with manually processing the abatements that the abatement procedures had been automated and therefore to stop the manual recording of this activity.[13] This, coupled with programming errors made by the IT organization when it moved to an automated process, contributed to IRS recording the following erroneous transactions in taxpayer accounts in fiscal year 2016:[14]

- duplicate abatement transactions recorded in over 200 taxpayer accounts,
- abatement transactions that were 100 times the amount of the intended abatement amount recorded in 71 taxpayer accounts, and
- assessed or accrued interest for a 1,600-year period recorded in 71 taxpayer accounts.

Criteria. IRS policies direct its operating divisions to notify and coordinate with the CFO organization when making programming changes in IRS's information systems.[15] IRS policy also requires that the IT organization test and document test results for all programming changes before implementation.[16] Specifically, the IT organization is required to use the Applications Development transmittal checklist when developing program changes.[17]

Internal control standards state that management should internally communicate necessary quality information to achieve the entity's objectives; design control activities to achieve objectives and respond to risks, which includes designing control activities to reasonably assure that all transactions are completely and accurately recorded and clearly documenting internal control and all transactions and other significant events; design its information systems to obtain and process information to meet information requirements and respond to the entity's objectives and risks; and establish and operate activities to monitor the internal control system and evaluate the results.[18]

[12]IRS recorded penalty assessments against U.S. taxpayers that failed to timely file complete and accurate international informational returns required by law. U.S. taxpayers are required to report their worldwide income on international informational returns, and IRS uses these returns to verify that it assessed each taxpayer the correct income tax. IRM § 20.1.9.1, *International Penalties, Overview* (July 8, 2015). The procedural change IRS made in 2016 was to automatically record abatements of these failure-to-file penalty assessments for taxpayers that submitted extensions of time to file.

[13]Prior to automating this abatement procedure, IRS staff manually processed the abatements of these specific failure-to-file penalty assessments in accordance with IRM §§ 20.1.2.1.3.1.1 (July 8, 2016), 20.1.9.3.5 (July 8, 2015), 20.1.9.5.5 (July 8, 2015), and 21.8.2.22.2 (May 9, 2016).

[14]These represent the actual number of errors identified by IRS, which has been verified by GAO.

[15]IRS's Deputy Commissioner for Operations Support issued two memorandums to IRS senior executives regarding this policy. The first was issued on September 27, 2013, and the second one on October 19, 2015.

[16]IRS requires that IRS have a testing plan for all software applications that addresses verification and validation activities. IRM § 2.127.1.1.4, *IT Test Policy, Directive* (Mar. 16, 2015). This is applicable to all application releases, formal or informal, and regardless of whether testing is conducted internally or externally, such as by contractors. IRS's *IT Test Reference Guide* (Oct. 31, 2014) requires that when testing computer programs, IRS maintain its testing results in its documentation for at least a year after implementation.

[17]IRS's IT organization issued a memorandum to communicate this policy on November 18, 2009. Applications Development is a group within the IT organization that designs, develops, tests, deploys, and maintains IRS's information systems. The transmittal checklist is designed to provide IRS reasonable assurance that the IT organization adhered with its policies for software testing standards and procedures and documents that employees have performed the required checks, steps, and reviews.

[18]GAO-14-704G.

Cause. IRS did not have a process to reasonably assure that the operating division responsible for initiating the procedural changes and the IT organization were aware of the policy to notify and coordinate with the CFO organization when making programming changes in IRS's information systems. Because the operating division and IT organization did not consult the CFO organization on these programming changes, some of these changes the IT organization made resulted in unintended consequences and errors in taxpayer accounts. In addition, IRS did not update its IRM to reflect the new automated procedures for recording abatements for specific failure-to-file penalty assessments in its BMF or communicate the new procedures to affected staff until May 2016, more than 4 months after implementing the programming change. Consequently, staff continued to process these transactions manually, resulting in duplicate entries recorded in taxpayer accounts.[19] Further, the IT organization that made the programming changes did not thoroughly test each change to reasonably assure that the changes functioned as intended and did not complete an Applications Development transmittal checklist or retain supporting documentation of the tests, as required.

Effect. IRS's lack of coordination and communication with its CFO organization and the affected parties involved in processing these abatement transactions, along with not following procedures for testing and documenting procedural and programming changes, led to errors in taxpayer accounts. Such errors cause undue burden on taxpayers that are assessed amounts they do not owe, and increase the risk of misstatements in IRS's financial statements, as these types of programming errors have the potential to affect thousands or millions of taxpayer accounts.

Recommendations for Executive Action.

We recommend that the IRS Commissioner direct the appropriate IRS officials to take the following two actions:

- Develop and implement a process to reasonably assure that IRS operating divisions and the IT organization effectively coordinate with the CFO organization when making programming changes to information systems affecting financial reporting.
- Research and determine the reason the IT organization did not follow IRS policy to thoroughly test programming changes related to the automation of specific penalty abatement procedures to reasonably assure that they worked as intended before implementation. Based on this determination, establish a process to better ensure compliance with existing policies for testing programming changes, including the use and review of the Applications Development transmittal checklist when developing program changes and retention of test results.

We identified the following other deficiencies in IRS's internal control during our fiscal year 2016 audit that warrant management's attention.

IRM Policies and Procedures

The IRM is the official compilation of instructions to IRS staff on the administrative and operational policies and procedures used in carrying out tax administration responsibilities, preparing internal and external financial reports, safeguarding taxpayer receipts and information, and meeting other agency obligations. IRS procedural and operational changes typically originate from legislation, revenue rulings and procedures, regulatory changes,

[19]See the IRM Policies and Procedures point below for a recommendation on updating the IRM timely.

organizational restructuring, federal accounting and financial reporting standards, operational and procedural changes, interim and chief counsel guidance, or employee recommendations and feedback. When necessary, to initiate and communicate immediate changes to its operational policies and procedures, IRS issues interim guidance, in the form of memorandums or Servicewide Electronic Research Program (SERP) IRM procedural updates,[20] to quickly convey to employees a (1) new policy or procedure, (2) change to a current IRM policy or procedure, (3) temporary procedure, or (4) pilot program.[21] Accordingly, the IRM and interim guidance taken together represent IRS's primary source for policies and procedures, which remain in effect until amended, superseded, or rendered obsolete by the publication of a subsequent IRM or interim guidance. To provide explanatory instructions or further details on carrying out existing polices outlined in the IRM and interim guidance, IRS issues supplemental guidance, such as published products (internal documents and forms), organizational websites, job aids, local procedures (standard operating procedures), and training materials.[22] New policies and procedures may be introduced through IRM updates and interim guidance but not through supplemental guidance.[23] IRS program owners are directors with responsibility for establishing policy, processes, and procedures necessary to implement and manage their respective programs.[24] These directors are also responsible for developing and publishing the IRM sections pertaining to their programs and for verifying that their respective IRM sections reflect current procedures and practices implemented by agency personnel.

Condition. During our fiscal year 2016 audit, we found several instances where IRS's IRM was not updated to align with the understanding, procedures, and supplemental guidance that were being implemented or followed by IRS personnel. For example, during the audit we noted the following areas where the policies or information in the IRM were inconsistent with, or were not timely updated to reflect, current guidance, practices, or disclosures:

- the method of recording certain late-filing penalty abatements on taxpayer's accounts;[25]
- the frequency of performing (1) emergency/alarm contact-list validation, (2) duress alarm inventory validation,[26] and (3) federal security risk assessments; and
- the definition of the tax gap disclosed in IRS financial and other reports.[27]

We also found instances where IRS was incorrectly using supplemental guidance, such as standard operating procedures, as the primary source for initiating and communicating immediate changes in operational policies and procedures to staff rather than updating the IRM

[20]IRM § 1.11.8, *Servicewide Electronic Research Program (SERP)* (Dec. 9, 2016).

[21]IRM § 1.11.2.2, *IRM Standards* (Sept. 21, 2015).

[22]IRM § 1.11.2.2.1, *Supplemental Sources of Guidance* (Sept. 21, 2015).

[23]IRM § 1.11.2.2.2, *IRM Standards* (Sept. 21, 2015).

[24]IRM § 1.11.2.2.2, *Responsibilities for Maintaining the IRM* (Sept. 21, 2015).

[25]See the previous discussion in this report regarding changes to master file programs for details of this issue.

