Status of the Implementation of the Federal Financial Management Improvement Act

August 2, 2017

Reference Number: 2017-10-046
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STATUS OF THE IMPLEMENTATION OF THE FEDERAL FINANCIAL MANAGEMENT IMPROVEMENT ACT

Highlights

Final Report issued on August 2, 2017

Highlights of Reference Number: 2017-10-046 to the Internal Revenue Service Chief Financial Officer.

IMPACT ON TAXPAYERS

The Federal Financial Management Improvement Act (FFMIA) remediation plan is an important part of the IRS’s efforts to bring its financial management systems into compliance with the FFMIA and to provide reliable and timely financial data. Complete and reliable financial information is critical to the IRS’s ability to accurately report on the results of its operations to both internal and external stakeholders, including taxpayers.

WHY TIGTA DID THE AUDIT

The overall objectives of this review were to determine any instances of and reasons for missed intermediate target dates established in the IRS’s September 30, 2016, FFMIA remediation plan, and to determine whether the IRS has taken adequate corrective actions on TIGTA’s Fiscal Year 2015 audit findings related to the FFMIA remediation plan.

WHAT TIGTA FOUND

During Fiscal Year 2016, the IRS made progress on addressing certain aspects of its internal control weaknesses that affect its financial reporting. For example, the IRS closed nine of 17 open remediation actions related to the Unpaid Tax Assessments material weakness and did not miss any intermediate target dates for the corrective actions. In response to TIGTA’s recommendation made in the prior year’s report, the IRS properly documented all of the open Government Accountability Office (GAO) recommendations within its Fiscal Year 2016 remediation plan, and ensured that all the open recommendations were linked to the related corrective actions as required.

However, the IRS continues to include limited cost information in its quarterly remediation plans, and as previously recommended, TIGTA continues to believe that including implementation steps associated with the Customer Account Data Engine 2 Transition State 2 (CADE 2 TS2) would improve the remediation plan. The IRS anticipates that it will be unable to fully address the Unpaid Tax Assessments material weakness until implementation of the CADE 2 TS2, but the IRS does not list all the actions needed to fully implement the CADE 2 TS2 in the remediation plan. Additionally, as of February 2017, the Chief Financial Officer stated that the expected CADE 2 TS2 implementation date of November 2020 will likely be extended again, which would extend the date that the Unpaid Tax Assessments material weakness will be addressed.

WHAT TIGTA RECOMMENDED

TIGTA made no recommendations as a result of the work performed during this review. However, key IRS officials reviewed this report prior to its issuance and agreed with the facts and conclusions presented.
August 2, 2017

MEMORANDUM FOR CHIEF FINANCIAL OFFICER

FROM: Michael E. McKenney
Deputy Inspector General for Audit


This report presents the result of our review of the Status of the Implementation of the Federal Financial Management Improvement Act.1 The overall objectives of this review were to determine any instances of and reasons for missed intermediate target dates established in the Internal Revenue Service’s (IRS) September 30, 2016, (Fiscal Year 2016) Federal Financial Management Improvement Act (FFMIA) remediation plan, and to determine whether the IRS has taken adequate corrective actions on our Fiscal Year 2015 audit findings related to the FFMIA remediation plan. This review is included in our Fiscal Year 2017 Annual Audit Plan and addresses the major management challenge area of Achieving Program Efficiencies and Cost Savings.

The Treasury Inspector General for Tax Administration made no recommendations as a result of the work performed during this review. However, key IRS officials reviewed this report prior to its issuance and agreed with the facts and conclusions presented.

Management’s complete response to the draft report is included as Appendix IV.

Copies of this report are also being sent to the IRS managers affected by the report findings. If you have any questions, please contact me or Gregory Kutz, Assistant Inspector General for Audit, (Management Services and Exempt Organizations).

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## Abbreviations

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<td>CADE 2 TS2</td>
<td>Customer Account Data Engine 2 Transition State 2</td>
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<td>FFMIA</td>
<td>Federal Financial Management Improvement Act</td>
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<td>FY</td>
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<td>GAO</td>
<td>Government Accountability Office</td>
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Status of the Implementation of the Federal Financial Management Improvement Act

Background

The Federal Financial Management Improvement Act of 1996 (FFMIA)\(^1\) was established to advance Federal financial management by ensuring that financial management systems provide accurate, reliable, and timely financial management information to managers and Congress. Further, the Act requires that this disclosure should be done on a basis that is uniform across the Federal Government from year to year by consistently using professionally accepted accounting standards. Specifically, FFMIA Section 803(a) requires each agency to implement and maintain systems that comply substantially with:

