IRS FINANCIAL MANAGEMENT: HAS THERE BEEN ANY IMPROVEMENT?

HEARING

BEFORE THE

SUBCOMMITTEE ON GOVERNMENT MANAGEMENT, INFORMATION, AND TECHNOLOGY

OF THE

COMMITTEE ON GOVERNMENT REFORM AND OVERSIGHT HOUSE OF REPRESENTATIVES

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IRS FINANCIAL MANAGEMENT: HAS THERE BEEN ANY IMPROVEMENT?

THURSDAY, SEPTEMBER 19, 1996

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON GOVERNMENT MANAGEMENT,
INFORMATION, AND TECHNOLOGY,
COMMITTEE ON GOVERNMENT REFORM AND OVERSIGHT,
Washington, DC.

The subcommittee met, pursuant to notice, at 10:35 a.m., in room 210, Cannon House Office Building, Hon. Stephen Horn (chairman of the subcommittee) presiding.

Present: Representatives Horn, Maloney, and Davis.

Staff present: J. Russell George, staff director; Anna Miller, professional staff member; Erik Anderson, clerk; and Liza Mientus, Matt Pinkus, and Mark Stephenson, minority professional staff members.

Mr. HORN. The Subcommittee on Government Management, Information, and Technology will come to order. This morning we are holding an oversight hearing to assess the Internal Revenue Service's ability to improve its financial management systems so that it can receive an unqualified opinion from its auditors on its financial statements.

On November 14, 1995, this subcommittee held a hearing on financial management systems. At that session the subcommittee received testimony from the Office of Federal Financial Management and Office of Management and Budget, who told of a question asked of the Chief Financial Officer of the Internal Revenue Service. "Why are these IRS financial statements so terrible?" was the question, the response to which was, "Because they were never designed to be audited."

This colloquy gave rise to a column by the humorist Dave Barry in which he talked about not paying his taxes this year because his tax return was never designed to be audited. If the agency that impacts the lives of most Americans cannot get its financial house in order, it diminishes both its credibility and tax-paying citizens' voluntary compliance with the tax laws.

This state of affairs is intolerable in an agency that expects every American family to justify its own financial status. And as was noted by my colleagues, Mr. Traficant and Mr. Hefley, on the floor this morning, the burden of proof is on the citizen when it comes with the IRS, not on IRS. That is certainly one thing that needs to be changed.

The hearing this morning is a followup to the subcommittee's March 6th hearing on the Internal Revenue Service's inability to

produce reliable financial information in its financial statements. To put it simply, the problem is that the Internal Revenue Service reports amounts for revenues, tax refunds, other categories of financial information on its financial statements.

However, these amounts do not stand up to independent verification. When auditors review the IRS statements and look at the underlying records, their testing and recalculations of amounts result in totals that are not the same as the totals that the IRS is claiming as correct.

Auditors refer to this as being unable to give an opinion on the financial statements. Auditors have been unable to express an opinion on the reliability of the IRS financial statements for any of the four fiscal years from 1992 through 1995.

The auditors found five significant problems that remain uncorrected and until they are corrected, will prevent them from giving an opinion on the IRS financial statements in the future.

First, the amount of total revenue of $1.4 trillion, which the IRS reports for fiscal year 1995, and the amount of tax refunds, which the IRS reports as $122 billion for fiscal year 1995, cannot be verified.

Second, the amounts—reports for various types of taxes collected, Social Security, income, and excise taxes, for example—cannot be substantiated. The amounts reported by employers are transferred from the Treasury general fund whether or not those amounts have actually been collected so the trust funds are not adversely affected, but transferring moneys from the general fund to make up deficiencies means that other obligations of the Government are not being properly met.

Third, the reliability of reported estimates for fiscal year 1995 of $113 billion for valid accounts receivable and of $46 billion for collectible accounts receivable cannot be determined.

Fourth, much of the $3 billion the IRS reports in non-payroll expenses cannot be verified. Sometimes the IRS produces records from the wrong year when it is asked by the auditors to produce supporting documentation. Can you imagine what the IRS would say to you or me or anybody during an audit if you tried that?

Fifth, the amounts the IRS reported as appropriations available for expenditure for operations cannot be reconciled with Treasury records. The Internal Revenue Service has never successfully reconciled hundreds of millions of dollars in differences. When an auditor is doing an audit and notices differences of this magnitude never being reconciled, it is often an indication that there may be fraud going on. The IRS assures us that this is not the case.

But how they can be sure that there is no fraud if they cannot reconcile these amounts? If not fraud, then perhaps these differences mask expenditures for purposes other than the stated purpose of the appropriations. What does the fact that the IRS asks us to accept at face value amounts that cannot be verified mean in the whole scheme of things? It has repercussions beyond the Service itself.

The Government Management Reform Act requires that, starting this year, and annually thereafter, the executive branch departments must produce financial statements, have them audited, get a clean opinion, and that is a verification that they have been accu-

rately reported, their financial position, and the results of their activities.

The following year, fiscal 1997, an audited governmentwide financial statement is required. The IRS financial information is a very important part of the Department of the Treasury's financial statement and of the governmentwide financial statement. The revenue component, which the auditors cannot verify as correct, represents 90 percent of the total available to the Government.

There is much at stake here if we are to have reliable information about the money we have available to fulfill our obligations to the American people. In reports issued since fiscal year 1992 the General Accounting Office has issued 59 recommendations that, if acted on, would improve the recordkeeping and information systems of the IRS.

Today, we will hear how the IRS is planning to act on these recommendations and when they will be fully implemented. Today, we will review the IRS plans for improvement in developing accurate financial information and adequate internal controls that will ensure that errors are either prevented or detected quickly.

We will also assess the ability of the Internal Revenue Service's information system to produce reliable information. This includes the weaknesses in internal control policies and procedures, such as the failure to reconcile fund balances that have increased the risk of fraud and diminished the reliability of the information provided to Congress and to others.

Today's hearing includes several witnesses commenting on the IRS' financial management problems. Appearing today are Gene L. Dodaro, Assistant Comptroller General, Accounting and Information Management Division, General Accounting Office, Steven O. App, Deputy Chief Financial Officer, Department of the Treasury, and Anthony Musick, Chief Financial Officer of the Internal Revenue Service. We thank you all for joining us; we look forward to your testimony.

[The prepared statement of Hon. Stephen Horn follows:]

Opening Statement
Stephen Horn
"Internal Revenue Services Financial Management: Has There Been Any Improvement?"
September 19, 1996

A quorum being present, the Subcommittee on Government Management, Information and Technology will come to order. This morning we are holding an oversight hearing to assess the Internal Revenue Service's ability to improve its financial management systems so that it can receive an unqualified opinion from its auditors on its financial statements.

On November 14, 1995, this Subcommittee held a hearing on financial management systems. At that session, the Subcommittee received testimony from a witness, the Controller, Office of Federal Financial Management, Office of Management and Budget, who told of a question asked of the Chief Financial Officer of the Internal Revenue Service: 'Why are these IRS financial statements so terrible?' The response to which was 'Because they were never designed to be audited.' This colloquy gave rise to a column by the humorist Dave

Barry in which he talked about not paying his taxes this year because his tax return was never designed to be audited.

If the agency that impacts the lives of most Americans cannot get its financial house in order, it diminishes both its credibility and the taxpaying citizens' voluntary compliance with tax laws. This state of affairs is intolerable in an agency that expects every American family to justify its own financial status.

The hearing this morning is a follow-up to the Subcommittee's March 6th hearing on the Internal Revenue Service's inability to produce reliable financial information in its financial statements. To put it simply, the problem is that the Internal Revenue Service reports amounts for revenues, tax refunds, and other categories of financial information on its financial statements; however, these amounts do not stand up to independent verification. When auditors review the IRS statements and look at the underlying records, their testing and recalculations of amounts results in totals that are not the same as the totals that the IRS is claiming as correct.

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Third, the reliability of reported estimates for fiscal year 1995 of $113 billion for valid accounts receivable and of $46 billion for collectible accounts receivable cannot be determined.

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Fifth, the amounts the IRS reported as appropriations available for expenditure for operations cannot be reconciled with Treasury records. The IRS has never successfully reconciled hundreds of millions of dollars in differences. When an auditor is doing an audit and notices differences of this magnitude never being reconciled, it is often an indication that there may be fraud going on. The IRS assures us that that is not the case, but how can they be sure that there is no fraud if they cannot reconcile these amounts? If not, fraud, then perhaps these

differences mask expenditures for purposes other than the stated purpose of the appropriations?

What does the fact that the IRS asks us to accept at face value amounts that cannot be verified mean in the whole scheme of things? It has repercussions beyond the service itself. The Government Management Reform Act requires that, starting this year and annually thereafter, Executive Branch departments must produce financial statements, have them audited, and get a clean opinion, that is, a verification that they have accurately reported their financial position and the results of their activities. The following year, an audited Government-wide financial statement is required. The IRS's financial information is a very important part of the Department of the Treasury's financial statement and of the Government-wide financial statement.

The revenue component, which the auditors cannot verify as correct, represents 90 percent of the total available to the Government. There is much at stake here if we are to have reliable information about

the money we have available to fulfil our obligations to the American people.

In reports issued since fiscal 1992, the General Accounting Office has issued fifty-nine recommendations that if acted on would improve its record keeping and information systems. Today we will hear how the IRS is planning to act on these recommendations, and when they will be fully implemented.

Today, we will review the IRS' plans for improvement in developing accurate financial information and adequate internal controls that will ensure that errors are either prevented, or detected quickly.

We will also assess the ability of the Internal Revenue Service's information system to produce reliable information. This includes the weaknesses in internal control policies and procedures, such as failure to reconcile fund balances, that have increased the risk of fraud and diminished the reliability of the information provided to Congress and others.

Today's hearing includes several witnesses commenting on the IRS' financial management problems. Appearing today are:

Gene L. Dodaro, Assistant Comptroller General, Accounting and Information Management Division, General Accounting Office.

Steven O. App, Deputy Chief Financial Officer, Department of the Treasury.

Anthony Musick, Chief Financial Officer of the Internal Revenue Service.

We thank you all for joining us and look forward to your testimony.

Subcommittees of the House Government Reform and Oversight Committee swear in all witnesses for hearings. I ask each of you who will be testifying to stand and raise your right hand for the oath.

[Administer Oath]

Mr. HORN. And as you know the tradition, the subcommittees of the House Government Reform and Oversight Committee do swear in all witnesses for hearings, and I would ask each of you who will be testifying to stand and raise your right hands for the oath.

[Witnesses sworn.]

Mr. HORN. All of the five witnesses have affirmed, and the clerk will note that. And as you also know, since you are regulars, our practice is to include your written testimony in the hearing record after each of you is introduced, and we would appreciate having you orally summarize your written statement in 10 minutes or so. We are not going to hold you rigidly to that, we want you to feel you have made the case, and I am not going to be offended if you go over. But on the other hand, we do want to get the show on the road so there can be questioning.

We have a vote under way now. So we are going to recess this committee. Now that you are sworn in, you can tell the truth to each other and we will recess for about 15 minutes and reassemble here, by the time we get over and vote, at roughly 5 minutes of 11.

[Recess.]

Mr. HORN. Let's come to order. The ranking member has arrived and she would like her statement put in the record, and we are delighted to do it.

[The prepared statement of Hon. Carolyn B. Maloney follows:]

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Rep. Carolyn B. Maloney -- Opening Statement

Hearing on Oversight of Internal Revenue Service Financial Management--
Has There Been Any Improvement?

September 19, 1996

Thank you Mr. Chairman for holding this important hearing. I share your concern with the financial management of the federal government. It is a fundamental issue which must be addressed in these times of ever-greater budgetary restraint. The Chief Financial Officer Act of 1990 and the Government Management Reform Act of 1994 will help improve financial management in the federal government and it is important that we continue vigorous oversight to ensure proper and timely implementation.

One of the requirements of the 1990 CFO Act is that the General Accounting Office audit the Principal Financial Statements of the IRS. The report for fiscal year 1995 is very troubling, as was the report for fiscal year 1994 which we examined at an earlier hearing of this subcommittee last March. In fact, in each of the four years of audits of the IRS beginning with fiscal 1992, the GAO has been unable to render an opinion. If this situation is allowed to continue, it calls into question the ability of the executive branch to meet the rapidly approaching requirements for government-wide audits beginning in fiscal 1997.

So there is a sense of déjà vu surrounding today's testimony. Given the short time frame involved since we last examined this problem, I suspect that the answer to the question posed by the Chairman in giving a title to this hearing --"Has there Been Any Improvement?"--is "Not a whole lot.". However, I would point out that even though the problems are serious, they still take time to solve. I understand the IRS has a more vigorous action plan which they will describe for us today.

I look forward to both the GAO's presentation and the IRS/Treasury response. The GAO reports that it was unable to complete its audit for FY 1995 because of multiple shortcomings in the accounting practices at the IRS. Perhaps most worrying is the fact that the total revenue collected, $1.4 trillion, could not be reconciled to the accounts maintained in IRS master file. Also, the amounts of taxes collected for various purposes, such as social security, income and excise taxes, could not be substantiated.

(over)

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The IRS claims to be on the move toward significant improvement on these and many other accounting deficiencies. The subcommittee is eager to learn about this progress..

I am also concerned with problems the GAO has found with the IRS's Accounts Receivable. These represent money owed to the federal government -- namely to the taxpayer -- which have not been collected. I have a long-standing interest in this issue, and have worked with Chairman Horn in successfully enacting legislation on the collection of non-tax delinquencies. That will certainly be a subject for future hearings by this subcommittee.

I look forward to hearing our distinguished witnesses, and I thank the Chairman for his continuing vigilance on these issues.

Mr. HORN. So Mr. Dodaro, please begin. This is the first time I have ever been in this hearing room and I think I need a Hubbell telescope to see you down there. But I will say the podium is terrific, you can spread out, it is the only sensible podium, but this is strange, to be charitable.

So proceed, Gene.

STATEMENT OF GENE L. DODARO, ASSISTANT COMPTROLLER GENERAL, ACCOUNTING AND INFORMATION MANAGEMENT DIVISION, GENERAL ACCOUNTING OFFICE, ACCOMPANIED BY DIANE GUENSBERG AND GREGORY HOLLOWAY, GENERAL ACCOUNTING OFFICE

Mr. DODARO. Good morning, Mr. Chairman. We are pleased to be here today to talk about the progress IRS is making in addressing its financial management problems.

Mr. HORN. Excuse me, I might, for the record, say we now have a quorum. Go ahead.

Mr. DODARO. Good morning, Congresswoman Maloney, it is nice to see you again.

Mrs. MALONEY. Good morning. It is good to see you again.

Mr. DODARO. We are pleased to be here today to give you a status report on IRS' actions to correct its financial management problems.

As you pointed out in your opening statement, we have been auditing the IRS since fiscal year 1992 and I might point out that those audits have covered two different sets of financial statements to account for IRS. One is the administrative operations of the Internal Revenue Service, which are about $8 billion that IRS gets in appropriated funds to carry out its various activities. And then there is another set of financial statements that cover IRS' custodial responsibilities for the Government to collect the $1.3 to $1.4 trillion in revenue on behalf of the Federal Government.

Now, in the administrative statements, those covering the $8 billion that IRS uses to manage its own operations, it is in that area that we have seen the greatest progress so far. When we started back in 1992 there were several different administrative systems, accounting systems, that they had in place. They had problems even with controls over payroll operations.

Since then they have replaced those systems with one administrative accounting system that we think is good and an effort to better account for their funds. They have also worked with the National Finance Center at the Department of Agriculture to transfer their payroll functions there. So as a result, in the last year we were able to substantiate that about $5 billion of their $8 billion in appropriations that go for payroll were valid.

We have two remaining problems on the administrative area that need to be addressed. One is in documenting the receipt and acceptance of goods and services, particularly those services that IRS procures from the Government Printing Office, for example, all the tax forms that are mailed out, as well as rent and other activities that involve transactions among Federal agencies. There are difficulties capturing that accurately.

