United States General Accounting Office

GAO

Report to the Congress

July 1996

FINANCIAL AUDIT

Examination of IRS' Fiscal Year 1995 Financial Statements

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75 years

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GAO/AIMD-96-101

GAO

United States
General Accounting Office
Washington, D.C. 20548

Comptroller General
of the United States

B-261816

July 11, 1996

To the President of the Senate and the
Speaker of the House of Representatives

In accordance with the Chief Financial Officers Act of 1990, this report presents the results of our efforts to audit the Principal Financial Statements of the Internal Revenue Service (IRS) for fiscal years 1995 and 1994.

As in prior years, limitations on the scope of our audit and the problems that we found made it impossible to provide an affirmative opinion on:

- The Principal Financial Statements for 1995. Thus, the accompanying statements may be unreliable.
- Internal controls. Management did not assert that IRS controls were effective and we noted major weaknesses in recordkeeping and systems.
- Compliance with laws and regulations. We were unable to test the laws we considered necessary; accordingly, we are unable to report on the Internal Revenue Service's compliance with laws and regulations.

The report discusses IRS' continuing financial management problems and certain related matters. It also contains our formal opinions and reports on IRS' financial statements, internal controls, and compliance with laws and regulations and our audit objectives, scope, and methodology. We make no new recommendations in this report. Appendix I describes the status of IRS' efforts to implement the 59 recommendations we made in prior years.

We are sending copies of this report to the Commissioner of Internal Revenue, the Secretary of the Treasury, the Director of the Office of Management and Budget, the Chairmen and Ranking Minority Members of the Senate Committee on Governmental Affairs and the House Committee on Government Reform and Oversight, and other interested congressional committees. Copies will be made available to others upon request.

This report was prepared under the direction of Gregory M. Holloway, Director, Governmentwide Audits, with the support of IRS' Internal Audit staff and staff from the Accounting and Information Management Division's Governmentwide Audits Group and Audit Support and Quality Assurance Group. Mr. Holloway may be reached at (202) 512-9510.

Charles A. Bowsher
Comptroller General
of the United States

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Abbreviations

ADP	automated data processing
BMF	Business Master File
CFO	Chief Financial Officer
FMFIA	Federal Managers' Financial Integrity Act
FMS	Financial Management Service
FTD	federal tax deposit
IMF	Individual Master File
IRC	Internal Revenue Code
IRS	Internal Revenue Service
NMF	nonmaster file
OMB	Office of Management and Budget
RACS	Revenue Accounting Control System
SSA	Social Security Administration
TSM	Tax Systems Modernization

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To the Commissioner of Internal Revenue

In accordance with the Chief Financial Officers (CFO) Act of 1990, the Internal Revenue Service (IRS) prepared the accompanying Principal Financial Statements for the fiscal years ended September 30, 1995 and 1994. In our attempt to audit these principal financial statements for fiscal year 1995, we found the following.

- We are unable to give an opinion on the fiscal year 1995 Principal Financial Statements of the IRS because of the limitations on the scope of our work, which are discussed below. Thus, the Principal Financial Statements may be unreliable.
- Material weaknesses in internal controls resulted in ineffective controls over safeguarding assets from material loss, assuring material compliance with laws governing the use of budget authority and with other relevant laws and regulations, and assuring that there were no material misstatements in the Principal Financial Statements.
- We are unable to report on compliance with laws and regulations because of limitations on the scope of our work.

The following five financial management problems, which have undermined our ability to attest to the reliability of IRS' financial statements for the past 4 fiscal years, provide the basis for these conclusions.[1]

- One, the amounts of total revenue ($1.4 trillion) and tax refunds ($122 billion) cannot be verified or reconciled to accounting records maintained for individual taxpayers in the aggregate.
- Two, the amounts reported for various types of taxes collected (social security, income, and excise taxes, for example) cannot be substantiated.
- Three, the reliability of reported estimates of $113 billion for valid accounts receivable and $46 billion for collectible accounts receivable cannot be determined.
- Four, a significant portion of IRS' reported $3 billion in nonpayroll operating expenses cannot be verified.
- Five, the amounts IRS reported as appropriations available for expenditure for operations cannot be reconciled fully with Treasury's central accounting records showing these amounts, and hundreds of millions of dollars in differences have been identified.

[1]See Financial Audit: Examination of IRS' Fiscal Year 1994 Financial Statements (GAO/AIMD-95-141, August 4, 1995); Financial Audit: Examination of IRS' Fiscal Year 1993 Financial Statements (GAO/AIMD-94-120, June 15, 1994); and Financial Audit: Examination of IRS' Fiscal Year 1992 Financial Statements (GAO/AIMD-93-2, June 30, 1993).

IRS worked toward the goal of resolving these issues in time for our fiscal year 1995 financial statement audit. Progress was made, but many of IRS' efforts were not yet completed at the conclusion of the audit. IRS has continued its efforts to correct these problems with a goal of having these matters resolved in time for the fiscal year 1996 financial statement audit. Some of the corrective actions, particularly where they involve reprogramming software for IRS' antiquated systems and developing new systems, will require longer term solutions. Therefore, the focus of key IRS efforts are on interim solutions to facilitate reliable reporting while IRS works to put longer term corrective actions in place.

IRS advised us that, as of the end of May 1996, its status in correcting the problems our audit identified was as follows:

- IRS stated that it had developed software programs to capture, from its revenue financial management system, the detailed revenue and refund transactions that, in the short term, would support reported amounts in its future financial statements until longer term system fixes could be made to achieve more reliable reporting of these amounts. In addition, IRS is attempting to complete documentation of its revenue financial management system to (1) aid in identifying better interim reporting solutions for reporting revenues and refunds, (2) provide better insights on the longer term systems fixes needed to enable IRS to readily and reliably provide the underlying support for its reported revenue and refund amounts, and (3) demonstrate that the level of misstatement related to its inability to reconcile the detailed transactions it identifies in its interim reporting efforts to its summary account records would not be material.
- IRS asserted that it would continue its efforts to determine a means of using its current revenue financial management system's coding to identify its accounts receivable. IRS' efforts are focused on correcting known current coding errors through reviewing 100 percent of all receivables over a certain dollar threshold. In addition, through intensified training efforts and better internal control policies and procedures, it said it would seek to ensure more accurate input and processing of transactions that underpin accounts receivable.
- IRS stated that it had completed the reconciliation of its Fund Balance with Treasury accounts except for IRS' suspense accounts that contained reconciling items that were more than 6 months old. However, IRS said it was still in the process of making the necessary adjustments required to its general ledger and the related Department of the Treasury records to complete this effort.

- IRS stated that it believed the core issue for correcting its receipt and acceptance problems related to properly accounting for transactions with other federal agencies. IRS stated that it was performing a study of transactions with other federal agencies to determine and correct the problems in this process that are due to IRS policies and procedures and to identify those that need to be corrected governmentwide.

We could not verify the results of IRS' efforts as of the close of our fiscal year 1995 audit since they were not yet complete. However, we will continue to monitor IRS' progress and advise IRS as it attempts to identify and implement solutions for correcting its underlying financial management problems.

These financial management problems and certain other related matters are discussed further in the Significant Matters section of this report. Our conclusions on IRS' financial statements, internal controls, and compliance with laws and regulations are also included in the following sections.

Significant Matters

The overriding problem in providing an opinion on IRS' financial statements, reporting on its internal controls, and reporting on its compliance with laws and regulations is that IRS has not yet been able to provide support for major portions of the information presented in its financial statements and, in some cases where it was able to do so, the information was found to be in error. The principal purpose of our financial audits is to attest to the reliability of information presented in the financial statements and to independently verify management's assertions about the effectiveness of internal controls and whether the agency complied with laws and regulations. When information that underpins the reported financial statements is not available for audit, it sometimes results in the auditor being unable to render an opinion on the financial statements as a whole. This is because the auditor cannot evaluate sufficient evidence as a basis for forming an opinion on whether the information presented in the financial statements is correct, determining whether all significant internal controls through which the information was managed and processed were effective, and testing whether or not the agency, in this case IRS, complied with laws and regulations. This situation was the case for IRS for fiscal year 1995.

The following discusses the five material weaknesses[2] we found. Each weakness was identified in IRS' Federal Managers' Financial Integrity Act (FMFIA) report for fiscal year 1995.

Revenues and Accounts Receivable Remain Unsubstantiated

Revenues, including the related refunds and accounts receivable, are the two key areas in IRS' efforts to report Custodial financial statements. IRS collects tax receipts, receives tax returns, makes tax refunds to, and corresponds with hundreds of millions of taxpayers each year. IRS also tries to obtain compliance by enforcing the tax laws through its monitoring of accounts receivable. These activities involve processing and tracking billions of paper documents and, in fiscal year 1995, handling a reported $1.4 trillion in tax receipts and a reported $122 billion in tax refunds. Processing this volume of money and paperwork requires substantive coordination among IRS' more than 600 offices worldwide, approximately 12,000 financial institutions, and 12 Federal Reserve Banks throughout the country.

Revenue

For fiscal year 1995, IRS made several attempts at extracting taxpayer information from its masterfiles—the only detailed record of taxpayer information IRS maintains—to support the amounts it reported for revenues in its financial statements. However, IRS has not been able to make these amounts agree to the amounts included in its financial management systems and Treasury records. Further, IRS is unable to determine that the correct amounts are transferred to the ultimate recipient of the collected taxes. For fiscal year 1995, the detailed transactions from its masterfile accounts were not provided to us in a timely manner to substantiate the reported amounts and thus we could not determine the amount of the differences.

The core financial management control weaknesses that contribute greatly to these problems are that IRS does not have comprehensive documentation on how its financial management system works. It has not yet put into place the necessary procedures to routinely reconcile activity in its summary account records with that maintained in its detailed masterfile records of 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.

