



G A O

Accountability * Integrity * Reliability

United States General Accounting Office
Washington, DC 20548

July 18, 2002

The Honorable Charles O. Rossotti
Commissioner of Internal Revenue

Subject: *Management Report: Improvements Needed in IRS's Accounting
Procedures and Internal Controls*

Dear Mr. Rossotti:

In February 2002, we issued our report on the results of our audit of the Internal Revenue Service's (IRS's) financial statements as of, and for the fiscal years ending, September 30, 2001, and 2000,¹ and on the effectiveness of its internal controls as of September 30, 2001. We also reported our conclusions on IRS's compliance with significant provisions of selected laws and regulations and on whether IRS's financial management systems substantially comply with requirements of the Federal Financial Management Improvement Act of 1996. A separate report on the implementation status of recommendations from our prior IRS financial audits and related financial management reports will be issued shortly.

The purpose of this report is to discuss additional matters identified during our fiscal year 2001 audit regarding accounting procedures and internal controls that could be improved. These matters are not considered material in relation to the financial statements; however, they warrant management's consideration.

Results in Brief

During fiscal year 2001, IRS had a number of internal control issues that affected financial reporting, including safeguarding of assets. These issues concern policies and procedures over (1) receipt of taxpayer payments, (2) courier services that transport taxpayer data, (3) employee fingerprint records, (4) issuance of manual refunds, (5) release of tax liens, (6) recording of property and equipment (P&E) transactions, (7) linking of property and accounting records, (8) software licenses,

¹U.S. General Accounting Office, *Financial Audit: IRS's Fiscal Year 2001 and 2000 Financial Statements*, [GAO-02-414](#) (Washington D.C.: Feb. 27, 2002).

Report Documentation Page

Report Date 00JUL2002	Report Type N/A	Dates Covered (from... to) -
Title and Subtitle Management Report: Improvements Needed in IRS's Accounting Procedures and Internal Controls	Contract Number	
	Grant Number	
	Program Element Number	
Author(s)	Project Number	
	Task Number	
	Work Unit Number	
Performing Organization Name(s) and Address(es) U.S. General Accounting Office 441 G Street NW, Room LM Washington, D.C. 20548	Performing Organization Report Number GAO-02-746r	
Sponsoring/Monitoring Agency Name(s) and Address(es)	Sponsor/Monitor's Acronym(s)	
	Sponsor/Monitor's Report Number(s)	
Distribution/Availability Statement Approved for public release, distribution unlimited		
Supplementary Notes		
Abstract see report		
Subject Terms		
Report Classification unclassified	Classification of this page unclassified	
Classification of Abstract unclassified	Limitation of Abstract SAR	
Number of Pages 27		

(9) reimbursable receivables,² and (10) recording changes in administrative account balances.

Specifically, we found the following.

- IRS did not have adequate controls over taxpayer payments received at certain field locations. We found that (1) although receipts were usually issued, notices reminding taxpayers to obtain receipts for payments were not present, (2) at two field office locations, payments placed in drop boxes were processed by only one employee, and (3) payment logs were not reconciled to taxpayer documents. As a result, IRS's risk of theft, loss, or misuse of taxpayer deposits was increased.
- IRS service center campuses did not ensure that couriers had undergone background checks. As a result, IRS's risk of theft, loss, or misuse of deposits and taxpayer information was increased.
- IRS's database to track fingerprint results was subject to technical constraints and human error. These issues resulted in numerous instances of erroneous or missing data. Incomplete and inaccurate fingerprint data may hamper IRS's investigations of security violations.
- IRS staff did not always perform or document required monitoring of manually processed tax refunds. As a result, the risk that other staff or IRS's automated tax system could issue duplicate refunds was increased.
- IRS did not record the dates on which certificate of lien releases were mailed to courts and we noted long delays between the date of the IRS certificate of lien release and the date the local jurisdiction recorded its receipt. Delays in releasing tax liens could cause undue hardship and burden to taxpayers who are attempting to sell property or apply for commercial credit.
- IRS did not follow procedures for promptly recording assets on its property management system, resulting in delays in the proper accounting for hundreds of P&E items, such as microcomputers.
- IRS's asset acquisition costs on the accounting records could not always be linked to assets recorded on the inventory records. Consequently, the existence of certain property acquired and recorded on accounting records during fiscal year 2001 was not verifiable.

²IRS provides goods and services to federal agencies, state and foreign governments, and private organizations on a reimbursable cost basis. Payments due to IRS for these activities are referred to as reimbursable receivables.

- IRS's property management system did not maintain an inventory of software or software licenses. As a result, IRS could not determine its compliance with software licenses or effectively account for and manage acquired software.
- IRS did not adequately monitor and review reimbursable receivables to determine their validity or collectibility. As a result, certain amounts recorded as reimbursable receivables reported on IRS's financial statements were not valid or were uncollectible.
- IRS did not have procedures to estimate and accrue material changes in administrative account balances throughout the fiscal year. The lack of these procedures going forward may preclude IRS from having assurance that interim financial statements it is required to prepare for fiscal year 2002 per the Office of Management and Budget (OMB) Bulletin 01-09, *Form and Content of Agency Financial Statements*, are reliable.

At the end of our discussion on each of these issues, we offer recommendations for strengthening IRS's internal controls.

In its comments, IRS agreed with our recommendations and described actions it was taking or had planned to address several of the control weaknesses described in this report. At the end of our discussion of each of the issues in this report, we have summarized IRS's related comments and provided our evaluation. We also considered IRS's feedback on our findings and have made revisions as appropriate.

Scope and Methodology

As part of our audit of IRS's fiscal years 2001 and 2000 financial statements, we evaluated IRS's internal controls and its compliance with selected provisions of laws and regulations. We designed our audit procedures to test relevant controls and included tests for proper authorization, execution, accounting, and reporting of transactions.

We conducted our audit in accordance with U.S. generally accepted government auditing standards. Further details on our scope and methodology are included in our February 2002 report on the results of our fiscal years 2001 and 2000 financial statement audit.³ We requested comments on a draft of this report from the Commissioner of IRS or his designee. We received written comments from the Deputy Commissioner and have reprinted the comments in enclosure I to this report.

³[GAO-02-414](#).

IRS Needs to Strengthen Controls Over Taxpayer Receipts

During our fiscal year 2001 financial audit, we identified several issues related to IRS's controls over taxpayer receipts that increased the risk that such receipts could be lost or stolen and that the theft would not be timely detected. GAO's *Standards for Internal Controls in the Federal Government* requires agencies to establish controls to safeguard valuable assets and reduce the risk of error or fraud. The standards state that such controls should include 1) periodic comparisons between resources and records to ensure proper accountability and 2) segregation of duties so that no one individual controls all aspects of a transaction.