Second, as you pointed out, reconciling their cash accounts with the Treasury Department. In both of these areas, based on our sug-

gestions and discussions with the IRS, they have brought in some outside contract support to help. We are monitoring their activities closely and I would hope in the next year we can see some progress on those two areas. So I think in the administrative accounting area for IRS' appropriation we are beginning to see some progress in that area.

Now, on the revenue side, I think that is a different story. The revenue responsibilities, collection responsibilities, are enormous. There are deep problems with the accounting systems over there in terms of their capability to keep track of this. But part of the problem is rooted in how tax receipts come into the Treasury Department and IRS in terms of their not being adequately distinguished. About 80 percent of the taxes are collected from businesses and they send in lump sums, which include income tax, Social Security taxes, and they are not really designated by type of tax at the point of collection, and this creates a massive reconciliation problem for the IRS. Now, they should be able to do this but their current systems do not permit that. Also, in the accounts receivable area, as you pointed out, we have had trouble substantiating the balances there. Again, there are not good detailed subsidiary records that distinguish valid accounts receivable from other compliance assessments that IRS has levied on people as a means to try to get them to pay their taxes, so there is no sorting out of what is valid, what is not, and what is collectible.

We have worked with them to come up with a good statistical sampling approach in the short run to take some of these accounts and to accurately assess and come up with a good figure so the Congress and others know how much delinquent taxes there are and, more importantly, how much is really collectible in the long run.

Now, we have worked with the IRS and they have developed some short-term fixes in this revenue accounting area, but the longer term fixes are going to be dependent upon their ability to put in place new and enhanced accounting and information systems, and this is a very important issue.

This is an area we have some concern about the Service's ability in. As we talked to this committee about in March, IRS' ability in their tax system modernization effort to develop systems is not at an adequate level yet. As you recall, I mentioned that they were considered to be a level I organization in terms of their ability to develop software, which was not a level commensurate with the task that they had. We made about a dozen recommendations in that area. They are beginning to put in place the right processes and tools, but it is going to take a while before they are able to move up.

As you recall, level I meant that the system-development efforts were at the very initial level, and that was distinguished by ad hoc and oftentimes chaotic development, which means that some of the systems that they develop work well, many others do not. They need to get to a process where they can produce that on an acceptable basis.

Their ability to develop their tax system modernization capabilities is very much an integral part of their ability to fix their financial management problems as well.

Obviously there is also more at stake here in terms of the CFO requirements unfolding. The Department of the Treasury, for the first time for fiscal year 1996 we will have financial statements that cover the entire Department of Treasury. IRS is such a large part of the Department that the problems at IRS will affect the ability of auditors to render an opinion on Treasury's department-wide statements.

Likewise, we, GAO, as auditors of the consolidated financial statements of the Federal Government, will be—it will be difficult to render an opinion on the governmentwide statements. IRS collects virtually all of the major revenue sources of the Government, most of the receivables—about two-thirds of the reported receivables in the Government come from delinquent taxes—so it has an enormous impact on both the Treasury statements as well as the governmentwide statements.

Now, in order to get remedies for these problems and not as auditors just pointing out these problems, we have been working with the IRS to develop an action plan. I was concerned in the early years that we did not have a good detailed plan to make progress. In the last year, and particularly in the last 6 months, I see where we have made more progress. I think we have a good plan now.

The question is whether IRS can execute that plan. We are monitoring and working with them very carefully. I am encouraged by the fact that finally, I think, IRS understands the depth of their problems and is moving to begin to put in place strategies. I think these hearings that have been held by this committee have been very helpful in that regard and I would encourage the committee to continue to provide oversight in this area.

My colleagues and I would be pleased to answer any questions.

[The prepared statement of Mr. Dodaro follows:]

Mr. Chairman and Members of the Subcommittee:

We are pleased to be here today to discuss IRS' efforts to prepare reliable financial statements, as required by the expanded Chief Financial Officers (CFO) Act of 1990, and to make fundamental financial management improvements. Our recent reports and testimonies, including our March 1996 testimony before the Subcommittee, detailed the substantial problems IRS has in accounting for over $1 trillion in monies collected from American taxpayers and billions of dollars in delinquent taxes owed to the government.[1] Until resolved, these weaknesses will continue to affect the credibility of information used to report the results of IRS' financial operations and measure its performance.

While serious problems have been identified, the CFO requirements have provided the impetus for efforts to improve IRS operations. They have:

-- led to IRS top managers having a much better understanding than ever before of IRS' serious accounting and reporting problems,

-- provided information on the magnitude of IRS' tax receivables collection problems, and

-- identified the need for stronger controls over such areas as payroll operations.

IRS has made some progress in responding to the problems we have identified. Over the past 4 years, we have made 59 recommendations to improve IRS' financial management systems and reporting. IRS agreed with these recommendations and has been working to implement them and correct its financial management systems and information problems. In our assessment this year, we determined that IRS had completed 17 of these recommendations and efforts are underway to address the remaining areas. As part of our audit of IRS' fiscal year 1996 financial statements, we will examine additional actions IRS has taken to complete other recommendations we have made.

However, many difficult problems remain to be corrected before we would be able to express an opinion on IRS' financial statements. With our assistance, IRS is working on a plan of interim strategies to solve these problems, with a goal of having these matters resolved in time for the fiscal year 1996 financial statement audit. For some areas, especially in accounting for revenue, IRS will need to make more sweeping changes to fully

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[1]Our recent reports and testimonies detailing IRS' financial management problems are listed in attachment I.

address systems problems. In these cases, longer-term solutions involving reprogramming software for IRS' antiquated systems and developing new systems will be required.

Follow-through by IRS is essential to ensure that its short- and long-term plans are carried out and effectively solve financial management problems. In the past, IRS has not always provided the follow-through needed to complete necessary corrective measures. Solving these problems is essential to provide reliable financial information and ensure taxpayers that their tax dollars are properly accounted for in accordance with federal accounting standards. The accuracy of IRS' financial statements is also key to both IRS and the Congress for (1) ensuring adequate accountability for IRS programs, (2) assessing the impact of tax policies, and (3) measuring IRS' performance and cost effectiveness in carrying out its numerous tax enforcement, customer service, and collection activities.

Today, we will focus on

-- the status of IRS' efforts to implement our recommendations and develop a detailed plan with explicit, measurable goals and a set timetable for actions to correct its financial management weaknesses;

-- IRS' progress in addressing the major problems that have prevented us from expressing an opinion on its financial statements;

-- the impact that IRS' problems in developing Tax Systems Modernization have on improving financial information; and

-- the significant adverse affect that delays in resolving IRS' financial management weaknesses could have on preparing and auditing Treasury's agencywide financial statements and the financial statements for the entire government.

ADDRESSING SERIOUS FINANCIAL MANAGEMENT PROBLEMS

IRS prepares separate sets of financial statements showing the results of its operations for (1) administrative operations, which include $8 billion in payroll and other expenses, and (2) custodial functions, which reflect $1.4 trillion in tax collections. IRS began preparing these annual statements starting with those for fiscal year 1992 as part of a pilot program under the CFO Act of 1990.

We have been unable to express an opinion on the reliability of these financial statements for any of the 4 fiscal years from 1992 through 1995. We identified fundamental problems with IRS'

administrative and custodial financial statements that are not yet fully corrected. Until resolved, they will continue to prevent us from expressing an opinion on IRS' financial statements in the future. The following sections outline these problems and IRS' improvement plans and progress.

Accounting for Administrative Operations Has Improved but Problems Remain

Each year, IRS spends billions of dollars in operating expenses to (1) process tax returns, provide taxpayer assistance, and manage tax programs, (2) enforce tax laws, and (3) develop and maintain information systems. For fiscal year 1995, IRS reported $8.1 billion in operating costs, including $5.3 billion for payroll and other personnel costs and $2.8 billion for the cost of goods and services, such as rent, printing, and acquiring and maintaining automatic data processing equipment.

Our initial financial audits identified serious problems in accounting for and reporting on IRS administrative operations, which has resulted in IRS making improvement in these areas. For example, IRS has successfully

- implemented a financial management system (which according to Treasury, conforms to the government's standard general ledger) to account for its appropriated funds, which has helped IRS to correct some of its past transaction processing problems that diminished the accuracy and reliability of its cost information, and

- transferred its payroll processing to the Department of Agriculture's National Finance Center and, as a result, improved its accounting for payroll expenses.

These improvements have made IRS' accounting for its administrative operations much better today than it was 4 years ago. For example, we are now able to substantiate IRS' payroll expenses of about $5 billion. However, the following two major problems still need to be fully corrected.

- A significant portion of IRS' reported $3 billion in nonpayroll operating expenses for goods and services could not be verified.

- The amounts IRS reported as appropriations available for expenditure for operations could not be reconciled fully with Treasury's central accounting records showing these amounts, and in the past, hundreds of millions of dollars in gross differences had been identified.

Receipt of Goods and Services We found several problems in attempting to substantiate amounts IRS reported as having been spent for goods and services. IRS did not have support for when and if certain goods or services were received and, in other instances, did not have support for reported expense amounts. For example, IRS accepts Government Printing Office (GPO) bills as being accurate and records an expense in its financial records without first verifying that the printing goods and services being billed were actually delivered and accepted. Also, in instances where IRS could provide information showing proper receipt and acceptance of goods and services, expenses were often recorded in the wrong fiscal year. This problem occurs because (1) IRS offices that receive and accept goods and services do not always forward to IRS accounting offices evidence supporting these actions and (2) IRS accounting offices used inconsistent, and in some cases incorrect, policies and procedures for recording expenses.

Ensuring that goods and services have been received and properly accounted for are fundamental accounting steps and controls. Over the past 4 years, we have recommended that IRS

-- revise its procedures to incorporate the requirements that accurate receipt and acceptance data on invoiced items be obtained prior to payment and that supervisors ensure that these procedures are carried out, and

-- revise its document control procedures to require IRS units that actually receive goods and services to promptly forward receiving reports to accounting offices so that these transactions can be properly accounted for.

IRS believes the core issue for correcting its receipt and acceptance problems relate to properly accounting for transactions with other federal agencies. IRS' plans to address this issue by

-- completely and accurately documenting its current accounting systems and control procedures for procuring, receiving, accepting, and paying for goods and services through other federal agencies, such as GPO and the General Services Administration, and recording the related budgetary, expense, and cash disbursement transactions;

-- identifying and evaluating the reliability of available documentary evidence and systems, which until this point have been developed and utilized primarily to meet operational rather than financial reporting objectives,

-- working with other federal agencies to explore ways to improve the timeliness, nature, and extent of documentation

supporting interagency payments that would allow IRS to properly account for these interagency transactions, and

-- developing both short- and long-term improvements to its accounting systems and control procedures, including modifications to its automated systems to allow for direct interfaces between its operating systems and its general ledger accounting system.

IRS is now beginning to deal with this problem in a comprehensive way. To that end, IRS has engaged an accounting firm to assist it in carrying out this plan. We are closely monitoring IRS' and its contractor's progress because, only through an intense concerted effort, will the proposed solutions be implemented on time for the fiscal year 1996 audit.

Fund Balance Reconciliation Issues Also, we could not verify the accuracy of IRS' Fund Balance with Treasury accounts that are related to IRS' appropriation accounts for its operations. The Fund Balance accounts are used to record cash receipts and cash disbursements for these appropriations. These accounts are much like checking accounts with a bank, and their balances represent the amount of appropriations available to IRS for expenditure. Accordingly, like bank checking accounts, each month, these accounts must be reconciled with the bank's records, and any differences reported to the bank. In this case, the banker is Treasury and the differences are great.

These accounts have been unreconciled in each of the years we have audited IRS' financial statements. The net reconciling differences are made up of gross differences in the hundreds of millions of dollars. For example, we reported last year that IRS was researching $13 million in net differences that consisted of $661 million of increases and $674 million of decreases.

We have recommended that IRS

-- promptly resolve differences between IRS and Treasury records of IRS' cash balances and adjust accounts accordingly, and

-- promptly investigate and record suspense account items to appropriate appropriation accounts.

In fiscal year 1995, IRS hired a contractor to provide information on the differences between IRS and Treasury records through fiscal year 1995 and established a task force to resolve the differences the contractor identified. IRS found that documentation was no longer available to resolve prefiscal year 1993 differences, which resulted in $10 million of net positive cash reconciling differences being written off. IRS has not yet completed the research necessary to resolve fiscal year 1993, 1994, and 1995

differences. Further, additional research is required to resolve differences held in IRS' Suspense Accounts and Budget Clearing Accounts at Treasury.

To this end, IRS has developed plans to

-- complete its posting of adjustments to its appropriation accounts for fiscal year 1995 based on our review of these adjustments, and

-- engage a contractor to assist in completing its reconciliation of balances remaining in its Budget Clearing Accounts and Suspense Accounts.

IRS plans to complete the necessary adjustments to its records and Treasury's records prior to the closing of its books for fiscal year 1996. In addition to completing this research, IRS must ensure that effective processes and procedures are in place to routinely reconcile its Fund Balance with Treasury accounts. In this regard, IRS has created a unit to manage the reconciliation of these accounts on an ongoing basis.

Overall, IRS' success in resolving the basic accounting and control issues involving its administrative operations will be indicative of its commitment and ability to resolve larger and more complex issues involving accounts receivable and revenue accounting.

Accounts Receivable Could Not Be Verified

We could not verify the validity of either the $113 billion of accounts receivable or the $46 billion of collectible accounts receivables that IRS reported on its fiscal year 1995 financial statements. In our audit of IRS' fiscal year 1992 financial statements, after performing a detailed analysis of IRS' receivables as of June 30, 1991, we estimated that only $65 billion of about $105 billion in gross reported receivables that we reviewed was valid for financial reporting purposes and that only $19 billion of the valid receivables was collectible. At the time, IRS had reported that $66 billion of the $105 billion was collectible.

In our audit of IRS' fiscal year 1992 financial statements, we recommended that IRS take steps to ensure the accuracy of the balances reported in its financial statements by, in the long-term,

-- identifying which assessments currently recorded in the masterfile represent valid receivables, and

-- designating new assessments that should be included in the receivables balance as they are recorded.

We recommended also that, until these capabilities are implemented, IRS should rely on statistical sampling to determine what portion of its assessments represent valid receivables.

Subsequently, we helped IRS develop a statistical sampling method that, if properly applied, would allow it to reliably estimate and report valid and collectible accounts receivable on its financial statements. We evaluated and tested IRS' use of the method as part of our succeeding financial audits and found that IRS made errors in carrying out the statistical sampling procedures, which rendered the sampling results unreliable. For the fiscal year 1995 audit, for the first time, IRS tried, also without success, to specifically identify its accounts receivable.

Further, IRS' accounting and reporting for accounts receivable is hampered by the limitations of its financial management system. IRS' system is not designed to specifically identify and separately track from detailed taxpayer records those owing taxes reportable as accounts receivable.

To mitigate this system's limitation in fiscal year 1995, IRS reported accounts receivable by using the uncollected assessment information from its computer system's master files, which were automatically sorted into either compliance assessments or financial receivables. In this way, IRS planned to identify the amount specifically related to financial receivables and report it as valid accounts receivable as of September 30, 1995.

However, when we tested a sample of the automated sorting results, we found cases in which the financial management system's data were incorrect, and thus, did not properly segregate compliance assessments from financial receivables. We identified instances in which compliance assessments were classified as financial receivables, and thus, incorrectly included as accounts receivable; and other cases in which financial receivables were classified as compliance assessments, and thus, improperly excluded from accounts receivable. Based on the testing results, we concluded that the process IRS used in 1995 was unreliable for projecting the total inventory of outstanding assessments. Consequently, the accounts receivable reported on the fiscal year 1995 financial statements could not be relied on.

IRS' plans call for improving accounts receivable reporting in the short term by

-- analyzing, by September 30, 1996, its inventory of uncollected assessments to determine ways to resolve issues

concerning the financial management system's underlying data limitations, and

-- reliably determining, by January 6, 1997, the estimated amount of accounts receivable that is collectible.

Also, IRS needs to review and update current policies and procedures for maintaining documentation supporting accounts receivable, and where necessary, train employees to properly record detailed taxpayer transactions. Currently, IRS is reviewing its policies for retaining documentation supporting accounts receivable.