- Federal Government financial management systems requirements.
- The United States Government Standard General Ledger at the transaction level.\(^2\)

The FFMIA also requires financial statement auditors to report on agency compliance with the three stated requirements as part of financial statement audit reports,\(^3\) and agency heads are required to determine, based on the audit report and other information, whether their financial management systems comply with the FFMIA requirements. If the agency does not comply, it is required to develop a remediation plan that describes the resources, remedies, and intermediate target dates for achieving compliance, and file the plan with the Office of Management and Budget. In addition, Section 804(b) requires that the Inspector General shall report to Congress instances and reasons when an agency has not met the intermediate target dates established in the remediation plan.

In December 1993,\(^4\) the Government Accountability Office (GAO) reported on significant financial management weaknesses that affected the Internal Revenue Service’s (IRS) ability to account for unpaid tax assessments.\(^5\) Because the GAO has reported noncompliance with the requirements

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\(^2\) Provides a uniform Chart of Accounts and technical guidance to be used in standardizing Federal agency accounting.
\(^3\) The Government Accountability Office is responsible for auditing the IRS’s financial statements annually.
\(^4\) GAO (formerly known as the General Accounting Office), GAO/Accounting and Information Management Division (AMID) - AIMD-94-22, Important IRS Revenue Information Is Unavailable or Unreliable (Dec. 21, 1993).
\(^5\) An unpaid tax assessment is a legally enforceable claim against a taxpayer and consists of taxes, penalties, and interest that have not been collected or abated (a reduction in a tax assessment).
of the FFMTA, primarily because of the weaknesses in unpaid tax assessments, the IRS has been required to prepare and maintain a remediation plan.

In November 2016, the GAO reported that the IRS continues to have a material weakness in internal control over unpaid tax assessments.\(^6\) The GAO stated:

\textit{The continuing material weakness in internal control over unpaid assessments was primarily caused by financial system limitations and other control deficiencies that rendered IRS’s systems unable to properly distinguish between taxes receivable, compliance assessments, and write-offs, as necessary to determine reliable balances for financial reporting purposes... In response to GAO’s recommendations from prior audits, IRS has taken actions over the years to address this material weakness, including developing a long-term corrective action plan. However, the plan does not include milestones or related completion dates for most of the actions, so it is unclear when the IRS will fully address the issues that cause significant inaccuracies in the unpaid tax assessments information it maintains.}

Additionally, in a May 2016 management report,\(^8\) the GAO closed two recommendations and issued one new recommendation related to the Unpaid Tax Assessments material weakness. The new recommendation required IRS officials to establish and implement a formal process to annually review unpaid tax assessments that are manually classified to determine whether the classification is correct for the current fiscal year.

The FFMTA remediation plan is an important part of the IRS’s efforts to bring its financial management systems into compliance with the FFMTA and to provide reliable and timely financial data. Complete and reliable financial information is critical to the IRS’s ability to accurately report on the results of its operations to both internal and external stakeholders, including taxpayers.

This review was performed with information obtained from the IRS Headquarters in Washington, D.C., in the office of the Chief Financial Officer during the period November 2016 through April 2017. We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and

\(^6\) In December 2013, the GAO explained that a material weakness is a deficiency, or combination of deficiencies, in internal control 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 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.

\(^7\) GAO, GAO-17-140, Financial Audit: IRS’s Fiscal Years 2016 and 2015 Financial Statements (Nov. 10, 2016).

\(^8\) GAO, GAO-16-457R, IRS Management Report: Improvements Are Needed to Enhance the Internal Revenue Service’s Internal Control over Financial Reporting (May 18, 2016).
conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. Detailed information on our audit objectives, scope, and methodology is presented in Appendix I. Major contributors to the report are listed in Appendix II.
Results of Review

Intermediate Target Dates Were Met and Government Accountability Office Recommendations Were Properly Documented, but Cost Information Is Still Limited

Intermediate target dates were met

Our review identified that the IRS did not miss any intermediate target dates on its quarterly remediation plan related to the Unpaid Tax Assessments material weakness during Fiscal Year (FY) 2016. As of September 30, 2016, the IRS completed nine of 17 remediation actions during the fiscal year and listed eight remaining actions. The eight remaining actions have expected completion dates in FYs 2017, 2018, or 2021. Section 803(c)(3)(A) of the FFMIA states that an agency’s remediation plan shall include intermediate target dates necessary to bring the agency’s financial management system into substantial compliance. The IRS has listed these dates as required and did not extend any intermediate target dates.

