



*The Modernization and Information  
Technology Services Organization Can  
Improve Its Budget Formulation, Execution,  
and Review Processes*

**May 9, 2007**

**Reference Number: 2007-20-064**

This report has cleared the Treasury Inspector General for Tax Administration disclosure review process and information determined to be restricted from public release has been redacted from this document.

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TREASURY INSPECTOR GENERAL  
FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY  
WASHINGTON, D.C. 20220

May 9, 2007

**MEMORANDUM FOR CHIEF INFORMATION OFFICER**

**FROM:** *Michael R. Phillips*  
Michael R. Phillips  
Deputy Inspector General for Audit

**SUBJECT:** Final Audit Report – The Modernization and Information Technology Services Organization Can Improve Its Budget Formulation, Execution, and Review Processes (Audit # 200620015)

This report presents the results of our review of the Internal Revenue Service (IRS) Modernization and Information Technology Services (MITS) organization budgeting and accounting activities. The overall objective of this review was to assess the adequacy of the processes and controls for developing, monitoring, and accounting for the MITS organization budget. This review was part of our Fiscal Year 2006 audit plan for reviews of the MITS organization.

*Impact on the Taxpayer*

The Financial Management Services (FMS) organization, under the Associate Chief Information Officer, Management, provides executive leadership, direction, and policy in all matters pertaining to budget and financial policy, formulation and financial analysis, and information technology services expense management across the MITS organization. We identified areas for improvement in the MITS organization budget formulation, execution, and review processes. These improvements will help provide more effective use of taxpayer funds in the MITS organization operations.

*Synopsis*

The MITS organization uses guidance provided by the Office of Management and Budget, the Chief Financial Officer, and the FMS organization to develop and manage its budget. The FMS organization has developed its own specific budget execution guidance, including the MITS



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Financial Operating Guidelines, to supplement the Office of Management and Budget and Chief Financial Officer guidance.

The IRS budgets for Modernization Program hardware and contractor costs in the Business Systems Modernization expenditure plan and funds the costs through the Information Technology Investments account. With implementation of the HR Connect<sup>1</sup> and the Integrated Financial System computer applications, the IRS has been able to begin tracking its labor costs associated with the Modernization Program.

The Modernization Program develops its budget based on the needs of the information technology projects within the Program. Modernization Program budget estimates are based on approved project business cases, and yearly allocations are made based on target completion dates and project goals. These estimates are approved by IRS executives and reviewed by the Government Accountability Office. However, the remainder of the MITS organization budget is based on its prior year's funding plus adjustments for inflation, salary increases, and funds availability.

If a budget is not based on planned resources needed to achieve organizational goals, budget shortfalls and overages can occur. When this happens, funds must be shifted between programs and fund centers to allow the organization to achieve its goals. In Fiscal Year 2006, the MITS organization had to move close to \$624 million (almost 39 percent) of its \$1.6 billion budget between programs and fund centers to continue supporting the IRS' computing needs.

The FMS organization Budget Planning Office is responsible for soliciting, receiving, reviewing, and processing budget estimates from the MITS organization offices. However, there are no formalized FMS organization procedures for the budget formulation process.

Fund centers are used to establish fund balances for program spending. The MITS organization can transfer funds from one fund center to another to address budget shortages and surpluses that occur during the fiscal year due to changes in program direction or in divisional priorities. The Office of Management and Budget and IRS guidelines from the Chief Financial Officer require reviews of financial plan spending to assess the execution of budget plans and make funding adjustments, when necessary. We found the procedures for transferring funds were not always followed and guidance for performing spending reviews is not complete.

### *Recommendations*

To address the MITS organization budget development, we recommended the Chief Information Officer implement a process to develop the entire MITS organization budget in line with the Information Technology Modernization Vision and Strategy's rolling 5-year prioritized plan.

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<sup>1</sup> See Appendix IV for a glossary of terms.



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The budget process should consider organizational goals for each of the MITS organization components and include costs for operations and maintenance of existing computer systems, telecommunication systems, and other programs such as end-user support and help desk activities.

To address the processes for budget formulation, execution, and monitoring, we recommended the Chief Information Officer ensure (1) the draft Budget Cycle procedures are approved and implemented timely; (2) the FMS organization supplements the budget formulation processes with detailed procedures documenting FMS organization staff duties and responsibilities for soliciting, receiving, reviewing, and reporting MITS organization budget estimates; (3) the draft Budget Cycle document is approved timely and the spending review procedures are implemented; and (4) the FMS organization supplements the spending review reporting with additional procedures that identify Fund Center Changes necessary to realign funds in response to spending review results.

### Response

The Chief Information Officer agreed with all of our recommendations. Planned corrective actions include developing a MITS organization 5-year strategic budget process to address the information technology budget needs not covered by the Information Technology Modernization Vision and Strategy. Additionally, the MITS organization plans to develop an implementation schedule to ensure Budget Cycle and spending review documents are approved and distributed timely. These plans include developing standard operating procedures for the FMS organization staff and detailed standard operating procedures for Fund Center Changes. Management's complete response to the draft report is included as Appendix V.