In addition, IRS will be challenged to fully meet the federal accounting standards for accounting for accounts receivable, which become effective for fiscal year 1998. IRS will need to

-- design its financial management system to analyze all outstanding amounts to properly identify and report valid accounts receivable and the amount expected to be collected;

-- track all activity affecting IRS' accounts receivable balance, including collections as a result of enforcement efforts, tax abatements, and aging of receivables; and

-- provide dollar information about its compliance assessments.

Accounting for Revenue

Our audit of IRS' fiscal year 1995 financial statements found that

-- the amounts of total revenue (reported to be $1.4 trillion for fiscal year 1995) and tax refunds (reported to be $122 billion for fiscal year 1995) could not be verified or reconciled to accounting records maintained for individual taxpayers in the aggregate, and

-- the amounts reported for various types of taxes collected (social security, income, and excise taxes, for example) could not be substantiated.

Our financial audits have found that IRS' financial statement amounts for revenue, in total and by type of tax, were not derived from its revenue general ledger accounting system or its master files of detailed individual taxpayer records. The revenue accounting system does not contain detailed information by type of tax, such as individual income tax or corporate tax, and the master file cannot summarize the taxpayer information needed to support the amounts identified in the system. As a result, IRS relied without much success on alternative sources, such as

Treasury schedules, to obtain the summary total by type of tax needed for its financial statement presentation.

To substantiate the Treasury figures, our audits attempted to reconcile IRS' master files--the only detailed records available of tax revenue collected--with Treasury records. For fiscal year 1994, for example, we found that IRS' reported total of $1.3 trillion for revenue collections taken from Treasury schedules was $10.4 billion more than what was recorded in IRS' master files. Because IRS was unable to satisfactorily explain, and we could not determine the reasons for this difference, the full magnitude of the discrepancy remains uncertain.

In addition to the difference in total revenues collected, we also found large discrepancies between information in IRS' master files and the Treasury data used for the various types of taxes reported in IRS' financial statements. For fiscal year 1994, for example, some of the larger reported amounts in IRS' financial statement for which IRS had insufficient support were $615 billion in individual taxes collected--this amount was $10.8 billion more than what was recorded in IRS' master files; $433 billion in social security insurance taxes collected--this amount was $5 billion less than what was recorded in IRS' master files; and $148 billion in corporate income taxes--this amount was $6.6 billion more than what was recorded in IRS' master files. Thus, IRS did not know and we could not determine if the reported amounts were correct. These discrepancies also further reduce our confidence in the accuracy of the amount of total revenues collected.

Causes of IRS' Revenue Accounting Problem Contributing to these discrepancies is a fundamental problem in the way tax payments are reported to IRS. About 80 percent, or about $1.1 trillion, of total tax payments are made by businesses and typically include (1) taxes withheld from employees' checks for income taxes, (2) Federal Insurance Compensation Act (FICA) collections, and (3) the employer's matching share of FICA. IRS requires business taxpayers to make tax payments using federal tax deposit coupons.

The payment coupons identify the type of tax return to which they relate, such as a Form 941, Quarterly Wage and Tax Return, but do not specifically identify either the type of taxes being paid or the individuals whose tax withholdings are being paid. For example, a payment coupon indicating that a deposit relates to a Form 941 return can cover payments for employees' tax withholding, FICA taxes, and employers' FICA taxes. Because only the total dollars being deposited are indicated on the coupon, IRS knows that the entire amount relates to a Form 941 return but does not know how much of the deposit relates to the different kinds of taxes covered by that type of return.

Consequently, at the time tax payments are made, IRS is not provided information on the ultimate recipient of the taxes collected. Furthermore, the type of tax being collected is not distinguished early in the collection stream. This creates a massive reconciliation process involving billions of transactions and subsequent tax return filings.

For example, when an individual files a tax return, IRS initially accepts amounts reported as a legitimate record of a taxpayer's income and taxes withheld. For IRS' purposes, these amounts represent taxes paid because they cannot be readily verified to the taxes reported by an individual's employer as having been paid. At the end of each year, IRS receives information on individual taxpayers' earnings from the Social Security Administration. IRS compares the information from the Social Security Administration to the amounts reported by taxpayers with their tax returns. However, this matching process can take 2 and a half years or more to complete, making IRS' efforts to identify noncompliant taxpayers extremely slow and significantly hindering IRS' ability to collect amounts subsequently identified as owed from false or incorrectly reported amounts.

Consistent with this process, IRS' system is designed to identify only total receipts by type of return and not the entity which is to receive the funds collected, such as the General Fund at Treasury for employee income tax withholdings or the Social Security Trust Fund for FICA. Ideally, the system should contain summarized information on detailed taxpayer accounts, and such amounts should be readily and routinely reconciled to the detailed taxpayer records in IRS' master files.

Also, IRS has not yet established an adequate procedure to reconcile the revenue data that the system does capture with data recorded and reported by Treasury. Further, documentation describing what IRS' financial management system is programmed to do is neither comprehensive nor up-to-date, which means that IRS does not yet have a complete picture of the financial system's operations--a prerequisite to fixing the problems.

Beginning with our audit of IRS' fiscal year 1992 financial statements, we have made recommendations to correct weaknesses involving IRS' revenue accounting system and processes. They include

-- addressing limitations in the information submitted to IRS with tax payments by requiring that payments identify the type of taxes being collected,

-- implementing procedures to complete reconciliations of revenue and refund amounts with amounts reported by the Treasury, and

-- documenting IRS' financial management system to identify and correct the limitations and weaknesses that hamper its ability to substantiate the revenue and refund amounts reported on its financial statements.

Short-term Fixes to Revenue Accounting Problems The problem of identifying collections by type of tax results from inherent limitations in IRS' present financial system. To correct this problem in the short-term, IRS has developed a methodology that uses software programs IRS believes will capture from its revenue financial management system the detailed revenue and refund transactions that would support reported amounts in its future financial statements. In short, this approach is directed at developing reasonable estimates of taxes by type of tax collected by using the capabilities of IRS' present systems.

To reconcile IRS' tax revenue data with Treasury's balances, IRS' plans call for the extracts from these software programs to be available in accordance with the following schedule.

-- Data for the first 6 months of fiscal year 1996 will be available by October 1, 1996.

-- Data for the entire fiscal year will be available by January 15, 1997.

To provide an allocation of taxes between Social Security, income, and excise taxes, IRS plans call for the extracts from these software programs to be available in the following timeframes.

-- Allocations for the first three quarters of fiscal year 1996 are due by November 30, 1996.

-- An allocation for the final quarter of fiscal year 1996 is due by January 30, 1997.

Also, regarding the issue of reconciling accounting records with individual taxpayer accounts, IRS is trying to better understand the differences between its systems and Treasury's records. To gain this understanding, IRS plans to soon complete documentation of its revenue financial management system. This is critical to (1) aid in identifying better interim solutions for reporting revenues and refunds and (2) provide better insights on the longer term system fixes needed to enable IRS to readily and reliably provide the underlying support for its reported revenue and refund amounts.

Fixing Revenue Accounting Problem Long-term IRS has not yet put in place the necessary procedures to routinely reconcile activity in its summary accounting records with that maintained in its detailed masterfile records or taxpayer accounts. This

problem is further exacerbated by IRS' financial management system, which was not designed to support financial statement presentation, and thus significantly hinders IRS' ability to identify the ultimate recipient of collected taxes.

Longer term system fixes are necessary to achieve more reliable reporting of these amounts. In this regard, as part of Tax Systems Modernization, IRS has designed the Electronic Federal Tax Payment System (EFTPS), to electronically receive deposits from businesses. EFTPS is planned to be operational by the end of 1996. If implemented as designed, EFTPS will have the capability of collecting actual receipt information for excise and social security taxes.

However, not all employers will be required to use EFTPS to make their federal tax deposit payments. According to IRS officials, approximately 20 percent of the employers that make federal tax deposit payments will have the option of remaining with the current system, which provides limited information. Therefore, even if employers that use EFTPS are required to provide additional information on social security and excise taxes, to the extent that some businesses will still make deposits using the current system, IRS will not have the complete information it needs to determine collections from excise and social security taxes.

In addition, IRS will have to make changes to meet criteria for determining revenue that are contained in federal accounting standards, which will be effective for fiscal year 1998. This will require IRS to account for the source and disposition of all taxes in a manner that enables accurate reporting of cash collections and accounts receivable and appropriate transfers of revenue to the various trust funds and the general fund. To achieve this, IRS' accounting system will need to capture the flow of all revenue-related transactions from assessment to ultimate collection and disposition.

Also, IRS' revenue accounting system does not meet the government's standard general ledger or other financial management systems requirements. According to IRS, these requirements are not being met because the revenue accounting system was designed more than 10 years ago to post transactions to taxpayers' accounts. IRS is in the initial stages of developing a new revenue financial accounting system which is expected to meet the government's standard general ledger and other financial management systems requirements. However, the new system is not expected to be completed until after 1998.

TSM PROBLEMS IMPACT IRS' FINANCIAL INFORMATION

IRS' capability to develop and make automated systems changes is an area of continuing concern, as we have discussed in our reports and testimonies on IRS' Tax Systems Modernization (TSM). (See attachment I.) In March 1996, we testified before the Subcommittee on IRS' significant challenges in financial management and systems modernization, which are central to IRS' guardianship of federal revenues and ability to function efficiently in an increasingly technological environment.

In summary, IRS has initiated actions that begin to implement the dozens of recommendations we have previously made to correct management and technical problems in developing TSM. Many of these actions are still incomplete and do not yet respond fully to any of our recommendations. As a result, until IRS makes more progress in correcting its management and technical weaknesses, its ability to develop systems and make changes to correct financial management problems will be hampered.

IRS TOUCHES FINANCIAL REPORTING ACROSS GOVERNMENT

The CFO Act, as expanded by the Government Management Reform Act of 1994, requires the 24 CFO Act agencies to prepare, and subject to audit, financial statements covering all accounts and associated activities of each office, bureau, and activity of the agency. This requirement begins with agencies' financial statement for fiscal year 1996. Audit reports are to be prepared by March 1 of 1997 and each year thereafter.

In addition to agencywide financial statements, the expanded CFO Act requires the Secretary of the Treasury to annually prepare consolidated financial statements depicting the Executive Branch's financial status. This requirement begins with financial statements for fiscal year 1997; GAO is to audit them by March 31 of each year, beginning in 1998.

IRS' financial information will provide significant input to the preparation and audit of both Treasury's agencywide and the governmentwide financial statements. For example:

-- With $1.4 trillion in tax revenue, IRS accounts for the vast majority of the government's total reported fiscal year 1995 revenue.

-- IRS' $113 billion in reported accounts receivables is over two-thirds, or about 68 percent, of the government's total fiscal year 1995 accounts receivables, which Treasury reported to be more than $166 billion.

Also, IRS financial reporting affects the financial reports of the government agencies for which IRS collects tax receipts, such as the Social Security Administration for the Social Security Trust Fund and the Department of Labor for the Unemployment Trust Fund. Beginning in fiscal year 1998, to meet federal accounting standards, IRS will have to disclose the reasons for any continuing noncompliance with the laws relating to the disposition of tax revenue to trust funds and the amount of over- or underfunding, if reasonably estimable.

As a central government financial management leader, it is essential for the Department of the Treasury to ensure that the problems IRS faces in preparing financial statements on its operations are promptly resolved so that these problems do not delay the preparation, or affect the credibility, of Treasury's agencywide financial statements. Also, unless IRS' financial management problems are dealt with, they will affect the ability to render an opinion on the governmentwide financial statements.

IRS FOLLOW-THROUGH WILL BE CRITICAL

In summary, it will be essential for IRS to follow-through and ensure that its planned short-term, interim actions are completed on schedule to improve the reliability of IRS' financial statements, and we will continue to work with IRS in doing so. We also will continue to monitor IRS' efforts to complete our recommendations and implement longer-term systems improvements. The Subcommittee's continued oversight of IRS' progress in implementing the CFO Act and preparing auditable financial statements will provide important impetus as well.

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Mr. Chairman, this concludes my statement. I would be happy to now respond to any questions.

RECENT GAO REPORTS AND TESTIMONIES RELATED TO IRS' FINANCIAL MANAGEMENT AND TSM PROBLEMS

FINANCIAL AUDIT REPORTS

Financial Audit: Examination of IRS' Fiscal Year 1992 Financial Statements (GAO/AIMD-93-2, June 30, 1993)

Financial Audit: Examination of IRS' Fiscal Year 1993 Financial Statements (GAO/AIMD-94-120, June 15, 1994)

Financial Audit: Examination of IRS' Fiscal Year 1994 Financial Statements (GAO/AIMD-95-141, August 4, 1995)

Financial Audit: Examination of IRS' Fiscal Year 1995 Financial Statements (GAO/AIMD-96-101, July 11, 1996)

REPORTS AND TESTIMONIES RELATED TO IRS FINANCIAL AUDITS AND TSM

IRS Operations: Significant Challenges in Financial Management and Systems Modernization (GAO/T-AIMD-96-56, March 6, 1996)

Tax Systems Modernization: Management and Technical Weaknesses Must Be Overcome To Achieve Success (GAO/T-AIMD-96-75, March 26, 1996)

Tax Systems Modernization: Progress in Achieving IRS' Business Vision (GAO/T-GGD-96-123, May 9, 1996)

Letter to the Chairman, Committee on Governmental Affairs, U.S. Senate, on security weaknesses at IRS' Cyberfile Data Center (AIMD-96-85R, May 9, 1996)

Financial Audit: Actions Needed to Improve IRS Financial Management (GAO/T-AIMD-96-96, June 6, 1996)

Tax Systems Modernization: Actions Underway But IRS Has Not Yet Corrected Management and Technical Weaknesses (GAO/AIMD-96-106, June 7, 1996)

Tax Systems Modernization: Cyberfile Project Was Poorly Planned and Managed (GAO/AIMD-96-140, August 26, 1996)

Internal Revenue Service: Business Operations Need Continued Improvement (GAO/AIMD/GGD-96-152, September 9, 1996)

Internal Revenue Service: Critical Need to Continue Improving Core Business Practices (GAO/T-AIMD/GGD-96-188, September 10, 1996)

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Mr. HORN. We are going to follow the 5-minute rule on questions. Mrs. Maloney and I will alternate so that we all have a crack at it and we might alternate 20 times, for all I know.

Mrs. MALONEY. I have to be on the floor.

Mr. HORN. Oh, you have to?

Mrs. MALONEY. If you will excuse me, I have been called to the floor for the debate.

Mr. HORN. You speak for me, too, over there. I should be there, too, fighting that battle. Well, thank you for coming.

Mrs. MALONEY. Mr. Chairman, I just want to say for the record how much I have enjoyed working with you this year. I believe this is the last hearing? You have got another one coming?

Mr. HORN. We might have a couple after the election. Either you will be chairman or I will be chairman.

Mrs. MALONEY. In this session?

Mr. HORN. Yes.

Gene, what I am curious about on this plan—you are absolutely right and I am sure we will discuss it more with representatives of the IRS—but of the 59 recommendations, obviously, when you make them, these are not incrementally or sequentially to be followed.

Mr. DODARO. Right.

Mr. HORN. Has a plan been developed of what the big picture is so we can deal with that?

Have we separated the minutiae that would be nice to have down from the basic goal achiever that will get us there? Where are we on that? What are we talking about?

Mr. DODARO. I think we are at different places, Mr. Chairman. I think on the administrative accounting area we have got a good plan that will get us there and it is just a matter of execution. This is on the reconciling the cash accounts with Treasury and having documentation for receiving goods and services other than payroll, which are computers, hardware, and other services from Government agencies. I think we are close there and I think it is just a matter of putting in the discipline to get the documentation and to get the transactions recorded properly and follow the right procedures.

In the revenue area, I do not think we have clearly—the Service has yet a clear vision of how to fix that problem long term. They are developing solutions in that area and I think that—I am encouraged by the fact that they are beginning to talk about it, but I do not think we are there yet in the revenue arena. That is tied up in their ability to develop systems generally. I do think that we are not going to be able to solve that problem with one silver bullet, so I think making incremental progress is important. I think a lot of the data is in the current revenue systems, but there is such poor documentation of that system that they are having difficulty reconciling the amounts. And as you know, Mr. Chairman, you have held hearings on the year 2000 problem, about the problems that can be created by the lack of documentation, and it is also characteristic of organizations. We are going to have a continuing dialog with them on that, but I would say the fix is in place for the revenue area are going to take us only a certain percentage of the way.