[26]IRS uses duress alarms to notify security personnel of situations that are potentially dangerous to its employees and to help protect its facilities, property, and taxpayer information and receipts. IRM § 10.2.14.9.1, *Intrusion Detection Systems and Duress Alarms* (Aug. 17, 2016).

[27]The tax gap is the difference between taxes owed and taxes paid on time and arises when taxpayers, whether intentionally or inadvertently, fail to (1) accurately report tax liabilities on tax returns (underreporting), (2) pay taxes due from filed returns (underpayment), or (3) file a required tax return altogether or on time (nonfiling). In 2016, IRS estimated the annual net tax gap to be about $406 billion.

or issuing interim guidance in the form of memorandums and SERP IRM procedural updates as required.

Criteria. According to the IRM, program owner directors are required to review their respective IRM sections annually for organizational, operational, or other changes. If changes are needed, program owner directors are responsible for updating the IRM accordingly. In addition, all supplemental guidance must comply with the policies and procedures included in the IRM and cannot supersede the IRM.[28]

Internal control standards state that management should implement control activities through documented policies.[29] The standards also provide that management periodically review policies, procedures, and related controls for continued relevance and effectiveness in achieving the entity's objectives or addressing related risks. These reviews should occur timely to assist management in determining whether control activities are designed and implemented appropriately. The standards also state that management should internally communicate the necessary information to achieve the entity's objectives.

Cause. IRS did not have an effective process in place to reasonably assure that program owner directors reviewed their respective IRM sections annually to ensure that they reflect the design and implementation of the internal control procedures in place. In some instances, program owner directors were not aware of the requirement to review their respective IRM sections annually or the requirement to use interim guidance rather than supplemental guidance to communicate changes in or establish new policy.

Effect. Outdated and inconsistent policies and procedures increase the risk of errors or misstatements in the financial statements and related note disclosures. In addition, designing and implementing procedures that do not align with official agency policy increases the risk that these procedures may not support achieving IRS's overall goals and objectives, applicable standards, or laws and regulations.

Recommendations for Executive Action.

We recommend that the IRS Commissioner direct the appropriate IRS officials to take the following three actions:

Strengthen the process for reasonably assuring that the IRM is reviewed annually to align with the current control procedures and guidance being implemented by agency personnel. This should include a mechanism for reasonably assuring that program owner directors (1) review their respective program control activities and related guidance annually and timely update the IRM as needed, (2) document their reviews, and (3) utilize interim guidance and supplemental guidance correctly for their intended purposes.

Ensure that the respective Agency-Wide Shared Services IRM and supplemental guidance related to the frequency of performing (1) emergency/alarm contact-list validation, (2) duress alarm inventory validation, and (3) federal security risk assessments are consistent.

- Update the respective (1) Privacy, Governmental Liaison and Disclosure and (2) CFO IRM sections related to the definition of the tax gap to align with the current understanding followed by IRS personnel.

[28] IRM § 1.11.2, *Internal Revenue Manual (IRM) Process* (Sept. 21, 2015).

[29] GAO 14-704G.

Digital Signatures on Forms Related to the Authorization of Manual Refunds

IRS's systems generate most refunds automatically after taxpayers' returns are recorded to their master file accounts.[30] However, IRS requires that refunds meeting certain criteria, such as refunds related to certain hardship conditions or those exceeding $100 million, be manually reviewed and approved before disbursement.[31] IRS refers to these refunds as manual refunds. In fiscal year 2016, IRS disbursed approximately $43 billion in manual refunds. IRS authorizes specific individuals to sign and approve manual refunds, and effective January 2016, these approvals must be done via a digital signature.[32] Authorizations are documented on manual refund signature authorization forms, which are maintained by the manual refund units. Before processing a manual refund, a tax examiner in the manual refund unit is required to verify that the individual who signed and approved the manual refund is authorized to do so by comparing the signature on the manual refund request form to the signature on the manual refund signature authorization form.

Condition. We found that IRS did not properly ensure that the digital signatures on certain forms related to the authorization of manual refunds originated from authorized staff in order to verify the validity of the signatures. Specifically, IRS used printed copies of the manual refund request forms and the manual refund signature authorization forms to perform its review of authorized signatures, rather than verifying the validity of the digital signatures on the forms. Consequently, IRS could not validate that the digital signatures were actually recorded on the forms by the authorized approving officials.

Criteria. According to the IRM, entities relying on digital signatures are responsible for verifying that the signatures are valid.[33] Internal control standards state that management should design control activities to achieve objectives and respond to risks, for example, designing control activities so that all transactions are authorized and executed only by persons acting within the scope of their authority.[34]

Cause. The IRM pertaining to the processing of manual refunds did not require that IRS staff verify the validity of the digital signatures on the manual refund request forms and the manual refund signature authorization forms.

Effect. Because manual refunds bypass most of the system validity checks that occur with automated refunds, the risk of erroneous or fraudulent refunds being approved and disbursed is increased. Therefore, by not verifying the validity of digital signatures on manual refund-related forms, IRS increases the risk that unauthorized individuals may fraudulently alter the printed forms, thereby increasing its risk of issuing fraudulent refunds.

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[30]Refunds include overpayments made by taxpayers and payments for various tax credits, including the Earned Income Tax Credit and the Premium Tax Credit.

[31]IRM § 21.4.4.2, *Why Would A Manual Refund Be Needed?* (Mar. 26, 2015), and IRM § 3.17.79.3.6, *Manual Refunds $1 Million or More and $10 Million or More* (Nov. 19, 2015).

[32]IRM § 3.17.79.3.5, *Employees Authorized to Sign Requests for Refunds* (Nov. 19, 2015). Digital signatures transform data that when properly implemented provide a mechanism for verifying origin, integrity, and validity.

[33]IRM § 10.8.52.2.8, *Relying Parties* (Feb. 9, 2015).

[34]GAO-14-704G.

Recommendation for Executive Action.

We recommend that the IRS Commissioner direct the appropriate IRS officials to revise the applicable IRM sections pertaining to manual refunds to require employees to verify the validity of the digital signatures on the manual refund request forms and the manual refund signature authorization forms.

Assignment of User Access Rights in IRS's Human Resources Information Management System

IRS uses the information management system Human Resources (HR) Connect to process its personnel actions, such as hiring, promotions, and pay increases.[35] Once IRS approves personnel actions in HR Connect, it releases the information to the National Finance Center (NFC).[36] According to IRS officials, HR assistants within its Employment Operations office are allowed to create pay-related personnel actions in HR Connect, but only HR specialists within this office are allowed to approve and release pay-related actions to NFC.[37] IRS system administrators use IRS's guidance, *HR Connect HR User Profiles Desk Guide*, to assign system access to IRS staff based on their position titles.

Condition. During our fiscal year 2016 audit, we observed in HR Connect that IRS assigned HR assistants the same level of access as its HR specialists. This enables HR assistants to create, approve, and release pay-related personnel actions to NFC.

Criteria. Internal control standards state that management should design the entity's information system and related internal control activities to achieve objectives and respond to risks,[38] which includes restricting authorized users to the applications or functions commensurate with their assigned responsibilities, supporting an appropriate segregation of duties.

Cause. IRS's guidance for granting access to the HR Connect system provides the same level of access to HR assistants and HR specialists.[39]

Effect. By allowing HR assistants access to create, approve, and release pay-related personnel actions to NFC, IRS does not have reasonable assurance that all such actions have the proper level of approval, thereby increasing the risk that erroneous or fraudulent personnel actions are released to NFC.

Recommendations for Executive Action.

We recommend that the IRS Commissioner direct the appropriate IRS officials to take the following two actions:

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[35]HR Connect is a web-based personnel processing system operated by the Department of the Treasury.

[36]NFC is a shared services provider within the U.S. Department of Agriculture that provides payroll services for IRS and certain other federal agencies.

[37]Employment Operations is an office within IRS's Human Capital Office's Employment, Talent and Security Division and provides support services in the recruitment and hiring of IRS's workforce. We define "pay-related actions" as personnel actions that affect an employee's annual gross salary, such as hiring, separations, promotions, and cost-of-living adjustments.

[38]GAO-14-704G.

[39]HR Connect allows IRS to customize system access levels based on each employee's position and duties.