In prior audits, we had noted weaknesses in IRS's physical controls over service center campus and field office taxpayer receipts.⁴ We recommended that IRS (1) establish procedures to provide receipts to walk-in taxpayers⁵ at IRS service center campuses regardless of the method of payment, and (2) post signs at the campuses to remind taxpayers to ask for receipts. We also recommended that IRS record remittances made by walk-in taxpayers in control logs prior to depositing them in a locked container, and that IRS reconcile the control log information to the tax receipts prior to processing. As a result of our recommendations, IRS issued guidance in 1999 and updated its procedures in 2000 on controls over receipts. Specifically, these procedures required IRS to (1) post signs in all service center campus lobbies to remind taxpayers to request a receipt, (2) record payments made by walk-in taxpayers on control logs, and (3) establish segregation of duties for recording and reconciling taxpayer receipts.

During our fiscal year 2001 audit, we found that service center campuses no longer accepted walk-in payments, but rather directed taxpayers to field offices. At the field offices we visited, we found that although IRS employees usually issued a receipt for walk-in payments, IRS had no policy requiring that field offices issue a receipt for all payments. Additionally, IRS had no requirement that signs be posted in field office lobbies to remind taxpayers to request receipts. One field office we visited had not posted such signs. The issuance of receipts for all payments, followed by timely and

⁴U.S. General Accounting Office, *Internal Revenue Service: Physical Security Over Taxpayer Receipts and Data Needs Improvement*, [GAO/AIMD-99-15](#) (Washington D.C.: Nov. 30, 1998); U.S. General Accounting Office, *Internal Revenue Service: Custodial Financial Management Weaknesses*, [GAO/AIMD-99-193](#) (Washington D.C.: Aug. 4, 1999); U.S. General Accounting Office, *Internal Revenue Service: Recommendations to Improve Financial and Operational Management*, [GAO-01-42](#) (Washington D.C.: Nov. 17, 2000); and U.S. General Accounting Office, *Internal Revenue Service: Progress Made, but Further Actions Needed to Improve Financial Management*, [GAO-02-35](#) (Washington D.C.: Oct. 19, 2001).

⁵Walk-in taxpayers are individual taxpayers who choose to conduct business with IRS in person. Generally, these individuals are directed to the IRS field offices which have units set up to handle questions and accept payments from such taxpayers.

thorough management reviews of receipts issued, provides better accountability for walk-in payments received by IRS.

Additionally, we found control issues related to drop boxes maintained at field offices for walk-in taxpayers to deposit payments. At each of the two offices we visited, we found that only one employee emptied the drop box and recorded the payments on a log. At one of the offices, the same employee later reconciled the payments to the log. Requiring two employees to retrieve and record payments from drop boxes establishes better control and accountability for these receipts. However, IRS currently does not have a policy requiring dual control over drop box receipts. Additionally, IRS did not provide adequate oversight to ensure that its employees adhered to its policy regarding segregation of duties over the reconciliation of receipts. This increases the risk of theft of taxpayer payments.

IRS did not have policies/procedures to reconcile receipts found during final candling to the final candling log.⁶ As a result, we found that two IRS service center campuses and one of two lockbox banks⁷ we visited did not reconcile receipts found during final candling to the candling logs. At the lockbox bank, we noted that two separate logs were used to record checks found during final candling. Employees performing final candling recorded only the number of checks found on the initial log while a supervisor prepared a second more detailed log several hours later that identified the taxpayer and the amount of the check. However, the supervisor did not reconcile the number of checks indicated on the initial log with the checks on hand. Consequently, bank managers were unable to explain differences we noted between the number of checks on the initial log and the detailed log. The failure to maintain adequate control logs of all checks found during final candling increases the risk that not all checks will be accounted for and eventually credited to taxpayers' accounts.

Recommendations

We recommend that you direct IRS management to develop policies and procedures to require that

- field office employees provide taxpayers receipts for all walk-in payments;

⁶Final candling occurs at the end of the mail extraction process. After contents from envelopes are extracted, IRS staff illuminate, or "candle" all envelopes which have already gone through the extraction process to ensure that all contents are actually removed prior to the envelopes' destruction.

⁷A lockbox refers to a commercial bank with a designated post office box to which taxpayers are instructed to mail their payments and related tax documents. These lockbox banks process the documents, deposit the payments, then forward the documents and data to IRS service center campuses to update the taxpayers' accounts. Treasury's Financial Management Service (FMS) has agreements with nine lockbox bank locations on IRS's behalf.

- field offices post signs in the most visible locations to remind taxpayers to obtain receipts for payments;
- two employees be present when payments are collected and logged from drop boxes;
- IRS and lockbox employees performing final candling record receipts in a control log at the time of discovery, recording at a minimum the total number of payments found, the amount of each payment, and the taxpayer who submitted the payment; and
- IRS and lockbox managers or designated officials reconcile logs of payments found during final candling to the related receipts and documents.

We also recommend that you direct IRS headquarters management to ensure that field office management comply with existing receipt control policies that require a segregation of duties between employees who prepare control logs for walk-in payments and employees who reconcile the control logs to the actual payments.

IRS's Comments and Our Evaluation

In its comments, IRS noted that it had taken several actions to address this finding. Specifically, IRS stated that it (1) revised signs and posted them in all Taxpayer Assistance Centers or field offices notifying taxpayers that they may request a receipt, (2) distributed to Taxpayer Assistance Center sites or field offices a procedural memo outlining separation of duties to emphasize the need to have more than one employee process drop box payments, and (3) established a task force to develop procedures to reconcile payment logs. We will evaluate the effectiveness of IRS's efforts during our fiscal year 2002 financial audit.

IRS Needs Better Enforcement Of Courier Service Policy

During our fiscal year 2001 audit, we found that IRS did not have effective controls in place to ensure that new courier service requirements were enforced. Since November 1998, we reported that IRS did not have effective controls over courier services responsible for transporting taxpayer receipts.⁸ This increased IRS's risk of theft, loss, or misuse of deposits and taxpayer information. We recommended that IRS develop policies to ensure that contracts related to courier services do not unduly expose the government or taxpayers to losses in the event of lost, stolen, or damaged deposits in transit. In response, IRS issued courier service standards that require that courier service employees pass a limited background investigation.