I might also add that this last year we verified IRS had completed 17 of our recommendations, which was up. If you recall, in the March hearing it was 13. They believe they have other recommendations completed and we are in the process of verifying that in the 1996 audit. But I think the vision in the revenue area still needs work.

Mr. HORN. Have you been through this type of experience with other Federal agencies where GAO has established a relationship of, one, going in and looking, making some recommendations, then sitting down with them as to how, based on what you have seen in the private sector, public sector, these could be implemented? Is there any other agency where you have had that similar relationship?

Mr. DODARO. Oh, yes.

Mr. HORN. What are they?

Mr. DODARO. We have had—well, for example, in the Government corporations area we had responsibility for auditing the Resolution Trust Corporation. We just completed our last audit as that organization has gone out of business and transferred those responsibilities to FDIC.

We worked with RTC from the standpoint—in the beginning we were at the point we are at IRS of having disclaimers and eventually working with them, fixing their control problems, putting in good systems and discipline. We were able to have a clean opinion on RTC.

The same with the Pension Benefit Guarantee Corporation. Over a number of years we were able to work with them as well. We have been working with FDIC for a number of years. In the Government corporations we have had the requirement for a financial audit in place for a number of years and GAO has had that responsibility, so we worked very closely, and it takes a number of years but, with concerted effort, it can be done.

We have also started now with the CFO requirements. We were working with the Customs Service initially for a couple of years. We have turned that audit over now to the Treasury Inspector General, but we are still providing some technical assistance. We did early audits in trying to work with the Education Department in the student loan insurance area. We have started, as we have talked in this committee, over at the Defense Department. I cannot report the same progress there.

Mr. HORN. You have not found the $25 billion yet?

Mr. DODARO. No, no.

Mr. HORN. That they tell me isn't stolen, but they cannot find it.

Mr. DODARO. Well, and it keeps changing.

But we have examples, clearly, in the Government corporation areas and in some of the Federal agencies where, working over time—and there are examples of other agencies where the IG's are doing the same thing.

Mr. HORN. OK, so you have had that experience. Now, what I want to know is what were the keys to success in those other agencies? Are there similar factors in IRS and if IRS does not have them, what is it that they are lacking that these other agencies have had to make the transition a success?

Mr. DODARO. The critical factors of success, in my opinion, are, No. 1, having a detailed action plan that is credible, has very explicit milestones, and can be used to track progress both on the part of the managers within the agency as well as the Congress.

In the early years, as I mentioned in my statement, I was very troubled by the fact that IRS, I believe, underestimated the severity of their problems and underestimated what it was going to take to fix the problems in the correct manner.

And even when we were doing the audit for fiscal year 1994, I wrote a letter to the commissioner, basically saying that I was concerned that we did not have a plan in place. It was not until early spring in this past year where we have gotten a plan was developed and we have worked with IRS to refine that plan. So I think for the first time we have a credible plan to address some of the issues, albeit some of them still short term, but at least it is progress and I think we are moving in the right direction.

Mr. HORN. OK, and has IRS fixed the responsibility for implementation on that plan on one person or how are they administering it?

Mr. DODARO. Basically, responsibility rests with the Chief Financial Officer, the CFO, Tony Musick.

One area that I am a little concerned about is that Tony has to deal with other people in the IRS to get some of the changes put in place. For example, while the CFO has total responsibility over the administrative accounting operations, that person does not have responsibility over the revenue accounting function. Now, we at GAO made a recommendation over the years to give more responsibility for revenue accounting to the Chief Financial Officer.

Mr. HORN. Yes, but whose choice is that? When Congress said, "Establish a Chief Financial Officer," they did not say, "you simply handle supervision of administrative accounting but if you have another type of accounting, such as revenue accounting, sorry, you do not handle that?" Aren't we holding them responsible for all fiscal matters within that agency?

Mr. DODARO. Yes, and the legislation was not as specific on this point. We do have a little bit of an unusual situation at IRS in that you have large custodial, governmentwide responsibilities there for revenue collection as well as internally. And there is no one organizational solution.

The biggest problem is that the revenue accounting systems were not developed with sufficient input from the financial people at IRS so that they have good controls in place and could be used for financial reporting purposes. Revenue systems were largely developed by people who have responsibility for processing the tax returns and they were more interested in making sure that refunds got out quickly and they could track physically the returns as they come through the system.

Mr. HOLLOWAY. And just to amplify on what he said, I think that is a very important nuance that really needs to be looked at in the context of the tax system modernization effort, because as they move to redesign their data bases I think it is important that one of the functional requirements that need to be looked at and considered and incorporated are the financial accounting and reporting needs.

A lot of emphasis, much like in times past when they developed those, has been placed on trying to enhance customer service and improve production, which are all very important things that need to be considered, but I think, likewise, as they go to develop whatever the new data base is going to look like, consideration needs to be given to some of the dilemmas that they are confronted with from a financial reporting and accounting perspective.

Mr. DODARO. Mr. Chairman, I think this is the second critical success factor. One is having a plan. The other factor is making it happen and making it reality and having follow-through. Follow-through has been a problem at IRS. It is largely still functionally aligned and a lot of people have different responsibilities for different areas.

Fixing some of their financial problems and their systems problems requires a broader approach in the organization and, as you well know from the jobs that you have had over the years, that is the hardest part, is to get a large organization to work together.

And Tony is going to need help from other parts of IRS, and this is where the role of the Deputy Commissioner and the Commissioner becomes important in that they need to followup and if things are not getting done, they either need to realign responsibilities or make it clear and directed to people that they need to cooperate with him to bring this to closure.

The third factor that I think is important, success factor, is continual congressional oversight. I mentioned the RTC earlier. One of the comments, as we were testifying years ago on RTC and why they could not get a clean opinion, and at the same time Congress was being asked to increase appropriations to bail out the savings and loan problems and giving those to the RTC, one congressional member said, "Why should we give the RTC any additional money if they cannnot account for the appropriations that we have given them before?"

Congress put a lot of pressure to get the RTC cleaned up, because they were concerned with the difficulties that were ensuing by pumping a lot of money into the RTC to clean up the S&L crisis.

So continual congressional pressure, having follow-through by the agency managers in doing their job, and all rooted in a very good detailed plan, are the three keys of success.

Mr. HORN. Now, do you see in the CFO-Deputy Commissioner-Commissioner relationship at IRS anything different than you see in other agencies as to the CFO's reporting? Is there something unique in IRS? In other words, are they taking it seriously at top management, of which the CFO is part?

Mr. DODARO. I think they are definitely committed to trying to fix the problem, but I think they need to exercise more discipline at the top. The same issue, I have made the same point about their tax system modernization program. Basically, IRS was allowing a lot of functional areas—you know, they are a large decentralized organization, the districts, the regions, the different functional areas, whether you are talking about processing returns or collecting revenue, were pretty much autonomous—and I think there still needs to be more of a cohesive management structure developed at the top of the IRS to integrate the CFO, to bring the new chief information officer that they have in place into that, and to make it

a cohesive team with an overall architecture or blueprint for bringing about these reforms. They are not quite there yet, in my opinion.

Mr. HORN. And we will pursue that with the Chief Financial Officer when we get to it.

My last part of this series of questions is the degree to which money, additional authority, et cetera, are involved here. How much can be done under existing appropriations? Does IRS have the authority to move money around, reprogramming authority, within the agency, and do they have their own revenue sources they can tap for modernization or does that have to be a congressional appropriation?

Mr. DODARO. Most of the money, and I will ask Greg to add on to this, to run IRS' operations, including the modernization program, come from appropriated funds of the Congress. Actually, in our last tax system modernization report we issued in June we recommended that since the IRS had so many management and technical weaknesses in their capability to manage that program, that the funding be restricted and limited to tax system modernization, to only critical operation and maintenance problems, building their capability in small projects.

The IRS does have some reprogramming authority—I will ask Greg to talk about that—but the funding for their systems efforts comes from appropriations, the large bulk of it, and not from any other independent sources.

Mr. HORN. And they have spent the money we have appropriated when we have directed it for systems on systems? Because we have a few agencies, and IRS was one of them, that used the money simply to hire more people and did not follow Congress' direction.

Mr. DODARO. Yes, well, one of the problems we have had and we reported on in our financial audits was the inability to track the cost of the tax system modernization effort. We have had some problems exactly pinning that down in those areas and, also, not only what goes for new development under tax system modernization versus what is operation and maintenance of your existing systems—sometimes that goes back and forth as well. So we are trying to, as part of our audits, tie down how that money is actually expended.

Mr. HORN. OK, Mr. Holloway, do you want to comment on reprogramming, then Mr. Davis will take over.

Mr. HOLLOWAY. I think in the case of reprogramming, I think IRS has the capacity to reprogram as any other Federal agency would in terms of moving money around, but I think the context of your question, if I recall, dealt more with the impact of that with the presumption of adding more money to help cure the problems and fix the issues.

In the end, and I just wanted to amplify one of the things that Mr. Dodaro said, that it strikes me that one of the things that is going to be critical, while certainly the responsibility rests with the CFO, I have to reiterate the criticality of complete institutional support. No CFO, in the private sector or the public sector, will be able to effectively do their job if they do not have full and unwaivering support at the top that provokes support and cooperation throughout the organization.

Mr. HORN. Does your experience with IRS lead you to believe they have the support at the top?

Mr. HOLLOWAY. My experience at IRS leads me to believe that from a full institutional perspective I am not sure that the breadth of support that needs to be there to always, at a priority level, push things through has always been present and consistent. Now, if that is a function of the top or just the difficulty of managing a large bureaucracy, I do not know.

Mr. HORN. Well, that is certainly my impression, and when you look at who gets appointed commissioner, with all due respect to the fine talents they bring as tax lawyers, or whatever, they have never run anything. They have never run any large agency.

What we need in a couple of these places are people that are skilled managers that can pull people together, can focus on the plan and, as you say, hold goals to know when we have achieved it and can back up a CFO who needs the help of some egomaniac that is parallel in the organization to him or her, as the case may be.

Mr. HOLLOWAY. I think you are exactly right in that interpretation, that that is what is necessary.

Mr. HORN. Well, Mr. Davis, the gentleman from Virginia.

Mr. DAVIS. Thank you, Mr. Chairman. Mr. Dodaro, let me ask you, if you were auditing an agency's financial statements and had to report on whether the agency was or was not in compliance with the applicable Federal accounting standards and Federal financial management systems requirements, would you be able to do so?

Mr. DODARO. Yes, I believe so. I mean, we in the Federal Government now, through a joint arrangement with OMB, GAO, and the Treasury Department, have set up a Federal Accounting Standards Advisory Board and they have recommended new accounting standards for the Federal Government, which become effective in the next couple of years.

There are also some systems requirements that have been put in place. I think it would require, perhaps, some interpretations and help, as anything does in an area that is complicated like that, but I——

Mr. DAVIS. But there is enough specific guidance when you take a look at the OMB circulars and the publications issued by the Joint Financial Management Improvement Program and so on to enable an auditor to make that determination?

Mr. DODARO. Yes, I believe it is a good starting point. I think there would be additional issues that we would have to discuss but I think the foundation, augmented by the new accounting standards that are being issued, I think that helps it quite a bit.

Mr. DAVIS. I think Mr. Horn got at this, but in your opinion do you think the Department of the Treasury and the IRS have developed an effective plan for implementing the Government Management Reform Act requirements in terms of the plan?

Mr. DODARO. Most of our focus to date has been at the IRS level. We are beginning a look at the Treasury Department level. I think they have begun planning on this effort. We are now looking at the Bureau of Public Debt and Treasury's Financial Management Service for the first time and we are developing opinions along those lines. I think they are beginning to focus on it, but I do believe that

we are going to need to have more concerted attention to fix some of the problems that are going to be encountered.

I guess what I am saying is I think their attention is increasing, but probably not at the level it really needs to be in order to fix some of the problems.

Mr. HOLLOWAY. I think the other thing, if I can just amplify for a second, the ultimate proof, if you will, is the outcome you get. I think while an auditor's opinion is certainly not an end-all, it is certainly an indicator of the effectiveness of a plan or the progress against that plan.

One of the things a disclaimer of opinion infers is the fact that you did not have the ability to determine whether or not what was reported was correct. That would suggest, if that persisted too long, that—it would either call into question the quality of the plan or the effectiveness of its implementation.

So I think when you look at Treasury—and I think one of the reasons GMRA is so important and congressional oversight is so important is that you have an opportunity annually to look at do they have an effective plan and are they progressing? And that opinion will be one indicator of that and that opinion is based on their level of compliance with standards.

Mr. DODARO. I think one of the biggest issues right now with the Government Management Reform Act—with the new accounting standards, we have all the management tools in place to make improvements—the real question is are there incentives enough to make the changes and to make them fast enough?

That is going to be one that is going to revolve largely around congressional oversight. If this matters and it is clearly made an important priority and the Congress holds people accountable for making that progress, then I think you will see some changes.

Mr. DAVIS. Well, that was really getting to my next question, which I kind of scribbled out. Are there additional actions Congress could take at this point to ensure the IRS financial management problems are resolved, or do you think holding this hearing at this point is enough and we may want to revisit as they work their way through this over the next year?

Mr. DODARO. I think regular oversight hearings are imperative to making progress. If the Congress does not send a message that this is important to us, not only this committee, which has jurisdiction over the CFO Act, but equally as importantly, the appropriations committees and the authorizing committees for the agencies, that is what will get the attention of the departments and agencies to make progress.

And there have to be some consequences for not making that progress. One of the things is there is nothing in the CFO Act now that says, if you get a disclaimer or if you do not get an opinion, there is any penalty to that that encourages you to do that, and right now all we have in order to increase leverage is the public report card that comes out of the audit opinion, because that creates—if you get a bad report card, it creates attention.

Mr. DAVIS. You know, Professor Horn is known to give report cards. [Laughter.]

He may want to come out with his own on this.

Mr. HORN. As my colleague knows, recently we gave only four out of 24 agencies A's and we gave about two or three B's and two C's and the rest were D's and F's. Some of my best friends were heading those agencies.

Mr. DAVIS. IRS did OK, as I recall.

Mr. DODARO. Actually, that report card on the year 2000, I can tell you, from being in the trenches with some of those agency officials, has made a difference. I mean, people are mumbling, "Gee, we got an F here, we had better do something."

Mr. HOLLOWAY. That is one of the important features of GMRA, because I do not want us to get lost even in this hearing on just IRS. I think some of the problems that they have been confronted with you are going to see across Government. I do not think IRS is the oddball; I think they are more the rule than the exception and, if anything, while I am sure this scrutiny has created some pain for IRS, I think it will go a long way to get them ahead of the curve of what you are going to find in other agencies as the reporting under the GMRA starts to surface.

Mr. DAVIS. Let me ask another—kind of switch gears a little. I understand that in fiscal year 1993 the IRS began its report as part of its audited financial statements and accounts receivable amount based on a statistical estimate. The GAO reported that this amount is acceptable only for periodically reporting an approximate financial statement amount at a designated date. The IRS is unable to account for changes in accounts receivable from year to year and cannot provide detailed information on the composition or aging of accounts receivables. It seems to have no detailed subsidiary record of accounts receivable, nor does it have a short-term strategy to identify all those who legitimately owe it money.

Are all of these circumstances still the same? When has the IRS told you that it will correct these situations?

Mr. HOLLOWAY. I think Mr. Dodaro alluded to this earlier. This is one of the concerns in the revenue area. The short answer to that is yes, they still do not have a subsidiary record and, without that subsidiary record—and I want to be clear about this, because in typical accounting you have a maintained subsidiary record of accounts receivable that you would track, all of the collections and new receivables related to that through. That is not what IRS does. A big part of that is just systems design flaw. What they effectively have to do is run a software program to extract receivables at any given point in time, which gives you no capacity to track the activity in an effective way from period to period, which then makes it difficult to gauge what your performance has been in trying to collect against those receivables, even identify what they are.