- Revise system access rights in HR Connect to prevent HR assistants within the Employment Operations office from approving and releasing pay-related personnel actions to NFC.
- Revise the *HR Connect HR User Profiles Desk Guide* to clearly indicate that HR assistants within the Employment Operations office should not be granted access to approve and release pay-related personnel actions to NFC.

Review of the Process for Determining Intragovernmental Costs and Costs with the Public

Office of Management and Budget (OMB) Circular No. A-136, *Financial Reporting Requirements*, states that (1) agencies should report costs by major programs in their financial statements and (2) agencies—in the notes to their financial statements—should disclose intragovernmental costs separately from costs with the public by major program.[40] IRS performs an allocation process to group all costs by major program for financial reporting.[41] Although IRS records its costs as either intragovernmental or with the public, its allocation process does not provide such designations for the major program cost amounts. Therefore, in order to comply with OMB Circular No. A-136, IRS performs an additional process, which involves the use of estimates, to determine the intragovernmental costs and costs with the public by major program for financial reporting.

Condition. In fiscal year 2016, we found that the intragovernmental costs and costs with the public by major program that IRS disclosed with its financial statements were reasonable; however, we found that IRS had not reviewed its process for determining these costs for almost 10 years in order to assess the continued reliability of its process and whether any adjustments are needed to respond to changes in circumstances.

Criteria. Internal control standards state that management should design the entity's information system and related control activities to achieve objectives and respond to risks and should implement control activities through policies.[42] For example, management should evaluate information processing objectives to meet the defined information requirements, such as determining that transactions are recorded at the correct amount in the right account at each stage of processing. In addition, management should periodically review policies, procedures, and related control activities for continued relevance and effectiveness in achieving the entity's objectives or addressing related risks.

Cause. IRS does not have policies and procedures that require a periodic review of its process for determining the intragovernmental costs and costs with the public for each major program reported in the notes to the financial statements.

Effect. By not performing periodic reviews over its process for determining the intragovernmental costs and costs with the public for each major program, IRS increases the risk that it will not detect estimates that may not be reasonable based on current conditions. This, in turn, increases the risk that the intragovernmental costs and costs with the public

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[40]Intragovernmental costs are costs of goods or services provided to another reporting entity within the federal government. Costs with the public are exchange transactions made between the reporting entity and a nonfederal entity.

[41]Some of IRS's costs are not traceable or assigned to one of IRS's major programs at the transaction level. As a result, IRS performs a complex allocation process to assign costs to its major programs.

[42]GAO-14-704G.

reported in the major program amounts in the notes to its financial statements may not be reliable.

Recommendation for Executive Action.

We recommend that the IRS Commissioner direct the appropriate IRS officials to establish and implement procedures to periodically review the process for determining the intragovernmental costs and costs with the public for each major program reported in the notes to the financial statements to provide reasonable assurance that these amounts are reliable and fairly presented.

Accuracy of Asset Disposal Dates

IRS maintains inventory records for its trackable assets, including asset disposal dates, in its Knowledge, Incident Problem Service Asset Management (KISAM) inventory system.[43] Upon final disposal of an asset, IRS Facilities Management and Security Services (FMSS) provides the disposal documents to the KISAM inventory coordinator who then updates KISAM with the disposal date. IRS's Financial Reports Office then conducts research using disposal data extracts from KISAM to determine the disposal amounts that should be recorded in the general ledger.

Condition. During our testing of a statistical sample of asset disposal transactions, we found 49 instances where the disposal date recorded in KISAM did not reflect the date on which the asset was removed from IRS premises based on disposal documents provided by FMSS.[44] In 24 instances, the KISAM disposal date preceded the asset's removal, and in 25 instances, the KISAM disposal date was subsequent to the asset's removal. For these 49 instances, the differences in the date between the time that the assets were removed and the disposal date recorded in KISAM ranged from 1 day to 902 days, with an average difference of about 56 days.

Criteria. The IRM states that all data fields on the KISAM inventory record should be correct and reflect the most current information on all assets.[45] Internal control standards state that management should design control activities to achieve objectives and respond to risks, for example, designing control activities so that all transactions are completely and accurately recorded. This applies to the entire process or life cycle of a transaction or event from its initiation and authorization through its final classification in summary records.[46]

Cause. According to the IRM, the KISAM disposal date is the date on which the reporting office relinquishes accountability for an asset as it is removed from IRS premises.[47] Although the IRM defines what the KISAM disposal date should represent, it is unclear how IRS defines what constitutes removal from IRS premises. For example, some disposed assets are immediately picked up by the entities to which they are being transferred to, while others are removed from

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[43]Trackable assets are those that are barcoded for inventory purposes, for example, laptops, desktop computers, and servers. On the other hand, internal parts, which are not individually barcoded, are not trackable.

[44]We tested a simple random attribute sample of 78 disposal transactions from IRS's population of 11,800 disposal transactions that occurred from October 1, 2015, through May 31, 2016. The number of deviations (49) in our 78-transaction sample is greater than our tolerable deviation rate of 5 percent.

[45]IRM § 1.14.4.14.2 (7), *Personal Property Management, KISAM Database – Creating/Uploading* (May 8, 2012).

[46]GAO-14-704G.

[47]IRM § 1.14.4.19 (2), *Personal Property Management, Glossaries, KISAM Definitions* (Nov. 24, 2014).

use and then placed in a container to be removed from IRS premises at a later date. Consequently, IRS staff did not consistently understand what events constituted removal from IRS premises and did not always record disposal dates in KISAM in conformance with IRS policy.

Effect. Significant differences between the timing of the disposal dates used to remove assets from IRS's general ledger and the date of the underlying events that IRS policy defines as constituting property disposal increase the risk that the related general ledger balances for property and equipment, accumulated depreciation, and depreciation expense may be misstated.

Recommendation for Executive Action.

We recommend that the IRS Commissioner direct the appropriate IRS officials to provide clear guidelines as to what events constitute removal from IRS premises and the disposal date that should be recorded in its inventory system, either through an update of the IRM or other property and equipment-related desk guides.

Status of Prior Audit Recommendations

IRS has continued to work to address many of the control deficiencies related to open recommendations from our prior financial audits. At the beginning of our fiscal year 2016 financial audit, there were 42 recommendations to improve IRS's financial operations and internal controls from prior year audits that we reported as open in our status of recommendations in the management report issued in May 2016.[48] In the course of performing our fiscal year 2016 financial audit, we identified numerous actions IRS took to address previously identified control deficiencies. On the basis of IRS's actions taken through September 30, 2016 that we were able to substantiate through our audit, we are closing 11 of these recommendations. As a result, a total of 41 recommendations need to be addressed—31 remaining from our prior years' audits and the 10 new recommendations we are making in this report. See enclosure I for more details on our assessment of the status of IRS's actions to address prior audit recommendations that remained open at the beginning of this year's audit.

Agency Comments and Our Evaluation

We provided a draft of this report to IRS for comment. In its comments, reproduced in enclosure II, IRS agreed with the 10 new recommendations and described actions it has taken or planned to take to address each recommendation. IRS stated that it is committed to implementing appropriate improvements to ensure that IRS maintains sound financial management practices. IRS's actions, if effectively implemented, should address the issues that gave rise to our recommendations. IRS also provided technical comments, which we incorporated as appropriate. We will evaluate the effectiveness of IRS's efforts during our audit of its fiscal year 2017 financial statements.

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This report contains recommendations to you. The head of a federal agency is required by 31 U.S.C. § 720 to submit a written statement on action taken or planned on our recommendations to the Senate Committee on Homeland Security and Governmental Affairs, the House

[48] GAO-16-457R.

Committee on Oversight and Government Reform, the congressional committees with jurisdiction over the programs and activities that are the subject of our recommendations, and GAO not later than 60 days after the date of this report. A written statement must also be sent to the Senate and House Committees on Appropriations with the agency's first request for appropriations made more than 60 days after the date of this report. Please send your statement of actions to me at clarkce@gao.gov or Ted Hu, Assistant Director, at hut@gao.gov.

We are sending copies of this report to the Chairmen and Ranking Members of the Senate Committee on Appropriations, Senate Committee on Finance, Senate Committee on Homeland Security and Governmental Affairs, House Committee on Appropriations, House Committee on Ways and Means, and House Committee on Oversight and Government Reform, and to the Chairman and Vice Chairman of the Senate Joint Committee on Taxation. We are also sending copies to the Secretary of the Treasury, the Director of the Office of Management and Budget, and the Chairman of the IRS Oversight Board. In addition, the report is available at no charge on the GAO website at http://www.gao.gov.