During our fiscal year 2001 audit, we identified weaknesses in IRS's enforcement of its courier service standards. Specifically, at the two IRS service center campuses we

⁸GAO/AIMD-99-15, GAO/AIMD-99-193, GAO-01-42, and GAO-02-35.

visited, we found that background checks for couriers were not performed or were performed too late. At one campus, managers did not believe a background check was required because their couriers did not physically enter the campus facility and the courier policy only required couriers given access to campus premises to pass a background check. The courier policy limits background check requirements to couriers given access to campus premises. However, to better protect the government and taxpayers against theft and losses, background checks should be performed on IRS couriers entrusted with deposits because they are given access to the deposits, which contain taxpayer data. Managers at another campus understood the intent of the courier policy and obtained background checks for its couriers even though they did not enter campus premises. However, the background checks for these couriers were not performed prior to entrusting them with deposits and taxpayer data because campus managers did not know how to initiate the background check process for couriers and did not know who was responsible for ensuring that this process was performed. As a result, fingerprints and background investigations on the couriers were not initiated until the latter part of fiscal year 2001. This increased IRS's risk of theft, loss, or misuse of deposits and taxpayer information.

Recommendation

To ensure that service center campus management and the courier service meet the intent of minimum courier policy requirements, we recommend that you direct IRS headquarters management to clarify that the requirement for background investigations is meant to apply to personnel being entrusted with taxpayer receipts and information, rather than just personnel being granted access to an IRS facility.

IRS's Comments and Our Evaluation

IRS agreed that courier service employees should undergo background checks. IRS noted it is working with FMS to modify courier service contracts and is amending the IRM to require the courier service to satisfy requirements for a basic investigation, which includes a Federal Bureau of Investigation (FBI) fingerprint and name check. We will evaluate the effectiveness of IRS's efforts during our fiscal year 2002 financial audit.

IRS Needs to Work With The National Finance Center To Correct Fingerprint System

During our fiscal year 2001 financial audit, we identified problems with the integrity of certain information in a key database system IRS uses to track compliance with its employee fingerprinting requirement. Specifically, we found numerous instances of missing or erroneous data in the National Finance Center's (NFC) Security Entry and Tracking System (SETS) database. According to IRS staff, these problems are due to both technical limitations in SETS and human error. Tracking fingerprint results

provides an important internal control for IRS to prevent the hiring of applicants with inappropriate backgrounds.

In response to issues we raised in previous audits concerning physical security of taxpayer receipts and data, IRS issued a directive in April 2000 that prohibited the hiring and placement of an applicant at any IRS location until the applicant's fingerprint check had been received and case disposition evaluated. An IRS memorandum issued April 23, 2001, provided guidance on monitoring IRS's background investigation program, including fingerprint results. The memorandum states, "It is critical to the integrity of the system that the information entered in SETS is timely and accurately entered." Based on the guidance, IRS officials are required to review a SETS report that tracks records that have missing fingerprint results or that indicate employees began work before their fingerprint results were received. The officials are required to follow up on these records, and update the SETS system accordingly.

Our analysis of over 20,500 employee records in the SETS system identified 411 records with missing or erroneous data. Specifically, there were 231 employee records with blank fields for the date fingerprint results were received and 180 employee records where the dates the fingerprint results were received were earlier than the dates the fingerprint checks were completed per information from the Office of Personnel Management (OPM). SETS data for 42 of the 180 employee records showed that the employees entered on duty after fingerprint results were received, while OPM data indicated that fingerprint results were not provided by OPM until after the employees began working at IRS facilities.

According to IRS officials, many of these discrepancies are due to technical constraints within SETS. For example,

- SETS did not always retain data fields when a person's status was changed from applicant to employee.
- The SETS database allows only one record or line entry per employee or social security number. Therefore, when subsequent fingerprint/background results are received and entered, SETS eliminates the initial fingerprint record and replaces it with the new data.
- The "enter-on-duty" dates for seasonal employees are "locked" in SETS for a period of time. When subsequent fingerprint checks are processed, the SETS system will show the most recent date that these subsequent fingerprint checks are initiated and completed. However, the system will not allow a change to the enter-on-duty date until the seasonal employee actually returns to IRS employment.

Additionally, IRS officials indicated that in some instances human error contributed to missing or erroneous information in SETS. Because of the constraints of the SETS

system, staff were using local tools for spreadsheet analysis to ensure that missing or misleading information was researched and pertinent data annotated accordingly, so that the local hiring and personnel officials could address questions regarding missing or erroneous information.

Because of the data integrity issues with respect to certain information in the SETS database, IRS's national office cannot effectively monitor servicewide compliance with its employee fingerprinting requirement. This increases the risk that employees without fingerprint results may have unsuitable backgrounds to handle cash, checks, and sensitive taxpayer information, thus increasing the risk of potential theft and for misuse of proprietary taxpayer information.

Recommendation

We recommend that you direct IRS management to work with the NFC to resolve the technical limitations that exist within the SETS database and continue to periodically review SETS data to detect and correct errors.

IRS's Comments and Our Evaluation

In commenting on this section, IRS stated that it will work through the Department of the Treasury in establishing a dialogue with NFC to address SETS issues. IRS also stated that it had recently trained its personnel on analyzing SETS data to ensure its accuracy and compliance with IRS's fingerprint policies. We will evaluate the effectiveness of IRS's efforts during our fiscal year 2002 financial audit.

IRS Needs to Ensure Compliance With Manual Refund Procedures

During our fiscal year 2001 audit, we found that IRS staff did not always comply with the agency's procedures designed to reduce the risk of issuance of duplicate refunds. In our prior audits of IRS's financial statements, we identified and reported weaknesses in IRS's controls over manual refunds that resulted in instances in which IRS issued duplicate refunds to taxpayers.⁹ This situation occurred because IRS's (1) automated and manual refund processes are not adequately coordinated to prevent duplicate refunds,¹⁰ (2) manual refunds bypass most of IRS's automated validity

⁹U.S. General Accounting Office, *Internal Revenue Service: Immediate and Long-Term Actions Needed to Improve Financial Management*, [GAO/AIMD-99-16](#) (Washington D.C.: Oct. 30, 1998) and [GAO-01-42](#).

¹⁰IRS issues most refunds through an automated system; however, refunds meeting certain criteria are separated for manual processing, including (1) refunds over \$1 million, (2) refunds below \$1, and (3) refunds based on a taxpayer's request for immediate payment due to hardship.

checks, and (3) manual refunds may not be recorded in the taxpayer's account until 6 weeks after the refund has been issued.