Copies of this report are also being sent to the IRS managers affected by the report recommendations. Please contact me at (202) 622-6510 if you have questions or Margaret E. Begg, Assistant Inspector General for Audit (Information Systems Programs), at (202) 622-8510.



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*Abbreviations*

FMS	Financial Management Services
IRS	Internal Revenue Service
MITS	Modernization and Information Technology Services



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## *Background*

The Internal Revenue Service (IRS) Financial Management Services (FMS) organization, under the Associate Chief Information Officer, Management, provides executive leadership, direction, and policy in all matters pertaining to budget and financial policy, formulation and financial analysis, and information technology services expense management across the Modernization and Information Technology Services (MITS) organization. The FMS organization also provides guidelines and direction on Federal Government budget and financial policy for information technology investments and operations. The FMS organization has two subordinate offices: the Budget Planning Office and the Budget Execution Office.

***The FMS organization manages the MITS organization budget formulation and execution as part of the IRS' budget administration.***

The Budget Planning Office establishes, maintains, and monitors adherence to budgetary policy and guidance. It also provides customer support and executive overview of information technology expense management. To accomplish its responsibilities, the Budget Planning Office manages budget formulation, plan development, and analysis; conducts trend and operational analyses; manages the MITS organization budget system, currently known as the Project Tracking System; and provides customer support, direction, oversight, and analysis of MITS organizationwide financial management issues.

The Budget Execution Office manages the MITS organization budget and all aspects of budget execution, including certification, funding, transfers, and analyses. These responsibilities include the development and distribution of financial guidance outlining rules governing the expenditure of information technology resources, defining budgeting roles and responsibilities, and establishing the timeline related to the development and execution of the MITS organization budget. To accomplish its responsibilities, the Budget Execution Office ensures the information technology plan aligns with customer strategies and objectives; guides and supports its customers in all information technology budget execution matters so that they can deliver their functional service and equipment requirements; develops and maintains the MITS organization budget execution program policies and guidelines; develops and generates external reports and analysis as needed by customers, external requesters, the Deputy Commissioner for Operations Support and the Chief Information Officer; and manages resources associated with MITS organizationwide programs (infrastructure, working capital fund, reimbursables, space, and housing) to ensure optimum planning and execution of such resources to meet the Chief Information Officer's goals and objectives.



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The Associate Chief Information Officer, Applications Development, supports the management of the MITS organization budget through the Resources Management Office, which works with the FMS organization to develop, monitor, adjust, and report on the Modernization Program portion of the MITS organization budget. The Resources Management Office is also responsible for managing budgets of significant nonModernization Program applications in development.

This review was performed at the MITS organization facilities in New Carrollton, Maryland, during the period August 2006 through February 2007. The audit was conducted in accordance with *Government Auditing Standards*. Detailed information on our audit objective, scope, and methodology is presented in Appendix I. Major contributors to the report are listed in Appendix II. Appendix IV presents a glossary of terms.



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## *Results of Review*

### ***The Modernization and Information Technology Services Organization Has Developed Formal Guidance for Budget Execution and Is Improving Its Modernization Program Budget Process***

The MITS organization uses guidance provided by the Office of Management and Budget, the IRS Chief Financial Officer, and the FMS organization to manage and execute its budget. The Office of Management and Budget provides high-level guidance in its Circular A-11, *Preparation, Submission, and Execution of the Budget*.<sup>1</sup> The Chief Financial Officer supplements Circular A-11 with several specific IRS guidance documents, the most comprehensive of which is the Chief Financial Officer's Financial Operating Guidelines.

***The MITS organization budget is developed through guidance from the Office of Management and Budget and the IRS Chief Financial Officer.***

The FMS organization has developed its own specific budget execution guidance, including the MITS Financial Operating Guidelines, to supplement the Office of Management and Budget and Chief Financial Officer guidance. The FMS organization guidance includes detailed procedures for spending plan development, monitoring, and execution. These procedures provide steps and tasks for the FMS organization staff working with MITS organization resource transfers, internal order accounting, obligations, commitments, and reimbursable transactions. The FMS organization guidance also provides detailed procedures for working with the Modernization Program budget.

### ***The IRS is improving the process to account for labor costs associated with the Modernization Program***

The IRS budgets for Modernization Program hardware and contractor costs in the Business Systems Modernization expenditure plan and funds the costs through the Information Technology Investments account. However, the IRS budgets and funds labor costs associated with the Modernization Program through the MITS organization Information Systems budget.

In November 2001, we reported the Modernization Program did not accurately account for IRS costs associated with Modernization projects.<sup>2</sup> We found that, while the IRS tracked and

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<sup>1</sup> Circular A-11, *Preparation, Submission, and Execution of the Budget*, dated June 30, 2006.

<sup>2</sup> *Modernization Project Teams Need to Follow Key Systems Development Processes* (Reference Number 2002-20-025, dated November 2001).



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monitored contractor costs, it had not established a means to accurately track and report the IRS labor costs associated with Modernization projects.