[2]A material weakness is a condition in which the design or operation of one or more of the internal control structure elements does not reduce to a relatively low level the risk that errors or irregularities in amounts that would be material to the financial statements may occur and not be detected promptly by employees in the normal course of performing their duties.

This occurs because the system requires that corporate and individual taxpayers pay multiple taxes at the same time without readily identifying the application of the payments to the various taxes paid.[3] As a result, IRS is forced to make the allocation of collections to the recipient based on the total tax owed as identified on the related tax return. The tax return is filed at a later date and may not contain sufficient information if the amount of taxes owed on the return does not agree with the amount paid, as is sometimes the case.

IRS has developed computer programs to extract the detailed masterfile data from its records but continues to be unable to reconcile the detailed extracted data to the summary accounts. In an interim effort to prepare reliable financial statement information, IRS is attempting to demonstrate the maximum exposure likely attributable to the unexplained differences and provide the necessary information to fix the identified system flaws. This interim plan involves IRS continuing its efforts to develop detailed comprehensive documentation of its current financial management system. We are monitoring IRS' efforts closely, providing guidance and recommendations, and reporting at regular intervals to IRS' senior management on the agency's progress and actions needed to correct these problems in the short and long term.

As reported since our audit of IRS' fiscal year 1992 financial statements, IRS cannot ensure that it distributes excise taxes based on collections, as required by law, because it bases these distributions on the amount reported on the tax return, that is, the assessed amount. However, during fiscal year 1995, IRS analyzed excise taxes by specific trust funds to determine if there were significant differences between taxes paid and amounts reported as owed on the return and found that these differences were insignificant. Because IRS completed this analysis after our audit was completed, we were unable to examine and determine the reliability of this information.

Accounts Receivable

For fiscal year 1995, IRS attempted to test a statistical sample of its inventory of open assessments to categorize them between financial accounts receivable and compliance assessments.[4] For all the 4 fiscal

[3]For an explanation of how IRS processes tax returns, tax information, and payments, see Financial Audit: Actions Needed to Improve IRS Financial Management (GAO/T-AIMD 96-96, June 6, 1996).

[4]Compliance assessments occur when IRS records an assessment to a taxpayer's account, but neither the taxpayer nor a court has agreed that the assessment is appropriate. IRS makes these assessments to encourage compliance with the tax laws. Financial accounts receivable arise when taxpayers agree to assessments or a court determines that an amount is owed.

years we have audited[5] IRS' financial statements, IRS has had difficulty separating, in its masterfile records of taxpayer accounts, its financial accounts receivable, from the amounts it has assessed only for compliance purposes because the design of IRS' masterfiles commingles these amounts.

In fiscal year 1995, IRS expanded its previous years' efforts by trying to first separate the inventory of assessments into accounts receivable and compliance assessments based on its coding of these assessments in its financial management system and then testing the accuracy of this coding to separate accounts receivable from compliance assessments on a taxpayer account basis. However, these efforts were unsuccessful because of mistakes made in performing the statistical tests and errors found in the coding of the assessments in IRS' financial management systems which made the sample results unreliable for projecting to the total inventory of outstanding assessments. Our tests of the fiscal year 1995 data found significant errors at levels that made the result of any projections from the samples taken unreliable.

The actions needed to resolve the key financial management control weaknesses in accounts receivable are consistent with recommendations from our prior reports and are as follows: (1) better review and approval procedures are needed before assessment information is entered into IRS' masterfile system, (2) clearer lines of authority and responsibility are needed between IRS' taxpayer service and the Chief Financial Officer's operations to ensure that internal control procedures are properly identified and strictly adhered to, (3) procedures need to be developed for processing in-process accounts and properly applying them to the respective taxpayer accounts, and (4) periodic detailed taxpayer account reviews should be performed as a quality review measure to ensure that the proper coding is taking place for taxpayer accounts. In addition, IRS needs to (1) continue its efforts to review taxpayer accounts with amounts owed to ensure that they are properly coded and accounted for and (2) perform more macro analysis of its inventory of assessments to identify aberrations and other systemic problems that will need to be corrected to accurately report on accounts receivable. We will continue to monitor IRS' progress in this area and provide guidance and recommendations as it proceeds.

[5]For a discussion of the problems with IRS' accounts receivable in our fiscal years 1992 through 1994 audits, see Financial Audit: Actions Needed to Improve IRS Financial Management (GAO/T-AIMD-96-96, June 6, 1996).

Administrative Operations Have Improved but More Improvement Is Needed

For fiscal year 1995, IRS had a reported $8.1 billion in operating expenses and related assets and liabilities used and incurred in its administrative operations. The key asset in its administrative operations is its Fund Balance with Treasury accounts and the related Unexpended Appropriations accounts. Its operating expenses can be readily separated between its efforts to account for and report, in fiscal year 1995, its $5.3 billion in payroll costs and $2.8 billion in nonpayroll costs.

IRS has made progress in accounting for and reporting its administrative operations. In fiscal year 1992, for the most part, we were unsuccessful in our attempts to audit IRS' records for its administrative operations. IRS' accounting records were in total disarray, and it could not substantiate large portions of the reported amounts. In addition, internal control policies and procedures were either nonexistent, inappropriately focused, or not followed. For fiscal year 1995, IRS had a core accounting system in place that tracked its financial management activity. Two critical problems, however, have continued to persist that were identified in our fiscal year 1992 audit: (1) IRS' Fund Balance with Treasury accounts remain unreconciled, though some progress has been made toward that end and (2) IRS has not been able to provide support as to whether and when certain nonpayroll goods and services paid for were received and, in instances where support existed, we found that the cost associated with the purchase was often recorded and reported in the wrong fiscal year.

Fund Balance With Treasury

IRS' Fund Balance with Treasury accounts historically were not being reconciled. For the most part, IRS' personnel were only tracking the gross differences between their accounting records and what Treasury (the equivalent of their bank) reported to them for their administrative receipts and disbursements. This resulted in years of unreconciled amounts accumulating that were never researched and resolved and that were made difficult to research and resolve when the amounts were required to be audited.

These accounts have been unreconciled in each of the years of our prior audits—1992 through 1994—with net reconciling differences in the millions of dollars that were made up of gross reconciling differences in the hundreds of millions of dollars. We were not provided the information to fully determine the gross amount of the differences for fiscal year 1995 and, thus, while we do know the accounts remain unreconciled, we do not know by how much.

Over the last 2 fiscal years, IRS has made adjustments to its accounting records to write off large portions of the gross unreconciled amounts where it could not determine what the correct disposition of the difference should be after several efforts at researching the items. In addition, it hired a contractor to identify the differences[6] between its accounting records and what it had reported to Treasury as its activity in its Fund Balance with Treasury accounts. IRS, though, has still not fully reconciled its differences between its records and Treasury's records that are reported to IRS through its budget clearing accounts[7]—for items that are more than 6 months old that remain unreconciled—and that are identified on its statement of differences—for similar items that are less than 6 months old.

Similarly, IRS still needs to investigate and resolve amounts in its suspense accounts, many of which have been in suspense for 1 year or more. In addition, IRS has not disposed of some of the reconciling items between its accounting records and what it reported to Treasury that were identified by the contractor. Through further contractor assistance or more intensified internal efforts, IRS must get these accounts fully reconciled. In addition, IRS needs to look more closely at the skill mix of its staff assigned with the responsibility of completing this reconciliation process.

If these accounts remain unreconciled, it will continue to be difficult to provide an opinion on either IRS' administrative financial statements or management's assertion about the effectiveness of internal controls. It will also continue to be impossible to determine whether IRS has complied with all of the appropriate laws and regulations to which it is subject. Notwithstanding the problems these unreconciled accounts present for rendering an opinion, these accounts make it impossible, or at best difficult, for IRS or anyone else to know whether its operating funds have been improperly spent and calls into question the accuracy of its reported operating expenses, assets, and liabilities.

Receipt and Acceptance

IRS did not provide support as to whether and when it received goods and services for significant portions of its nonpayroll operating expenses and, in several instances where the support was provided, we found that the cost should have been included in another period. Simply stated, this situation is much like when IRS audits a taxpayer. If the taxpayer cannot

[6]Much like what occurs with a checking account, differences between accounting records and bank records can occur because of timing differences or errors in recording transactions. However, the differences identified by the contractor were those between IRS' accounting records and the reports of receipts and disbursements IRS sends to Treasury.

[7]Budget clearing accounts are accounts that serve as suspense accounts for unidentified transactions.

show independent evidence that an expense that was deducted on the tax return was incurred in the year under audit, the expense would be disallowed and the taxpayer's tax liability increased. Likewise, when IRS cannot provide support for its reported expenses or the support shows that the expenses should be properly included in a different fiscal year, the auditor cannot provide an opinion on the amounts. Simply put, we cannot determine whether this expense was an expense of the current period—when no support exists—or whether it must be adjusted from the current year's expenses—when the support shows it is in the wrong period. Our interim testing of IRS' accounting records covering the first 10 months of fiscal year 1995 showed significant amounts of nonpayroll costs that were either unsupported or recorded in the wrong period.

IRS' nonpayroll expenses that we reviewed included purchases from other federal agencies as well as from commercial vendors for printing services, postage, computer equipment, and many other costs. IRS' lack of control over receipt and acceptance of goods and services, combined with its problems in linking the controls over goods and services purchased to the payment for these goods and services, makes it especially vulnerable to vendors, both federal and commercial, billing IRS for goods and services not provided or for amounts in excess of what was provided. This would be comparable to an individual or business receiving an invoice and paying it without verifying that the purchased item had been received and accepted, based on an assumption that someone else in the household or business received it. For example, IRS has an inventory management system that tracks when printed tax forms are received and used. However, the information tracked in this system is not used or integrated with the payment system for making vendor payments nor with any other system used to account for and report IRS' operating expense for printing these forms.