In response to our findings, IRS implemented a series of written procedures to reduce the risk of issuing duplicate refunds. These procedures require employees initiating a manual refund to (1) monitor the taxpayer's master file¹¹ account until the refund is recorded in the account, and (2) document their monitoring actions on case history sheets. The procedures also require that supervisors review the initiator's monitoring actions and document this review. By monitoring the taxpayer's master file account, the employee can detect the recording of subsequent computer-generated or other manual refunds and take action to stop duplicate refunds from being issued. Documenting the monitoring action allows supervisors to verify and ensure that the monitoring is being performed.

In our fiscal year 2001 financial audit, we found that IRS personnel were not always following IRS's manual refund procedures. Specifically, we found that employees initiating manual refunds did not always monitor accounts or document their monitoring actions, and that supervisors did not always review the initiator's monitoring actions. At the two service center campuses we visited, employees and supervisors stated they were unaware of the agency's manual refund requirements. At one of these campuses, local procedures required clerks, rather than the staff initiating the manual refund, to monitor accounts. However, the clerks did not document their monitoring actions, and supervisors did not review these actions. The failure to follow IRS's refund monitoring procedures increases the risk that a duplicate refund will be issued.

Recommendation

We recommend that you direct IRS management to issue a formal reminder of existing IRS manual refund procedures to supervisors and staff.

IRS's Comments and Our Evaluation

In its comments, IRS noted that it sent a communication to all service center campuses and field offices requiring that the appropriate IRS division monitor all manual refunds to ensure that no duplicate refunds are issued and to ensure that manual refunds are recorded in the taxpayer's account. IRS stated that this communication also required management to document their review. We will evaluate the effectiveness of IRS's efforts during our fiscal year 2002 financial audit.

¹¹The master file is a detailed database containing taxpayer information.

IRS Needs Procedures to Track Status of Lien Releases

In previous audits and again during our fiscal year 2001 audit, we found that IRS did not comply with certain provisions of the Internal Revenue Code (IRC) regarding the timely release of federal tax liens. However, because IRS lacks procedures to adequately track the lien release process, neither we nor IRS were able to determine the full extent of the problem. The failure to promptly release tax liens could cause undue hardship and burden to taxpayers who are attempting to sell property or apply for commercial credit.

The IRC grants IRS the power to file a lien against the property of any taxpayer who neglects or refuses to pay all assessed federal taxes. The lien becomes effective when it is filed with a designated office, such as a courthouse in the county where the taxpayer's property is located. The lien serves to protect the interest of the federal government and serves as a public notice to current and potential creditors of the government's interest in the taxpayer's property. For example, federal tax liens are disclosed in credit reports of individuals. Under Section 6325 of the IRC, IRS is required to release a federal tax lien within 30 days after the date the tax liability is satisfied or has become legally unenforceable or the Secretary of the Treasury has accepted a bond for the assessed tax.

In our fiscal year 2001 financial audit, we tested a statistical sample of 59 tax cases with liens in which the taxpayers' total outstanding tax liabilities were either paid off or abated during fiscal year 2001. We found 5 instances in which IRS's Automated Lien System (ALS)¹² clearly indicated that IRS had not released the applicable federal tax lien within the statutory requirement. Based on these 5 cases, we estimated that 8 percent of all liens were not released timely.¹³ However, we also identified 9 additional cases where the liens may not have been effectively released within the required period. In these cases, the time between the date on the IRS lien release certificate and the date when the jurisdiction handling the lien stamped the form as received exceeded 30 days, in some instances substantially. For 5 of these 9 cases, the period between the date on IRS's lien release certificate document and the date of

¹²IRS uses ALS to issue and release federal tax liens. ALS is updated for new liens and tax accounts by revenue officers at IRS's field offices. ALS generates a certificate of release of lien automatically for liens that expire after a set period of time or when the statutory collection period for an account expires. For accounts that are fully paid or otherwise satisfied, ALS generates the certificate of release of lien only after it receives the "fully paid" status of the account through a weekly interface with the master file. The certificate of release of lien is sent to the county courthouse where the lien was originally filed for formal release of the lien.

¹³We are 95 percent confident that the confidence interval around this estimate ranges from 3 to 19 percent.

the receipt by the local jurisdiction exceeded 90 days. In 1 of these, the lien release was not recorded by the local jurisdiction until 9 months after the date on the lien release certificate.

Currently, the only information IRS has to determine whether a lien was released timely is the date on the certificate of release of lien. However, this is the date on which ALS generates the document and does not necessarily represent the date when the authorizing IRS official signed it or when IRS mailed it to the local jurisdiction. IRS procedures currently do not require employees to track the status of lien releases up to the point of delivery to the local jurisdiction. As a result, both we and IRS were unable to determine whether delays took place at IRS, the local jurisdiction, or a combination of the two, and thus devise a strategy to address these delays. However, since the lien is not legally released until recorded by the local jurisdiction, these delays could cause undue hardship and burden on taxpayers who want to sell property or apply for commercial credit.

Recommendation

We recommend that you direct IRS management to establish procedures to track the release of liens up to the point of delivery to the local jurisdiction to ensure liens are released timely to avoid unduly burdening taxpayers once they have satisfied their tax liability.

IRS's Comments and Our Evaluation

In commenting on this section, IRS agreed that the failure to timely release liens could cause undue hardship and additional burden on taxpayers, and that existing procedures should be strengthened to include monitoring the mailing of certificates of release. While IRS noted that the timely release of liens also depends upon the United States Postal Service delivering the release to the recording jurisdictions within established timeframes and the jurisdiction recording the certificates of release promptly after receipt, IRS accepted responsibility for generating certificates of release and transmitting them to the appropriate recording official. To ensure it accomplishes these actions within established timeframes, IRS stated that it is formulating procedures requiring a date stamp (mailing date) on the billing voucher, which lists each lien release IRS sends to the recording official. IRS stated it would also reemphasize to staff the importance of timely accomplishing all other lien processing steps. We will evaluate the effectiveness of IRS's efforts during our fiscal year 2002 financial audit.

IRS Needs to Improve Procedures for Recording P&E Acquisitions On Inventory Records

During our fiscal year 2001 audit, we continued to find issues with IRS's procedures for recording assets on its inventory records that inhibit IRS's ability to properly

account for and manage its assets. Specifically, we found that the P&E inventory did not always contain valid records. In addition, we found that assets were not always recorded promptly upon receipt. Accurate records are essential for maintaining control over P&E to ensure that assets are properly accounted for and safeguarded.