We acknowledge and appreciate the cooperation and assistance provided by IRS officials and staff during our audit of IRS's fiscal years 2016 and 2015 financial statements. If you or your staff have any questions about this report, please contact me at (202) 512-9377 or clarkce@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. GAO staff who made major contributions to this report are listed in enclosure III.

Sincerely yours,

Cheryl E. Clark

Cheryl E. Clark
Director
Financial Management and Assurance

Enclosures – 3

Enclosure I: Status of Recommendations from Prior Audits Reported as Open in GAO's 2015 Management Report

Table 1 shows the status of recommendations reported as open in our 2015 management report. The abbreviations used are defined in the legend at the end of the table.

Table 1: Status of Recommendations Reported as Open in GAO's 2015 Management Report

Unpaid assessments

ID Number	Recommendation per audit area	Year initially reported	Source report	Status
08-06	In instances where computer programs that control penalty assessments are not functioning in accordance with the intent of the IRM, take appropriate action to correct the programs so that they function in accordance with the IRM. **Action taken:** According to IRS, it had substantially completed its corrective actions to address the 19 programming errors that it had identified during its internal assessment of penalty computation programs. However, as of September 30, 2016, IRS had not provided us with documentation to support these corrective actions. We will continue to evaluate IRS's actions to address this recommendation during our fiscal year 2017 audit.	2007	GAO-08-368R	Open
10-04	Once IRS identifies the control weaknesses that result in inaccuracies or errors that materially affect the financial reporting of unpaid assessments, implement control procedures to routinely prevent, or to detect and correct, such errors. **Action taken:** IRS created a long-term corrective action plan that contains specific actions to improve control procedures to prevent or detect errors. While IRS completed some actions during fiscal year 2016, it has not completed most of the actions on the plan or documented milestones or target completion dates for these remaining actions. In addition, during fiscal year 2016, GAO and IRS continued to identify misclassified unpaid assessments that resulted from inaccuracies or errors in taxpayer accounts. Thus, IRS's actions to date have not been effective at fully addressing the issues that continue to cause a lack of transaction traceability and material inaccuracies produced by the subsidiary ledger. We will continue to evaluate IRS's actions to address this recommendation during our fiscal year 2017 audit.	2009	GAO-10-565R	Open

ID Number	Recommendation per audit area	Year initially reported	Source report	Status
15-02	Develop and implement agency-wide procedures to routinely monitor the accuracy of penalties recorded in taxpayer accounts to timely detect and correct errors. **Action taken:** During fiscal year 2015, IRS conducted a trial quality review to evaluate the accuracy of penalty assessments recorded in a sample of taxpayer accounts and took action to address the errors it identified. Based on its trial review, IRS developed procedures for performing this type of review in June 2016 and informed us that it would formalize procedures in the IRM to include routine monitoring and testing of the accuracy of penalty assessments in taxpayer accounts. However, as of September 30, 2016, IRS had not implemented these procedures or documented them in the IRM. We will continue to evaluate IRS's actions to address this recommendation during our fiscal year 2017 audit.	2014	GAO-15-480R	Open
16-01	Establish and implement formal policies and procedures to annually review unpaid tax assessments that are manually classified to determine whether the classification is correct for the current fiscal year. **Action taken:** On July 26, 2016, IRS issued a memorandum documenting a policy and procedures for the Revenue Transactional Analysis Section to annually review unpaid assessments that are manually classified. IRS also incorporated these in its fiscal year 2016 Unpaid Assessments Methodology. IRS's actions sufficiently address our recommendation.	2015	GAO-16-457R	Closed

Revenue

ID Number	Recommendation per audit area	Year initially reported	Source report	Status
06-05	Equip all TACs with adequate physical security controls to deter and prevent unauthorized access to restricted areas or office space occupied by other IRS units, including those TACs that are not scheduled to be reconfigured to the "new TAC" model in the near future. This includes appropriately separating customer service waiting areas from restricted areas in the near future by physical barriers, such as locked doors marked with signs barring entrance by unescorted customers. **Action taken:** As of September 30, 2016, IRS had 375 TACs in operation and stated that 65 have not been built to the "new TAC" model. However, IRS has mitigating controls at these 65 TAC locations to deter and prevent unauthorized access to restricted areas. IRS's actions sufficiently address our recommendation.	2005	GAO-06-543R	Closed

ID Number	Recommendation per audit area	Year initially reported	Source report	Status
09-09	Establish procedures requiring that each physical security analyst conduct a periodic documented review of the Emergency Signal History Report and emergency contact list for its respective location to ensure that (1) appropriate corrective actions have been planned for all incidents reported by the central monitoring station and (2) the emergency contact list for each location is current and includes only appropriate contacts. **Action taken:** IRS's efforts to address this recommendation are ongoing. In August 2016, IRS updated the IRM to require that (1) corrective actions are planned for all incidents reported by the central monitoring station and (2) the emergency contact list for each location is current and includes only appropriate contacts. IRS stated that in fiscal year 2017 it will update procedures and provide training to employees to help ensure that the updates to the guidance are communicated to affected employees. We will continue to evaluate IRS's corrective actions during our fiscal year 2017 audit.	2008	GAO-09-513R	Open
11-11	Perform a review of all existing contracts under $100,000 that (1) do not have an appointed contracting officer's technical representative and (2) do not require that contract employees obtain background investigations, to assess whether the services performed under each contract warrant a requirement that contract employees obtain background investigations. **Action taken:** During fiscal year 2015, IRS performed a review of existing contracts to assess whether the services performed under each contract warrant a requirement that contract employees obtain background checks; however, the review excluded interagency agreement contracts. During fiscal year 2016, IRS completed its review of interagency agreements to determine whether the services performed under each contract warrant the contracts to be modified to require background investigations on contract employees. IRS's actions sufficiently address our recommendation.	2010	GAO-11-494R	Closed
11-12	Based on a review of all existing contracts under $100,000 without an appointed contracting officer's technical representative that should require contract employees to obtain favorable background investigation results, amend those contracts to require that favorable background investigations be obtained for all relevant contract employees before routine, unescorted, unsupervised physical access to taxpayer information is granted. **Action taken:** According to IRS, it has completed its contract review and made appropriate modifications as of July 2016. However, the modifications to the contracts were not made available for our review during the fiscal year 2016 audit. We will continue to evaluate IRS's actions to address this recommendation during our fiscal year 2017 audit.	2010	GAO-11-494R	Open

ID Number	Recommendation per audit area	Year initially reported	Source report	Status
11-13	Establish a policy requiring collaborative oversight between IRS's key offices in determining whether potential service contracts involve routine, unescorted, unsupervised physical access to taxpayer information, thus requiring background investigations, regardless of contract award amount. This policy should include a process for the requiring business unit to communicate to the Office of Procurement and the HCO the services to be provided under the contract and any potential exposure of taxpayer information to contract employees providing the services, and for all three units to (1) evaluate the risk of exposure of taxpayer information prior to finalizing and awarding the contract and (2) ensure that the final contract requires favorable background investigations, as applicable, commensurate with the assessed risk. **Action taken:** IRS's efforts to address this recommendation are ongoing. IRS stated that during fiscal year 2017, several internal organizations will partner to identify the remaining actions needed to address this recommendation. According to IRS, these actions include developing policies and procedures to reasonably assure that (1) oversight between IRS's key offices is conducted to determine whether potential service awards IRS enters into involve routine, unescorted, unsupervised physical access to taxpayer information by contractors, thus requiring background investigations, and (2) the resulting processes make clear who is responsible for completing the various steps, as well as who must maintain documentation of the approved access determination prior to the contractor being allowed to provide the services. We will continue to evaluate IRS's actions to address this recommendation during our fiscal year 2017 audit.	2010	GAO-11-494R	Open
11-24	Revise the post orders for the SCCs and lockbox bank security guards to include specific procedures for timely reporting exterior lighting outages to SCCs or lockbox bank facilities management. These procedures should specify (1) whom to contact to report lighting outages and (2) how to document and track lighting outages until resolved. **Action taken:** IRS's efforts to address this recommendation are ongoing. IRS stated that during fiscal year 2017, it would update campus post orders to help ensure timely reporting, monitoring and repair of exterior lighting outages. In addition, AWSS engaged in discussions with personnel from FPS and GSA to coordinate responsibilities and suggested changes for post orders when security services are contracted by those entities. We will continue to evaluate IRS's actions to address this recommendation during our fiscal year 2017 audit.	2010	GAO-11-494R	Open