Computer Security

In our prior year reports,[8] we stated that IRS' computer security environment was inadequate. Our review of controls over IRS' computerized information systems, done to support our fiscal year 1995 audit, found that IRS has made some progress in addressing and initiating actions to resolve prior years' computer security issues; however, some of the fundamental security weaknesses we previously identified continued

[8]Financial Audit: Examination of IRS' Fiscal Year 1992 Financial Statements (GAO/AIMD-93-2, June 30, 1993); IRS Information Systems: Weaknesses Increase Risk of Fraud and Impair Reliability of Management Information (GAO/AIMD-93-34, September 22, 1993); Financial Audit: Examination of IRS' Fiscal Year 1993 Financial Statements (GAO/AIMD-94-120, June 15, 1994); and Financial Audit: Examination of IRS' Fiscal Year 1994 Financial Statements (GAO/AIMD-95-141, August 4, 1995).

to exist in this fiscal year. We will be studying these issues further and reporting on them in greater detail in a future report.

These deficiencies in internal controls may adversely affect any decision by management which is based, in whole or in part, on information that is inaccurate because of the deficiencies. Unaudited financial information reported by the Internal Revenue Service, including budget information, also may contain misstatements resulting from these deficiencies.

Disclaimer of Opinion on Principal Statements

As described above, we are unable to give an opinion on the Principal Financial Statements for fiscal year 1995. In addition, we were unable to give an opinion on the Principal Financial Statements for fiscal year 1994.[9]

Statement on Internal Controls

We gained an understanding of internal controls designed to

- safeguard assets against loss from unauthorized acquisition, use, or disposition;
- assure the execution of transactions in accordance with laws governing the use of budget authority and with other laws and regulations that have a direct and material effect on the Principal Financial Statements or that are listed in Office of Management and Budget (OMB) audit guidance and could have a material effect on the Principal Financial Statements; and
- properly record, process, and summarize transactions to permit the preparation of reliable financial statements and to maintain accountability for assets.

For fiscal years 1995 and 1994, we do not express an opinion on internal controls because the scope of our work was limited to determining our procedures for auditing the financial statements, not to express an opinion on internal controls. However, we found that the material weaknesses, described in the Significant Matters section of this report, resulted in ineffective controls that could lead to losses, noncompliance, or misstatements that are material in relation to the financial statements. Our

[9]See our fiscal year 1994 audit report Financial Audit: Examination of IRS' Fiscal Year 1994 Financial Statements (GAO/AIMD-95-141, August 4, 1995). See appendixes I and III of that report for a detailed explanation of our findings and recommendations, along with the status of IRS' corrective actions to respond to the problems we identified in our financial statement audits for fiscal years 1992, 1993, and 1994. At the completion of our audit for fiscal year 1994—which was substantively completed on May 1, 1995—IRS had completed 13 of the 59 recommendations that had been made.

internal control work would not necessarily disclose all material weaknesses.

Compliance With Laws and Regulations

Because of the limitations on the scope of our work as discussed above, we were unable to test the laws we considered necessary;[10] accordingly, we are unable to report on IRS' compliance with laws and regulations.

Status of Recommendations and Future Steps Needed

In our prior year reports (see footnote 1), we made 59 recommendations aimed at resolving IRS' financial management problems. In our assessment this year, we determined that IRS had completed 17 of these recommendations. See appendix I for the status of IRS' implementation efforts on the 59 recommendations from our prior year reports. IRS has stated its intention to commit the necessary resources and management oversight to resolve its financial management weaknesses and receive its first opinion on the fiscal year 1996 financial statements. In this regard, we are providing advice to IRS on how to resolve its long-standing and pervasive financial management problems.

Objectives, Scope, and Methodology

Management is responsible for

- preparing the annual financial statements in conformity with the basis of accounting described in note 1 of the Administrative and Custodial financial statements;
- establishing, maintaining, and assessing the internal control structure to provide reasonable assurance that the broad control objectives of the Federal Managers' Financial Integrity Act (FMFIA) are met; and
- complying with applicable laws and regulations.

We attempted to perform audit procedures on the limited information IRS was able to provide; however, for the reasons stated above, we were unable to perform the necessary audit procedures to opine on IRS' Principal Financial Statements.

Except for the limitations on the scope of our work on (1) the Principal Financial Statements, (2) internal controls, and (3) compliance with laws and regulations described above, we did our work in accordance with

[10]These are laws governing the use of budget authority and other laws and regulations that have a direct and material effect on the Principal Financial Statements or that are listed in OMB audit guidance and could have a material effect on the Principal Financial Statements.

generally accepted government auditing standards and OMB Bulletin 93-06, "Audit Requirements for Federal Financial Statements."

We requested written comments on a draft of this report from you or your designee. Your office provided us with written comments which are discussed in the following section and reprinted in appendix II.

Agency Comments and Our Evaluation

In commenting (see appendix II) on a draft of this report, IRS generally agreed with the facts as stated in our report. In addition, IRS reaffirmed its commitment to ensuring the integrity of its financial data.

Charles A. Bowsher
Comptroller General
of the United States

May 17, 1996

Principal Financial Statements

Department of the Treasury

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Internal Revenue Service

Internal Revenue Service

Chief Financial Officers
Annual Report
(Unaudited)

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Fiscal Year 1995

Overview to the Financial Statements

Internal Revenue Service

Overview to the Financial Statements
for the Fiscal Years Ended September 30, 1995 and 1994

Mission

The purpose of the Internal Revenue Service is to collect the proper amount of tax revenue at the least cost; serve the public by continually improving the quality of our products and services; and perform in a manner warranting the highest degree of public confidence in our integrity, efficiency and fairness.

Objectives

The Service has three objectives. The objectives translate the mission into broad, ongoing statements of strategic direction.

Increase Voluntary Compliance
Our objective is to encourage and assist taxpayers to voluntarily file timely and accurate returns and pay on time; when taxpayers do not comply, we will take appropriate enforcement actions. We do this to ensure we collect the proper amount of tax due at the least cost.

Maximize Customer Satisfaction & Reduce Burden
Our objective is to reduce the time and expense experienced by taxpayers, tax professionals, and others in complying with the tax laws, while increasing their satisfaction with the tax system. We do this to help collect the proper amount of tax at the least cost, serve the public, and increase public confidence in tax administration.

Achieve Quality-Driven Productivity Through Systems Improvement and Employee Development
Our objective is to continually improve the quality of products and services we provide by using systems improvement tools and techniques, and developing a highly-trained, diverse workforce. We do this to reduce costs to both government and the public, improve customer service, and help increase voluntary compliance.

Goals

To support the strategic direction set forth in the objectives, the Service established seven long-range goals--FY 2001 Performance Goals. The goals set the operational direction the Service will follow to accomplish its mission.

- Collect at least 90% of the total tax dollars due and owing, through increased voluntary compliance and enforcement.

- Achieve the recognition of the public, outside stakeholders, and IRS employees for the ethical conduct of IRS regarding:

  - Fair and uniform application of tax law;
  - Maintenance of the highest standards of integrity; and
  - Confidentiality and security of tax information.

- Reduce the burden taxpayers experience in fulfilling all of their tax responsibilities, from recordkeeping through final account settlement. Reduce time by 7% and expense by 3%. Increase customer satisfaction with IRS products and services.

INTERNAL REVENUE SERVICE
Overview to the Financial Statements
for the Fiscal Years Ended September 30, 1995 and 1994

Goals (Continued)

- Resolve 95% of taxpayer inquiries after only one contact.
- Reduce overall paper processing and handling:
  - Increase the number of returns filed on media other than paper to 80 million;
  - Receive all remittances electronically or by third-party processors;
  - Reduce by 50% Service- and taxpayer-initiated, account-related paper correspondence.
- Meet our diverse customers' needs in fulfilling their tax obligations and provide a work force that reflects the diversity of the civilian labor force.
- Increase the Service's productivity.

Structure of Operations

As of fiscal year end, on-rolls staffing reached 96,083 full-time, permanent employees while other than full-time permanent levels totaled 14,547.

The Service reorganized its office structure during the fiscal year to increase its operating efficiency. The new structure was announced on October 1, 1995. The following provides a summarization of the organizational changes.

- National Office - Washington, DC
  Develops broad nationwide policies and programs for the administration of tax laws and regulations.
- Regional Offices (reduced from 7 to 4)
  Execute nationwide plans and policies and coordinate, direct and review operations of all offices within the region.
- District Offices (reduced from 63 to 33)
  District offices provide taxpayers with the primary services of the IRS. This includes taxpayer assistance, collection; examination; and criminal investigation activities, and problem resolution services.
- Submission Processing Centers (five centers will replace 10 current Service Centers)
  The Submission Processing Centers process tax returns and related documents, process tax deposits, and update taxpayer account information.
- Computing Centers (remain at 3 sites)
  Consolidating computing operations currently performed in 10 Service Centers and 2 Computing Centers.
- Customer Service Centers (newly established at 23 sites)
  Consolidating customer service operations from: Taxpayer Service Toll-Free Sites; Automated Collection System Call Sites; Forms Distribution Toll-Free Operations; and Service Centers.

INTERNAL REVENUE SERVICE
Overview to the Financial Statements
for the Fiscal Years Ended September 30, 1995 and 1994

Key Performance Indicators

The Service's seven FY 2001 Performance Goals are designed as long-range objectives. To reach these goals by FY 2001, the Service established yearly targets designed to achieve measured incremental progress. These targets are tactical in nature, relate directly to the seven FY 2001 Performance Goals, and are monitored by Key Performance Indicators. The following tables provide the Key Performance Indicators that support each goal.

Collect at Least 90% of the Total Tax Dollars Due and Owing Through Increased Voluntary Compliance and Enforcement.