While we noted progress in IRS's efforts to promptly and accurately record P&E on its inventory records in fiscal year 2001, we nonetheless continued to find errors in IRS's property records, the most significant of which were discussed in our recently issued report on the results of our fiscal year 2001 audit.¹⁴ In addition to the issues discussed in that report, we also found that 12 of 210 (6 percent) randomly selected assets from the floor at 21 IRS facilities were not recorded on IRS's inventory records.¹⁵ Of the 21 buildings sampled, 7 (33 percent) had at least 1 asset in our sample of 10 items that was not recorded on the inventory records. Items not recorded included a vehicle, a laptop computer, a microcomputer, and printers. While we were unable to determine the exact reason these specific assets were not recorded, IRS personnel at 4 other sites we visited stated that procedures for recording P&E acquisitions did not function adequately to ensure that assets were promptly recorded on inventory records.

IRS's procedures for recording P&E acquisitions provide that the IRS National Office create "due-in" or skeletal property records in its property management system based on information extracted from IRS's procurement systems. The objective is to build an inventory template record with key information that Single Point Inventory Function (SPIF) personnel in the field offices can update upon receipt of the assets.

Based on our work, we found that improvements are needed to fully achieve this objective. SPIF personnel at four sites where we conducted testing noted that the National Office did not always create skeletal inventory records prior to the receipt of assets. If a skeletal record was not available upon the receipt of an asset, recording the asset on the inventory records was delayed because procedures do not allow SPIF units to create an inventory record. Before an asset could be added to the inventory records, it was necessary for the SPIF unit to research IRS's procurement system to identify requisition information and provide the information to the National Office with a request to create a skeletal asset record. As a result, delays occurred in recording some assets, and some assets were not recorded until they were discovered by IRS personnel during an annual inventory.

¹⁴GAO-02-414. As explained in this report, in a book-to-floor sample, we were unable to locate 25 of 210 recorded assets and concluded that IRS's P&E records were not adequate to maintain accountability over its property.

¹⁵For our floor-to-book sample, we obtained a representative selection of P&E items with a two-stage cluster sample. In the first stage, we selected a representative sample of 21 buildings. In the second stage, we selected a sample of 10 assets located at each of the 21 buildings and traced them to the inventory records.

For example, at one site, 178 computers received on September 10, 2001, were not recorded on the inventory records until October 1, 2001, because a skeletal record was not available when the assets were delivered. SPIF units at the sites we visited discovered hundreds of unrecorded items, such as microcomputers and monitors, during the fiscal year 2001 inventory. Not only were skeletal records not available when assets were delivered, but skeletal records were also initiated but not completed, resulting in invalid records. During our fiscal year 2001 audit, we found 461 invalid property records on IRS's inventory system because a skeletal record had been created but not completed. This reduces the reliability of the information maintained in the inventory system and impedes IRS management's ability to control and account for federal property.

Recommendations

We recommend that you direct IRS management to

- ensure that complete skeletal records are created and available for the SPIF units to update upon receipt of P&E, and
- develop procedures and edit checks to reduce the likelihood of invalid property records.

IRS's Comments and Our Evaluation

In its comments, IRS stated that it agreed with our recommendations and is taking actions to address this issue. IRS stated that it is developing a system and procedures to create skeletal records and to ensure timely updates to inventory records. We will evaluate the effectiveness of IRS's efforts during our fiscal year 2002 financial audit.

IRS Needs to Improve Its Process for Linking P&E Acquisitions to Property Records

During our fiscal year 2001 audit, we found that asset acquisition transactions recorded on accounting records could not always be linked to assets recorded on the property records. The ability to link costs recorded on the accounting records to property records is essential to verify the existence of assets purchased.

IRS's property management system does not capture the acquisition cost of P&E. As a result, the property management system does not provide either the detailed subsidiary records to support the general ledger control balances or the detailed information needed for financial reporting. To compensate for this deficiency, IRS extracts the acquisition costs of P&E from expense records at fiscal year end and accumulates the costs into pools of similar assets. Costs accumulated into asset pools are to be linked to assets recorded on the property records through IRS's procurement systems using procurement award numbers and requisition numbers.

However, we found that costs recorded in the accounting records could not always be linked to items recorded on the property records because the procurement award numbers and requisition numbers recorded on the property records were invalid or incomplete.

Although IRS was eventually able to link a majority of the P&E acquisitions we selected for testing during our fiscal year 2001 audit, this process took 6 weeks to complete. Additionally, IRS was unable to link a number of the P&E acquisition items to the property records. Specifically, IRS was unable to link 4 of 17 P&E acquisition transactions we tested to the property records and could only partially link the assets purchased in 3 other transactions. For example, IRS was able to link 90 of 180 computers purchased in 1 transaction to the property records.¹⁶ Consequently, the existence of all property acquired and recorded on the accounting records during fiscal year 2001 could not be verified.

Recommendation

We recommend that you direct IRS management to develop procedures to ensure that procurement award and requisition numbers recorded on property records are complete, accurate, and linked to the accounting records.

IRS's Comments and Our Evaluation

In commenting on this section, IRS stated that it agreed with our recommendation. IRS noted that it is developing procedures and systems to capture more detailed information on property records and that this process will require vendors to include requisition and procurement numbers of equipment purchases at the time of shipment. IRS also noted that the full integration of inventory procurement and accounting would occur with the implementation of its Integrated Financial System. We will evaluate the effectiveness of IRS's efforts during our fiscal year 2002 financial audit.

IRS Needs Records to Adequately Account for and Manage Software

During our fiscal year 2001 audit, we found that IRS's property management system did not capture information, such as the licensor, contract period, and number of authorized users essential to ensure that software and software licenses are controlled and utilized in accordance with software license contracts. The Joint Financial Management Improvement Program (JFMIP) Property Management Systems Requirements state that property management systems should capture information essential to ensuring that software and software licenses are controlled

¹⁶In some cases, sample transactions, which are disbursement amounts, were payments for multiple P&E items. For example, one sample transaction totaling \$466,020 was a disbursement for purchase of 180 computers with keyboards, mice, and monitors.

and in compliance with contractual licenses and agreements with software developers, vendors, or software licensors.

IRS's property management system did not provide an inventory of the number of software licenses or the number of software installations. To properly account for compliance with software license agreements, IRS must determine if the number of installations exceeds the number of licenses. IRS is in the process of identifying the number of software licenses to record in its property management system. However, as of the end of our audit, IRS had not yet recorded software licenses in its property management system nor had it developed an approach to assess if the number of installations are in compliance with the terms of these software licenses.

Recommendations

We recommend that you direct IRS management to

- record software licenses in IRS's property management system, and
- develop an approach to assess IRS's compliance with the terms of these software licenses.