That is why I think, as you start moving to TSM or whatever new systems you look at, one of the critical components needs to be the capacity to track who owes you money on a real-time basis and then to measure your performance against collecting that money.

Mr. DAVIS. I always say it is not all IRS' fault. I mean, Congress has switched gears sometimes over what strategy we are giving the IRS, the amounts of money and the programs and the way they are doing to do it, too, in fairness to them—I am sure they will testify on that. But it would help to have, as we talked before, a strategy

to identify these and I think it would help for more continuity up here in the way we do policy.

I think, Mr. Chairman, that is all I want to ask for right now.

Mr. HORN. I thank you very much. Let me ask, on this problem, what was the role of OMB, if any, in this? As I recall, the OMB is basically to issue standards across the Federal Government. How did they let Defense, with its 49 different accounting systems, and the IRS get so out of whack?

Mr. DODARO. Basically, over the years you had OMB put in place requirements and there are binders of circulars and they all have good well-intentioned requirements, but there was no requirement for the independent audit, and OMB is sitting there having very short-handed staff, had no ability to get any independent sources of information back as to whether people were complying with this circular or not.

I think they are also becoming concerned since these financial audits that the information they are receiving on simple budget execution data and funds control is not as good as what they originally thought.

So I think there was a lot of good faith on the part of OMB that people were complying and not until you really get to scrutiny of an independent financial audit have many of these things come to light. And I think that is the real difference and what it will really take.

I think for the first time, early next year, when you have the results for the first time across Government of audits of the 24 largest departments and agencies you will have a good governmentwide picture of the severity of financial management problems across the Government. Before this point in time you have only had just agencies that the Congress selected as pilots for us to go in and look at, so we have gotten quick snapshots of different parts of the government, but when you see it all put together, I think it will be quite disturbing.

Mr. HORN. Well, let me ask my last question on this. We might have others we send you, and you know the routine; if you could give us an answer, we would like to put them in the record. My last point would be this. You and your team of three others there that I am looking at, the four of you, you are familiar enough with IRS, where they are, what they have done, what they have not done. What I would like to know is, if tomorrow the Secretary of the Treasury called you and said, "Hey, have I got a deal for you. Why don't you come over here and straighten this mess out," what is the first thing you would do if you took the job that they are not doing and they ought to be doing?

Mr. DODARO. The first thing I would do is to get all the people in the room who have a role to play in this and have an integrated plan developed to get at this that I felt was comfortable, No. 1.

No. 2, I would go out and procure for myself top-flight expert advice from the outside to come in and provide me with additional information in this area, particularly in the area of systems development, because I know the capability in the IRS to develop systems is not good.

Third, I would make sure I have got a good plan to increase my capability in my organization to either develop software itself or to

procure software from the outside, which is not there. So I probably would hire and bring in somebody who could manage, contractors, technical contractors, to develop systems.

IRS' problems will not be fixed, because of the volume of the transactions and the magnitude of their business, without modern systems, and their track record in developing those systems is poor, and unless that is fixed, you are going to continue to have these problems and Band-Aid approaches.

So I would make sure I have got clear signals to all my managers, I would make sure I would get some expert advice, and I would bring in top-flight people who can develop and maintain state-of-the-art technology.

Mr. HORN. Ms. Guensberg, Mr. Holloway, have anything you want to add to that?

Mr. HOLLOWAY. The only thing I would amplify for emphasis' sake—and I say this from my own experience in the private sector when I took a similar position in the private sector—one of the things that was crucial to me being able to effectively do what they wanted me to do was knowing for certain that I had the authority to do what they wanted me to know, which meant to leverage and to impact people in what were the program aspects of our operation to get them to do what I needed them to do, because no matter how smart I might be or how effective my team might be, there would never be enough accountants and those types to do it all in an organization the size of IRS without clear priority support.

The difficulty is that is in the face of all of the program demands that are placed on an organization but they have to appreciate the criticality of the financial reporting and accounting. And unless you have that kind of leverage, where you know when you say something that people are going to respond and respond timely, it is not going to happen. And if it does, it is going to happen over a very long period of time.

Mr. HORN. Ms. Guensberg, do you want to add anything?

Ms. GUENSBERG. I guess the only thing I would add to that is to make sure that there are no gaps in the knowledge. I think Gene went a long way to talking about that in terms of getting people in who know how to design systems, but not only that, just where you are now.

IRS has worked, gotten some contractors in, to determine just how their own systems, or current systems, work, and I think that you have got to start from that basic knowledge so you can make good decisions. I just want to emphasize that.

Mr. HORN. I found as an executive that you hire consultants when you have not gone out to listen to people, and all consultants do is listen to people and the organization usually has a million good ideas for how you solve the problem if somebody only asked them.

I think the problem we have in Government, and private industry has just as many problems as we do, is nobody is listening to the person who says, "I could do that better," and get them all involved. And then you are absolutely right on the backup. When trouble comes, is the boss willing to say, "We want this done, folks, let's get all on board." And I am not convinced that is happening.

And I realize the IRS people are not about to tell me, either. I understand that. So that is why I am asking you those questions. I mean, you have been the consultants, in a way, that go in and people talk to you and tell you this and that and you have got a feel for it.

I thank you for your testimony. I assume some of you will stay and listen to the IRS testimony, because I would certainly like to have your thoughts after that, either privately, or on the record, or whatever. But I thank you for testifying. As usual, you have come up with a very thorough presentation and we appreciate it, so thanks for coming.

Mr. DODARO. Thank you very much.

Mr. HORN. We now have panel 2, Mr. App, the Deputy Chief Financial Officer, Department of the Treasury, and Anthony Musick, the Chief Financial Officer for the Internal Revenue Service. We are delighted to have you with us. Gentlemen, you know the routine, also.

[Witnesses sworn]

Mr. HORN. Both witnesses have affirmed, and please proceed as to which one of you goes first. Mr. App, we are delighted to have you open.

STATEMENTS OF STEVEN O. APP, DEPUTY CHIEF FINANCIAL OFFICER, DEPARTMENT OF THE TREASURY; AND ANTHONY MUSICK, CHIEF FINANCIAL OFFICER, INTERNAL REVENUE SERVICE

Mr. APP. Mr. Chairman and members of the subcommittee, thank you for inviting me here today to discuss financial management in the Department and the Internal Revenue Service.

As the chief financial agent of the U.S. Government, achieving sound financial management practices across the Treasury Department is one of our top priorities. I would like to point out that much of what I am going to talk about today is contained in the Department's first accountability report that we produced for 1995, a year ahead of when it is required under the Government Management and Reform Act. This report contains for the first time in one place all of the key financial information for the Treasury Department and we believe that it is a complete and useful and an honest assessment of where we are.

In your letter of invitation you asked for several items to be discussed. My colleague, the IRS CFO, will talk about some of the IRS specifics. I will address two issues which I believe you are interested in from a departmental perspective. Those are the impact of the IRS' problems on departmental and governmentwide financial statements as well as our compliance on a department level with A127, the OMB guidance on financial management systems.

As the GAO folks have alluded to, because IRS collects 98 percent of the Government's revenues, it obviously has a major impact in terms of materiality on our financial statements. No entity can get a clean opinion on its financial statements if its revenues cannot be audited. So I will be clear. As long as the IRS revenues cannot be audited, neither the IRS, the Department, nor the governmentwide financial statements can get an unqualified audit opinion.

Like you, we are very well aware of the need to resolve these problems and have continued to provide assistance to IRS at the Department level in achieving these goals. Our primary role at the Department level is to work with all concerned parties to achieve our mutual goals.

What this means is making sure that reasonable plans are in place, keeping close tabs on the progress in adhering to those plans, and helping to resolve any obstacles that arise. Both the Deputy Secretary as well as the CFO, George Muñoz, have stressed continuously throughout the Department, with the Inspector General, and with GAO that we need to work together to help IRS achieve a clean audit opinion.

This past June, I believe the Department has made some significant progress. We participated in an offsite meeting with GAO, with our IG's, myself, Tony, and other folks, and we developed a very detailed plan over 3 days to address the 1996 audit issues. We think this meeting was very productive and set the stage, dealing with several issues that have been problematic. I would say that all parties expressed some optimism that real progress can be made toward obtaining an opinion on the IRS financial statements.

To facilitate progress in this area, we plan to have several meetings where IRS, GAO, and Department officials will be present over the next couple of months to make sure that we adhere to the plan and make sure that progress is being made and try to resolve any issues that are outstanding.

The second issue in terms of compliance with A127, as we all have heard, good clean financial systems are what we need to produce clean audit opinions. The Department has made good progress over the past years, as you heard from the GAO folks, again, in migrating toward standard off-the-shelf software for its core accounting systems.

Most of the bureaus now use standard software packages off the GSA schedule. In addition, we are developing Departmentwide accounting principles and standards that incorporate the latest Federal Accounting Standards Advisory Board pronouncements. Of the current rules that are in effect, we feel that we are in compliance and, as the FASAB standards come on line in 1997 and 1998, we will also be in compliance.

I do want to point out that there are some notable exceptions that preclude us from being fully compliant with A127 requirements for the Department. Some examples are at the mint we are replacing a cumbersome accounting system with a fully integrated cost-management system. Now, at the mint for the past 2 years they have still achieved an unqualified audit opinion, but it has been because of very labor-intensive work that will be minimized as we put in this new system. So despite the fact that we have some systems problems at the mint, we were still able to get unqualified opinions.

The IRS revenue accounting system still does not use the standard general ledger, which Tony will talk about, and we have documented pretty well in various different sources as well as in our accountability report, right up front in the executive summary, that the revenue systems throughout the Treasury Department still need some work.

Let me just conclude by saying since the passage of the CFO Act the Department has made steady progress across the Department in obtaining unqualified opinions on the Bureau of Financial Statements. Briefly, in 1993, 8 of our 12 entities that were audited received unqualified opinions; 2 years later that number is improved to 10 out of 13.

To also address a point that GAO made to show that there is progress, GAO mentioned that they had worked with the Customs Bureau and has turned that over to our Inspector General. This year, for the first time, in 1995, Customs made some significant progress. They got a qualified opinion on their balance sheet; they still have a disclaimer on their statement of operations. So that is some progress there as well.

I would just like to conclude by noting that we are trying to address these issues with some short-term solutions, like I mentioned at the mint. These short-term solutions do tend to be resource-intensive but, hopefully, they will pave the way for longer term solutions and better systems that will improve the efficiency of collecting and reporting on this financial information.

Again, we are working closely with GAO. The Department is working to sort of oversee this process with the IRS, and I would be happy to respond to any questions now or after Mr. Musick testifies. Thank you.

[The prepared statement of Mr. App follows:]

Mr. Chairman and members of the Subcommittee, thank you for inviting me here today to discuss financial management in the Department and in the Internal Revenue Service. To paraphrase Secretary Rubin, "As the chief financial agent of the United States Government, Treasury is obligated to manage the resources given to us by the taxpayers with responsibility, accountability, and clarity." Accordingly, achieving sound financial management practices across the Department needs to be, and is, one of our top priorities. These hearings benefit everyone by focusing on the progress we have made and the challenges that still remain.

First, I would like to point out that much of what will be discussed here today is contained in the Department's Accountability Report for 1995. Treasury is one of the six agencies participating in the Accountability Report project under the Government Management Reform Act of 1994. We have furnished your staff with an advance copy of our 1995 report, and final printed copies will be available in several weeks.

In your letter of invitation, you described several specific areas that you would like addressed today. IRS' CFO, Anthony Musick, will specifically cover most of these areas as they pertain to IRS, so I will use my time to address two of the issues I believe you are interested in from a Departmental perspective.

Impact of IRS' problems on the Departmental and governmentwide financial statements

Because IRS collects about 98% of the government's revenues, it obviously has a major impact in terms of materiality on our financial statements -- at the IRS, Departmental, and governmentwide levels. And, no entity can get a clean opinion on its financial statements if its revenues cannot be audited.

Thus, so long as IRS' revenues cannot be audited, neither IRS', nor the Department's, as well as the governmentwide financial statements will be able to receive an unqualified audit opinion.

Like you, we are well aware of the need to resolve these problems, and have continued to provide assistance to IRS in achieving its goals. The primary Departmental role is to work with all concerned parties to achieve our mutual goals. This means making sure that reasonable plans are in place, keeping close tabs on progress in adhering to the plans, and helping to resolve obstacles that arise.

Deputy Secretary Summers has stressed the need for the Department, the Inspector General, and the General Accounting Office to continue working closely with IRS to achieve a clean audit opinion. Further, he has stressed the importance of obtaining clean audit opinions to all Treasury bureau heads.

This past June, the Department participated with the IRS, GAO, and the Treasury IG in an offsite planning session for the audit of IRS' 1996 financial statements. We think this meeting was very productive. It resulted in a detailed plan and schedule for the 1996 effort, and allowed for a

common understanding to be reached on several issues that had been problematic in the past. And, all parties expressed optimism that real progress could be achieved toward obtaining an opinion on IRS' 1996 financial statements.

To continue our efforts to facilitate progress, Departmental officials will participate in a meeting with IRS and GAO on October 3, 1996, to assess the progress being made on the 1996 audit and determine any adjustments that need to be made to the audit plan. We will continue to be closely involved throughout the 1996 audit process, and beyond.

Compliance with the requirements of OMB Circular A-127, Financial Management Systems

One of the key elements in obtaining clean audit opinions, and also in providing sound day to day management information, is having good systems that comply with the financial management systems requirements defined within OMB Circular A-127 (Financial Management Systems).

The Department has made good progress over the past few years in migrating towards standard off-the-shelf software packages for its core accounting systems. The Chief Financial Officers Act, the Federal Managers' Financial Integrity Act, and the Government Management Reform Act have all proven highly beneficial in this regard. Most of our bureaus now use these standard software packages, which are on the GSA approved schedule, for their primary accounting systems. We are also nearing completion of a major revision of the Department's Accounting Principles and Standards Manual, which will incorporate the requirements contained in Federal Accounting Standards Advisory Board pronouncements. While many of the Board's requirements are not effective until 1997 and beyond, we believe we are currently complying with those standards currently in effect.

However, there are notable exceptions that preclude us from being fully compliant with A-127 requirements across the Department. For example, the Mint is in the process of replacing its cumbersome accounting system with a fully integrated cost management system. (While the Mint received an unqualified opinion on its 1994 and 1995 financial statements, this required lots of intensive manual effort.) And, as Mr. Musick will describe, the IRS revenue accounting system does not yet utilize the U.S. Standard General Ledger chart of accounts.

The Department's revenue accounting problems have been well-documented by our revenue collecting bureaus (IRS, Customs, the Mint, and ATF), the GAO, our Inspector General, and independent accounting firms. In fact, the major audit findings from the FY 1995 CFO Act financial statement audits, which are also reported in our 1995 Federal Managers' Financial Integrity Act Report, identify material weaknesses in the accounting systems at these revenue collecting bureaus.

Of course, IRS' revenue accounting problems get the most attention because of IRS' sheer size ($1.3 trillion collected in 1995) and its interaction with the taxpaying public. Coupled with the complexity of its operations, and the material impact of IRS on the Departmental and

Governmentwide financial statements, resolving IRS's problems warrant a continued high level of Departmental involvement.

Concluding remarks

Since the passage of the CFO Act of 1990, we have made steady progress in obtaining unqualified opinions on our bureaus' financial statements. For 1993, 8 of 12 entities audited pursuant to the CFO Act received unqualified opinions; for 1995, that number had improved to 10 out of 13.

Of course, our two largest challenges in this regard are obtaining audit opinions on the revenues of the IRS and the Customs Service. We have plans in place to meet these challenges, and the Department will continue to work closely with both bureaus to keep those plans on track.

Before Mr. Musick gets into IRS' progress and future plans, I would like to conclude by noting that we are addressing short term solutions that, while resource intensive, should allow us to obtain clean audit opinions. At the same time, we are pursuing long term solutions that will improve the efficiency of day to day financial management across the Department.

As you are aware, the IRS' financial management systems are outdated and need to be replaced with state of the art systems, which will improve both internal and external financial information. This is a significant ongoing IRS effort in which we are using the GAO's recommendations as the basis for financial systems improvements.