With implementation of the HR Connect and the Integrated Financial System computer applications, the IRS has been able to begin tracking its labor costs associated with the Modernization Program through Internal Order codes. These codes allow the IRS to track costs to individual projects as well as to general Modernization Program support, such as requirements management and project testing. However, the current appropriation structure does not allow the proper association of these costs with the Modernization Program.

In September 2006, the IRS submitted a request to Congress to change its process to budget and account for Business Systems Modernization costs. The IRS requested that Congress add \$45 million to the Business Systems Modernization expenditure plan and Information Technology Investments account for Modernization Program employee salaries.

Accounting for IRS labor costs associated with the Modernization Program will allow for more accurate reporting of Modernization Program and project costs to outside stakeholders and will provide reliable data for use in future budget considerations. Additionally, Modernization Program management will be able to include these costs in important internal progress measurements, such as earned value management and return on investment.

***Accounting for IRS labor costs associated with the Modernization Program will allow the IRS to properly budget and fund all related Business Systems Modernization costs.***

***The Modernization and Information Technology Services Organization Budget Estimates Are Not Based Entirely on Program Objectives and Operations Planned for the Upcoming Budget Cycle***

The Modernization Program develops its budget based on the needs of the information technology projects within the Program. Modernization Program budget estimates are based on approved project business cases, and yearly allocations are made based on target completion dates and project goals. These estimates are approved by IRS executives and reviewed by the Government Accountability Office. The remainder of the MITS organization budget is based on its prior year's funding plus adjustments for inflation, salary increases, and funds availability.

We previously reported this condition in a March 2001 report,<sup>3</sup> which stated the MITS organization needed to shift significant amounts of funds within its appropriation (\$360 million in Fiscal Year 2000, almost \$1 of every \$4 budgeted) and requested an additional \$40 million from another appropriation to meet its budget needs. While much of the fund shifting and

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<sup>3</sup> *The Information Systems Organization Can Improve Processes to Manage Its Budget Appropriation* (Reference Number 2001-20-062, dated March 2001).



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transfers were due to the transition to a new MITS organizational structure that began during the fiscal year, adjustments were also needed because of changes in program direction or divisional priorities and revised or inaccurate plans. We recommended that improved controls for budget monitoring and review would help the MITS organization assess its future budget requirements and enhance the efficiency and effectiveness of its budget execution.

The Government Accountability Office identified similar conditions in a June 2002 report,<sup>4</sup> stating the IRS had not developed its MITS organization budget request in accordance with the best practices of leading organizations. The largest elements of the IRS budget request were not projects or systems but requests for staffing levels or other services. The Government Accountability Office also reported the IRS did not identify and assess the relative costs, benefits, and risks of specific projects or systems. Instead, the IRS simply took what was spent in the previous year in these categories and added the money to fund cost-of-living and salary increases.

Leading private- and public-sector organizations identify operations and maintenance projects and systems for inclusion in budget requests. They assess these projects or systems on the basis of expected costs, benefits, and risks to the organization; analyze them as a portfolio of competing funding options; and use this information to develop and support budget requests.

***Leading private- and public-sector organizations take a project- or system-oriented approach to managing not only new investments but also operations and maintenance of existing systems.***

If a budget is not based on planned resources needed to achieve organizational goals, budget shortfalls and overages can occur. When this happens, funds must be shifted between programs and fund centers to allow the organization to achieve its goals. In Fiscal Year 2006, the MITS organization had to move close to \$624 million between programs and fund centers to continue supporting the IRS' computing needs. The FMS organization transferred almost \$84 million of the \$624 million to an interim account while MITS organization management finalized funding decisions. These transfers made up almost 39 percent of the \$1.6 billion MITS organization budget appropriation.

The FMS organization also transferred almost \$79 million from the MITS organization to other IRS activities. In addition, the MITS organization received an interappropriation transfer of almost \$69 million that was part of its Fiscal Year 2006 budget appropriation. Figure 1 presents an analysis of the MITS organization budget reprogramming in Fiscal Year 2006.

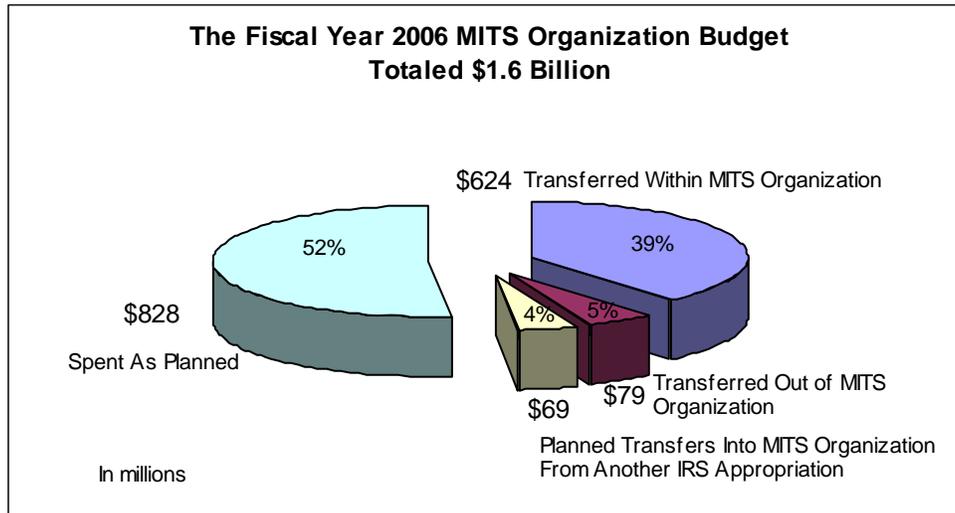
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<sup>4</sup> *Improving Adequacy of Information Systems Budget Justification* (GAO-02-704, dated June 2002).