Key Performance Indicators *	FY 1995	FY 1994	FY 1993	Change 94 to 95
Revenue Collected	$1,373,359,076	$1,275,700,178	$1,176,522,056	+7.7%
Revenue Protected	$7,576,080	$3,320,810	Not Available	+128%
Number of Returns Examined	2,100	1,427	1,300	+47%
Additional Tax and Penalties Recommended After Examination	$28,620,000	$23,925,598	$23,080,361	+19.6%
Collection Yield	$25,150,000	$23,450,000	$22,810,000	+7%

*** 000s Omitted**

Achieve the Recognition of the Public, Outside Stakeholders, and IRS Employees for the Ethical Conduct of the IRS.

Key Performance Indicators	FY 1995	FY 1994	FY 1993	Change 94 to 95
On a 10 point scale -- 10 highest -- Public Rating of IRS Ethics	In Process	6.3	6.1	Not Currently Available
On a 5 point scale -- 5 highest -- Employee Rating of IRS Ethics	3.22	(Survey made every other year)	3.00	+7.3% ('93 to'95)

Reduce the Burden Taxpayers Experience in Fulfilling All Their Tax Responsibilities, from Recordkeeping Through Final Account Settlement.

Key Performance Indicators	FY 1995	FY 1994	FY 1993	Change 94 to 95
% of Paid Preparer Individual Tax Returns	49%	49%	49%	0%
Total Time Expended by Taxpayers in Fulfilling their Tax Responsibilities	5.3 Billion Hours	5.1 Billion Hours	5.1 Billion Hours	+4%

INTERNAL REVENUE SERVICE
Overview to the Financial Statements
for the Fiscal Years Ended September 30, 1995 and 1994

Key Performance Indicators (continued)

Resolve 95% of Taxpayer Inquiries after Only One Contact.

Key Performance Indicators	FY 1995	FY 1994	FY 1993	Change 94 to 95
Taxpayer Service On-line Closures	95.3%	92%	83.9%	+3.3%
Level of Access	37%	New for 1995	New for 1995	N/A
Taxpayers Assisted	110,600,000	78,453,000	77,000,000	+41%
Technical Accuracy Rate	90.8%	90%	89%	+.8%

Reduce Overall Paper Processing and Handling.

Key Performance Indicators	FY 1995	FY 1994	FY 1993	Change 94 to 95
Number of Returns Filed	205,087,000	201,745,000	207,423,000	+1.7%
Number of Returns Filed Electronically (Individual)	11,115,738	15,800,000	12,500,000	-29.6%
Amount of Electronic Processes FTD Payments	$3,306,445,294	New Program in 1995	New Program in 1995	Not Applicable
Refund Timeliness	36 days	36 days	36 days	No Change

Provide a Workforce That Reflects the Diversity of the Civilian Labor Force

Key Performance Indicators	FY 1995	FY 1994	FY 1993	Change 94 to 95
Under-representation Index (UI) for White Females GS/GM 13-15 Positions	.58	.56	.54	+.02
Under-representation index for minorities GS/GM 13-15 Positions	1.00	.98	.95	+.02

Increase the Service's Productivity.

Key Performance Indicator	FY 1995	FY 1994	FY 1993	Change 94 to 95
Revenue Collected per Dollar Budget	$172	$161	$153	+6.8%

INTERNAL REVENUE SERVICE
Overview to the Financial Statements
for the Fiscal Years Ended September 30, 1995 and 1994

Tax Systems Modernization

Summary of FY 1995 Results

By making the tax system less burdensome for taxpayers, IRS is at the forefront of the effort to create a government that works faster, performs better, and costs less. Tax Systems Modernization (TSM), an integral part of this effort, is providing a better way of delivering service, influencing compliance, and administering the tax system. Although real progress was achieved, several areas need additional attention to realize TSM's full potential.

New Business Initiatives

Providing Taxpayers with Alternate Filing and Payment Options

- Forty thousand businesses made approximately $232.3 billion in Federal tax deposits by electronic funds transfer. This compares with 11,000 and $6 billion, respectively, for FY 1994.
- More than 14 million individual and business taxpayers filed electronic documents. This is down from last year's 16 million.
- Free electronic filing was offered at 232 IRS offices and more than 1,000 volunteer sites. In FY 1994, this service was offered in only 40 offices.
- Over 700,000 taxpayers in ten states filed Forms 1040EZ using their touchtone phones. This compares to over 500,000 taxpayers and 7 states last year.
- More than 1.5 million taxpayers in 29 states satisfied both Federal and state obligations by a single electronic transmission compared to last year's 1.1 million taxpayers in 23 states.

Processing Paper More Efficiently

Implemented the Service Center Recognition Image Processing System (SCRIPS) at five Submission Processing sites and processed nearly 70 million FTDs, 5 million 1040EZs, and 24 million IRP documents.

Building the Foundation for Improved Compliance Issue Detection

- Awarded the Service Center Support Services (SCSS) contract that will deliver the systems needed to provide employees with on-line access to taxpayer information.
- Installed Corporate Systems Modernization/Mirror Image Acquisition (CSM/MIA) mainframe computers at MCC and DCC to address capacity issues, improve operating efficiencies, and provide the bridge to TSM, and installed the Electronic Fraud Detection System (EFDS), which helped protect $70 million in revenue and stop 34,500 fraudulent refunds.

Providing Information and Tools to Customer Service Personnel

- After last year's pilot at Fresno Service Center and Nashville District, we:
  - began customer service operations at nine service centers and one district office;

INTERNAL REVENUE SERVICE
Overview to the Financial Statements
for the Fiscal Years Ended September 30, 1995 and 1994

Tax Systems Modernization (continued)

- installed Automated Call Distributors (ACDs) at fifteen additional customer service sites to help improve access to our telephone system;
- tested the first phase of the Integrated Case Processing (ICP) system at the Nashville Customer Service prototype. ICP will meet employees' information and processing needs by integrating capabilities now residing on different systems;
- made the Integrated Data Retrieval System (IDRS) available nationwide. This was an important step toward the IRS Business Vision where all accounts will be immediately accessible; and
- expanded the Corporate Files on-line (CFOL) project which eliminated the need to spend weeks trying to locate tax returns.

Providing Information and Tools to Field Compliance Personnel

- The Service established the National Office Research and Analysis (NORA) organization and 31 District Office Research and Analysis (DORA) sites to enhance compliance research capabilities. Prototyped and began rolling out the Integrated Collection System (ICS) to additional district offices. Results thus far indicate ICS increased collections per staff year by 30% during tests.

Streamlining the IRS Organization

- The Service continued a series of organizational changes to:
  - consolidate corporate computer accounting from 12 sites to three centralized mainframe computing centers;
  - consolidate returns processing operations currently performed in ten service centers into five Submission Processing Centers;
  - consolidated taxpayer account and correspondence services currently performed at many types of locations into 23 customer service centers; and
  - consolidated seven IRS regional offices to four.

- The Service developed plans to consolidate 63 IRS district offices to 33 by October 1, 1996.

Strengthening TSM Management

- The Service addressed the program management and implementation issues raised by the Administration, Congress, GAO, the National Research Council, and other outside experts, and also conducted a self-assessment of the Service's strategic information management practices using GAO's Best Practices for strategic information management.

Areas Requiring Additional Focus

As indicated in GAO's July 1995 Report on Tax Systems Modernization, <u>Management and Technical Weaknesses Must Be Corrected If Modernization Is To Succeed</u>, IRS must take additional steps to strengthen its management of modernization in such areas as:

- Accountability and responsibility, including strengthening the management and control over TSM, improving the consistency of planning documents, better linking reengineering efforts to modernization and enforcing standards;

- An electronic filing business strategy for targeting those sectors of the taxpaying population who can file electronically most cost beneficially;

INTERNAL REVENUE SERVICE
Overview to the Financial Statements
for the Fiscal Years Ended September 30, 1995 and 1994

Tax Systems Modernization (continued)

- Strategic information management issues involving an overall investment strategy, TSM costs and benefits, and enhancing technical skills and training;
- Software development issues including level 2 capabilities for contractors and consistent software development procedures and metrics; and
- Technical infrastructure issues involving the Integrated System Architecture, configuration management, security, disaster recovery and contingency plans, Test and Evaluation Master Plan, Integration Testing and Control Facility and the modernization integration plan (release engineering).

IRS Customer Service Standards

The Service established eight Customer Service Standards designed to address the needs and expectations of its customers. Through these standards, the Service demonstrates that our customers, the taxpayers, come first. Listed below are the results of these efforts:

FY 1995 Results

Easier Filing -- We expanded several alternative methods to simplify return filing. Nearly 15 million returns were filed using these methods:

- Over 11 million taxpayers filed electronically;
- Over 700,000 taxpayers filed using their telephones;
- Nearly 3 million taxpayers filed using an answer sheet form;
- Over 40,000 businesses were able to make their federal tax deposits, over 200 billion, electronically.

Access to Information -- We provided assistance to 118 million people through our various taxpayer service programs, an increase from 75 million in 1994.

- We helped:
  - over 39 million people through our toll-free phones;
  - nearly 62 million on Tele-Tax;
  - 7 million through office-assisted visits;
  - nearly 10 million taxpayers who called and left recorded questions after hours.
- Automated tax law and procedural information was available 24 hours every day.
- Access to automated refund status was increased to 16 hours per day.
- Live telephone assistance was expanded to ten hours each business day.
- Taxpayers were able to access over 600 tax forms, schedules and publications through FedWorld on the Internet.

INTERNAL REVENUE SERVICE
Overview to the Financial Statements
for the Fiscal Years Ended September 30, 1995 and 1994

IRS Customer Service Standards (continued)

Accuracy -- We achieved an accuracy rate of 91% in 1995 in answering tax law and account questions.

- For the more than 77 million individual tax refunds we processed, we achieved an accuracy rate of 99.5%.

Prompt Refunds--We met our goal of issuing all refunds promptly unless the return was incomplete, inaccurate, or needed to be reviewed to determine if the refunds claimed were accurate.