IRS's Comments and Our Evaluation

In its comments, IRS stated that it agreed with our recommendations. IRS stated that it is executing an action plan that will allow it to record existing software data into its property management database and establish a process that will inform the Asset Management office of new licenses purchased so they can be recorded within established timeframes. IRS stated that it is also developing an action plan that will set procedures and policies for the review and compliance to the terms of the licenses. We will evaluate the effectiveness of IRS's efforts during our fiscal year 2002 financial audit.

IRS Needs to Review and Properly Adjust Receivables in Its Accounting Records

During our fiscal year 2001 audit, we continued to find control weaknesses over IRS's accounting for reimbursable activities, which resulted in IRS overstating its receivables for reimbursable activities. During fiscal year 2000, we reported that the records IRS maintained regarding reimbursable receivables were not reliable.¹⁷ We recommended IRS routinely review and age open reimbursable receivables to identify accounts that are no longer valid or collectible. During fiscal year 2001, we did find that IRS began aging accounts for the purpose of writing off older transactions and that IRS revised loss percentages that it applied to receivable accounts to determine

¹⁷U.S. General Accounting Office, *Management Letter: Improvements Needed in IRS' Accounting Procedures and Internal Controls*, [GAO-01-880R](#) (Washington D.C.: July 30, 2001).

the net realizable value of these receivables. However, we found that IRS was still reporting reimbursable receivable amounts that were not valid receivables or that should have been written off as uncollectible.

GAO's Standards for Internal Control in the Federal Government states that internal controls should generally be designed to assure that ongoing monitoring occurs in the course of normal operations. This includes regular management and supervisory activities, comparisons, reconciliations, and other actions people take in performing their duties. Monitoring of receivables would include assessing receivables to determine both the accuracy of the recorded balance and the potential to collect the balance.

We tested a nonrepresentative selection of the five largest reimbursable receivables at the end of fiscal year 2001 and found exceptions involving two of the accounts. Specifically, we found that one of these accounts was not a valid receivable at fiscal year end, and the other receivable was not collectible and should therefore have been written off.

In the first instance, IRS improperly reported as receivables \$711,000 of fees charged to taxpayers for photocopying tax documents. IRS staff at service center campuses had collected these fees when services were provided and had recorded the collections in the IRS custodial accounting general ledger. IRS's general ledger system comprises both an independent administrative and a custodial general ledger that are not integrated with each other nor with their supporting records for material balances. Service center campus staff reported the revenue of the photocopy fees from the custodial general ledger to the administrative accounting staff prior to the closing of the accounting records at fiscal year end. However, the actual transfer of funds from the custodial system to the administrative accounting general ledger did not take place until after the end of the fiscal year. When IRS's administrative accounting staff recorded the fees in the administrative general ledger to recognize the revenue in the proper period, they recorded them as uncollected fees as of fiscal year end. As a result, the amount was erroneously included in the financial statements as a receivable.

In the second instance, IRS reported in its fiscal year 2001 financial statements a receivable totaling \$405,000 that represented an outstanding charge that had been disputed by another government agency. IRS had billed and collected \$2.1 million from the agency for services provided by IRS staff. However, the agency disputed \$405,000 of the billed amount and initiated actions to reclaim the disputed amount. Based on actions by the agency, Treasury applied the \$405,000 of charges against the IRS Treasury account and IRS agreed the amount was not collectible. Nonetheless, it was erroneously reported as a fully collectible receivable in IRS's financial statements. IRS noted that the methodology it uses to recognize uncollectible amounts resulted in the actual overstatement of receivables at fiscal year end being \$243,000.

Recommendation

In addition to fully implementing our previous recommendations regarding more effective review of reimbursable receivables,¹⁸ we recommend that you direct IRS management to ensure that, in the absence of an integrated general ledger system for IRS's custodial and administrative activities, IRS strengthen monitoring and analysis of receivables to ensure that receivables are not being erroneously recorded as a result of the lack of integration between these two activities.

IRS's Comments and Our Evaluation

In its comments, IRS stated that it agreed with our recommendation and that it is taking steps to better manage reimbursable activity. IRS noted for example, that it is now reconciling all reimbursable receivable accounts with the appropriate general ledger accounts monthly and is monitoring activities between custodial and administrative accounts as part of this reconciliation process. Additionally, IRS noted that it has implemented a process to routinely review open receivables and take action to write off amounts as appropriate. We will evaluate the effectiveness of IRS's efforts during our fiscal year 2002 financial audit.

IRS Needs to Develop Procedures to Estimate and Accrue Operating Revenue and Expenses

During our fiscal year 2001 financial audit, we noted that IRS continued to record material administrative transactions only at the end of the fiscal year. IRS's imputed costs¹⁹ and other benefit-related expenses are determined by other federal agencies, and IRS is informed of the annual amount only at the end of the fiscal year. In addition, its administrative operations receive exchange revenues from installment agreements and other types of user fees and these amounts are also recorded in the administrative accounts as exchange revenue only at the end of the fiscal year. IRS does not have a methodology for identifying operating activities and estimating reasonable monthly accruals for recognizing costs and exchange revenues for its administrative operations at interim periods. As a result, IRS's financial records for these activities were misstated at interim periods and the significance of these misstatements increases over the course of the fiscal year until IRS records these transactions at the end of the fiscal year.

GAO's *Standards for Internal Control in the Federal Government* requires agencies to implement internal control procedures to ensure ongoing reliability of its financial reporting. The standards also require that transactions be promptly recorded to maintain their relevance and value to management in controlling operations and

¹⁸GAO-01-880R.

¹⁹Imputed costs are IRS costs that have been paid in part or in full by other entities.

making decisions. Additionally, for fiscal year 2002, OMB Bulletin 01-09, *Form and Content of Agency Financial Statements*, requires agencies to report interim financial statements for the 6-month period ending March 31, 2002.

Even though IRS could readily estimate the annual amount of imputed costs and prepare monthly accruals, it did not have procedures for doing this during fiscal year 2001. Specifically, we found that imputed costs on IRS's general ledger were understated by \$406 million until IRS made an adjusting entry after September 30, 2001. In addition, employee benefit payment expenses were understated by \$73 million until IRS made a year-end adjusting entry. Exchange revenues for its administrative operations were also understated at interim periods because these revenues were not being estimated and accrued regularly in the administrative operations financial records when the amounts to accrue were readily available. Exchange revenues totaling over \$108 million were not recognized in the administrative accounting records until the end of the fiscal year. These revenues related primarily to user fees for the processing of installment agreements and reviews of exempt organizations/employer benefit plans.