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**Figure 1: MITS Organization Fiscal Year 2006 Budget Reprogramming Profile**



Source: Integrated Financial System – Report of Fiscal Year 2006 Reprogramming Activities.

In Fiscal Year 2008, the IRS will begin addressing resource requests for development, Modernization, and enhancements through the Information Technology Modernization Vision and Strategy. This will require the MITS organization divisions to develop their budgets based on prioritized organizational needs. Incorporating funding plans into the Information Technology Modernization Vision and Strategy will allow greater focus for future development and help prioritize these efforts based on budgeting constraints.

**Management Actions:** Subsequent to our December 2006 briefing with MITS organization managers on this topic and suggestion to improve the MITS organization budget formulation process by incorporating its entire budget into the Information Technology Modernization Vision and Strategy, we were advised the MITS organization began planning a process to incorporate our suggestion.

## **Recommendation**

**Recommendation 1:** The Chief Information Officer should implement a process to develop the entire MITS organization budget in line with the Information Technology Modernization Vision and Strategy’s rolling 5-year prioritized plan. The budget process should consider organizational goals for each of the MITS components and include costs for operations and maintenance of existing computer systems, telecommunication systems, and other programs such as end-user support and help desk activities.

**Management’s Response:** The Chief Information Officer agreed with this recommendation and plans to develop a MITS organization 5-year strategic budget



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process, in conjunction with the Core Services budget, to address the rest of the information technology budget not covered by the Information Technology Modernization Vision and Strategy.

***The Modernization and Information Technology Services Organization Does Not Have Formal Procedures for the Budget Formulation Process***

The MITS organization budget is developed and executed through the FMS organization, whose Budget Planning Office is responsible for soliciting, receiving, reviewing, and processing budget estimates from the MITS organization offices. However, there are no formalized FMS organization procedures for the budget formulation process.

In a March 2001 report,<sup>5</sup> we reported the Financial Planning and Budget Office Formulation Section (now referred to as the Budget Planning Office) did not document questioned data or discrepancies identified in the budget estimates received from the Information Systems organization (now the MITS organization) divisions. It did not have any written guidelines or operating procedures documenting staff duties and responsibilities for soliciting, receiving, reviewing, and reporting Information Systems organization budget estimates submitted from the Information Systems organization.

The Chief Information Officer's corrective action, which was documented as completed on July 1, 2001, stated that standard operating procedures would be implemented during the Fiscal Year 2003 budget formulation cycle. However, we have been unable to obtain any evidence that these standard operating procedures were developed.

If budget estimates are not consistently and appropriately solicited, received, reviewed, and reported, the resulting budgets may not provide the resources needed to achieve organizational goals. As a result, shortages and overages can occur, causing the need to shift funds between programs and fund centers to meet operational requirements.

***Management Actions:*** The FMS organization has developed a draft Budget Cycle document that defines, in broad terms, the activities and rules governing the MITS organization budget. As of December 6, 2006, this document was a draft and was expected to be approved and issued during Fiscal Year 2007. The FMS organization also is in the process of planning specific guidelines for the budget formulation process.

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<sup>5</sup> *The Information Systems Organization Can Improve Processes to Manage Its Budget Appropriation* (Reference Number 2001-20-062, dated March 2001).



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## **Recommendation**

**Recommendation 2:** The Chief Information Officer should ensure (1) the draft Budget Cycle procedures are approved and implemented timely and (2) the FMS organization supplements the budget formulation processes with detailed procedures documenting FMS organization staff duties and responsibilities for soliciting, receiving, reviewing, and reporting MITS organization budget estimates.

**Management's Response:** The Chief Information Officer agreed with this recommendation and plans to develop an implementation schedule to ensure Budget Cycle documents are approved and distributed timely. In addition, the Chief Information Officer plans to develop detailed standard operating procedures for the FMS organization staff.

## ***Procedures for Transferring Funds Were Not Followed, and Guidance for Performing Spending Reviews Is Not Complete***

Fund centers are used to establish fund balances for program spending. The MITS organization can transfer funds from one fund center to another to address budget shortages and surpluses that occur during the fiscal year due to changes in program direction or changes in divisional priorities. These transfers are referred to as Fund Center Changes. The Office of Management and Budget and IRS guidelines from the Chief Financial Officer require reviews of financial plan spending to assess the execution of budget plans and make funding adjustments, when necessary.

