Status of the Implementation of the Federal Financial Management Improvement Act

August 1, 2018

Reference Number: 2018-10-044

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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STATUS OF THE IMPLEMENTATION OF THE FEDERAL FINANCIAL MANAGEMENT IMPROVEMENT ACT

Highlights

Final Report issued on August 1, 2018

Highlights of Reference Number: 2018-10-044 to the Commissioner of Internal Revenue.

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, 2017, FFMIA remediation plan and to determine whether the IRS has taken adequate corrective actions on TIGTA's Fiscal Year 2016 audit findings related to the FFMIA remediation plan.

WHAT TIGTA FOUND

During Fiscal Year 2017, the IRS made progress on addressing certain aspects of its internal control weaknesses that affect its financial reporting. For example, the IRS closed six of 11 open remediation actions related to the Unpaid Tax Assessments material weakness. However, in May 2017, the Government Accountability Office made two new recommendations to the IRS on the Unpaid Tax Assessments material weakness, but the IRS did not properly document these new open recommendations in its Fiscal Year 2017 remediation plan as required. Additionally, TIGTA found that the IRS continues to include limited cost information in its quarterly remediation plans.

TIGTA also found that the IRS has changed its plans for addressing the Unpaid Tax Assessments material weakness. Specifically, since December 1993, the Government Accountability Office has reported that the IRS has a material weakness in internal controls over Unpaid Tax Assessments. In response, the IRS has reported that closing the material weakness is dependent on implementing the Customer Account Data Engine 2 Transition State 2 (CADE 2 TS2), which had a target completion date of November 2020.

In Fiscal Year 2017, the IRS stated that due to funding constraints, CADE 2 TS2 no longer includes strategic goals of addressing the Unpaid Tax Assessments material weakness. Instead, the IRS will focus its efforts to downgrade the material weakness by examining the feasibility of enhancing its existing financial systems and establishing both a task force on data quality within taxpayer accounts and a team to study and recommend financial systems enhancements. However, as with CADE 2 TS2, the success of the IRS's new plan depends on funding availability.

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.

TREASURY INSPECTOR GENERAL
FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY

WASHINGTON, D.C. 20220

August 1, 2018

MEMORANDUM FOR COMMISSIONER OF INTERNAL REVENUE

FROM: Michael E. McKenney
Deputy Inspector General for Audit

SUBJECT: Final Audit Report – Status of the Implementation of the Federal Financial Management Improvement Act (Audit # 201810002)

This report presents the results of our review of the Status of the Implementation of the Federal Financial Management Improvement Act. 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, 2017 (Fiscal Year 2017), Federal Financial Management Improvement Act (FFMIA)[1] remediation plan and to determine whether the IRS has taken adequate corrective actions on our Fiscal Year 2016 audit findings related to the FFMIA remediation plan.[2] This review is included in our Fiscal Year 2018 Annual Audit Plan and addresses the major management challenge area of Achieving Program Efficiencies and Cost Savings.

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

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.

If you have any questions, please contact me or Troy Paterson, Acting Assistant Inspector General for Audit (Management Services and Exempt Organizations).

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[1] Pub. L. No. 104-208, 110 Stat. 3009.
[2] Treasury Inspector General for Tax Administration, Ref. No. 2016-10-063, *Status of the Implementation of the Federal Financial Management Improvement Act* p. 6 (Aug. 2016).

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Abbreviations

CADE 2 TS2	Customer Account Data Engine 2 Transition State 2
CFO	Chief Financial Officer
FFMIA	Federal Financial Management Improvement Act
FY	Fiscal Year
GAO	Government Accountability Office
IRS	Internal Revenue Service
TIGTA	Treasury Inspector General for Tax Administration

Background

On November 9, 2017, the Government Accountability Office reported that the Internal Revenue Service continues to have a material weakness in internal controls over financial reporting as of September 30, 2017.

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 FFMIA 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.
- Applicable Federal Government accounting standards.
- 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, in consultation with the Office of Management and Budget, that describes the resources, remedies, and intermediate target dates for achieving compliance. 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, the Government Accountability Office (GAO) reported[4] 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

[1] Pub. L. No. 104-208, 110 Stat. 3009.
[2] The U.S. Government Standard General Ledger 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 Internal Revenue Service'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. 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 FFMIA, primarily because of the weaknesses in Unpaid Tax Assessments, the IRS has been required to prepare and maintain a remediation plan.