One-Stop Service -- Over 97%, or nearly 23 million of the estimated 23.5 million Taxpayer Service account inquiries we received were closed with one contact, up about 1% from 1994.

Canceling Penalties -- Penalties were waived for individuals in 243 cases and for businesses in 539 cases.

Resolving Problems -- The Problem Resolution Program received approximately 412,000 cases in Fiscal Year 1995. Contact was initiated within 1 week of receiving the case 88.2% of the time.

Simpler Forms -- The Service made changes to the tax forms and instructions this year to make them easier to use. As part of this effort, the IRS is soliciting ideas from the public.

Limitations of the Financial Statements

The financial statements have been prepared to report the financial position and results of operations of the Internal Revenue Service, pursuant to the requirements of the CFO Act.

While the statements generally have been prepared from the books and records of the IRS in accordance with the formats prescribed by OMB, they are different from the financial reports used to monitor and control budgetary resources that are prepared from the same books and records.

The statements should be read with the realization that they are for a component of a sovereign entity (the United States Government), that unfunded liabilities reported in the financial statements cannot be liquidated without the enactment of an appropriation, and that the payment of all liabilities other than for contracts can be abrogated by the sovereign entity.

Department of the Treasury

Internal Revenue Service

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Unaudited
Principal Financial Statements
Fiscal Years 1995 and 1994

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ADMINISTRATIVE

Statement of Financial Position

Statement of Operations

Notes to Principal Financial Statements

Statement of Financial Position (Administrative)

Department of the Treasury
Internal Revenue Service
Statement of Financial Position
Administrative

	September 30, 1995	September 30, 1994
	(In Millions)	
Operating Assets		
Funds with U.S. Treasury and cash (Note 2)	$1,432	$1,690
Receivables, non-federal, net (Note 3)	23	25
Advances and prepayments, non-federal	20	19
Property and equipment (Note 4)	---	---
Intragovernmental Assets:		
Receivables, net (Note 3)	59	73
Advances and prepayments	5	4
Total Operating Assets	$1,539	$1,811
Operating Liabilities		
Funded Liabilities		
Accounts payable	$358	$196
Accrued payroll and benefits	206	196
Deposit Funds	5	17
Total Funded Liabilities	569	409
Unfunded Liabilities		
Accrued annual leave	339	319
Actuarial liability (Note 5)	339	337
Commitments and contingencies (Note 6)	80	30
Total Unfunded Liabilities	758	686
Total Operating Liabilities	1,327	1,095
Net Position		
Unexpended appropriations (Note 7)	970	1,402
Less: Future funding requirements	(758)	(686)
Total Net Position	212	716
Total Operating Liabilities and Net Position	$1,539	$1,811

The accompanying notes are an integral part of these statements.

Statement of Operations (Administrative)

Department of the Treasury
Internal Revenue Service
Statement of Operations
Administrative

	September 30, 1995	September 30, 1994
	(In Millions)	
Revenue and Financing Sources		
Appropriations Used	$7,929	$7,134
Reimbursements	134	132
Other receipts	85	54
Less: Receipts transferred to Treasury	(85)	(54)
Total Financing Sources	8,063	7,266
Operating Expenses		
Administration and management	225	185
Processing tax returns and assistance	1,625	1,710
Tax law enforcement	4,514	3,982
Information systems	1,747	1,390
Violent Crime Reduction Trust Fund	4	---
Bad debts and writeoff (Note 3)	19	22
Total Operating Expenses	8,134	7,289
Less: Expenses To Be Funded By Future Appropriations*	72	23
Excess of Financing Sources Over Operating Expenses	$0	$0
Net Position, Beginning	$716	$585
Prior period adjustments (Note 9)	(14)	(56)
Expenses to be funded by future appropriations	(72)	(23)
Net Non-operating Changes (Note 8)	(418)	210
Net Position, Ending	$212	$716

** Difference of $1M due to rounding.*

The accompanying notes are an integral part of these statements.

Notes to Principal Financial Statements (Administrative)

INTERNAL REVENUE SERVICE
Notes to Principal Financial Statements - Administrative
for the Fiscal Years Ended September 30, 1995 and 1994

Note 1. Significant Accounting Policies

A. Reporting Entity

The Internal Revenue Service (the Service) is a bureau of the U.S. Department of the Treasury (Treasury). The Service was created in 1862 when the Congress established the Office of the Commissioner of the Internal Revenue. In 1952 the Bureau was reorganized by the Congress and in 1953 became the Internal Revenue Service.

The mission of the Service is to collect the proper amount of tax revenue at the least cost, serve the public by continually improving the quality of its products and services, and perform in a manner warranting the highest degree of public confidence in Service integrity, efficiency and fairness.

In fulfilling its mission, the Service maintains appropriated, trust and revolving funds. The accompanying principal financial statements of the Service include the accounts of all funds under Service control. The financial statements do not include federal income tax revenue and related receivables. All intra-agency balances and transactions have been eliminated. In addition, amounts relating to the GSA Building Delegation Allocation Account have been excluded from the financial statements.

B. Basis of Presentation

These financial statements have been prepared to report the financial position and results of operations of the Service as required by the Chief Financial Officers Act of 1990. Except as described in Note 1.D, they have been prepared from the books and records of the Service in accordance with:

- Accounting principles, standards, and requirements approved by the Federal Accounting Standards Advisory Board.
- Form and content requirements for financial statements included in Office of Management and Budget (OMB) Bulletin 94-01.
- Service accounting policies, procedures, and manuals.

These statements are therefore different from financial reports also prepared by the Service pursuant to OMB directives that are used to monitor and control the Service's use of budgetary resources.

On December 8, 1995, OMB granted a waiver to certain Treasury organizations from OMB Bulletin 94-01 requirements for preparation of statements of cash flows and budgetary resources and actual expenses. Accordingly, the Service has not presented those statements in the fiscal year 1995 financial statements.

INTERNAL REVENUE SERVICE
Notes to Principal Financial Statements - Administrative
for the Fiscal Years Ended September 30, 1995 and 1994

Note 1. Significant Accounting Policies (continued)

C. Budgets and Budgetary Accounting

Congress provides the Service with appropriations on an annual, multi-year, and no-year basis. Appropriations are used to finance operating expenses, purchase property and equipment, and meet program obligations. The Service also receives reimbursements from federal agencies and the public for services provided.

D. Basis of Accounting

Except for property and equipment, transactions are recorded on an accrual accounting basis. Under the accrual method, expenses and related revenues are recognized when a liability is incurred, without regard to receipt or payment of cash. Budgetary accounting facilitates compliance with legal constraints and controls over the use of federal funds.

The acquisition cost of property and equipment has not been capitalized. Acquisitions, leasehold improvements and operating and capital leases, are reported as operating expenditures in the Statement of Operations.

E. Operating Assets and Liabilities

Operating assets are resources that relate directly to the operating needs of the Service. These items include funds available to pay operating costs, non-tax receivables and advances and prepayments.

Operating liabilities relate to the internal operating requirements of the Service, including those that are not covered by budgetary resources. Liabilities not covered by budgetary resources are presented as unfunded liabilities in the Statement of Financial Position and represent expenses incurred and unpaid as of fiscal year end for which appropriations have not yet been provided.

F. Funds with the Treasury

The Treasury processes the Services's cash receipts and disbursements. Funds with the Treasury represent primarily appropriated funds available to pay current liabilities and finance authorized purchase commitments.

G. Accounts Receivable

Outstanding billed and unbilled reimbursable services to other federal agencies and the public comprise the majority of accounts receivable. The Service uses the allowance method for recognizing bad debt expense on accounts receivable. The allowances for uncollectible receivables are assessed periodically based on reviews of groups of accounts and individual accounts.

INTERNAL REVENUE SERVICE
Notes to Principal Financial Statements - Administrative
for the Fiscal Years Ended September 30, 1995 and 1994

Note 1. Significant Accounting Policies (continued)

H. Revenue and Financing Sources

The Service receives the majority of funding through annual, multiple year, no-year, and trust fund appropriations that may be used within statutory limits for operating and capital expenditures. Appropriations are recognized as financing sources when the related expenses are incurred. Reimbursement revenues are recognized when the services are provided.

The Service received $7 million in funding for the Violent Crime Reduction Trust Fund from the Justice Department, as authorized by the Violent Crime Control and Law Enforcement Act of 1994. This funding is used in tax law enforcement for combating public corruption and enhancing illegal tax enforcement activities.

Note 2. Funds with U.S. Treasury and Cash

Funds with U.S. Treasury and cash consisted of the following at September 30, 1995 and 1994:

	1995				1994
		Unobligated			
(Dollars in Millions)	Obligated	Available	Restricted	Total	Total
1995 appropriations	$698	--	$47	$745	--
1994 appropriations	178	--	14	192	$941
1993 appropriations	96	--	29	125	272
1992 appropriations	56	--	41	97	108
1991 appropriations	13	--	36	49	49
1990 appropriations	--	--	--	--	30
Violent Crime Reduction Trust Fund	4	--	--	4	--
Multi-year appropriations	--	70	--	70	--
No-year appropriations, including Tax Systems Modernization	110	36	--	146	273
Appropriated Funds	$1,155	$106	$167	$1,428	$1,673
Special Fund-User Fees	--	3	--	3	--
Deposit and Clearing Funds	(2)	--	--	(2)	13
Cash-Imprest Funds	--	--	3	3	4
Funds with U.S. Treasury and Cash	$1,153	$109	$170	$1,432	$1,690

INTERNAL REVENUE SERVICE
Notes to Principal Financial Statements - Administrative
for the Fiscal Years Ended September 30, 1995 and 1994

Note 3. Accounts Receivable

Accounts receivable and allowance for uncollectible accounts at September 30, 1995 consist of:

(Dollars in Millions)	Federal	Non - Federal
Receivables	$77	$31
Allowance for uncollectible accounts	(18)	(8)
	$59	$23

The allowance for uncollectible accounts was based on review of groups of accounts (by region, age and account type) and individual accounts. Accounts with less than a 50 percent likelihood of collection were included in the loss allowance.