### **The MITS organization did not follow prescribed guidelines in managing and approving changes to its budget**

To work within budget constraints, a Fund Center Change request should be initiated by the office providing additional funding and must be approved and signed by the appropriate official who is furnishing the funds (such as the Division Director or designated approving official, Division Information Officer, or Division Financial Plan manager or delegated budget contact). A Fund Center Change request for labor funding should be initiated using a Fund Center Change request document. The request is submitted to the FMS organization and processed in the Budget Execution Office.

The MITS organization did not always follow prescribed criteria when processing Fiscal Year 2006 Fund Center Change requests. We reviewed a sample of 64 Fiscal Year 2006 Fund Center Change requests involving almost \$500 million in fund transfers within the MITS organization financial plan. We found 28 problems in the preparation and processing of 23 (36 percent) of the 64 Fund Center Change requests, including:

- Fund Center Changes initiated by MITS organization offices not providing the additional funding – 13 requests (20 percent).



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- Fund Center Changes without evidence of managerial approval or review – 7 requests (11 percent).
- Fund Center Changes without sufficient documentation to support reasons for the change – 4 requests (6 percent).
- Fund Center Changes without the proper Fund Center Change request form or a similar document containing required information – 4 requests (6 percent).

Although the MITS organization has guidelines for the appropriate processing of Fund Center Change requests, the Budget Execution Office did not ensure all requests were appropriate, justified, and properly approved. This condition was reported in our previously cited March 2001 report, which stated the MITS organization had not ensured Fund Center Change requests were processed following the required criteria. The Chief Information Officer responded that the MITS organization would issue financial operating guidelines to ensure Fund Center Change requests are processed with appropriate reviews and approvals.

***Adequate internal controls for processing Fund Center Change requests can prevent extending the effects of a shortage or surplus in a program initiative.***

We again reported this condition in a February 2003 report,<sup>6</sup> which stated about 15 percent of the budget adjustments we reviewed were processed without evidence of appropriate managerial review, approval, or documentation. The Chief Information Officer responded that guidelines had been clarified to ensure all MITS organization budget adjustments are processed consistently. The Chief Information Officer also provided a plan for monitoring whether the updated guidance is being followed. The monitoring plan directs the Budget Execution Office to perform monthly reviews to ensure MITS organization Financial Operating Guidelines are in place and being followed. The FMS organization could not provide us with evidence of any reviews of the implementation or performance of these guidelines.

Adequate internal controls are necessary to ensure Fund Center Change requests are properly documented, approved, and reviewed to prevent misapplication of funds. Incorrect Fund Center Changes can create discrepancies in other financial plans, requiring additional Fund Center Changes to correct the errors. In addition, the absence of controls over Fund Center Changes may affect the accuracy of the amounts budgeted for program initiatives and can affect decisions involving the development of future-year budget estimates.

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<sup>6</sup> *Management of the Information Systems Budget Has Improved, but Additional Progress Can Be Made* (Reference Number 2003-20-070, dated February 2003).



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**The MITS organization budget appropriation spending review process can be improved**

The Office of Management and Budget requires agencies to review financial plan spending to assess the execution of budget plans and make funding adjustments when necessary. The Chief Financial Officer guidance requires performance of periodic budget spending reviews by the MITS organization. However, the MITS organization does not have formal procedures for performing spending reviews and reporting the results of these reviews. In addition, the MITS organization does not regularly perform spending reviews. Two spending reviews were performed during Fiscal Year 2006. The FMS organization used a contractor to help it perform a formal spending review in February 2006 and reported the results to MITS organization executives. A second, informal spending review was performed by the FMS organization in April 2006.

In our previously cited March 2001 report, we reported that, while spending reviews were performed and documented, the results were not adequately brought to the attention of financial plan managers or budget analysts to timely correct imbalances. The Chief Information Officer's corrective action, which was documented as completed in June 2001, was to implement guidelines for spending reviews in Fiscal Year 2001. The corrective action planned for these guidelines was to contain feedback mechanisms to ensure review results included approved spending levels, identified the need for timely financial plan changes (now called Fund Center Changes) to realign funds, and recognized potential subsequent-year effects. The guidelines were going to require that review results be communicated to the FMS organization, MITS organization executives, and business partners. However, we have been unable to obtain these guidelines.

The Chief Financial Officer is required to report financial plan balances to the Department of the Treasury monthly and to the Office of Management and Budget quarterly. These entities rely on accurate financial plan balances for use in planning and monitoring budget appropriations. The absence of sufficient spending reviews and reporting of review results precludes the meaningful analysis of current-year budget status and future-year planning.

*Management Actions:* As previously mentioned, the FMS organization has developed a draft Budget Cycle document that defines, in broad terms, the activities and rules governing the MITS organization budget. This document also includes procedures for performing spending reviews and reporting the results.