Had IRS prepared interim financial statements during fiscal year 2001, the effect of these omissions described above would have been interim information that contained material misstatements for net cost and exchange revenue. Until IRS establishes procedures for estimating and accruing imputed administrative costs and exchange revenues, it will not be able to produce reliable interim financial information.

We have made recommendations to address this weakness in our previous report²⁰ and thus we are not making any new recommendations. However, we wanted to bring to your attention the significance of this matter in light of the fiscal year 2002 requirement under OMB Bulletin 01-09.

IRS's Comments and Our Evaluation

In its comments, IRS agreed that it needs to estimate and accrue operating expenses in a timely manner. IRS stated that it began recording quarterly expense accruals in fiscal year 2002. Additionally, IRS stated that in fiscal year 2002, it began recording actual quarterly user fee revenues in its administrative accounts. We will evaluate the effectiveness of IRS's efforts during our fiscal year 2002 financial audit.

This report contains recommendations to you. The head of a federal agency is required by 31 U.S.C. 720 to submit a written statement on actions taken on these recommendations. You should submit your statement to the Senate Committee on Governmental Affairs and the House Committee on Government Reform within 60 days of the date of this report. A written statement must also be sent to the House

²⁰[GAO-02-35](#).

and Senate Committees on Appropriations with the agency's first request for appropriations made more than 60 days after the date of the report.

This report is intended for use by the management of IRS. We are sending copies to Chairmen and Ranking Minority Members of the Senate Committee on Appropriations; Senate Committee on Finance; Senate Committee on Governmental Affairs; Senate Committee on the Budget; Subcommittee on Treasury and General Government, Senate Committee on Appropriations; Subcommittee on Taxation and IRS Oversight, Senate Committee on Finance; and the Subcommittee on Oversight of Government Management, Restructuring, and the District of Columbia, Senate Committee on Governmental Affairs. We are also sending copies to the Chairmen and Ranking Minority Members of the House Committee on Appropriations; House Committee on Ways and Means; House Committee on Government Reform; House Committee on the Budget; Subcommittee on Treasury, Postal Service, and General Government, House Committee on Appropriations; Subcommittee on Government Efficiency, Financial Management, and Intergovernmental Relations, House Committee on Government Reform; and the Subcommittee on Oversight, House Committee on Ways and Means. In addition, we are sending copies of this report to the Chairman and Vice-Chairman of the Joint Committee on Taxation, the Secretary of the Treasury, the Director of the Office of Management and Budget, the Chairman of the IRS Oversight Board, and other interested parties. Copies will be made available to others upon request. The report is also available on GAO's internet homepage at <http://www.gao.gov>.

We acknowledge and appreciate the cooperation and assistance provided by IRS officials and staff during our audit of IRS's fiscal year 2001 and 2000 financial statements. If you have any questions or need assistance in addressing these matters, please contact Charles Payton, Assistant Director, at (213) 830-1084.

Sincerely yours,

A handwritten signature in cursive script that reads "Steven J. Sebastian".

Steven J. Sebastian
Director
Financial Management and Assurance



DEPUTY COMMISSIONER

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

June 20, 2002

Mr. Steven J. Sebastian
Acting Director
Financial Management and Assurance
U.S. General Accounting Office
441 G Street, NW
Washington, DC 20548

Dear Mr. Sebastian:

I am responding to your draft of the FY 2001 management letter entitled, *Management Letter: Improvements Needed in IRS's Accounting Procedures and Internal Controls*.

I agree we need to continue to improve accounting procedures and internal controls. In fact, management has already begun addressing several of the areas your recommendations cover. However, I disagree, in part, with some of the issues you raised. The following are our specific comments on each recommendation.

Recommendation: We recommend that you direct IRS management to develop and implement policies and procedures to require that field office employees provide taxpayer receipts for all walk-in payments; field offices post signs in the most visible locations to remind taxpayers to obtain receipts for payments; two employees be present when payments are collected and logged from drop boxes; IRS and lockbox employees performing final candling record receipts in a control log at the time of discovery, recording at a minimum the total number of payments found, the amount of each payment, and the taxpayer who submitted the payment; and IRS and lockbox managers or designated officials reconcile logs of payments found during final candling to the related receipts and documents.

We also recommend that you direct IRS headquarters management to ensure that field office management comply with existing receipt control policies that require a segregation of duties between employees who prepare control logs for walk-in payments and employees who reconcile the control logs to the actual payments.

Comments: We have taken the following corrective actions to address this finding:

- 1) Revised Document 10161 to indicate a receipt is available upon request and posted signs in all Taxpayer Assistance Centers (TAC) or field offices notifying taxpayers that they can request a receipt
- 2) Distributed to TAC sites or field offices a procedural memo outlining separation of duties to emphasize the need to have more than one employee process drop box payments

- 3) Established a task force to develop procedures to reconcile payment logs. We expect to issue procedures to TAC or field offices by October 1, 2002. SB/SE will work with W&I to ensure we include these changes in Lockbox Processing Guidelines for January 2003. This will also be an agenda item for discussion at the 2002 Lockbox Conference in August 2002.

Recommendation: We recommend that you direct IRS headquarters management to clarify that the intent of the requirement for background investigations is meant to apply to personnel being entrusted with taxpayer receipts and information rather than just personnel being granted access to an IRS facility.

Comments: We disagree with GAO's finding that IRS service centers did not verify that couriers transporting bank deposits were insured. The IRS has always required courier service employees to be licensed, insured, or bonded. However, we agree that courier service employees should undergo background checks. We are working with FMS to modify courier service contracts. For example, we will amend IRM 3.8.45, Campuses Deposit Activity, courier service minimum requirements (effective August 1, 2002) to include the following language:

A. Courier Service

Shall ensure that courier service employees designated to transport Internal Revenue Service deposits and/or requiring access to Internal Revenue sites satisfy the requirements for a Basic Investigation, which includes a FBI Fingerprint and Name check, as defined in IRM 1.23.2.2.8.1.1.

Recommendation: We recommend that you direct IRS management to work with the National Finance Center (NFC) to resolve the technical limitations that exist within the SETS database and continue to periodically review SETS data to detect and correct errors.

Comments: All NFC contact is facilitated through the Office of Human Resource Enterprise Systems (OHRES), Department of the Treasury. We will prepare a letter for the Chief, Agency-Wide Shared Services' signature addressed to the Director, OHRES requesting assistance to establish a dialogue with NFC to address SETS issues. The goal of this action is to make SETS a better tool for tracking fingerprints and background investigations. We will submit the letter to Treasury by June 28, 2002.