ID Number	Recommendation per audit area	Year initially reported	Source report	Status
12-10	Update the IRM to specify steps to be followed to prevent campus support clerks as well as any other employees who process payments through the electronic check presentment system from making adjustments to taxpayer accounts. **Action taken:** During fiscal year 2012, IRS updated the IRM to require managers to verify that all campus support employees who process payments through the electronic check presentment system have the appropriate command code restriction in their IDRS profiles to prevent them from making adjustments to taxpayer accounts. However, during our subsequent audits we found that in updating the IRM, IRS did not undertake a global review of the level of access provided to all employee groups who handle hard-copy taxpayer receipts and related sensitive information to ensure that their levels of IDRS access were appropriate. As a result, in May 2016, IRS reassessed the risks at its TACs, including the specific risks and mitigating factors associated with allowing TAC employees to process taxpayer remittances through the electronic check presentment system and to adjust taxpayer accounts. However, IRS did not update the IRM to reflect the conclusions from the risk assessment related to TAC employees needing access to certain sensitive command codes as part of their normal job duties. We will continue to evaluate IRS's actions to address this recommendation during our fiscal year 2017 audit.	2011	GAO-12-683R	Open
13-05	Perform a risk assessment to determine the appropriate level of IDRS access that should be granted to employee groups that handle hard-copy taxpayer receipts and related sensitive taxpayer information as part of their job responsibilities. **Action taken:** According to IRS, a risk assessment was performed to determine the appropriate level of IDRS access that should be granted to employee groups that handle hard-copy taxpayer receipts and related sensitive taxpayer information as part of their job responsibilities. However, during our fiscal year 2016 audit, we identified a group of employees at an SCC who handle hard-copy taxpayer receipts and related sensitive taxpayer information and can make adjustments to taxpayer accounts. Based on the information obtained, it is unclear whether the risks associated with these employees were considered in a risk assessment. We will continue to evaluate IRS's actions to address this recommendation during our fiscal year 2017 audit.	2012	GAO-13-420R	Open

ID Number	Recommendation per audit area	Year initially reported	Source report	Status
13-06	Based on the results of the risk assessment, update the IRM accordingly to specify the appropriate level of IDRS access that should be allowed for (1) remittance perfection technicians and (2) all other employee groups with IDRS access that handle hard-copy taxpayer receipts and related sensitive information as part of their job responsibilities. **Action taken:** As a result of its risk assessment efforts thus far, IRS updated the IRM to restrict the use of certain IDRS command codes for remittance perfection technicians. In addition, in May 2016, IRS reassessed the risks at its TACs, including the specific risks and mitigating factors associated with allowing TAC employees to process taxpayer remittances and to adjust taxpayer accounts. However, IRS did not update the IRM to reflect the conclusions from the risk assessment related to TAC employees. Further, during our fiscal year 2016 audit, we identified a group of employees at an SCC who handle hard-copy taxpayer receipts and related sensitive taxpayer information and can make adjustments to taxpayer accounts. Based on the information obtained, it is unclear whether the risks associated with these employees were considered in a risk assessment. We will continue to evaluate IRS's actions to address this recommendation during our fiscal year 2017 audit.	2012	GAO-13-420R	Open
13-07	Establish procedures to implement the updated IRM, including required steps to follow to prevent (1) remittance perfection technicians and (2) all other employee groups that handle hard-copy taxpayer receipts and related sensitive information as part of their job responsibilities from gaining access to command codes not required as part of their designated job duties. **Action taken:** As a result of its risk assessment efforts thus far, IRS updated the IRM to include procedures to restrict the use of certain IDRS command codes for remittance perfection technicians. However, the IRM has not been updated based on the results of the risk assessment related to TAC employees and, if applicable, other employees who have access to sensitive command codes and handle hard-copy taxpayer receipts and related sensitive information as part of their job duties. We will continue to evaluate IRS's actions to address this recommendation during our fiscal year 2017 audit.	2012	GAO-13-420R	Open

ID Number	Recommendation per audit area	Year initially reported	Source report	Status
15-03	Determine the reason(s) why TAC managers and personnel did not consistently comply with existing IRM requirements that TAC managers and personnel (1) perform and document reviews of the Follow-Up Review Log by the last day of the following month, (2) maintain control copies of transmittal forms, and (3) ship taxpayer receipts and information via traceable overnight mail and, based on this determination, establish a process to better enforce compliance with these requirements. **Action taken:** IRS's efforts to address this recommendation are ongoing. IRS stated that it has performed a study of the causes of noncompliance with the IRM requirements and will complete all related corrective actions by May 2017. We will continue to evaluate IRS's actions to address this recommendation during our fiscal year 2017 audit.	2014	GAO-15-480R	Open
15-04	Update the IRM to require managers to reconcile transmittal forms with the Follow-Up Review Log to reasonably assure that personnel are properly entering transmittal forms into the log and are appropriately documenting follow-up on unacknowledged transmittals of taxpayer receipts and information. **Action taken:** While IRS updated the IRM in April 2016 to require TAC managers to (1) perform a semiannual reconciliation of document transmittal forms to the associated Follow-Up Review Log to monitor employee compliance with IRM requirements and (2) document this reconciliation on Form 14698, Field Assistance Taxpayer Assistance Centers Remittance and Non-Remittance Log Reconciliation, our fiscal year 2016 audit testing identified instances where the use of the form was not fully implemented at the TACs we visited. Further, we continued to identify instances where TAC employees did not always (1) track document transmittals on the Follow-up Review Log and (2) follow up on late acknowledgments timely. In one instance, we found that TAC personnel did not document on the log the actions that were taken for a package that was lost; however, the manager had completed a review of the Follow-up Review Log. We will continue to evaluate the results of IRS's corrective actions during our fiscal year 2017 audit.	2014	GAO-15-480R	Open
15-05	Update the IRM to specify that unauthorized access awareness training requirements apply to non-IRS contractors who have unescorted physical access to IRS facilities. **Action taken:** During fiscal year 2016, IRS issued interim guidance to update the IRM, which requires that all contractors with unescorted staff-like access, whether directly or indirectly contracted by IRS, complete information protection and security awareness training within 10 business days of approved staff-like access and annually thereafter. IRS's actions sufficiently address our recommendation.	2014	GAO-15-480R	Closed

ID Number	Recommendation per audit area	Year initially reported	Source report	Status
15-06	Establish a process to ensure that the requirement for unauthorized access awareness training is explicitly communicated to non-IRS contractors who have unescorted access to IRS facilities. **Action taken:** IRS's efforts to address this recommendation are ongoing. IRS stated that by July 2017, it will partner with FPS and GSA to establish a process to help ensure that all contractors who require unescorted access are first approved for interim or final staff-like access and complete mandatory information protection and security awareness training within 10 business days of approved staff-like access. We will continue to evaluate IRS's actions to address this recommendation during our fiscal year 2017 audit.	2014	GAO-15-480R	Open
15-07	Establish procedures to monitor whether non-IRS contractors with unescorted physical access to IRS facilities are receiving unauthorized access awareness training. **Action taken:** IRS's efforts to address this recommendation are ongoing. IRS stated that by July 2017, it will send out a communication to its FMSS field offices that will include SOPs for monitoring training and acquiring unauthorized access awareness training documentation for each non-IRS contract employee. We will continue to evaluate IRS's actions to address this recommendation during our fiscal year 2017 audit.	2014	GAO-15-480R	Open
15-08	Determine the reasons why staff did not consistently comply with IRS's existing requirements for the final candling of receipts at SCCs and lockbox banks, including logging remittances found during final candling on the final candling log at the time of discovery, safeguarding the remittances at the time of discovery, transferring the remittances to the deposit unit promptly, and passing one envelope at a time over the light source, and based on this determination, establish a process to better enforce compliance with these requirements. **Action taken:** IRS's efforts to address this recommendation are ongoing. IRS stated that by July 2017, it will identify and analyze the risks associated with candling at the SCCs and lockbox banks, along with any mitigating factors, to determine if further actions are warranted. We will continue to evaluate IRS's actions to address this recommendation during our fiscal year 2017 audit.	2014	GAO-15-480R	Open