### ***Recommendation***

**Recommendation 3:** The Chief Information Officer should ensure (1) the draft Budget Cycle document is approved timely and the spending review procedures are implemented and (2) the FMS organization supplements the spending review reporting with additional procedures that identify Fund Center Changes necessary to realign funds in response to spending review results.



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**Management's Response:** The Chief Information Officer agreed with this recommendation and plans to develop an implementation schedule to ensure Budget Cycle and spending review documents are approved and distributed timely. In addition, the Chief Information Officer plans to develop detailed standard operating procedures for Fund Center Changes.



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## **Appendix I**

### *Detailed Objective, Scope, and Methodology*

The overall objective of this review was to assess the adequacy of the processes and controls for developing, monitoring, and accounting for the MITS organization budget. This review was part of our Fiscal Year 2006 audit plan for reviews of the MITS organization.

To accomplish our objective, we identified the internal control systems and criteria used as guidance for the development and execution of the MITS organization budget. These systems and criteria include guidance provided by the Office of Management and Budget, the IRS Chief Financial Officer, the Internal Revenue Manual, and the operations of the Integrated Financial System.<sup>1</sup> We reviewed available documentation and interviewed staff members from the FMS organization and the Application Development organization Resources Management Office. Specifically, we:

- I. Determined whether the FMS organization's policies and procedures enabled effective formulation, development, and monitoring of the MITS organization budget.
- II. Determined whether the FMS organization had adequate internal controls for its budget formulation to provide appropriate reviews of MITS organization budget estimates and to process the estimates into the MITS organization budget.
- III. Reviewed the MITS organization budget execution processes to determine whether all critical internal controls were implemented and whether they provide for an accurate accounting of the MITS organization's operations. As part of this assessment, we selected judgmental samples of a total of 64 Fund Center Change requests from the 2,092 Fund Center Change requests made during Fiscal Year 2006. Our selection was based on the dollar amount of the request and on the originator and receiver of the funding so we reviewed requests from each MITS organization division. We used judgmental samples because we did not plan to project our audit results.
  - A. Selected a judgmental sample of 20 Fund Center Change transactions from the 208 transfers made between fund centers in the MITS organization.
  - B. Selected a judgmental sample of 16 Fund Center Change requests for intra-appropriation transactions from the 553 transactions made between divisions in the MITS organization.

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<sup>1</sup> See Appendix IV for a glossary of terms.



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- C. Selected a judgmental sample of 27 Fund Center Change requests for intra-appropriation transactions from the 1,330 transactions made within divisions in the MITS organization.
  - D. Reviewed the one interappropriation transfer made to the MITS organization from the IRS.
- IV. Reviewed the MITS organization budget formulation processes to determine whether sufficient internal controls were in place to ensure the accuracy of budget formulation and execution for the Business Systems Modernization expenditures.

**Validity and reliability of data from computer-based systems**

The IRS provided Integrated Financial System information showing Fiscal Year 2006 budget allocations, Fund Center Changes, intra-appropriation transfers, and interappropriation transfers. We relied on the Government Accountability Office's assessment of the reliability of the computer-processed data from the Integrated Financial System. During a review of the IRS' financial statements, the Government Accountability Office concluded the expense and reimbursable revenue information processed through the Integrated Financial System for Fiscal Years 2005 and 2006 was reliable in all material respects.<sup>2</sup>

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<sup>2</sup> *IRS's Fiscal Years 2006 and 2005 Financial Statements* (GAO-07-136, dated November 2006).



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**Appendix II**

*Major Contributors to This Report*

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Edward A. Neuwirth, Audit Manager  
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Glen J. Rhoades, Senior Auditor



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## **Appendix III**

### *Report Distribution List*

Commissioner C  
Office of the Commissioner – Attn: Chief of Staff  
Deputy Commissioner for Operations Support OS  
Associate Chief Information Officer, Applications Development OS:CIO:AD  
Associate Chief Information Officer, Management OS:CIO:M  
Director, Stakeholder Management OS:CIO:SM  
Deputy Associate Chief Information Officer, Business Integration OS:CIO:ES:BI  
Director, Financial Management Services OS:CIO:M:FM  
Chief Counsel CC  
National Taxpayer Advocate TA  
Director, Office of Legislative Affairs CL:LA  
Director, Office of Program Evaluation and Risk Analysis RAS:O  
Office of Internal Control OS:CFO:CPIC:IC  
Audit Liaisons:  
    Associate Chief Information Officer, Applications Development OS:CIO:AD  
    Associate Chief Information Officer, Management OS:CIO:M  
    Director, Program Oversight OS:CIO:SM:PO



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**Appendix IV**

*Glossary of Terms*

<b>Term</b>	<b>Definition</b>
Division Information Officer	Division Information Officers are the information systems executives dedicated to each IRS operating division.
Earned Value Management	Earned value management involves measuring actual cost and work accomplished against the budgeted cost and planned work scheduled. Variances are analyzed for decision making.
e-Services	The e-Services project provides a set of web-based business products as incentives to third parties to increase electronic filing, in addition to providing electronic customer account management capabilities to all businesses, individuals, and other customers.
Fund Center	A fund center, formerly referred to as a financial plan, is a designated program area requiring a resource distribution. Fund centers are used to establish fund balances for program spending.
HR Connect	The HR Connect application delivers an enterprise solution to allow IRS employees to access and manage their human resources information online.