Reimbursable receivables for fiscal years prior to 1994 increased in 1995 by a total of approximately $19 million, primarily because of adjustments posted to reconcile cash, equity, and budgetary accounts. This increase does not represent collectible accounts and has been reserved 100%.

Based on group review of reimbursable receivables, the loss allowance consists of: 1) 100% of fiscal year 1991, 1992, and 1993 reimbursable receivables of $1, $12, and $10 million, respectively, and 2) $2 million of fiscal year 1994 reimbursable receivables of $7 million. No fiscal year 1995 reimbursable receivables were classified as uncollectible accounts.

Based on individual account review of non-reimbursable receivables, the loss allowance was determined to be $1 million of non-reimbursable receivables of $25 million.

Note 4. Property and Equipment

The acquisition cost of all property, equipment and supplies is expensed in the Statement of Collections and Operations, rather than capitalized and depreciated, due to system limitations. System limitations include non-integration of fixed asset systems with the general ledger and lack of depreciation information.

The Integrated Network and Operations Management System (INOMS) and the Computer Resource Management System (CRMS) track and report automated data processing (ADP) equipment, software, and telecommunications equipment. All ADP and telecommunications equipment costing $300 or more is tracked. Purchased software with a cost of $25,000 or greater is tracked. The service life for ADP and telecommunications equipment ranges from 5 to 15 years.

The Service uses the Property Asset Tracking System (PATS) to track non-ADP equipment. Non-ADP equipment with a cost of $100 or greater is tracked. Asset life for fixed assets in PATS ranges from 3 to 10 years.

Tax Systems Modernization (TSM) purchases are included in applicable ADP and telecommunications categories. Fiscal year 1995 expended appropriations for all TSM equipment including operating leases, rental costs, and others is approximately $144 million.

INTERNAL REVENUE SERVICE
Notes to Principal Financial Statements - Administrative
for the Fiscal Years Ended September 30, 1995 and 1994

Note 4. Property and Equipment (continued)

The land and buildings occupied by the Service are provided by the General Services Administration (GSA). GSA charges the Service a Standard Level Users Charge (SLUC), which approximates commercial rental rates for similar properties.

At September 30, 1995 property and equipment balances were increased by a net adjustment of $9 million to additions and deletions to record transactions applicable to prior fiscal years.

Selected information about property and equipment valued at $5,000 or greater and purchased software costing $25,000 or greater is provided below.

(Dollars in Millions)

Classes of Property and Equipment	Balance 10/01/94	Additions	Deletions	Balance 9/30/95
ADP equipment and software	$450	$94	$28	$516
Furniture	12	1	1	12
Non-ADP equipment	28	1	2	27
Investigative equipment	28	12	23	17
Vehicles	56	19	4	71
Telecommunications equip.	184	24	25	183
Total	$758	$151	$83	$826

Note 5. Unfunded Actuarial Liability

The category unfunded actuarial liability relates to the Service's estimated Federal Employee's Compensation Act (FECA) liabilities. The liability for workers' compensation benefits includes expected payments for death, disability, medical and miscellaneous costs for approved compensation cases. The liability was determined by the Department of Labor for Treasury. The amount applicable to the Service was allocated by Treasury. The amount of the liability is $339 million as of September 30, 1995 and $337 million as of September 30, 1994.

Note 6. Unfunded Commitments and Contingencies

As of September 30, 1995, the Service recorded contingent liabilities of $80 million for pending and threatened legal matters for which it is probable, in the opinion of Chief Counsel, the Service will incur a liability. The liabilities could change depending on the ultimate outcome of cases. Further, in the opinion of Chief Counsel, additional losses from pending and threatened legal matters considered reasonably possible are estimated to be $2 million.

The Service is also involved in various legal actions in connection with which the United States will probably be liable for amounts payable from the Judgement Fund administered by the Justice Department in accordance with 31 U.S.C. 1304 and therefore are not reported in the statements. Generally, the IRS is not liable from its own appropriations for litigated judgements awarded to plaintiffs in federal court. In the opinion of Chief Counsel, it is probable that approximately $12 million will be payable from the Justice Department Judgement Fund for judgements and settlements relating to Service litigation and claims and reasonably possible that an additional $6 million of such claims will be payable by this fund.

INTERNAL REVENUE SERVICE
Notes to Principal Financial Statements - Administrative
for the Fiscal Years Ended September 30, 1995 and 1994

Note 7.
Unexpended Appropriations

The category unexpended appropriations within the operating net position section reflects total budget authority unrestricted and restricted for obligations, plus undelivered orders. Unexpended appropriations comprised the following on September 30, 1995 and 1994:

(Dollars in Millions)

Unobligated balances:	1995	1994
Unrestricted	$90	$154
Restricted	170	51
Undelivered orders	710	1,245
Total unexpended appropriations	$970	$1,450

Note 8.
Net Non-Operating Changes

The net non-operating changes in net position comprised the following on September 30, 1995 and 1994:

(Dollars in Millions)	1995	1994
Appropriations received	$7,516	$7,344
Appropriations used	(7,929)	(7,134)
Reclassification	(5)	-0-
Total net non-operating changes	$ (418)	$ 210

Appropriations received represents funding sources realized in fiscal year 1995. Appropriations used includes expenses financed by appropriations received in current and prior fiscal years. Of the $418 million, $5 million of the Appropriations Used amount is a net effect of certain reclassifications of Funds With U.S. Treasury.

Budget authority was increased during fiscal year 1995 by a net amount of $11 million in transfers between no-year appropriations and expired appropriations. This amount represents the net of $19 million of transfers from expired appropriations to no-year appropriations and $8 million from a no-year appropriation to an expired appropriation.

Note 9.
Prior Period Adjustments

The fiscal year 1994 accounts payable balance has been restated by an additional $8 million. This amount represents goods or services which had been received but not recorded as accounts payable in fiscal year 1994. The balances of appropriations used, operating expenses, and net position have been restated to reflect this increased balance in accounts payable. Additionally, the balance of net position at the end of fiscal year 1994 reflects prior period charges as follows:

	1995	1994
Prior period intragovernmental expense	$ ---	$(45)
Prepaid rent	(14)	(11)
Total prior period adjustments	$(14)	$(56)

Department of the Treasury

Internal Revenue Service

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Unaudited
Principal Financial Statements
Fiscal Years 1995 and 1994

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<u>CUSTODIAL</u>

Statement of Financial Position

Statement of Collections

Notes to Principal Financial Statements

Statement of Financial Position - Revolving Fund

Statement of Activity - Revolving Fund

Note to Revolving Fund Statements

Statement of Financial Position (Custodial)

Department of the Treasury
Internal Revenue Service
Statement of Financial Position
Custodial

	September 30, 1995	September 30, 1994
	(In Millions)	
Custodial Assets		
Federal tax receivables, net of allowance for doubtful accounts of $66,618 in 1995 and $34,215 in 1994 (Note 2)	$46,130	$35,030
Funds with U.S. Treasury (Note 3)	(2,914)	4,543
Seized monies (Note 4)	5	9
Total Custodial Assets	$43,221	$39,582
Custodial Liabilities		
Due to U.S. Treasury	$46,130	$35,030
Other custodial liabilities (Note 5)	58,673	59,501
Deferred revenue (Note 8)	1,967	
Seized monies (Note 4)	5	9
Commitments and contingencies (Note 6)	11,139	6,541
Total Custodial Liabilities	117,914	101,081
Custodial Net Position		
Unexpended appropriations (Note 3)	(3,199)	2,790
Cumulative results of operations (Note 8)	(1,967)	
Less: Future funding requirements (Note 7)	(69,527)	(64,289)
Total Custodial Net Position	(74,693)	(61,499)
Total Custodial Liabilities and Net Position	$43,221	$39,582

The accompanying notes are an integral part of these statements.

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Statement of Activity (Custodial)

Department of the Treasury
Internal Revenue Service
Statement of Custodial Activity
Years Ended September 30, 1995 and 1994

	1995 (In Millions)			1994
Tax Revenues for Others:	**Revenue**	**Refunds**	**Net**	**Net**
Collections of federal revenue (Notes 8 and 9)				
Payroll taxes (Note 11)	$926,535	$1,863	$924,672	$874,518
Individual income taxes (Note 12)	202,398	98,903	103,495	89,683
Corporate income taxes	174,202	18,851	155,351	137,727
Excise taxes	45,330	1,951	43,379	41,760
Estate and gift taxes	14,577	441	14,136	15,166
Railroad retirement	4,326	62	4,264	4,107
Federal unemployment taxes	5,803	109	5,694	5,458
Unclassified	188	317	(129)	
Total Taxes	1,373,359	122,497	1,250,862	1,168,419
Other federal revenue			300	569
Fees			2	28
Total Collections of Federal Revenue			1,251,164	1,169,016
Transfers to Treasury, Net of Refund Appropriations (Note 10)			(1,253,131)	(1,169,016)
Net Collections			($1,967)	$0

The accompanying notes are an integral part of these statements.

Notes to Financial Statements (Custodial)

INTERNAL REVENUE SERVICE
Notes to Financial Statements - Custodial
for the Fiscal Years Ended September 30, 1995 and 1994

Note 1. Significant Accounting Policies

A. Reporting Entity

The accompanying financial statements pertain to the Custodial segment of the Service and include all funds relating to this area of the Service except for the revolving fund. All intra-agency balances and transactions have been eliminated.