That concludes my prepared remarks. I would be happy to respond to any questions you may have now, although you may prefer to wait until after you have heard Mr. Musick's statement to ask us questions. Thank you.

Mr. HORN. Well, if you can wait, we would like to get Mr. Musick and then get all of us in the dialog. Mr. Musick.

Mr. MUSICK. Thank you, Mr. Chairman. I am pleased to be here today to discuss the progress the Internal Revenue Service has made in improving financial management as a result of our financial statement audits and the progress the Service has made toward correcting the five major problems cited by the GAO as significant reasons preventing them from attesting to the IRS' financial statements.

The IRS is one of the pilot agencies under the CFO Act of 1990 that has both made progress and faced unexpected challenges in meeting financial audit requirements. The process of preparing financial statements and having them audited imposes a critically important discipline on us.

As you are aware, prior to the enactment of the CFO Act, we were not required to prepare financial statements or to have financial audits. When the GAO began auditing our financial statements in 1992, we were not working with systems designed to provide data in accordance with the CFO Act.

Our revenue and administrative accounting systems were designed many years ago to complement our processing systems. These systems were designed with strong controls but did not provide the information necessary to report on our financial position. In addition to our systems problems, our size alone has made it difficult to quickly obtain a clean opinion. We collect over $1 trillion, handle over 1 billion information documents, process more than 200 million returns, deal with 12,000 financial institutions, and 12 Federal reserve banks in some 600 locations. Any complex system will produce errors, and ours does. We make every effort to detect and correct them promptly.

We are quite concerned that the Service has not received an unqualified opinion on its financial statements, but that does not mean the money the IRS is collecting or spending has simply disappeared or somehow been misappropriated. This has not occurred. Nor do I believe that we are letting audit or financial problems go uncorrected.

To better understand what we are doing to comply with the CFO Act, it is important to keep in mind that the Service has two sets of financial statements, one administrative and two custodial, and has two separate financial processes to track funds: the administrative system that handles our appropriated funds; and our revenue system that tracks tax collections. This distinction is important when reviewing the GAO audit findings and what we are doing to improve both systems to comply with the CFO Act.

Just 5 years ago we had eight separate administrative systems that were not linked to each other. Now we have a single corporate data base for our some $7 billion in appropriated funds. This system fully complies with the joint Financial Management Improvement Program core requirements, including the U.S. standard general ledger and other governmentwide standards.

In addition, in the last several years we made other measurable improvements. For instance, we transferred payroll to the National Finance Center and interfaced this with our accounting system. Our travel vouchers are automated and last year 80 percent of the

travel vouchers were filed electronically and people were paid within 5 to 7 days after their supervisor approved the voucher electronically.

We implemented commitment accounting procedures, so that we would have timely information about how money is being spent and so that we can manage our expenditures more carefully, and we have linked other administrative systems, like the procurement system, which allows us to transfer obligations electronically.

Since the first audit in 1992, I believe we've made significant improvements, resulting in GAO's FY 1994 and 1995 audit reports focusing on two administrative accounting issues: failure to reconcile our cash accounts with Treasury and the lack of receipt and acceptance documentation for some of the non-payroll payments to other Federal agencies, such as rent payments to GSA, and printing payments to GPO.

The overriding problem with both cash reconciliation and receipt and acceptance relates to inter-agency payments. We are currently reviewing this process to determine the issue and how to address those within the organization and also to identify what may be governmentwide problems.

Second, we have reconciled our cash balances to Treasury records through fiscal year 1995, and we are current through 1996. Furthermore, we will ensure that these balances are reconciled on a monthly basis. I might add, when I was here last time I told you that this was inexcusable and we would correct it, and we have corrected the issue with cash.

The three revenue issues identified by GAO relate to design of our system, and that is the revenue accounting and control system, and to accounts receivable. The revenue system was implemented during 1984 and was not designed to provide the detailed information required by the CFO Act for financial statement presentation.

It was designed to ensure that cash is deposited in the bank and that the transactions are properly posted to taxpayers' accounts. It does that very well. The problems with the revenue system have related to its inability to provide detailed transaction data. Because summary data is posted to the system, it could not be reconciled on a transaction-by-transaction basis with our master file accounts.

While we can and do reconcile gross amounts collected, we have been unable to give the auditors the information that they would like to have to tie individual transactions to their source. For fiscal year 1995 we began, in cooperation with the GAO, the extensive analysis and documentation of all revenue transaction flows and source documentation. Detailed flow charts were prepared to document revenue flows between the revenue system and supporting feeder systems.

As a result of this, we began to extract detailed information from the master file to prepare our financial statements and to provide an audit trail. This same process will be used in preparing our fiscal year 1996 financial statements. We are also discussing a short-term solution that would use the standard general ledger purchase for the administrative system to capture and map detailed revenue transaction data from the master file.

Another revenue-related area that has caused concern is converting our inventory of assessments to an accounts-receivable number.

Like businesses, the IRS has accounts receivable. Unlike private businesses, however, our customers are not purchasing products and their credit-worthiness is not determined prior to a transaction. In short, we do not choose our customers. Furthermore, the law prescribes we keep the accounts on the books for 10 years.

To overcome these problems for the financial reporting purposes, the GAO and IRS have agreed to a common definition on how to classify the inventory. Starting with the 1995 statements, we classified the inventory as, one, financial receivables. These were amounts the taxpayers have agreed to pay or courts have set and we believe that they are collectible.

Second is financial writeoffs, which are financial receivables that have subsequently been determined to have no further collection potential and, third, compliance assessments. These are amounts the taxpayers have not agreed to or on which the courts have not acted. We hope this methodology will go a long way to resolving some of our accounts-receivable issues.

Finally, the GAO has also made 59 supporting recommendations through their financial statement audits for the last 4 fiscal years. Of the 59 recommendations, the IRS and GAO agree that we have implemented and thus closed 17 of them. Of the remaining 42, the IRS believes that we have met the requirements to close another 22. However, before we actually close these, we will work with the GAO to get agreement.

I have tried to describe to you the priority and significance that we attach to our financial management responsibilities under the Chief Financial Officers Act. The audits are a tremendous amount of work both for IRS and GAO, but they are also a tremendous help. We believe we are closer to getting an unqualified opinion on our financial statements but we are not there yet.

It is my hope that the IRS in the near future will be looked upon as an example of how the CFO Act has improved the credibility of the Government in the eyes of the public. Mr. Chairman, this concludes my remarks. I would be happy to answer any questions.

[The prepared statement of Mr. Musick follows:]

STATEMENT OF
ANTHONY MUSICK
CHIEF FINANCIAL OFFICER OF THE INTERNAL REVENUE SERVICE

BEFORE THE
SUBCOMMITTEE ON GOVERNMENT MANAGEMENT,
INFORMATION AND TECHNOLOGY

SEPTEMBER 19, 1996

Mr. Chairman and Distinguished Members of the Subcommittee: Good morning.

I am pleased to be here today to discuss the progress the Internal Revenue Service has made in improving financial management as a result of our financial statement audits and the progress the Service has made toward correcting the five major problems cited by the General Accounting Office (GAO) as the significant reasons preventing it from attesting to the IRS financial statements.

IRS Commissioner Richardson testified before you in March of this year on how we are fulfilling our responsibility for implementing the Chief Financial Officers Act of 1990. At that time, she emphasized our total corporate commitment to getting a clean audit opinion from the General Accounting Office by improving financial management in the Service. Today, I appreciate the opportunity to discuss the progress we have made and the cooperative effort we have under way with the GAO.

As a certified public accountant, and with a background as an auditor with a public accounting firm, the Environmental Protection Agency, and the GAO, I believe I can offer a good perspective on the problems, and opportunities, that are presented by a financial audit of any Government agency. I have seen some significant changes in

financial management at IRS -- and will discuss some of those in a few minutes -- but, notwithstanding these positive improvements, I recognize that there is still much to do. We have a detailed action plan that addresses corrective actions and tracks the progress toward correcting deficiencies, implementing identified recommendations, and accomplishing other initiatives aimed toward improving the Service's financial operations.

Chief Financial Officers' Act of 1990

The IRS, as one of the pilot agencies under the Chief Financial Officers' Act of 1990, has both made progress and faced unexpected challenges in meeting financial audit requirements. In this regard, our experience is similar to that of most of the other pilot agencies: only two have received unqualified opinions on their FY1995 statements. However, we are using the CFO Act and the financial statement audit as our blueprint for financial management improvements. The process of preparing financial statements and having them audited imposes a critically important discipline on us -- a discipline that can only benefit the taxpayers of the United States. It is only appropriate that we be held to the same standards to which we hold taxpayers.

Since the CFO Act became effective, we have made significant improvements in our financial management systems, and now have a new administrative accounting system. We are also working on short-term solutions and long-term redesigns that will modernize our revenue accounting system and ensure that it provides information that is needed for the financial statement audit. However, the CFO Act and the financial

statement audit have created significant challenges for us as a large, mature organization.

Financial Statement Audit - A Major Challenge

As you are aware, prior to enactment of the 1990 CFO Act, the IRS was not required to prepare financial statements or to have financial audits. When the GAO began auditing our financial statements in 1992, we were not working with systems designed to provide data in accordance with the CFO Act. Our revenue and administrative accounting systems were designed many years ago to complement our processing systems. These systems were designed with strong controls but did not provide the information necessary to report on our financial position.

In addition to our system problems, our size alone has made it difficult to obtain a clean opinion quickly. As the primary collector of the nation's revenues, we collect over $1 trillion, and GAO has verified that this has been properly deposited in the Treasury. This is no small accomplishment for an organization that also handles over one billion information documents per year, processes more than 200 million returns, issues more than 90 million refunds, and deals with over 12,000 financial institutions and 12 Federal Reserve Banks in some 600 locations. Any complex system will produce some errors, and ours does, but we make great efforts to detect and correct them promptly.

We are quite concerned that the IRS has not "passed" its financial audit. But it is important to understand, as is explained in the GAO report, that the GAO is unable to reconcile amounts reported in the financial statements to the detailed accounting

records. It does not mean that the money the IRS is supposed to be collecting or spending has simply disappeared -- or somehow been misappropriated. This has not occurred.

Results of FY 1995 Audit

The IRS' first financial statement audit by the GAO was for FY1992. Since that time, as I mentioned earlier, we have made some significant improvements. The GAO has recognized the progress we have made since 1992 in implementing a new administrative accounting system, in transferring our payroll processing to the Department of Agriculture's National Finance Center, and in improving the accounting for federal revenues. They also provided us with 59 recommendations for improvements that are needed throughout our financial management operations.

Even though we have received a disclaimer each year, I think it is misleading to characterize our financial management problems as ones that "remain uncorrected." We have not been ignoring them. In the FY1995 audit report, GAO noted that progress had been made, but that many of our corrective actions were not completed at the conclusion of the audit. Our corrective actions are being taken in close coordination with GAO, and they will continue to monitor our progress and advise us on the results.

For example, in June, I met for three days with GAO and Treasury Inspector General representatives to review the FY1995 audit of the financial statements and plan for the FY1996 audit. We discussed short-term and long-term strategies for resolving our audit issues and identified detailed actions which were incorporated into

our action plan. We plan to hold follow-up meetings with GAO to ensure that the FY1996 audit stays on schedule and that issues raised are resolved promptly.

We believe it is very important to work closely with the auditors, whether they are the GAO, the IG, or a public accounting firm. As I have stated, we have not been standing still. Over the past four fiscal years, GAO has been unable to attest to the amounts reported on the IRS financial statements; however, in fiscal year 1992 we had eight separate administrative systems that didn't talk to each other, the revenue system flows had not been totally documented, and we did not have a definition of accounts receivable. We now have five basic issues we are working on with the GAO -- I will address each of these later in my testimony.

To better understand what we are doing to comply with the CFO Act, it is important to keep in mind that the Service has two sets of financial statements: (1) administrative and (2) custodial; and has two separate financial processes to track funds: the administrative system that handles our appropriated funds and our revenue system that tracks tax collections. To recognize the distinction between these two systems is important to understand the GAO's audit findings and what we are doing to improve both systems to comply with the CFO Act.

Improvements in Administrative Accounting

We are very proud of the significant improvements we have made in our administrative accounting system. Just five years ago, we had eight separate systems that were not linked to each other. Now we have a single corporate data base for our approximately $7 billion in appropriated funds. This system provides an integrated,

auditable, comprehensive accounting and budgeting system that fully complies with the Joint Financial Management Improvement Program (JFMIP) core requirements, including the U. S. Standard General Ledger (SGL), and other government-wide standards that apply to automated financial systems. It collects, processes, maintains, transmits, and reports data about financial events; supports financial planning and budgeting activities; accumulates and reports cost information; and supports the preparation of financial statements. In addition, in the last several years we have made other measurable improvements. For instance:

- As stated, we implemented our integrated financial system. We also transferred payroll to the National Finance Center, and integrated other administrative systems to capture data at the source and transmit this data electronically to our corporate financial database.

- Our travel vouchers have been automated nationwide. The traveler keys the travel information into the system, certifies the electronic voucher, and sends it to the supervisor. Once the supervisor approves the voucher, the traveler will receive payment in 5 to 7 days Over 80% of our travel vouchers were processed this way in FY 1995

- We implemented commitment accounting procedures, so that we will have timely information about how money is being spent and so that we can manage our expenditures more carefully.

- We linked the procurement system with the administrative accounting system to enable obligations to be transferred electronically.

Since the first audit in 1992, I believe we have made significant improvements, resulting in GAO's FY1994 and FY1995 audit reports focussing on just two administrative accounting issues -- failure to reconcile our accounts with Treasury and the lack of receipt and acceptance documentation for some non-payroll payments to other Federal agencies, such as rent payments to GSA and printing payments to GPO.

The overriding problem with both cash reconciliation and receipt and acceptance relates to interagency payments. We are currently reviewing this process to determine the issues that we have to address and identify those that may be Government wide; therefore, the solution may require the assistance of GSA and GPO, as well as other Federal agencies.

We have reconciled our cash balances to Treasury's records through FY1995 and we are current on our FY1996 reconciliations. Furthermore, we will ensure that these balances are reconciled on a monthly basis. However, we still have transactions in a budget clearing account and in suspense accounts that will be resolved during our year-end processing.

Accounting for the Revenue that the IRS Collects

The Revenue Accounting Control System (RACS), which was implemented during 1984, was not designed to provide the detailed information required by the CFO Act for financial statement presentation. It also does not use the Standard General Ledger because it was designed in 1984 to ensure that cash is deposited in the bank and that the transactions are properly posted to a taxpayer's account. It does this very well. However, we also believe that the system meets all the Treasury Financial Manual reporting requirements and provides data to meet the Federal Accounting Standards Advisory Board (FASAB) reporting requirements.

Most of the problems raised by GAO concern the substantiating of data with the revenue collected. Because summary data is posted to RACS, it could not be reconciled on a transaction-by-transaction basis with our Master file accounts.

While we can and do reconcile gross amounts collected, we have been unable to give GAO auditors the information that they would like to have to tie individual transactions to their sources. Because the revenue system was not designed to provide financial position data and does not track to detailed transactions, our challenge is to augment our revenue accounting information to meet the requirements of the CFO Act.

For the FY1995 audit in cooperation with the GAO, we began the extensive analysis and documentation of all revenue transaction flows and source documentation. Detailed flowcharts were prepared to document revenue flows between RACS and supporting feeder systems. Site visits were made with the GAO to all service centers to validate these flowcharts and further document, as necessary, detailed transaction flows that were unique to a service center. The results of this process provide a solid foundation for the auditors and us to better understand our processes and assist us in developing data extracts to meet audit requirements.

In 1995, the IRS also greatly refined its process to generate detailed transaction data from the Master file. This same process will be used in preparing our FY1996 financial statements, even as we continue to build on our experience and to refine our program extracts.

In June 1996, the Service implemented the Interim Revenue Accounting Control System (IRACS) nationwide to replace RACS. Through this effort, our primary focus was limited to moving the existing software to a new platform and making minor

modifications to the programming. This was not intended to address the financial issues.