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<b>Term</b>	<b>Definition</b>
Information Technology Modernization Vision and Strategy	The Information Technology Modernization Vision and Strategy establishes a 5-year plan that drives investment decisions; addresses the priorities around modernizing front-line tax administration and supporting technical capabilities; and leverages existing systems (where possible) and new development (where necessary) to optimize capacity, manage program costs, and deliver business value on a more incremental and frequent basis.
Integrated Financial System	The Integrated Financial System is intended to address administrative financial management weaknesses. The first release of the Integrated Financial System included the Accounts Payable, Accounts Receivable, General Ledger, Budget Execution, Cost Management, and Financial Reporting activities. A future Integrated Financial System release will be needed to fully resolve all administrative financial management weaknesses.
Return on Investment	Return on investment is the net profit or loss in an accounting period divided by the capital investment used during the period, usually expressed as an annual percentage return.
Working Capital Fund	A working capital fund is a fund established to finance operating activities.



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**Appendix V**

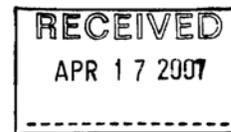
*Management's Response to the Draft Report*



CHIEF INFORMATION OFFICER

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

April 17, 2007



MEMORANDUM FOR DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: Richard A. Spires  
Chief Information Officer

SUBJECT: Draft Report – The Modernization and Information Technology  
Services Organization Can Improve Its Budget Formulation, Execution,  
and Review Processes (Audit #200620015)

Thank you for the opportunity to review the subject draft audit report and to meet with the audit team to discuss previous report observations. As a result of these meetings, the audit team incorporated our suggested management action into the draft report.

We are pleased with the Treasury Inspector General for Tax Administration's (TIGTA) acknowledgement that the Internal Revenue Service's (IRS) Modernization and Information Technology Services (MITS) organization is continuing to make significant progress in the area of financial management. We agree with TIGTA that we should have had certain formalized procedures already in place as a result of their 2001 audit. In this regard, in the last fiscal year, we examined all budget processes across the MITS organization and began developing corresponding documentation. As a result, we are in the final stages of issuing policies, procedures, and a budget cycle that go far beyond what was contemplated in 2001. In addition, we are pleased that TIGTA observed the following accomplishments:

- The IRS implemented the HR Connect and the Integrated Financial System (IFS) computer applications and began tracking IRS labor costs associated with the modernization program through internal order codes. Internal order codes allow the IRS to track individual project costs, along with general modernization program support, such as requirements management and project testing.
- The IRS' accounting for its modernization program-associated labor costs will allow more accurate reporting of these costs to outside stakeholders as well as provide reliable data for use in future budget considerations. Additionally, this method of accounting will enable inclusion of these costs in important internal progress measurements, such as earned value management and return on investment.
- The MITS organization has developed formal guidance for budget execution and improvement to its modernization program budget process. In addition, TIGTA found that the Financial Management Services (FMS) guidance includes detailed procedures for



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spend plan development, monitoring, and execution. These procedures provide steps and tasks for the FMS organization's staff to work with MITS for resource transfers, internal order accounting, obligations, commitments, and reimbursable transactions. The FMS organization guidance also provides detailed procedures for working with the modernization program budget.

Although we acknowledge and welcome the audit team's advice on ways to further develop the budget formulation and execution processes, we are concerned that some of the statements contained in the draft audit report could be misinterpreted. Specifically, we are concerned with the following report statements:

- 1. The FMS organization's Budget Planning Office is responsible for soliciting, receiving, reviewing, and processing budget estimates from the MITS organization offices. However, there are no formalized FMS procedures for the budget formulation process.*

As stated earlier, we agree that the MITS organization should have had formalized procedures in place as a result of the 2001 audit. However, MITS did have informal processes consistent with the guidance provided by the Chief Financial Officer (CFO). The budget cycle procedures, currently in draft, represent the budget formulation process under which MITS has operated for the past three years. As discussed during the audit, these procedures will be published in final with detailed guidance required to ensure all budget estimates are sound and accurate.

- 2. The FMS organization also transferred almost \$79 million out of the MITS organization to other IRS activities. In addition, the MITS organization received an inter-appropriation transfer of almost \$69 million that was part of its Fiscal Year 2006 budget appropriation.*

In recent years, MITS has implemented efforts to centrally manage certain cross-organizational programs to ensure funds are used for the highest priority investment. As a result, funds are transferred once management direction/approval is provided. This has contributed to significant internal reprogramming changes. Of the \$79 million transferred out, 65% represented program changes in the IRS and a Congressional Rescission. Within the IFS system, we are not aware of an alternative approach to handle this activity.