B. Basis of Presentation

These Custodial financial statements have been prepared to report the financial position and results of operations of the Service as required by the Chief Financial Officers Act of 1990. They have been prepared from the books and records of the Service in accordance with the form and content for entity financial statements specified by the Office of Management and Budget (OMB) in OMB Bulletin 94-01, and the Service's accounting policies which are summarized in this note. These statements are therefore different from the financial reports, also prepared by the Service pursuant to OMB directives, that are used to monitor and control the Service's use of budgetary resources.

C. Budgets and Budgetary Accounting

Permanent, indefinite appropriations, which are not subject to budgetary ceilings set by Congress during the annual appropriation process, are available for the payment of tax refunds, related interest and earned income credits in excess of tax liabilities.

D. Basis of Accounting

Federal revenue is reported on the cash basis of accounting, i.e., when remittances are received. Refunds and refund offsets are also reported on the cash basis of accounting. Tax receivables and an offsetting liability to the U.S. Treasury are also presented in the Statement of Financial Position to more accurately present the financial position of the Service. Tax receivables and liabilities for refunds payable are not accrued until related tax returns are filed.

E. Custodial Assets and Liabilities

Custodial assets include federal tax receivables, funds for the payment of refunds, and other resources. Custodial assets are offset by separate custodial net position categories to fully present the financial position of the Custodial segment of the Service. In addition, other custodial liabilities are offset by future funding requirements in the custodial net position section.

F. Transactions in Process

Transactions in process include collections and manual assessments and abatements which have been received by the Service but not posted to taxpayer accounts at the end of the fiscal year. The most significant components of transactions in process are employment, excise and other taxes collected through

INTERNAL REVENUE SERVICE
Notes to Financial Statements - Custodial
for the Fiscal Years Ended September 30, 1995 and 1994

Note 1. Significant Accounting Policies (continued)

the FTD system.

At the end of the fiscal year the books are held open several weeks in order to post transactions in process to taxpayer accounts. At the conclusion of this process, remaining unposted transactions, if any, represent potential liabilities or offsets to tax receivables.

G. Reclassifications

Certain 1994 amounts have been reclassified to conform to 1995 classifications.

H. Revolving Fund

In 1995, amounts pertaining to the financial position and activity of the revolving fund are not reported as part of the Custodial Financial Statements. Rather, Revolving Fund Statements are now presented in a separate section, following the Supplemental Information of the Custodial Statements. To ensure comparability, Custodial information for fiscal year 1994 has been restated to exclude revolving fund balances.

Note 2. Federal Tax Receivables and Collateral

For fiscal year 1995 the Service divided the total inventory of assessments into two major categories: 1) financial receivables and 2) compliance assessments. This new methodology, adopted in 1995 for valuing receivables, differs from the sampling methodology utilized in 1994. As of September 30, 1995, total financial receivables were $112.7 billion with an allowance amount of $66.6 billion. Net receivables were $46.1 billion.

Financial receivables consist of balances due where the Service has demonstrated the existence of a receivable through information provided directly from the taxpayer, or through actions taken by the Service which support or validate the Service's claim, such as securing the taxpayer's agreement.

Excluded from financial receivables are $25.2 billion in receivables designated as financial write-offs. Financial write-offs are a separate category of financial receivables whose ultimate collection is unlikely. Due to the ten year statute of limitations, the Service must maintain these accounts on the masterfile until the statute for collection expires.

Also excluded from financial receivables are $62.9 billion in compliance assessments. Compliance assessments consist of assessments primarily made for enforcement purposes. Actions may still be taken by the Service to collect these assessments, but because the taxpayer has not responded to validate the claim, there is not an established claim with the taxpayer. Compliance assessments have been excluded from total tax receivables due to the uncertainty of their collection.

The allowance for doubtful accounts reflects an estimate of the portion of total financial receivables deemed to be uncollectible. This valuation was derived using sampling techniques applied to stratified samples taken from total financial

INTERNAL REVENUE SERVICE
Notes to Financial Statements - Custodial
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Note 2. Federal Tax Receivables and Collateral (continued)

receivables. After selection of samples from the various age and dollar strata, rates of collection were derived and applied to the entire population. The sample sizes selected were designed to produce a 95% confidence interval.

The methodology employed in 1995 for reporting and valuing net tax receivables is in accordance with applicable accounting standards. However, the methodology utilized in 1994 did not meet applicable accounting standards because it relied on a sample to estimate total receivables. Normally, such a change in accounting principle would necessitate the reporting of a prior period adjustment. However, since the retroactive effect of this change cannot be calculated and reported in the financial statements, receivable balances for 1994 have not been restated to reflect the new methodology.

As of September 30, 1995 and 1994, the IRS held collateral valued at $120 million and $350 million respectively.

Note 3. Funds with U.S. Treasury and Unexpended Appropriations

Funds with U.S. Treasury in the custodial segment were comprised of the following at September 30, 1995 and 1994:

(Dollars in Millions)

	1995	1994
Appropriated Funds	($3,121)	$4,263
Deposit and Clearing Funds	207	280
Funds with U.S. Treasury - Custodial	($2,914)	$4,543

The negative amount for Appropriated Funds is a result of a supplemental warrant not being requested in fiscal year 1995 for $6.015 billion. The supplemental warrant was requested and issued in the new fiscal year.

The negative fund balance also produces a negative unexpended appropriation amount in the Custodial Net Position Section. The ($3,199) billion amount is comprised of the negative appropriated funds amount of ($3,121) billion and the ($78) million refund adjustment amount (see Note 9).

Note 4. Seized Monies and Property

Seized property and monies of the Service originate from its collection activities and its role in criminal investigations. Seized property includes cars, machinery, furniture, and real estate.

The Internal Revenue Code (IRC) authorizes the Service, as part of its collection activities, to seize property and monies in order to compel payment for delinquent tax obligations. The IRC prescribes detailed procedures for the seizure of property and monies, including proper methods for notifying parties and details of sale. Seized property is held and safeguarded by the Service until such time as the taxpayer has exhausted available remedies under the law. Generally, the seized

INTERNAL REVENUE SERVICE
Notes to Financial Statements - Custodial
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Note 4. Seized Monies and Property (continued)

property is sold and the proceeds used to satisfy the delinquent tax obligation. Seized monies are applied immediately to satisfy delinquent taxes.

The IRC also authorizes the seizure of property and monies resulting from investigations conducted by Criminal Investigation personnel of the Service. Property and monies are seized as part of the forfeiture laws pertaining to property used for criminal purposes. These seizures occur primarily from IRS jurisdiction over violations of the IRC or money laundering crimes as provided in Title 18, U.S.C. Criminal Investigation personnel may place certain forfeited properties (other than seized monies) into official use. When this occurs, the forfeited property is recorded as an asset held by the Service.

In accordance with applicable standards, seized monies are reported on the Statements of Financial Position, while seized property, collateral and acquired property are disclosed in the footnotes only. For fiscal year 1995 the Service utilized the Taxpayer Estimated Equity Valuation Method to provide seized property values for its financial statements. This methodology differs from the one employed in 1994. However, since the 1994 balance for seized property cannot be recalculated using the new methodology, the seized property balance for 1994 has not been restated.

As of September 30, 1995 and 1994, the IRS held seized property valued at $239 million and $420 million and acquired property valued at $2 million and $3 million respectively. In addition, as of September 30, 1995 and 1994, the IRS held seized monies valued at $5 million and $9 million , respectively.

Note 5. Other Custodial Liabilities

The category Other Custodial Liabilities is comprised primarily of liabilities to taxpayers for transactions in process and frozen tax refunds. Taxpayer advances, tax refunds payable, deposit and clearing funds and other liabilities comprise the remaining amount of Other Custodial Liabilities.

Transactions in process include collections and certain other remittances which have not yet posted to taxpayer accounts. Remaining unposted transactions, if any, represent potential liabilities or offsets to accounts receivable.

Liabilities for frozen tax refunds are refunds due to taxpayers but delayed or "frozen" pending a closer review to ensure that the refund is valid and, in fact, due to the taxpayer. Only a portion of total frozen tax refunds meet the criteria for recordation as liabilities. Included in these liabilities are advances, potential offsets to tax receivables and pending adjustments.

In 1995 changes were made in the methodology for valuing the frozen refund liability. Specifically, changes were made in the method of classifying frozen refund amounts. This change affected whether amounts meet the criteria of a liability, advance payment, or a prepayment credit. Prepayment credits are not shown as liabilities. Normally, such a change in accounting method would necessitate the reporting of a prior period adjustment. However, since the retroactive effect of this change cannot be calculated and reported in the financial

INTERNAL REVENUE SERVICE
Notes to Financial Statements - Custodial
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Note 5. Other Custodial Liabilities (continued)

statements, the frozen credit liability for 1994 has not been restated to reflect the new methodology.

Prepayments in the form of withheld or estimated taxes are not considered liabilities for financial statement purposes. Custodial liabilities also include liabilities for taxpayer deposits and clearing account liabilities. Other Custodial Liabilities were comprised of the following on September 30, 1995 and 1994:

(Dollars in Millions)

	1995	1994
Transactions in Process	$ ---	$10,649
Frozen Tax Refunds and Credits	53,484	44,388
Advances	2,490	2,674
Tax Refunds Payable	1,715	1,473
Deposit and Clearing Funds	207	280
Other Taxpayer Liabilities	777	37
	$58,673	$59,501

The amount of $53.484 billion is comprised of liabilities of $28.685 billion, advance payments of $12.955 billion and other of $11.844 billion.

Note 6. Unfunded Commitments and Contingencies

As of September 30, 1995 and 1994 there are $11.1 billion and $6.5 billion, respectively, in taxpayer claims for refunds of assessed taxes which management considers in all probability will be paid. Of these amounts, reported as of September 30, 1995 and 1994, $7.5 billion and $4.2 billion, respectively, are pending review by Examination and Appeals and $3.6 billion and $2.3 billion, respectively, are pending judicial review by federal courts.