In November 2017, the GAO reported that the IRS continues to have a material weakness[6] in internal controls over Unpaid Tax Assessments.[7] The GAO stated:

> *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 federal 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 establishing a task force to improve unpaid assessments data quality. However, further enhancements to IRS's financial systems are needed to address the continuing issues with the accuracy of tax records, enable the IRS to record reliable taxes receivable transaction detail, improve IRS's ability to effectively manage taxpayer's accounts, and reduce taxpayer burden.*

Additionally, in a May 2017 management report,[8] the GAO closed one recommendation and issued two new recommendations related to the Unpaid Tax Assessments material weakness. The new recommendations required IRS officials to take the following actions:

- Develop and implement a process to reasonably assure that IRS operating divisions and the Information Technology organization effectively coordinate with the Chief Financial Officer (CFO) organization when making programming changes to information systems affecting financial reporting.
- Research and determine the reason the Information Technology 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

[6] 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-18-165, *Financial Audit: IRS's Fiscal Years 2017 and 2016 Financial Statements* (Nov. 2017).
[8] GAO, GAO-17-454R, *IRS Management Report: Improvements Are Needed to Enhance the Internal Revenue Service's Internal Control Over Financial Reporting* (May 2017).

review of the Applications Development transmittal checklist when developing program changes and retention of test results.

The 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.

This review was performed with information obtained from the IRS Headquarters in Washington, D.C., in the office of the CFO during the period November 2017 through April 2018. 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 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

Although Intermediate Target Dates Were Met, Significant Challenges Remain

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) 2017.[9] As of September 30, 2017, the IRS completed six of 11 remediation actions during the fiscal year and listed five remaining actions. The five remaining actions have expected completion dates in FYs 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 intermediate target dates as required.

GAO recommendations were not included in the remediation plan

For our FY 2017 review of the IRS's FFMIA remediation plan, two of five GAO recommendations related to Unpaid Tax Assessments were not included in the quarterly remediation plans as required. In the May 2017 GAO management report issued to the Commissioner of the IRS, the GAO presented the internal control deficiencies identified during its audit of the IRS's FYs 2016 and 2015 financial statements.[10] The audit report identified a new internal control deficiency that contributed to the IRS's continuing material weakness in internal controls over Unpaid Tax Assessments. As a result, the GAO provided two new recommendations pertaining to the newly identified deficiency. IRS guidelines[11] require the responsible office to identify in the remediation plans all new remediation actions and the related GAO recommendation as well as provide a concise but complete description of the action to be taken and the resources required for implementation of any action.[12] However, our review of the

[9] Any yearly accounting period, regardless of its relationship to a calendar year. The Federal Government's fiscal year begins on October 1 and ends on September 30.
[10] GAO, GAO-17-140, *Financial Audit: IRS's Fiscal Years 2016 and 2015 Financial Statements* (Nov. 2016).
[11] Internal Revenue Manual 1.4.2 *Resource Guide for Managers, Monitoring and Improving Internal Control* (Feb. 4, 2015).
[12] For the three prior recommendations, we verified that the corrective actions were included in the FY 2017 quarterly remediation plans and were linked to the open GAO recommendations, as required by Internal Revenue Manual 1.4.2.13, *Resource Guide for Managers, Remediation Plan* (Dec. 14, 2012).

IRS's September 30, 2017, remediation plan found that the two new recommendations from the May 2017 GAO management report were not documented in quarterly remediation plans.

The IRS explained that the two new GAO recommendations were not included within the FY 2017 remediation plan because it is IRS policy to not include recommendations in the plan until the Management Controls Executive Steering Committee meets and approves the recommendations. This committee is an advisory committee to the Commissioner and Deputy Commissioners who have overall responsibility for ensuring that the IRS has an effective internal control program in place. The IRS also stated it requires time to research the recommendations and come up with corrective actions that have specific due dates before they are presented to the committee for approval. The committee meets quarterly to discuss the status of material weaknesses, significant deficiencies, issues of noncompliance with laws and regulations, and Service-wide progress made in closing open GAO and Treasury Inspector General for Tax Administration (TIGTA) audit recommendations. Although the committee had met since the GAO issued the management report with the two new recommendations in May 2017, it had not approved including the new recommendations into the FY 2017 remediation plans.[13] As recommended in a prior TIGTA report, the CFO should include all open GAO recommendations in the remediation plan. The IRS agreed with this recommendation in its response, stating that all future remediation plans will be updated and will include all open GAO recommendations.[14] Without including this detailed information, the IRS may not develop corrective actions that will address all of the GAO's recommendations.