ID Number	Recommendation per audit area	Year initially reported	Source report	Status
16-02	Establish a process to prevent Employment Operations staff from allowing potential employees to enter on duty without favorable determinations of suitability by Personnel Security adjudicators. **Action taken:** In December 2015, the HCO developed a process and revised procedures in an attempt to improve the monitoring of Employment Operations office decisions to reasonably assure that new employees do not enter on duty before prescreening adjudications are completed and approved by Personnel Security adjudicators. However, during our fiscal year 2016 audit, we identified IRS employees who entered on duty without completed or approved suitability adjudication determinations. We will continue to evaluate IRS's actions to address this recommendation during our fiscal year 2017 audit.	2015	GAO-16-457R	Open
16-03	Establish a policy and procedures requiring IRS officials to review and address situations in which it is later discovered that an employee deemed unsuitable for employment during the prescreening process was erroneously allowed to enter on duty. **Action taken:** While IRS responded that it established a policy and procedures, it did not provide documentation to sufficiently demonstrate that the policy and procedures were implemented. During our fiscal year 2016 audit, we identified an instance where an employee was allowed to enter on duty and it was subsequently discovered that this employee was deemed unsuitable for employment during the prescreening process. IRS did not provide additional documentation to demonstrate that its procedures had been carried out for this employee. We will continue to evaluate IRS's actions to address this recommendation during our fiscal year 2017 audit.	2015	GAO-16-457R	Open
16-04	Develop and provide training, on a recurring basis, to all FMSS specialists and managers involved in the duress alarm validation and testing process to reinforce the related policies and procedures. **Action taken:** According to IRS, in February 2016, AWSS developed and provided training on duress alarm validation and testing to FMSS specialists and managers. However, during our June 2016 field office audit testing, we found that the FMSS specialists responsible for the physical security at the sites we visited had not received training on duress alarm validation and testing. Further, our testing identified instances where (1) duress alarm testing did not include all duress alarms, (2) documented validations of the duress alarm inventory were not completed timely or available to individuals (FMSS and non-FMSS staff) before each test was conducted, and (3) descriptions of the duress alarm inventory used by the security specialist to conduct testing were labeled incorrectly. During follow up discussions with IRS officials, we were informed that FMSS specialists were not fully evaluating alarm test results and adhering to established procedures for monitoring those tests. We will continue to evaluate IRS's efforts to address this recommendation during our fiscal year 2017 audit.	2015	GAO-16-457R	Open

ID Number	Recommendation per audit area	Year initially reported	Source report	Status
16-05	Develop job aids that provide detailed written guidance for TAC (1) group managers for use in answering TSRRD review questions effectively and (2) territory managers that explicitly outline the requirements for reviewing TSRRD submissions. **Action taken:** In September 2016, the Wage and Investment organization developed a job aid that provides specific written guidance for TAC group managers to use in answering TSRRD review questions and outlines the territory managers' requirements for reviewing TSRRD submissions. IRS's actions sufficiently address our recommendation.	2015	GAO-16-457R	Closed
16-06	Establish and implement a policy requiring recurring training for TAC group and territory managers on their TSRRD responsibilities, including detailed instructions for completing responses to questions in TSRRD and for reviewing TSRRD submissions for accuracy and completeness. This training should be updated for changes in TSRRD questions over time and be provided to new TAC group and territory managers soon after they are hired or appointed. **Action taken:** IRS efforts to address this recommendation are ongoing. IRS stated that during fiscal year 2017, the Wage and Investment organization will incorporate into the IRM its new training policy requiring training for TAC group and territory managers on their TSRRD responsibilities, including specific instructions for completing questions in TSRRD and for reviewing TSRRD submissions. According to IRS, this training will be provided on a recurring basis to account for changes in TSRRD questions and newly hired or appointed TAC group and territory managers. As these actions occurred after the end of fiscal year 2016, we will evaluate IRS's actions to address this recommendation during our fiscal year 2017 audit.	2015	GAO-16-457R	Open

Refunds

ID Number	Recommendation per audit area	Year initially reported	Source report	Status
14-14	Update the training manuals and related training provided to Submission Processing examiners to ensure that the examiners are provided proper guidance for correctly processing refund claims associated with deceased taxpayers. **Action taken:** In fiscal year 2016, IRS updated its training manuals and related training provided to Submission Processing examiners to include guidance for correctly processing refund claims associated with deceased taxpayers. IRS's actions sufficiently address our recommendation.	2013	GAO-14-433R	Closed

ID Number	Recommendation per audit area	Year initially reported	Source report	Status
14-15	Establish and implement policies and procedures requiring a review process to reasonably assure that the accounts related to deceased taxpayers are only reopened for valid refunds. **Action taken:** In January 2016, IRS automated the process of locking deceased taxpayer accounts during its year-end processing. However, during our fiscal year 2016 audit, we continued to find instances in which IRS employees reopened deceased taxpayer accounts and disbursed invalid refunds. We will continue to evaluate IRS's actions to address this recommendation during our fiscal year 2017 audit.	2013	GAO-14-433R	Open
14-16	Establish and implement policies and procedures that require monitoring to reasonably assure that accounts related to deceased taxpayers that have been reopened are timely closed after processing the refund. **Action taken:** In January 2016, IRS automated the process of locking accounts related to deceased taxpayers during its year-end processing. However, during our fiscal year 2016 audit, we continued to find instances in which IRS employees reopened deceased taxpayer accounts to process refunds and did not close them timely. We will continue to evaluate IRS's actions to address this recommendation during our fiscal year 2017 audit.	2013	GAO-14-433R	Open
16-07	Determine the reason(s) why staff did not always comply with IRS's established policies and procedures related to initiating, monitoring, and reviewing the monitoring of manual refunds and, based on this determination, establish a process to better enforce compliance with these requirements. **Action taken:** IRS efforts to address this recommendation are ongoing. IRS stated that by September 2017, it will determine the reasons for staff noncompliance with established policies and procedures related to initiating, monitoring, and reviewing the monitoring of manual refunds, and based on this determination, establish a process to better enforce compliance with these requirements. We will continue to evaluate IRS's actions to address this recommendation during our fiscal year 2017 audit.	2015	GAO-16-457R	Open
16-08	Enhance the training program provided to COs to address all the job responsibilities related to certifying manual refunds for payment, including the required review of supporting documentation for manual refunds. **Action taken:** IRS stated that in February 2016, it provided a refresher course to COs as part of their annual training to address their responsibilities related to certifying manual refunds. However, based on our review of the refresher course materials, the course did not address our recommendation to enhance the training program. For example, the materials did not provide guidelines on how to perform the required reviews related to certifying manual refunds. As a result, during our fiscal year 2016 audit, we continued to find instances where the COs did not comply with the review requirements. We will continue to evaluate IRS's actions to address this recommendation during our fiscal year 2017 audit.	2015	GAO-16-457R	Open

ID Number	Recommendation per audit area	Year initially reported	Source report	Status
16-09	Issue a written reminder to quality review units responsible for reviewing the work of ICO tax examiners reiterating the existing quality review requirement to select and review cases, on a weekly basis, worked by each ICO tax examiner. **Action taken:** In March 2016, IRS issued a written reminder to IRS quality review units responsible for reviewing the work of ICO tax examiners reiterating the existing quality review requirements, including the selection and review of cases on a weekly basis. IRS indicated that it will reissue this reminder periodically, as needed. IRS's action sufficiently addresses our recommendation.	2015	GAO-16-457R	Closed
16-10	Identify the cause of and implement a solution for dealing with the periodic backlogs of ICO inventory that is hampering the performance of quality reviews. **Action taken:** IRS efforts to address this recommendation are ongoing. IRS stated that by September 2017, it will identify a cause of and implement a solution for dealing with the periodic backlogs of ICO inventory. We will continue to evaluate IRS's actions to address this recommendation during our fiscal year 2017 audit.	2015	GAO-16-457R	Open