All GAO recommendations were included in the remediation plan

For our FY 2016 review of the IRS’s FFMIA remediation plan, all four open GAO recommendations were included in the quarterly remediation plans, as required. In our prior FY 2015 review of the IRS’s FFMIA remediation plan,9 TIGTA found that the IRS did not include all of the GAO recommendations in its quarterly plans; specifically, three of the five open recommendations were not documented in the FY 2015 quarterly plans. As a result, TIGTA recommended that all open GAO recommendations be included in the remediation plan, and that the IRS ensure that all recommendations were reconciled and linked to the corrective action. In May 2016,10 the GAO issued a management report to the Commissioner of the IRS to present the internal control deficiencies identified during its audit of the IRS’s FYs 2015 and 2014 financial statements. The report identified a new internal control deficiency that contributed to the IRS’s continuing material weakness in internal control over unpaid tax assessments. As a result, the GAO provided a new recommendation pertaining to the newly identified internal control deficiency. The inclusion of this new recommendation brought the total of open GAO recommendations related to the unpaid assessments material weakness to

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Our review of the IRS’s September 30, 2016, remediation plan found that the new recommendation from the May 2016 GAO management report was documented in quarterly remediation plans, as well as the previous remaining recommendations. We also verified that the corrective actions included in the quarterly remediation plans were linked to the open GAO recommendations, as required.

As a result, we were able to reconcile the IRS’s corrective actions with the GAO’s recommendations. Providing this detailed information of the action to be taken and the resources required for implementation of any action provides assurance that the IRS develops corrective actions that address all of the GAO’s recommendations.

Corrective actions still have limited cost information listed

Although all corrective actions were linked to the GAO recommendations as required, the corrective actions still have limited cost information listed. In TIGTA’s FY 2014 FFMIA review, we recommended that the IRS Chief Financial Officer include detailed cost estimate information associated with each specific corrective action and link each action to the GAO recommendations in each quarterly remediation plan. The IRS agreed with this recommendation in its response stating that the Chief Financial Officer would include detailed cost estimates and link actions in the plan to the GAO recommendations; however, the IRS added that it would determine what information was needed when resources are solely tied to use of existing staff.

We found that, in the September 30, 2016, remediation plan, only one of nine corrective actions had detailed costs listed. For the remaining eight items, the IRS stated that the actions’ costs were “absorbed by normal business practices.”

The FFMIA requires that remediation plans include the resources, remedies, and intermediate target dates necessary to bring the agency’s financial management systems into substantial compliance. The FFMIA also requires agencies to include the estimated and actual resources needed to implement action plans and requires that these resources be identified by fiscal year. In addition, the IRS’s guidance requires that the responsible organization provide all costs, including estimates, to implement the recommendations and the dollar amount approved by project.

The IRS has stated that it generally will only include costs once they are known, which is usually after an action has been approved or completed, and it did not have plans in place to include estimated costs because budgetary uncertainties make including that information problematic. However, we found examples of remediation actions for which actual or estimated costs should have been listed but were not. For example, the IRS should include estimated costs in the

11 The GAO previously had five open recommendations, but closed two recommendations and issued one new recommendation related to the Unpaid Tax Assessments material weakness.
remediation plan when it knows it will incur costs in obtaining assistance from data or subject matter experts.

**The Unpaid Tax Assessments Material Weakness Remains a Challenge**

The IRS anticipates it will be unable to fully address the Unpaid Tax Assessments material weakness until the implementation of the Customer Account Data Engine 2 Transition State 2 (CADE 2 TS2). As of February 2017, the Chief Financial Officer stated that the expected CADE 2 TS2 implementation date of November 2020 will likely be extended, which would extend the date that the Unpaid Tax Assessments material weakness will be addressed. The revised date for the CADE 2 TS2 has not yet been determined, but once it is, the IRS is planning to reassess the November 2020 implementation date for the Unpaid Tax Assessments material weakness.

According to IRS management, the CADE 2 TS2 is expected to provide better clarity and transparency of IRS accounts, which will lead to more accurate reporting of the IRS’s unpaid tax assessments. However, management explained that the timely implementation of the CADE 2 TS2 is dependent upon funding and resource availability. According to the IRS, the prior expected implementation date for the CADE 2 TS2 was delayed from November 2014 to November 2020 due to funding and other information technology priorities. The IRS’s ability to improve reporting on unpaid tax assessment balances is likely to be further extended.