IRACS connects the database located at our Detroit Computing Center with our 10 service centers. The system:

- improves balancing routines and validity checks;
- provides additional information on-line;
- retains three years' worth of data instead of the one month that was retained in RACS; and
- interacts electronically with, and extracts data from, other tax processing systems.

Finally, the Service is currently considering various avenues to provide detailed transactions and to move toward implementing the Standard General Ledger for revenue transactions. As an example, we are discussing the potential of using the SGL purchased for the administrative system to capture detailed transactions from the Master file and map that data to the revenue general ledger. This would allow us to meet the requirement for an SGL in the revenue system and give us the detail necessary to support a large percentage of our custodial financial statement information. However, this will also give rise to other issues such as reconciling the data in the revenue system with the general ledger. In this effort, the Service would then move forward to incorporate the need for controlling transactions with the need for financial reporting.

Accounts Receivable

Another area that has caused concern is converting our inventory of assessments to an accounting definition for accounts receivable. Like businesses, the IRS has accounts receivable. Unlike private businesses, however, our customers are not purchasing products, and their credit-worthiness is not determined prior to a transaction. In short, we do not choose our customers. Furthermore, the law prescribes how long we must keep accounts receivable on the books -- 10 years. Thus, unlike private sector businesses, the IRS' accounts receivable cannot be written off for 10 years even when we know that they are not collectible.

It is also very important to realize that we start with an inventory of accounts, not a true accounts receivable like a business that sells a product or service. Let me explain what makes up the total amount of the inventory. When taxpayers either do not file returns or file inaccurate returns, we make assessments based on the tax laws irrespective of collection potential. We record these unpaid assessments and keep them on our books for as long as they are legally collectible. While we attempt to collect these debts, some accounts are obviously uncollectible for various reasons -- for example, the taxpayer has died or is insolvent. In other words, we know at the outset that some of these assessments will not be collected. But beyond unpaid taxes, our gross accounts receivable also include the ever-increasing interest and penalties related to those unpaid taxes.

To overcome this problem for financial reporting purposes, the GAO and IRS have agreed to a common definition of financial receivables. Starting with the FY1995

statements, we classified amounts as financial receivables (the amounts that taxpayers have agreed to pay or courts have set, and we believe are collectible), financial write-offs (financial receivables that have subsequently been determined to have no further collection potential), and compliance assessments (those amounts that taxpayers have not agreed to or on which the courts have not acted).

We will continue to make changes to the present inventory system to meet our financial reporting requirements. This involves correcting some deficiencies in the present systemic process, requesting some additional Master file reports, and continuing to evaluate and analyze the procedures and policies for how the data is entered into our current systems. We believe these steps will provide us the best means of defining and reporting on our accounts receivable in accordance with applicable accounting standards, at least in the near term.

Progress Toward Correcting the Five Major Problems Cited by GAO

Although I have briefly described what we are doing to address the five major issues cited by GAO, let me summarize what we are doing on each issue.

1. **The amounts of total revenue and tax refunds cannot be verified or reconciled to accounting records maintained for individual taxpayers.**

   We have devised a new approach to provide GAO with detailed revenue and refund data. Instead of starting with summary amounts in the Revenue Accounting and Control System (RACS), the Service's Master File records were used as the basis to support revenue receipts and refunds reported on our financial statements. Our revenue system was then reconciled to the Master File

records. To support our financial statement information for the FY 1996 audit, with concurrence of the GAO, we have pulled interim (six month) detailed transactions from the Master File and are reconciling it to RACS. I believe that GAO will verify our extract process and begin their testing for 1996 much earlier than in prior years.

2. **Amounts reported for various types of taxes collected (social security, income, and excise tax, for example) cannot be substantiated.**

In preparing our FY1995 financial statements, we made great progress in developing methods to substantiate the revenue collected. For Social Security, we developed an extract that enables us to report and match assessment and collection information. As stated earlier, we are also using the Master File to provide all detailed transactions to support income tax collected. Finally, for excise taxes, we will continue to perform analysis of monies assessed and collected to determine if there are significant differences. Additionally, to prepare for the FY 1997 statements, we are developing programming that will enable us to have detailed assessment and collection information as we do with Social Security.

3. **The reliability of reported estimates for $113 billion in accounts receivable and $46 billion for collectible receivables cannot be determined.**

During the prior audit, initial testing by GAO resulted in its conclusion that the Service's systemic program that classified receivables as compliance assessments, financial receivables, and financial write-offs was, in fact, flawed,

thus putting our entire reported accounts receivable portfolio amount in question. The GAO curtailed its audit at that point prior to reviewing any detailed source documentation for the selected cases. Based on its review of cases this year to determine the validity of our categorizations, GAO has indicated that the systemic process is more accurately segmenting our portfolio of receivables. Their next step, scheduled for October-November of this year, is to review the supporting source documentation for the selected cases to verify they are accurate.

4. **A significant portion of IRS' reported $3 billion in nonpayroll operating expenses cannot be verified.**

This is a receipt and acceptance issue related to goods and services received from other federal agencies paid via the government's Online Payment and Collection (OPAC) system. The basic question is: "Did we get what we paid for?" The bulk of these payments are made to the Government Printing Office (GPO) for tax and other publications, and to the General Services Administration (GSA) for rent and other reimbursable services. We have been working closely with GAO to define the problem areas and to propose interim and long-term solutions to the receipt and acceptance issues. We are also working with the program areas in IRS--e.g., Publishing Services and Real Estate--on the development of new procedures for receipt and acceptance and with the other agencies themselves to resolve ongoing OPAC payment issues. Additionally, we are working with our procurement office on the development of new

procedures for interagency agreements to ensure that all other interagency payments will be accounted for properly and timely.

5. **Amounts reported as appropriations available for expenditure for operations cannot be reconciled fully with Treasury's central accounting records.**

To address this issue and ensure that future cash balances would be reconciled timely, we instituted an automated cash reconciliation program, with contractor assistance, during FY1995. This program included all of the Service's operational appropriations. Adjustments to cash balances were identified and will be posted to correct the FY1995 balances. The adjustments are currently being reviewed by GAO for appropriateness and accuracy. During FY1996, we completed the cash reconciliation process by reconciling with Treasury the remaining cash balances, which consisted of Budget Clearing Accounts and Suspense Accounts. Required adjustments are being identified and will be recorded to the accounts prior to closing the books for FY1996.

Status of the 59 recommendations

The GAO has made 59 supporting recommendations through its financial statement audits for the last four fiscal years. Of the 59 recommendations, the IRS and GAO agree that we have implemented and thus closed 17 of them. Of the remaining 42, the IRS believes that we have met the requirements to close 22. Before we actually close these, we will work with GAO to get agreement. Of the remaining 20, 11 are scheduled to be completed by January 1, 1997; five by September 30, 1997; and the

last four have completion dates beyond the end of FY1997. The IRS is committed to working with GAO to resolve these recommendations and believes that through mutual cooperation and effort we will achieve this goal.

In addition to work on the action plan, we need to determine how we can account for revenue processing and bring it into compliance with federal accounting standards. The action plan covers in detail all the issues relating to administrative accounting, accounts receivable, and revenue accounting and represents the efforts of the CFO in cooperation with the other functions in the Service to continuously strive for improved financial management and ultimately a clean audit opinion.

Conclusion

I have tried to describe to you and the members of the Subcommittee the priority and significance that we attach to our financial management responsibilities under the Chief Financial Officers' Act. The audits are a tremendous amount of work -- both for IRS and GAO -- but they are also a tremendous help. We believe we are closer to getting a clean opinion on our financial statements, but we are not there yet. It is my hope that the IRS in the near future will be looked upon as an example of how the CFO Act has improved the credibility of government in the eyes of the public.

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Mr. Chairman, that concludes my remarks. I would be happy to answer any questions.

Mr. HORN. Well, thank you very much. I will start with one question for both of you—it is the same question. When you have got a problem that you see and you feel—and we will start with Mr. App, who is Deputy Chief Financial Officer for the Treasury—and you feel you cannot resolve it, on whose door do you pound to get some guidance and some help, Mr. App?

Mr. APP. First of all, I would say that within the Treasury Department we have learned a lot of lessons over the last couple of years, as I mentioned in the progress that each bureau has made, and going into 1996 we have actually had several meetings where IRS and all the bureau people are there, sort of being our own consultants and sharing information, and we have used that to produce kind of lessons-learned documents so that bureaus who are not quite there yet can learn from those that are. So in a way we have done some of that self-critique and learning and consulting with ourselves.

Absent that, we do rely on the different auditors. We use some private-sector firms as well as our IG, and GAO to help make recommendations and then try to implement them. If we fall short on the implementation side and we feel we cannot do it ourselves, I would imagine we would seek outside support from somewhere.

Mr. HORN. Well, let's say you have a recalcitrant bureau chief who has been there for 30 years and he has seen administrations come and go—I am sure you do not have anybody like this, but I have seen them somewhere in some administration—and he just waits you out. Now, what do you do when you have got that type of obstacle and you have tried charm, you have tried persuasion, you have tried logic, you have tried everything you can think of, and you are just at a dead end? Whose door do you knock on to share the problem and get a little help?

Mr. APP. I think you go to the highest levels in the Department. As I mentioned, the Secretary, who has just signed the 1995 report, and the Deputy Secretary, are aware of these issues and you go to them, first, as well as these oversight hearings, I think, help create a certain amount of peer pressure to get the job done, and if there are people that need to be shuffled around, then I guess that might be part of it as well.

Mr. HORN. Now, you are the Deputy Chief Financial Officer.

Mr. APP. That is right.

Mr. HORN. What does the Chief Financial Officer do in Treasury? I notice you did not knock on his door.

Mr. APP. The Chief Financial Officer at Treasury has a lot of things under his jurisdiction. One of those is to try to get all bureaus in a clean opinion and has been instrumental in both volunteering the Treasury Department to be a pilot in the accountability report—also, governmentwide, chairs the CFO Council and has tried to lift all the agencies in terms of a lot of these different standards, so it is a division of labor, if you will, that we try to achieve.

Mr. HORN. Basically, isn't the truth of the matter you are the Chief Financial Officer, you just are not paid that?

Mr. APP. No, that is not correct.

Mr. HORN. Well, you are free, you say, to walk into the Deputy Secretary's office or the Secretary's office if you have got a real cri-

sis, right, somewhere in Treasury that they ought to know about before they read it in the Washington Post or the Washington Times?

Mr. APP. The CFO at Treasury has raised this. The Deputy Secretary and the Secretary have talked to all the bureaus about the urgency of getting clean opinions as well as the IRS, so the CFO has raised it to the highest levels in the Department, and the Secretary and the Deputy Secretary, as Tony can attest to, have talked to the IRS Commissioner as well about it.

Again, when we see progress in all the bureaus, we are marching toward having all the bureaus get clean opinions. Customs made significant progress this year. So did ATF. So we really want everybody to get there and there has been the highest urgency established.

Mr. HORN. Is there an executive committee that meets in the Treasury where the Secretary presides or the Deputy Secretary presides and they meet with assistant secretaries and bureau chiefs, or how does it work down there?

Mr. APP. Yes, there is. There is a meeting on a regular basis that the Secretary and/or the Deputy Secretary chair and all the bureau heads are present at that meeting and issues like this are raised. In fact, at one of the recent meetings they had this particular issue was specifically raised by the Deputy Secretary to all of the bureau heads on the advent of us releasing the 1995 accountability report.

Mr. HORN. Is this a working meeting or a ceremonial meeting? By that, I mean do they all sit around like chickens on a chair or do they get into a discussion and really discuss a topic until they get some resolution of it?

Mr. APP. They tee up all the critical issues and they do discuss them.

Mr. HORN. How often does that go on, weekly, monthly?

Mr. APP. I think it is every other week.

Mr. HORN. Every other week. Now, who represents the role of the Chief Financial Officer at that meeting, you or Mr. Muñoz?

Mr. APP. Mr. Muñoz.

Mr. HORN. OK, do you sit in on this meeting?

DR. APP: From time to time Tony and I have been asked to come to make presentations on selected topics.

Mr. HORN. So you do not sit in throughout the meeting?

Mr. APP. If we are invited to a particular meeting, we would sit in for the whole meeting, but not every meeting.

Mr. HORN. OK, let's go at IRS. If you need some help, Mr. Musick, whose door do you knock on at IRS?

Mr. MUSICK. The Deputy Commissioner and the Commissioner, plus on Mondays and Fridays we have meetings with the other chiefs along with the Deputy Commissioner and the Commissioner to bring these type of issues up.

Mr. HORN. So if you have got a problem with a recalcitrant bureau chief somewhere in IRS, then, and you have tried everything, you are saying you get the support to deal with that?

Mr. MUSICK. I definitely do, and I have another way to resolve it, also. As we mentioned, we now have a corporate data base and I control both the budget and the accounting, and if I have a prob-

lem I will make sure they won't process any of their funds that they have been authorized to use until we get it resolved.

Mr. HORN. That helps get their attention.

Mr. MUSICK. I have noticed that money always helps.

Mr. HORN. I have used that method myself on some occasions.

You have heard the GAO testimony when I asked them, OK, if you went in there, what would you guys do, and gals? So what did you think, were they on target there?

Mr. MUSICK. I think they are on target and, to be very candid, within the IRS I think we have done some of those things. About 3 or 4 months ago we had an executive conference. The Commissioner asked me to get up and speak about the financial audit. I told them some of the problems we were having and how we needed their help throughout all these districts to make sure that people are following the rules and not to be real creative in what they were doing and just, again, comply with the existing rules.

Second, we are taking a look at the systems. I think, as I mentioned to you and as GAO said, we have come a long way, I think, on the administrative side. We need to see what we can do with the revenue side. The revenue system that was designed to ensure cash gets to the bank and transactions are posted to the master file, that works. The other two pieces we are trying to do is to figure out to find out our financial position and try to track data on a transaction-by-transaction basis.

What we just started to look into was is that we have the equivalent of a standard general ledger, or the standard general ledger, on our administrative system, can we use that or something like that to post these transactions? What that would mean is that we would probably be running two systems for a while until we could figure a way to marry those together. So I think we have taken care of that.

The last point, I think, with GAO's help this last 6 months, the Department's help, and a lot of work of people within the Internal Revenue Service, we have a detailed action plan and we have put that together, and I know that the committee has asked for it and I brought at least one copy here I can leave with. It tells the status of where we are. It talks about what we are going to do to get there, and it also identifies what we are planning to do for the remaining recommendations that are open, also. That is on a data base that we update monthly and track that on a monthly basis.

Mr. HORN. Let me pursue that a little more, because Mr. Dodaro and Mr. Holloway, in their comments, in essence, said one of the problems is that the CFO in IRS has responsibility over the administrative accounts but not the revenue accounts. Now, how much of a problem is that?

Mr. MUSICK. Well, my personal opinion is that right now I do not see that as a problem, because, as I mentioned earlier, I have a very good working relationship with the folks that are in the revenue accounting. I think the difficulty is when you get into this and you look at 10 service centers with thousands of people, it is just not revenue accounting that is going on, it is the processing of those returns and that paper.

In my own head I have not figured out a way to separate that from—the revenue piece away from the processing piece. So what

we have done in the CFO area, we have set up a small group to work with the revenue people to try to figure out what we need to do to meet the requirements of the financial audit and the CFO Act, but allow them the opportunity to continue to process things for tax administration.

Mr. HORN. How you monitor revenue—you obviously check it in, in terms of the check has arrived. Do you deposit it as fast as you can in the Treasury depository so it is earning interest for the Government and that kind of thing?

Mr. MUSICK. That is right.

Mr. HORN. Now, what is missing here that a corporation, which also has revenue coming in, does that we are not doing and seem to have difficulty doing? Have you served in the corporate world at all?

Mr. MUSICK. I have served a little bit and I did some financial audits like 25 years ago, but I think the biggest thing is that people are complying with a tax law. They are not selling a product. I do not have a day-to-day business going on with you as a supplier of my products. Therefore, do I need a subsidiary ledger to figure out how much you as a supplier either I owe or you owe me on a day-to-day basis?