Net cost

ID Number	Recommendation per audit area	Year initially reported	Source report	Status
13-11	Establish and implement written policies or procedures that require the agency to record the obligation of funds when a contract or agreement is entered into and prior to taking delivery of goods or services. **Action taken:** On August 7, 2015, IRS updated the IRM to require IRS to record the obligation of funds prior to taking delivery of goods and services. However, we found instances during our fiscal year 2016 audit where IRS did not obligate funds prior to recording receipt and acceptance of goods or services, prior to the start of the period of performance, or both. We will continue to evaluate IRS's efforts to effectively implement its procedures during our fiscal year 2017 audit.	2012	GAO-13-420R	Open

ID Number	Recommendation per audit area	Year initially reported	Source report	Status
16-16	Establish and implement detailed written procedures for calculating future lease payments for noncancelable operating leases that are reported in the notes to the financial statements. The procedures should (1) include steps for considering any ad hoc clauses that may have specific termination dates and (2) include a requirement for supervisory review to provide reasonable assurance of the accuracy of future lease payment amounts for noncancelable operating leases. **Action taken:** In October 2016, IRS established procedures for calculating future lease payments for noncancelable operating leases that are reported in the notes to its financial statements. The procedures included (1) steps for considering any ad hoc clauses that may have specific termination dates and (2) a requirement for supervisor review to provide reasonable assurance of the accuracy of future lease payment amounts for noncancelable operating leases. As these actions occurred after the end of fiscal year 2016, we will evaluate IRS's actions to address this recommendation during our fiscal year 2017 audit.	2015	GAO-16-457R	Open
16-17	Update IRS's accounting code guide for payroll adjustments to include detailed steps for human resources specialists to verify that submitted payroll adjustments processed by NFC are processed correctly, including against the correct pay period and fiscal year. **Action taken:** In March 2016, IRS updated its accounting code guide for payroll adjustments to include detailed steps for human resources specialists to verify that submitted payroll adjustments processed by NFC are processed correctly, including against the correct pay period and fiscal year. IRS's action sufficiently addresses our recommendation.	2015	GAO-16-457R	Closed

P&E

ID Number	Recommendation per audit area	Year initially reported	Source report	Status
15-10	Establish and implement written procedures to reasonably assure that assets that are reclassified during the voucher review process are properly added to KISAM or CIMIS for tracking purposes, as applicable. **Action taken:** In fiscal year 2015, IRS revised its written procedures to require that assets reclassified during the voucher review process be added to KISAM or CIMIS. However, the procedures were not revised until after we conducted our internal control testing in fiscal year 2015. We tested IRS's implementation of the revised procedures during our fiscal year 2016 audit and did not identify any exceptions. IRS's actions sufficiently address our recommendation.	2014	GAO-15-480R	Closed

ID Number	Recommendation per audit area	Year initially reported	Source report	Status
15-11	Update the Hardware Asset Management SOP to include a requirement for periodic supervisory review to provide reasonable assurance that certain asset acquisitions are properly entered into KISAM. **Action taken:** In fiscal year 2015, IRS's IT organization updated its procedures to include quarterly supervisory reviews to reasonably assure that asset acquisitions are properly entered into KISAM. However, our fiscal year 2015 internal control testing included assets that were acquired prior to IRS updating the procedures. We tested IRS's implementation of the revised procedures during our fiscal year 2016 audit and did not identify any exceptions. IRS's actions sufficiently address our recommendation.	2014	GAO-15-480R	Closed
16-11	Establish policies for (1) how long an asset can remain in missing status before it is removed from P&E reported on the financial statements and (2) how long assets can go unverified during the annual inventory process before they are identified as missing in the property management system. **Action taken:** IRS's IT organization issued AM064, Asset Management Policy Directive to Identify Uncertified Class A and Class B Assets as Missing in KISAM, effective October 1, 2016. The directive states that in accordance with the annual Hardware Asset Management Inventory Certification Plan, assets that are not verified or certified for more than two inventory cycles should be identified as missing in IRS's property management system. It further states that the property management system should be updated by the end of the first quarter of the fiscal year after an asset meets the "missing" criterion. In November 2016, IRS's CFO organization developed the Missing Assets Financial Reporting Assessment procedure, which states that assets in missing status for 1 year or more should be removed from the P&E reported on IRS's financial statements. As these actions occurred after the end of fiscal year 2016, we will evaluate IRS's actions to address this recommendation during our fiscal year 2017 audit.	2015	GAO-16-457R	Open
16-12	Establish and implement procedures to reasonably assure that missing assets are timely removed from the financial statements when applicable. **Action taken:** In November 2016, IRS's CFO organization established the Missing Assets Financial Reporting Assessment procedure, which included procedures for identifying assets that have been in missing status in the property management system for 1 year or more and removing them from the P&E reported on the financial statements. As this procedure was established after the end of fiscal year 2016, we will evaluate IRS's implementation of this procedure during our fiscal year 2017 audit.	2015	GAO-16-457R	Open

ID Number	Recommendation per audit area	Year initially reported	Source report	Status
16-13	Establish and implement monitoring procedures designed to reasonably assure that the key detailed information for tangible capitalized P&E is properly recorded and updated in the KISAM system. **Action taken:** IRS's IT organization established SOP FY17-01, Asset Management Program Monitoring and Review, effective October 1, 2016. The SOP details the IRS Asset Management Group's procedures for conducting a quarterly review on a sample of asset records and transactions in KISAM to verify the accuracy and completeness of key KISAM data elements and correct any discrepancies found. In September 2016, IRS issued AWSS-01-0916-0001, Interim Guidance for IRM 1.14.4, *Personal Property Management*, to require the FMSS territory manager or section chief to perform quarterly sample reviews of non-IT assets in KISAM to verify that key data elements are complete and updated. As these procedures were established after we conducted our internal control testing in fiscal year 2016, we will evaluate IRS's implementation of these procedures during our fiscal year 2017 audit.	2015	GAO-16-457R	Open
16-14	Design a process to reasonably assure the adequacy of detailed supporting information for tangible P&E amounts recorded in the general ledger. **Action taken:** IRS's actions to address this recommendation are ongoing. According to IRS, by September 2017, its CFO organization will implement a P&E subsidiary ledger, and will design and implement processes based on the subsidiary ledger that will reasonably assure the adequacy of detailed supporting information for tangible P&E amounts recorded in the general ledger. We will assess IRS's actions to address this recommendation during our fiscal year 2017 audit.	2015	GAO-16-457R	Open
16-15	Update IRS policies and procedures for managerial reviews of disposal activities to explicitly instruct managers to assess whether disposal actions are approved by those authorized to do so and that approval is obtained prior to the disposal of assets. **Action taken:** In September 2016, IRS issued AWSS-01-0916-0001, Interim Guidance for IRM 1.14.4, *Personal Property Management*, to require the FMSS territory manager or section chief to perform quarterly sample reviews of disposal activities to verify that disposal actions are approved prior to the disposal of assets and by an approving authority (i.e., the FMSS territory manager or section chief). To facilitate the quarterly review, the interim guidance states that IRS FMSS Headquarters Property and Asset Management staff should (1) provide instructions and submission due dates for the review to the territories, (2) provide disposal sample data for each territory, (3) evaluate the territories' completed disposal sample review, and (4) provide the results of their evaluation to the territories. IRS's actions sufficiently address our recommendation.	2015	GAO-16-457R	Closed

Legend:

AWSS:	Agency-Wide Shared Services
CFO:	Chief Financial Officer
CIMIS:	Criminal Investigation Management Information System
CO:	certifying officer
FMSS:	Facilities Management and Security Services
FPS:	Federal Protective Service
GSA:	General Services Administration
HCO:	Human Capital Office
ICO:	Input Correction Operation
IDRS:	Integrated Data Retrieval System
IRM:	Internal Revenue Manual
IRS:	Internal Revenue Service
IT:	Information Technology
KISAM:	Knowledge, Incident/Problem, Service Asset Management
NFC:	National Finance Center
P&E:	property and equipment
SCC:	service center campus
SOP:	Standard Operating Procedure
TAC:	Taxpayer Assistance Center
TSRRD:	TAC Security and Remittance Review Database

Source: GAO evaluation of the status of recommendations as of September 30, 2016. | GAO-17-454R.

Note: See GAO, *Management Report: Improvements Are Needed to Enhance the Internal Revenue Service's Internal Control over Financial Reporting*, GAO-16-457R (Washington, D.C.: May 18, 2016).