The Unpaid Tax Assessments material weakness remains a challenge

During FY 2017, the IRS made changes to the actions required to address the Unpaid Tax Assessments material weakness. Since December 1993, the GAO has reported that the IRS has a material weakness in internal controls over Unpaid Tax Assessments. In response, the IRS has reported that closing the material weakness is dependent on implementing the Customer Account Data Engine 2 Transition State 2 (CADE 2 TS2),[15] which had a target completion date of November 2020. However, in Fiscal Year 2017, the IRS stated that due to funding constraints, CADE 2 TS2 no longer includes strategic goals of addressing the Unpaid Tax Assessments material weakness. Instead, the IRS is working to reduce the material weakness to a significant deficiency by November 2020. The IRS's efforts to downgrade the material weakness will include examining the feasibility of enhancing its existing financial systems and establishing both a task force on data quality within taxpayer accounts and a team to study and recommend financial systems enhancements. As of May 2017, the total cost of the CADE 2 project, since its

[13] The new recommendations were later included within the first quarter of the FY 2018 remediation plan.
[14] TIGTA, Ref. No. 2016-10-063, *Status of the Implementation of the Federal Financial Management Improvement Act* p. 6 (Aug. 2016).
[15] The CADE 2 is part of the IRS's modernization efforts. The CADE 2 TS2 planned scope focuses, in part, on resolving financial material weaknesses.

inception, was $642 million.[16] The newly formed financial systems enhancement team has developed recommendations for financial system enhancements outside of the CADE 2. However, as with CADE 2 TS2, the success of the team's progress depends on funding availability. 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 on its accounting systems.

Corrective actions still have limited cost information listed

Although 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,[17] we recommended that the IRS CFO 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 CFO would include detailed cost estimates and link actions in the plan to the GAO recommendations.

We found that the IRS continues to include limited cost information in its quarterly remediation plans. In the September 30, 2017, remediation plan, none of the five corrective actions had detailed costs listed. Specifically, 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.[18]

In TIGTA's FY 2016 FFMIA review,[19] the IRS 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 continued to find examples of remediation actions for which actual or estimated costs could have been listed as required, but were not. For

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[16] IRS Information Technology, Chief Information Officer, *FY 2017 3rd Quarter IT Investment Report Draft V.2.6*, (June 22, 2017). IT = Information Technology.
[17] TIGTA, Ref. No. 2015-10-065, *The Internal Revenue Service Has Extended Its Estimated Federal Financial Management Improvement Act Remediation Date to November 2020* p. 11 (Aug. 2015).
[18] Internal Revenue Manual 1.4.2 *Resource Guide for Managers, Monitoring and Improving Internal Control* (Feb. 4, 2015).
[19] TIGTA, Ref. No. 2017-10-046, *Status of the Implementation of the Federal Financial Management Improvement Act* p. 5 (Aug. 2017).

example, the IRS should include estimated costs in the remediation plan when it knows it will incur salary or contract costs in obtaining assistance from data or subject matter experts.

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, 2017 (FY 2017),[1] FFMIA[2] remediation plan and to determine whether the IRS has taken adequate corrective actions on our FY 2016 audit findings related to the FFMIA remediation plan.[3] 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, 2017, remediation plan was consistent with GAO recommendations from the IRS's FYs 2017 and 2016 financial audits and related financial management reports.

III. Determined whether the IRS missed any intermediate target dates established in its remediation plan and whether 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 2016 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 objective: 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.

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[1] Any yearly accounting period, regardless of its relationship to a calendar year. The Federal Government's fiscal year begins on October 1 and ends on September 30.
[2] Pub. L. No. 104-208, 110 Stat. 3009.
[3] TIGTA, Ref. No. 2016-10-063, *Status of the Implementation of the Federal Financial Management Improvement Act* p. 6 (Aug. 2016).

Appendix II

Major Contributors to This Report

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

Report Distribution List

Deputy Commissioner for Operations Support
Chief Financial Officer
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Appendix IV

Management's Response to the Draft Report

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

CHIEF FINANCIAL OFFICER

July 5, 2018

MEMORANDUM FOR MICHAEL E. MCKENNEY
DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: Ursula S. Gillis
Chief Financial Officer

SUBJECT: Draft Audit Report – Status of the Implementation of the Federal Financial Management Improvement Act (Audit # 201810002)

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 have made progress on addressing certain aspects of our internal control weaknesses affecting financial reporting.

We acknowledge that two GAO recommendations were not included in the September 30, 2017, remediation plan. Our practice has been that the Management Controls Executive Steering Committee must approve changes to the remediation plan since its charter at that time stipulated that one of the committee's responsibilities was "approving new and revised corrective actions/corrective action plans to correct Material Weaknesses and Significant Deficiencies." In this instance the committee had not met to approve the associated corrective actions prior to the audit. Going forward, we will include all GAO recommendations with corrective actions in the remediation plan timely.

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 Internal Controls, at 202-803-9151.