Our master file is set up by taxpayer and we know what those amounts are that are owed and we can track the data coming in. I think that is the same problem we are having with accounts receivable. We assess based on people not complying with the tax laws. We have to do a lot of work after that to determine if that is truly an accounts receivable and they owe us money. Sometimes they do and sometimes they do not, and that is the difficulty that we had, is taking this large number that is an inventory of assessments and trying to get it down to an accounting term of an accounts receivable, what is really owed out of that. So you are starting with an inventory and getting down.

A corporation knows, when they sell a product, you owe them either a product or a service, and it is a little bit different. I think that is probably what I would see as the main distinction. And how we adjust that and how we adapt our systems to that, I will tell you, is very difficult. We have very complex systems and that is what has taken us so much time.

Mr. HORN. What about a bank that is collecting on a mortgage? Is there some similarity there to what you are doing?

Mr. MUSICK. The similarity is that I have signed a contract and a mortgage. They lent me money and I have to pay that money back, the same as a credit card lends me money, except they give me a piece of plastic and I charge on it and I pay that money back on a periodic basis, usually monthly.

You know, we deal with people maybe once a year and that is when they file their returns.

Mr. HORN. But with a bank you log it—or any institution that has got a loan out—you log it in and you deposit it and you know how much more you are going to get the next month.

Mr. MUSICK. Yes, and we do that and it goes into the master file. The difficulty is we bundle all these transactions up and summarize them and post them to the accounting system. What we do not

have is the system does not track each detailed transaction going through the process. It tracks them in lumps.

Mr. HORN. Well, OK, so that is where part of the problem is.

Mr. MUSICK. That is part of the problem.

Mr. HORN. So give me an idea of some of those transaction points in the process that normal accounting in a corporation would pick up and you are not picking them up because they are apparently going through in groups of checks? They are not individual?

Mr. MUSICK. Well, they are going through a summary data. I think a corporation would have an individual account for everybody and they would track every one of those transactions. Our master file does that, but the accounting system that controls that does not link back to it on a detailed basis.

If we had a company with five of us in this room that you were collecting money from me and I owed you money as a corporation, that would probably come through and each transaction would individually be posted. We do that. The accounting system would probably pick that up, also.

What we do is lump all that stuff together to make sure it gets through the pipeline which we call our tax processing, and it does post individually but we track it at a summary level. So after it is posted, I cannot take and say, OK, this block of numbers relates to this one transaction in the master file.

Mr. HORN. What are the cost implications and the time implications if you took a check from a taxpayer and you had to account for that throughout the system from one point to the other? I mean, if that is what you are saying we do in the private sector, generally, we account for that movement along.

Mr. MUSICK. Yes, and that is what we are trying to do on an individual transaction basis. We do do it on a summary basis, by which I mean 100 of these are lumped together.

Mr. HORN. What is the cost and whatnot if you did it on an individual basis? I realize there is the American people is what you are talking about as a customer——

Mr. MUSICK. Right.

Mr. HORN [continuing]. Or the American homeowner or renter, or whatever.

So you know, how do we get—do we ever get to solve this problem, given the accounting standards?

Mr. MUSICK. Yes, we can solve the problem. I think we have——

Mr. HORN. How do we solve it?

Mr. MUSICK. Well, I think if you can picture that we have multiple systems that do this collection and they go through a number of other systems to get to the posting of the master file, what we have been doing, what we did in 1995 and we plan for 1996 at the end of the fiscal year, 99 percent of the transactions are sitting, probably, in the master file and have been posted.

So we have determined extracts that we can pull all that detail out, and we are doing that now so that we can provide it to GAO so that they can do the audit. We also have that detail in a way that we can now summarize the data any way we need to.

The other piece of that would be is instead of just doing an extract, we would pull that data and figure out a way to post it as

the Government standards require, with a Government standard general ledger, on a transaction-by-transaction basis.

The solution that we are trying to look at is that we are doing that on our appropriated funds, is there a way to take that system, or pieces of that system, and move it over and do it on our revenue that we collect.

Mr. HORN. In terms of looking for fraud, when that check comes in to one of your processing centers, once it gets deposited in the Treasury, you do not have to worry about that check any more, right?

Mr. MUSICK. Cash goes into the Treasury.

Mr. HORN. The cash goes in the Treasury, it is safely there, the check is filed—I don't know, what do you do with those checks anyhow? Do you keep them or do you burn them, photograph them, or what?

Mr. MUSICK. I never thought about. I don't think we——

Mr. HORN. It goes back essentially to the bank?

Mr. MUSICK. Yes.

Mr. HORN. I am just curious. Is there any danger in the process you are using now of fraud occurring and you cannot find it, where somebody just creams something off the account somehow, and have you had any of those cases?

Mr. MUSICK. I am not aware of any of those cases in my tenure as the CFO. I am not aware of that. Over the last year and a half I have not heard of any of those cases. There is fraud detection that goes on as it relates to tax administration, and that is always going on, but I am not aware of anything internally where there has been any fraud identified.

Mr. HORN. OK, in terms of the payment transaction process you are not aware of any fraud?

Mr. MUSICK. Not at this point.

Mr. HORN. So you are saying it can only occur in IRS in the tax administration part. Now, how does that work?

Mr. MUSICK. Well, that is what I have been explaining, the tax administration part. Either the cash is deposited in the bank, depending on the type of payment it is—it is usually from a corporation for a Federal tax deposit which would include excise taxes, Social Security taxes—that goes directly to a bank and they collect that for us and that goes to the Treasury Department. The paperwork comes in and it gets processed through the system and the organization gets credit for it when it is posted to the master file account.

Some checks will come into the service centers at the end of the year for tax payments or estimated payments during the year and those would get processed. Those are reconciled on a nightly basis and resolved every night. Any issues resolved at night the taxpayer gets credit and the deposits are made directly to the bank.

The other thing is that we have been moving to try to use lockboxes, where the taxpayer would send checks directly to a lockbox, and so only you would be getting the paperwork to process the transaction through the service center.

So there are controls in place to ensure that the cash is there and to ensure that the taxpayer is getting credit. The difficulty, as I have tried to say, is that some of this is done at a summary level

and try to get the detailed transactions so that we can get the statements audited is what has been the difficulty.

Mr. HORN. Have you ever had cases where the taxpayer says, "Wait a minute, I sent my check in and it has not cleared my bank." What do we do in those cases?

Mr. MUSICK. I could get that answer for you. I don't know, because I don't have direct responsibility over the tax administration, but there is a series of controls in place like any organization has. I can tell you that we would resolve that.

I would sit here and be the first one to tell you that we don't post everything to the taxpayer's account accurately and I am sure we make mistakes, but one of the best controls you have is the taxpayer, who will come back in and say IRS has made a mistake and fix it. And those errors are corrected as soon as they are found and determined to be found.

Mr. HORN. Staff is interested in this one. What is the reason that there are differences between what employers report on their 941 reports and what is collected by the IRS?

Mr. MUSICK. Again, I would have to look into that, but the issue would be is that the employer—we have an FTD coupon right now, we are hoping to automate that process, where the employer would pay a certain amount and they could check the box off. That cash comes in and that cash is posted to their account. Then we get their return, which is the assessed amount, and that comes in and we match those up. I would have to look in to find out individual reasons, but possibly they did not estimate correctly might be an issue, or they just did not pay, they did not file the return, it could be a number of reasons, I guess, but I could get you more specifics on that.

Mr. HORN. Because we are talking, really, Social Security and excise taxes here.

Mr. MUSICK. Yes, excise taxes, Social Security taxes, those types of things.

Mr. HORN. I take it GAO feels that there are differences between, say, the private sector and IRS on how that might be handled?

Mr. MUSICK. There are, and one of the issues is that the law states that we turn over to the Social Security the assessed amount which is on the return. Now, the way I work that in my mind is that an employer makes deposits, and say they don't deposit enough cash, we would still turn over what was the assessed amount. That goes into our queue of our accounts receivable and that has to be worked like any other tax receivable.

Mr. HORN. And you would then bill them or what? Or you just assess them when their tax form is finally filed?

Mr. MUSICK. Probably assess them, send them a notice, try to find out what the problem is. There is a whole series that I would have to get you the answer for, what we go through for each type of a transaction.

Mr. HORN. As I understand it, the Treasury transfers the funds based on what the employer reports to the trust funds?

Mr. MUSICK. That is right.

Mr. HORN. And you are saying that is a little dubious sometimes as to whether that is the appropriate amount to be filed? But some-

times you never know. Let's say you are an individual quarterly that has to file and this quarter you suddenly have a drop in your business, so you don't have to do all that.

Mr. MUSICK. Right.

Mr. HORN. At the end of the year is the only time you are really going to know where you are.

Mr. MUSICK. Right, but it is my understanding the law requires us to transfer that amount. Like I said, if they didn't pay, then we would go back and collect it like an accounts receivable; it would go into the receivables queue.

Mr. HORN. Of the 59, or whatever it is—what is it, 59 recommendations, of the GAO——

Mr. MUSICK. Fifty-nine recommendations, yes, sir.

Mr. HORN [continuing]. Which are the ones that you feel you just cannot get done? Have you analyzed that? Or would you just say they are off the track?

Mr. MUSICK. Yes, we have analyzed all of them. Like I said, I would be glad at some other time to go through every one, but we have sat down and we feel that there are only four that we see that are going to go beyond, I believe, 1997.

Probably the one that is causing us one of the more significant problems, and I am not too sure if it is laid out as one recommendation, is the issue I just mentioned about trying to accommodate the revenue transactions into a standard general ledger and to be able to prepare financial statements from something like that. We are not really sure if that will work, but we think it will.

Mr. HORN. One of the problems you find any time you deal with computers is computers are not the magic bullet. You have got to look at the system and change that.

Mr. MUSICK. That is right.

Mr. HORN. Most of the things in terms of the computing that needs to be done, have you got the type of equipment you need now, or the software that goes with it, or can this be off the shelf? Given your unique situation on the revenue side, you are going to have to face up to other ways to write that program, but what is your feeling on the hardware, the software, as to whether you get it off the shelf or are we into one of these crazy FAA-type boondoggles or military-type boondoggles where they don't solve the problem? They could have solved it if they took it off the shelf. Everybody has got their view of how the design should be, nobody has the guts to say no, and the next thing you know you are into $3 billion and nobody is doing anything.

I have had enough experience with those. They tire me. So what are you going to do about this stuff?

Mr. MUSICK. OK, let me go back and mention that the administrative system that we have, which is a corporate data base, is off the shelf. We purchased that off the shelf.

Now, go to the revenue system. We currently have a revenue system, as I mentioned, that ensures cash is deposited and that transactions get posted. What I would like to try to do is use the off-the-shelf standard general ledger in the administrative system to pick up the other data that is needed to meet the requirements of the CFO Act.

The issue I don't know, and I am not an I.S. person, is how I then take the system that controls the transactions going through the pipeline with the system that is going to provide me financial position and marry those together. I don't have an answer for that. I don't know if it would have to be built or if I would contract to have it built or you could take an off-the-shelf package and modify it to meet that. I don't have an answer for that. But that is the approach we are trying to take right now.

Mr. HORN. What is your timetable to resolve that as to what the answer would be?

Mr. MUSICK. Well, the short-term timetable, I hope, would be some time next year, 1997, I would hope, by the end of it or the beginning of the fiscal year, but I don't know if that is going to be realistic. The long-term approach, we would probably be looking at determining at that point over the next year as we try to implement the standard general ledger for the revenue pieces to determine what I would call a phase two, is how would we marry these two together. Again, that might take a few years down the road. I really don't have a timeframe set for that right now.

Mr. HORN. Well, apparently you are just absolutely not going to make the balance sheet requirement of the act.

Mr. MUSICK. Well, what we are trying to do, and that was the point that we met with GAO and I believe that GAO is going to have to see how well we did that this year, we can make the balance sheet requirements, and the way we are doing it is extracting all the detailed data out of the master file to build those financial statements on a transaction-by-transaction basis.

Then what we are trying to do is say if we have got all this detailed data out of the master file, on the one hand, we have the summary data in the revenue system, the issue is can we reconcile those two systems? And if we can reconcile those two systems, we can build the financial statements and GAO will have an audit trail that will go back to look at detailed transactions.

One of the other things that we have been wrestling with, because of the issue of source documentation, is that a lot of the way the data is filed in our service centers is how it was filed for tax administration, not how it was filed to provide support for a financial audit.

An example would be if somebody is under appeals or having an exam and they are looking at 3 years of tax returns, it might get all filed back with the final results, all 3 years, but the financial audit might want to come in and look at one of those pieces of data, and that is some of the problems we have been having, trying to wrestle with.

I would say, finally, the other issue we are trying to balance is that we have got to balance the requirements for the financial audit with the continuing requirements of tax administration, of collecting the money, and ensuring that the taxpayers' accounts are properly credited.

Mr. HORN. What is your reprogramming authority within IRS?

Mr. MUSICK. I believe between appropriations we have 5 percent.

Mr. HORN. On the debt collection law which I got through, the parallel is coming out of Congresswoman Johnson's subcommittee, which will apply to the IRS, since Ways and Means had jurisdiction

on that—as you know, some of the collection money goes back to each agency so they can use it to improve the collection systems, and you could certainly, it seems to me, justify that to clean up some of the systems you are troubled with.

What I am wondering is, has any plan been submitted to the relevant appropriations subcommittees in either body as to what you are going to need to get into conformity under this act?

Mr. MUSICK. I don't believe so. What we have been trying to do is we get a separate I.S. budget and we have been laying out a plan to try to get funds out of that appropriation to take care of this. We have an investment review board which we just—that manages those projects and that was just started several months ago. I will be the chair of that board shortly and, therefore, I believe this will be one of my priorities, at least as the chair of that board.

Mr. HORN. Which are the recommendations in terms of human being help and cooperation that are the most difficult to implement of the remaining ones?

Mr. MUSICK. I think that—if it is the people issues, I don't think are that they are not qualified. One of the things that I believe—that I have struggled with is that many of the folks that work for me and in the revenue accounting area grew up in the Government. As you are well aware, prior to 1990, the concern was making sure that you did not go anti-deficient and stayed within your appropriation.

Now all of a sudden we are being asked to identify—prepare financial statements, excuse me, develop financial statements and prepare financial statements. No one has ever gone through a discipline of a financial audit and what is required by the auditors.

I can give you one brief example on the administrative side. A couple of years ago, when we were trying to get data for the first time out of the new administrative system, the General Accounting Office came in and asked for a listing of accounts payable. Well, the people that interpreted that, our system tracks every payable from the day it went pit, they gave them a balance that tied back; the problem was, they gave them everything since 1991 or 1992. It balanced. What I have had difficulty with is explaining to people that that is an annual type of thing and that is the difficulty that we are working through with people, is to get them educated and to get them to understand that.

The same thing with our district people and our service center people. They have done things that they are doing as a basis for tax administration and the real control on them had been before that the obligations that they put on the books were appropriate. Now we are trying to make sure that they understand that there is going to be somebody coming back in and reviewing those obligations and they have to really sit down and ensure that they got the documentation and it is available, and it is available in a way that they can explain it to the auditors and not explain it to somebody else who is in tax administration.

Mr. HORN. Let me ask you one last question, and that would be on the 2000 conversion problem. Does IRS have any problems with that two-digit year bit?

Mr. MUSICK. We have got a big group looking into it. On the revenue side, our CIO, the chief information officer, has a group that

is looking to that to resolve it. And on the administrative side, since we purchased a package off the shelf, we believe that we can get it resolved by purchasing an enhancement or an upgrade to our existing package.

Mr. HORN. OK, I thank you for coming and you will be able to get a decent lunch today, because I have got to go vote on the floor. But before leaving, I want to thank the staff that helped prepare it, thank the witnesses, and your staffs, J. Russell George, our staff director, Anna Miller, who is to my immediate left, the professional staff member for the hearing, and Erik Anderson, our clerk, and Brook Musser, our faithful intern.

Minority staff—they don't have all the staff here—they have Liza Mientus, Matt Pinkus, and Mark Stephenson, we thank you all, and our reporter, Romelle Million. Thank you very much.

This hearing is adjourned.

[Whereupon, at 12:25 p.m., the subcommittee was adjourned.]

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