Enclosure II: Comments from the Internal Revenue Service

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

COMMISSIONER

May 5, 2017

Ms. Cheryl E. Clark
Director
Financial Management and Assurance
U.S. Government Accountability Office
441 G Street, NW
Washington, DC 20548

Dear Ms. Clark:

I am writing in response to the Government Accountability Office (GAO) draft report titled *Management Report: Improvements Are Needed to Enhance the IRS's Internal Control over Financial Reporting (GAO-17-454R).* We are pleased that GAO acknowledged our progress in addressing our financial management challenges and agreed to close 11 prior year financial management recommendations. We continue to make significant progress in addressing internal control deficiencies and improving financial management as evidenced by 17 consecutive years of clean audit opinions on our financial statements.

During fiscal year 2016, IRS continued to strengthen its processes and controls over physical security and internal control monitoring at Taxpayer Assistance Centers, and unpaid assessments. The enclosed response addresses each of your new recommendations.

We are committed to implementing appropriate improvements to ensure that the IRS maintains sound financial management practices. If you have any questions, please contact me, or a member of your staff may contact Ursula Gillis, Chief Financial Officer, at 202-317-6400.

Sincerely,

John A. Koskinen

Enclosure

Enclosure

GAO Recommendations and IRS Responses to
GAO FY 2016 Management Report
"Improvements Are Needed to Enhance the Internal Revenue Service's Internal Control over Financial Reporting"
GAO-17-454R

<u>Recommendation #1</u>: We recommend that the IRS Commissioner direct the appropriate IRS officials to develop and implement a process to reasonably assure that IRS operating divisions and the IT organization effectively coordinate with the CFO organization when making programming changes to information systems affecting financial reporting.

Comments: The IRS agrees with this recommendation. By December 2017, the Information Technology (IT) organization, in collaboration with the Chief Financial Officer (CFO) organization, will develop and implement a process to reasonably assure that IRS operating divisions and the IT organization effectively coordinate with the CFO organization when making programming changes to information systems affecting financial reporting.

<u>Recommendation #2</u>: We recommend that the IRS Commissioner direct the appropriate IRS officials to research and determine the reason the IT organization did not follow IRS policy to thoroughly test programming changes related to the automation of specific penalty abatement procedures to reasonably assure that they worked as intended before implementation. Based on this determination, establish a process to better ensure compliance with existing policies for testing programming changes, including the use and review of the Applications Development transmittal checklist when developing program changes and retention of test results.

Comments: The IRS agrees with this recommendation. By June 2018, the IT organization will research IRS policies and practices for testing programming changes to determine what modifications may be needed to reasonably assure programming changes work as intended before implementation. Based on this research, the IT organization will update the affected policies and implement any related process changes, as needed.

<u>Recommendation #3</u>: We recommend that the IRS Commissioner direct the appropriate IRS officials to strengthen the process for reasonably assuring that the IRM is reviewed annually to align with the current control procedures and guidance being implemented by agency personnel. This should include a mechanism for reasonably assuring that program owner directors (1) review their respective program control activities and related guidance annually and timely update the IRM as needed, (2) document their reviews, and (3) utilize interim guidance and supplemental guidance correctly for their intended purposes.

Comments: The IRS agrees with this recommendation. By March 2018, the Research, Applied Analytics and Statistics organization will strengthen the process to reasonably assure that all IRMs are reviewed annually to align with the current control procedures and guidance being implemented by IRS personnel. This will include a mechanism to reasonably assure that program owner directors (1) review their respective program control activities and related guidance annually, and update the IRM timely, if needed; (2) document their reviews; and (3) use interim guidance and supplemental guidance correctly for their intended purposes.

Recommendation #4: We recommend that the IRS Commissioner direct the appropriate IRS officials to ensure the respective Agency-Wide Shared Services IRM and supplemental guidance related to the frequency of performing (1) emergency/alarm contact-list validation, (2) duress alarm inventory validation, and (3) federal security risk are consistent.

Comments: The IRS agrees with this recommendation and considers it closed. In February 2017, the Agency-Wide Shared Services (AWSS) organization updated SOP-17-0002, *Alarm Notification, Testing and Maintenance*, to synchronize the frequency of performing (1) emergency/alarm contact-list validation, (2) duress alarm inventory validation, and (3) federal security risk assessments, with revised IRM 10.2.14.9, *Methods of Providing Protection, Detection Equipment*, and IRM 10.2.11.2.5 (3), *Facility Security Risk Management*.

Recommendation #5: We recommend that the IRS Commissioner direct the appropriate IRS officials to update the respective (1) Privacy, Governmental Liaison and Disclosure and (2) CFO IRM sections related to the definition of the tax gap to align with the current understanding followed by IRS personnel.

Comments: The IRS agrees with this recommendation.

- In April 2017, the CFO organization updated IRM 1.34.1.2 (124), *Revenue Accounting, Definitions and Acronyms*, to align the tax gap definition with the current understanding followed by IRS personnel.

- By February 2018, the Privacy, Governmental Liaison and Disclosure organization will remove the tax gap definition from IRM 11.4.1.3.1.2, *Tax Gap Initiatives*.

Recommendation #6: We recommend that the IRS Commissioner direct the appropriate IRS officials to revise the applicable IRM sections pertaining to manual refunds to require employees to verify the validity of the digital signatures on the manual refund request forms and the manual refund signature authorization forms.

Comments: The IRS agrees with this recommendation. By March 2018, the Wage and Investment (W&I) organization will revise the applicable IRM manual refund sections to require that employees validate the digital signatures on the manual refund request forms and the manual refund signature authorization forms.

Recommendation #7: We recommend that the IRS Commissioner direct the appropriate IRS officials to revise system access rights in HR Connect to prevent HR assistants within the Employment Operations office from approving and releasing pay-related personnel actions to NFC.

Comments: The IRS agrees with this recommendation and considers it closed. In February 2017, the Human Capital Office (HCO) revised system access rights in HR Connect to prevent the Employment Operations Office HR assistants from approving and releasing pay-related personnel actions to the National Finance Center (NFC).

Recommendation #8: We recommend that the IRS Commissioner direct the appropriate IRS officials to revise the HR Connect HR User Profiles Desk Guide to clearly indicate that HR assistants within the Employment Operations office should not be granted access to approve and release pay-related personnel actions to NFC.

Comments: The IRS agrees with this recommendation and considers it closed. In February 2017, HCO revised the HR Connect HR User Profiles Desk Guide to clearly indicate that the Employment Operations Office HR assistants should not be granted access to approve and release pay-related personnel actions to NFC.

Recommendation #9: We recommend that the IRS Commissioner direct the appropriate IRS officials to establish and implement procedures to periodically review the process for determining the intragovernmental costs and costs with the public for each major program reported in the notes to the financial statements to provide reasonable assurance that these amounts are reliable and fairly presented.

Comments: The IRS agrees with this recommendation. By February 2018, the CFO organization will establish and implement procedures to review periodically the process for determining intragovernmental and public costs for each major program reported in the notes to the financial statements, providing reasonable assurance that these amounts are reliable and presented fairly.

Recommendation #10: We recommend that the IRS Commissioner direct the appropriate IRS officials to provide clear guidelines as to what events constitute removal from IRS premises and the disposal date that should be recorded in its inventory system, either through an update of the IRM or other property and equipment related desk guides.

Comments: The IRS agrees with this recommendation. By December 2017, the AWSS organization will provide clear guidelines on events that constitute removal of trackable property and equipment assets from IRS premises, and the disposal date that should be recorded in its inventory system, either by updating the IRM or the property and equipment-related desk guides.

Text of Agency Comment Letter

Page 1

May 5, 2017

Ms. Cheryl E. Clark Director

Financial Management and Assurance

U.S. Government Accountability Office 441 G Street, NW

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John A. Koskinen

Enclosure

Page 2

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Comments:

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Enclosure III: GAO Contact and Staff Acknowledgments

GAO Contact

Cheryl E. Clark, (202) 512-9377 or clarkce@gao.gov

Staff Acknowledgments

In addition to the contact named above, the following individuals made major contributions to this report: Ted Hu (Assistant Director), Ricky Cavazos, Liliam Coronado, Nina Crocker, Chuck Fox, Richard Guthrie, Vivian Ly, John Sawyer, Kevin Scott, Elizabeth Sodipo, Eric Stalcup, Sunny Stanley, Vanessa Taja, Lien To, LaDonna Towler, Cherry Vasquez, and Gary Wiggins.

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