Personnel offices must review SETS data monthly and ensure its accuracy and compliance with IRS' fingerprint policies. We concluded three days of personnel training on June 6, 2002, that focused on managing the fingerprint and background investigation program and devoted a module to analyzing SETS data. All 23 personnel offices were represented, with approximately 40 individuals in attendance.

Recommendation: We recommend that you direct IRS management to issue a formal reminder of existing IRS manual refund procedures to supervisors and staff.

See comment 1.

Comments: We issued an Information Alert on December 6, 2001, with the following procedures:

W&I or SB/SE (depending on the taxpayer) will monitor all manual refunds to ensure we issue no duplicate refunds and post the manual refund, and will document the monitoring actions. Management will review and document their review to ensure monitoring for duplicate refunds is ongoing until the manual refund posts to the applicable account.

Recommendation: We recommend that you direct IRS management to establish procedures to track the release of liens up to the point of delivery to the local jurisdiction to ensure liens are released timely to avoid unduly burdening the taxpayer once they have satisfied their tax liability.

Comments: We agree that failure to timely release liens can cause undue hardship and additional burden on taxpayers. We also agree procedures should include monitoring the mailing of certificates of release after the Automated Lien System (ALS) generates the certificate.

Our ALS units normally print and mail certificates of release. Some locations are able to electronically transmit liens and releases to the recording official, a process that works efficiently and with little delay. In those locations requiring manual processing of paper documents, we have determined that our offices mail certificates of release at least weekly. Some offices mail these certificates daily. We not only depend on our own procedures for mailing but we also depend upon the United States Postal Service (USPS) to deliver the release to the recording jurisdictions within established timeframes. We also depend on the recording jurisdiction to record certificates of release promptly after receipt.

We accept full responsibility for generating certificates of release and transmitting them to the appropriate recording official, by mail or electronic transfer, within the timeframes established by law. To further ensure we accomplish these actions within established timeframes, including document mailing, we are formulating procedures requiring a date stamp (mailing date) on the billing voucher. This document lists each release we send to the recording official. When we issue these procedures to the field, we will re-emphasize the need to timely accomplish all other processing steps.

We believe these procedures will further reduce taxpayer burden. Those processes outside the IRS' control (USPS and recording jurisdictions) continue to add risk and contribute to additional taxpayer burden.

Recommendation: We recommend that you direct IRS management to ensure that complete skeletal records are created and available for the SPIF units to update upon receipt of P&E, and develop and implement procedures and edit checks to reduce the likelihood of invalid property records.

Comments: We agree with this recommendation and are developing requirements to implement an Electronic Packing Slip to address it. We will require vendors to forward, in an electronic format, specific information pertaining to equipment purchases at the time of shipment. We will use this information to build the skeletal records prior to the equipment arriving on site. In conjunction with this effort, we are developing policies and procedures to track these skeleton records and follow up with appropriate sites after a determined length of time to ensure timeliness of record updates. We will include these procedures in the IRM. In addition, we are currently reviewing the database for data anomalies and following up with appropriate areas for corrections. This also triggers process and procedural improvements to prevent future anomalies. We are also expanding our use of Network monitoring tools to track asset activity and are refining transactional business rules to enhance and tighten data validation prior to its entry into the database. Shortly, we will have the capability to implement mass updates of asset transactions.

Recommendation: We recommend that you direct IRS management to develop and implement procedures to ensure that procurement award and requisition numbers recorded on property records are complete, accurate, and linked to the accounting records.

Comments: We agree with this recommendation. The Electronic Packing Slip mentioned above will also require vendors to include requisition and procurement numbers of equipment purchases at the time of shipment. We will use this information to build the skeletal records prior to the equipment arriving on site. Full integration of inventory procurement and accounting will occur with the implementation of the Integrated Financial System.

Recommendation: We recommend that you direct IRS management to record software licenses in IRS' property management system, and develop an approach to assess IRS's compliance with the terms of these software licenses.

Comments: We agree with this recommendation. We are executing an action plan that will allow us to populate the existing software data into the Information Technology and Asset Management Systems (ITAMS) database. Included in this action plan is the repeatable process that will inform the Asset Management office of new licenses as we purchase them so we can include them in the database within established timeframes. We are also developing an action plan that will set procedures and policies for the review and compliance to the terms of the licenses.

Recommendation: In addition to fully implementing our previous recommendations regarding more effective review of reimbursable receivables, we recommend that you direct IRS management to ensure that, in the absence of an integrated general ledger system for IRS's custodial and administrative activities, IRS strengthen monitoring and analysis of receivables to ensure that receivables are not being erroneously recorded as a result of the lack of integration between these two activities.

Comments: We agree with your recommendation and have taken steps to better manage reimbursable activity. We are reconciling all reimbursable receivable accounts with the appropriate general ledger accounts monthly. We are monitoring activities between custodial and administrative accounts as part of this reconciliation process. This reconciliation process will ensure that we do not reflect intra-agency transfers as receivables from an outside party. We now have a process in place to routinely review open receivables and take action to write off amounts as appropriate. We are also developing and testing new AFS transactions to properly record activity affecting prior year accounts, which was the cause of the overstatement of the two specific reimbursable receivables identified in your FY 2001 audit.

Recommendation: GAO did not cite a specific new recommendation relative to IRS's need to develop procedures to estimate and accrue operating revenue and expenses. However, they did note that they have made recommendations on this topic in the past and the importance of addressing this issue in light of the need to prepare interim financial reports.

Comments: We agree we must estimate and accrue operating expenses in a timely manner. The ultimate goal is to accrue monthly during the year. We began recording quarterly accruals for actuarial FECA (worker's compensation), accrued annual leave, and imputed interest costs in FY 2002 and plan to do so monthly in the near future. We disagree that we should estimate revenue from user fees and record it on a pro forma basis during the year. In FY 2002, we began recording actual revenues from user fees in our administrative accounts quarterly.

I appreciate your input and will continue to take the necessary steps to improve our financial management. With the continued dedication and cooperation of both our staffs, we will further enhance accounting procedures and internal controls.

Sincerely,



Bob Wenzel

Enclosure I

The following is GAO's comment on the Internal Revenue Service's letter dated June 20, 2002.

GAO Comment

1. We have deleted material on this topic from our report.

GAO Contacts and Staff Acknowledgments

GAO Contacts

Ted Hu, (213) 830-1108

David Elder, (213) 830-1112

Acknowledgments

Staff making key contributions to this report were: Beverly Burke, Gloria Cano, William Cordrey, John Davis, Charles R. Fox, Meafelia Gusukuma, Eric D. Johns, George Jones, Delores Lee, Angel Sharma, and Leonard Zapata.