In addition, during the execution year, funding issues may occur that require reprioritization due to budget shortfalls or unplanned requirements, such as emergency fixes or new legislation. The inter-appropriation transfers of \$69 million occurred as a result of the IRS directing more funds to MITS' information technology investments than was received in the congressional budget process.

- 3. The Chief Financial Officer is required to report financial plan balances to the Department of the Treasury on a monthly basis and to the Office of Management and Budget on a quarterly basis. These entities rely on accurate financial plan balances for use in planning and monitoring budget appropriations. The absence of sufficient spending reviews and reporting of review results precludes the meaningful analysis of current year budget status and future year planning.*



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We agree that the CFO has certain reporting responsibilities for which they rely on the functional areas to provide accurate data in IFS. In support of the CFO's monthly reports, FMS conducts monthly monitoring and reconciliation activities to ensure obligations are recorded correctly and are within fund availability. Although the CFO does not specify how many spend plan reviews to conduct in a given year, MITS conducted two reviews last fiscal year. Our process did not have a formal report of review results; however, MITS FMS did secure CIO approval throughout the review process and the results were reported across MITS. FMS also maintained a detailed spreadsheet containing documentation of open questions, responses to those questions, and agreements by the CIO as questions were resolved, along with tracking of all financial plan changes approved during the review. While FMS had all the pertinent information on the Fund Center Change (FCC) Log (located on the shared drive) and the emails associated with preparing each FCC during spend plan and CFO reviews, this did not always occur for all FCCs processed during the entire fiscal year. MITS has more comprehensive work under way in this area, which includes publishing detailed guidance to ensure FCC procedures are consistently followed.

We appreciate your continued support and the valuable assistance and guidance that your team provides. If you have any questions, please contact me at (202) 622-6800. Members of your staff may also contact Perry Robinett, Director of Program Oversight, at (202) 283-6283.

Attachment



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*The Modernization and Information Technology Services Organization Can Improve Its Budget Formulation, Execution, and Review Processes*

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Draft Report – The Modernization and Information Technology Services Organization Can Improve Its Budget Formulation, Execution, and Review Processes (Audit #200620015)

**RECOMMENDATION #1:** The Chief Information Officer should implement a process to develop the entire MITS organization budget in line with the Information Technology Modernization Vision and Strategy’s rolling 5-year prioritized plan. The budget should consider organizational goals and resource needs and incorporate core services costs for operations and maintenance of existing computer and telecommunication systems, and operating costs for executing programs such as end-user support and help desk activities.

**CORRECTIVE ACTION #1:** We agree with this recommendation. We will develop a MITS 5-year strategic budget process, in conjunction with the Core Services budget, to address the remainder of the IT budget not covered by the Modernization Vision and Strategy (MV&S).

**IMPLEMENTATION DATE:** October 1, 2008

**RESPONSIBLE OFFICIAL:** Associate Chief Information Officer Management; Director, Financial Management Services

**CORRECTIVE ACTION MONITORING PLAN:** Monthly meetings with the Strategic Budget Core Team will be scheduled to monitor status. Additionally, we will provide monthly status updates to the MITS Oversight Office until closure.

**RECOMMENDATION #2:** The Chief Information Officer should ensure the draft Budget Cycle procedures are timely approved and implemented. In addition, the FMS organization should supplement the budget formulation processes with detailed procedures documenting FMS organization staff duties and responsibilities for soliciting, receiving, reviewing, and reporting MITS organization budget estimates.

**CORRECTIVE ACTION #2:** We agree with this recommendation. We will develop an implementation schedule to ensure timely approval and distribution of budget cycle documents. In addition, we will develop detailed standard operating procedures for the Financial Management Services (FMS) staff.

**IMPLEMENTATION DATE:** January 1, 2008

**RESPONSIBLE OFFICIAL:** Associate Chief Information Officer Management; Director, Financial Management Services

**CORRECTIVE ACTION MONITORING PLAN:** Monthly meetings with the Budget Planning Office will be scheduled to monitor status. Additionally, we will provide monthly status updates to the MITS Oversight Office until closure.



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Draft Report – The Modernization and Information Technology Services Organization Can Improve Its Budget Formulation, Execution, and Review Processes (Audit #200620015)

**RECOMMENDATION #3:** The Chief Information Officer should ensure the draft Budget Cycle document is timely approved and the spending review procedures are implemented. In addition, the FMS organization should supplement the spending review reporting with additional procedures that identify Fund Center Changes necessary to realign funds in response to spending review results.

**CORRECTIVE ACTION #3:** We agree with this recommendation. We will develop an implementation schedule to ensure timely approval and distribution of budget cycle and spend review documents. In addition, we will develop detailed standard operating procedures for Fund Center Changes.

**IMPLEMENTATION DATE:** January 1, 2008

**RESPONSIBLE OFFICIAL:** Associate Chief Information Officer Management; Director, Financial Management Services

**CORRECTIVE ACTION MONITORING PLAN:** Monthly meetings with the Budget Execution Office will be scheduled to monitor status. Additionally, we will provide monthly status updates to the MITS Oversight Office until closure.