We previously recommended that the IRS include CADE 2 TS2 actions in its remediation plan because IRS management indicated that the CADE 2 TS2 system was a key part of the IRS’s strategy for addressing its material weakness related to unpaid tax assessments. The IRS disagreed with this recommendation, stating that because the IRS does not classify the CADE 2 TS2 as a financial system, it does not need to be included in the FFMIA remediation plan. While the IRS’s September 30, 2016, remediation plan explained that the CADE 2 TS2 is expected to resolve the material weakness by November 2020, the details of the CADE 2 TS2 were not described in the plan. The IRS only listed the overall estimated costs for each phase of the CADE 2 TS2 implementation in the Executive Summary section; however, no detailed actions were listed. The IRS did prepare a long-term action plan in June 2015 with more than 200 actions to address the Unpaid Tax Assessments material weakness; however, some of the potential actions were not listed in the remediation plan and the long-term action plan did not include milestones or related dates for most of the actions. According to the IRS, as the actions listed on the long-term action plan are approved or completed, they will eventually be integrated into the remediation plan.

Because of the importance of the CADE 2 TS2 to FFMIA implementation, we continue to believe that including implementation steps associated with the CADE 2 TS2 would improve the remediation plan. Until then, it is unclear when and how the IRS plans to fully address the issues that cause significant inaccuracies in the unpaid tax assessments information maintained in its accounting systems.
Appendix I

**Detailed Objectives, Scope, and Methodology**

The overall objectives of this review were to determine any instances of and reasons for missed intermediate target dates established in the IRS’s September 30, 2016, (FY 2016) FFMIA remediation plan, and to determine whether the IRS has taken adequate corrective actions on our FY 2015 audit findings related to the FFMIA remediation plan.¹ To accomplish our objectives, we:

I. Gained an understanding of the requirements of the FFMIA, including Office of Management and Budget and Department of the Treasury guidance for compliance with the Act.

II. Determined whether the IRS’s September 30, 2016, remediation plan was consistent with GAO recommendations from the IRS’s FYs 2016 and 2015 financial audits and related financial management reports.

III. Determined whether the IRS missed any intermediate target dates established in its remediation plan, and if any intermediate target dates were extended without sufficient documentation to support the revised dates.

IV. Determined whether the IRS had taken adequate corrective actions on our FY 2015 audit findings related to the FFMIA remediation plan.

**Internal controls methodology**

Internal controls relate to management’s plans, methods, and procedures used to meet their mission, goals, and objectives. Internal controls include the processes and procedures for planning, organizing, directing, and controlling program operations. They include the systems for measuring, reporting, and monitoring program performance. We determined that the following internal controls were relevant to our audit objectives: the IRS’s policies, procedures, and practices for tracking remediation actions implemented due to identified material weaknesses. We evaluated these controls by interviewing management and reviewing applicable documentation.

Major Contributors to This Report

Gregory D. Kutz, Assistant Inspector General for Audit (Management Services and Exempt Organizations)
Jonathan T. Meyer, Director
LaToya Penn, Audit Manager
Sylvia Sloan McPherson, Lead Auditor
Appendix III

Report Distribution List

Commissioner
Office of the Commissioner – Attn: Chief of Staff
Deputy Commissioner for Operations Support
Deputy Chief Financial Officer
Director, Office of Audit Coordination
MEMORANDUM FOR MICHAEL E. MCKENNEY
DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: Ursula S. Gillis
Chief Financial Officer


July 5, 2017

Thank you for the opportunity to review the draft audit report titled, Status of the Implementation of the Federal Financial Management Improvement Act. We appreciate you acknowledging that the IRS has not missed any intermediate target dates for corrective actions and that we continue to address internal control aspects of the Unpaid Tax Assessments material weakness.

Since your recommendation in 2016, the IRS has documented all open GAO recommendations within the remediation plan and linked open recommendations to related corrective actions. We continue to refine and improve the remediation plan to maximize its effectiveness.

The IRS faces many challenges including funding constraints, competing priorities, and implementing significant new programs, all impeding the implementation of Customer Account Data Engine 2 Transition State 2 (CADE 2 TS2). Our uncertain budget environment also impedes our long-term implementation planning. Nevertheless, we continue to work diligently to remediate the material weakness and affirm the IRS’s commitment to fiscal accuracy to all of our stakeholders.

If you have any questions, please contact me at 202-317-6400, or a member of your staff may contact John Pekarik, Associate Chief Financial Officer for Corporate Planning and Internal Control, at 202-803-9151.