Note 7. Future Funding Requirements

Future funding requirements are an offset, in the net position section, to unfunded liabilities. As an offset to unfunded liabilities, they represent expenses incurred and unpaid as of fiscal year end for which appropriations for their payment have not yet been provided. Future funding requirements were comprised of the following at September 30, 1995 and 1994:

(Dollars in Millions)

Custodial Items:

	1995	1994
Transactions in Process	$ ---	$10,649
Frozen Tax Refunds and Credits	53,484	44,388
Refunds Payable	1,637	---
Advances	2,490	2,674
Other Taxpayer Liabilities	777	37
Commitments and Contingencies	11,139	6,541
	$69,527	$64,289

INTERNAL REVENUE SERVICE
Notes to Financial Statements - Custodial
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Note 8. Federal Revenue and Transfers to Treasury

Federal revenue is reported on the cash basis. Beginning in FY 1995, the IRS adopted a new basis for timing the recognition of revenue and a new method of extracting the supporting detail transactions which comprise revenue. In FY 1995 these changes resulted in a net reduction in revenue of $1.967 billion from what would have been reported under the prior method. The amount transferred to Treasury is unaffected by the changes. Accordingly, the net effect of the change in FY 1995 creates a timing difference between revenue and amounts transferred to Treasury of $1.967 billion. The difference is reflected as Net Collections in the Statement of Custodial Activity and Deferred Revenue in the Statement of Financial Position. The net effect on revenues and transfers to Treasury is shown in the table below.

(Dollars in Millions)

	Prior Method	New Method	Difference
Revenue	$1,375,326	$1,373,359	($1,967)
Transfers to Treasury	1,375,326	1,375,326	--
	$ -0-	($1,967)	($1,967)

For FTD deposits - the largest component of revenue - recognition under the new method is as of the date the taxpayer makes a deposit at his commercial bank. Transfers to Treasury is deferred until the funds are deposited by the commercial bank in the Federal Reserve, usually the following day. Under the prior accounting method, both revenue and transfers to Treasury were recognized the day of receipt by the Federal Reserve. The change has no effect on revenue sources other than FTD receipts.

Beginning in FY 1995, detail revenue transactions supporting the amount in the statements are obtained from the master files of taxpayer accounts. This is the single, complete source of transactional data and provides the most reliable basis for stating revenue. Prior to FY 1995, revenue was reported based on confirmed receipt of funds by the Federal Reserve, and was not directly linked to individual transactions. This change also creates a timing difference; i.e., due to processing time, there may be a delay of up to a week or longer between receipt of the funds by the Federal Reserve and posting the transaction to the taxpayer's account in the master files. In addition, the amount is affected by complexities involved in extracting data from a large scale system with complete accuracy. In the opinion of management, the advantages of linking revenue to detail transactions outweigh immaterial differences caused by this change.

Note 9. Refunds

Refunds are reported on a cash basis. In FY 1995, the IRS adopted a new method of extracting detail transactions from the master files to support total refunds

INTERNAL REVENUE SERVICE
Notes to Financial Statements - Custodial
for the Fiscal Years Ended September 30, 1995 and 1994

Note 9. Refunds (continued)

reported in the statements. In FY 1995, this change resulted in an increase in refunds of $78 million from what would have been reported under the prior method. In addition, Unexpended Appropriations on the Statement of Financial Position received a charge of $78 million due to the increase in refund appropriations used during the fiscal year. The net effect on refunds and appropriations is shown in the table below.

(Dollars in Millions)

	Prior Method	New Method	Difference
Refunds	$122,419	$122,497	($78)
Refund Appropriations	122,419	122,497	($78)

Prior to FY 1995, refunds were based only on confirmed cash disbursements from Treasury, and not linked directly to underlying transactions. Under the new method, refunds are based on transactions extracted from the master files. Refund transactions in the master files are recorded when the tax return posts and there is an overall credit in the account. Accordingly, there may be timing differences between transactions in the master files and confirmed cash disbursements. In addition the amount may be affected by complexities involved in extracting data from a large scale system with complete accuracy. In the opinion of management, extracting detail refund transactions from the master files provides a more reliable basis for financial statement balances.

Note 10. Transfers to Treasury

Net transfers to Treasury using the new method of reporting revenues and refunds for fiscal year 1995, and the prior method for fiscal year 1994 were as follows:

(Dollars in Millions)

	1995	1994
Tax Revenue	$1,375,326	$1,275,132
Other Revenue	302	597
Refunds	(122,497)	(106,713)
Net Transfers to Treasury	$1,253,131	$1,169,016

Note 11. Payroll Taxes

Payroll taxes are comprised of Social Security taxes (FICA) and withheld federal income taxes. Both taxes are deposited by employers through the FTD system and reported on employers' quarterly tax returns. Payroll taxes are allocable between the general fund and the Social Security trust funds. The amount allocable to the Social Security trust funds is FICA assessments for the fiscal year--reported on

INTERNAL REVENUE SERVICE
Notes to Financial Statements - Custodial
for the Fiscal Years Ended September 30, 1995 and 1994

Note 11. Payroll Taxes (continued)

employers' quarterly tax returns or assessed as additional taxes due--without regard to amounts collected. Distribution of payroll tax revenue in this manner is made pursuant to section 201(a)(3) of the Social Security Act, and is consistent with the proposed standard for revenue recognition of the Federal Accounting Standards Advisory Board.

Distribution of assessed FICA rather than collections results in a relatively greater proportion of tax revenues accruing to the trust funds. The effect is illustrated in the table below. In the first column, net payroll tax revenue is allocated to Social Security based on FICA assessments, as required under the law. In the second proforma set of columns, collections and refunds in each employer's account have been allocated first to Social Security FICA, to the extent of actual collections. The balance, if any, is allocated to the general fund.

Payroll Taxes:

(Dollars in Millions)

	FY 1995 Revenue	FY 1995 Proforma Revenue		
	Net	Collections	Refunds	Net
Social Security	$430,598	$421,720		$421,720
General Fund	494,074	504,815	$1,863	502,952
Totals	$924,672	$926,535	$1,863	$924,672

Note 12. Individual Income Taxes

All individual income taxes other than withheld federal income taxes are included in this category: estimated taxes, payments with returns, notices and other direct payments. All refunds of individual income taxes, including amounts attributable to withheld federal income taxes, are reported in this category.

Within the category, self employment taxes and taxes on social security benefits are allocable to the Social Security trust funds. The amount of self employment tax allocable to Social Security is assessments, as reported on individual tax returns filed during the fiscal year or assessed as additional taxes due. Distribution of individual income tax revenue in this manner is made pursuant to Section 201(a)(4) of the Social Security Act for self employment taxes, and is consistent with the proposed standard for revenue recognition of the Federal Accounting Standards Advisory Board.

The amount of tax on social security benefits allocable to the trust fund is based on quarterly estimates made by Treasury. Under Section 121 of the Social Security Amendments of 1983, tax on social security benefits is to be estimated quarterly and adjusted for actual liabilities on filed returns.

INTERNAL REVENUE SERVICE
Notes to Financial Statements - Custodial
for the Fiscal Years Ended September 30, 1995 and 1994

Note 12. Individual Income Taxes (continued)

The table below shows the distribution of individual income tax revenue between Social Security and the general fund.

(Dollars in Millions)

		FY 1995 Net Revenue
Individual Income Taxes:		
Social Security		
Self Employment Taxes	$ 26,126	
Tax on Benefits	9,132	
	$ 35,258	$ 35,258
General Fund		68,237
Totals		$103,495

Statement of Financial Position (Revolving Fund)

Department of the Treasury
Internal Revenue Service
Statement of Financial Position
Revolving Fund

	September 30, 1995	September 30, 1994
	(In Millions)	
Revolving Fund Assets (Note 1)		
Funds with U.S. Treasury	$7	$12
Land and Building Inventory	3	--
Total Revolving Fund Assets	$10	$12
Revolving Fund Net Position (Note 1)		
Unexpended appropriations	$10	$12

The accompanying note is an integral part of these statements.

Statement of Activity (Revolving Fund)

Department of the Treasury
Internal Revenue Service
Statement of Revolving Fund Activity

	Years Ended September 30,	
	1995	*1994*
	(In Millions)	
Revolving Fund Sales (Note 1)	**$7**	$3
Less: Revolving Fund Costs (Note 1)	7	3
Net Activity	**$0**	$0

The accompanying note is an integral part of these statements.

Note to Financial Statements (Revolving Fund)

INTERNAL REVENUE SERVICE
Note to Financial Statements - Revolving Fund
for the Fiscal Years Ended September 30, 1995 and 1994

Note 1. Revolving Fund

The Federal Tax Lien Act of 1966 authorized the creation of a revolving fund for the redemption of real property on which a tax lien has been filed. The fund was established under permanent authority and is therefore available without fiscal year limitation.

In accordance with Section 7425 of the IRC and Section 2410 of Title 28, the revolving fund can be used to redeem real property foreclosed upon by a holder of a lien which is superior to the tax lien. Real property is redeemed when the Service pays the lienholder the amount bid at sale plus interest and certain post-sale expenses. The Service may then sell the property, reimburse the fund and apply the net proceeds to the outstanding tax obligation.

The revolving fund is reimbursed from the proceeds of the sale in an amount equal to the outlay from the fund for the redemption. The balance of the proceeds is applied against the amount of the tax, interest, penalties and the costs of sale. The remainder, if any, would revert to the parties legally entitled to it.

Supplemental Management Information

Department of the Treasury

Internal Revenue Service

Supplemental Management Information
Fiscal Year 1995

INTERNAL REVENUE SERVICE
Supplemental Management Information
for the Fiscal Years Ended September 30, 1995 and 1994

Financial Management

Federal Manager's Financial Integrity Act (FMFIA)

FMFIA is one in a series of laws enacted to govern federal agency accounting and financial reporting. The FMFIA directs federal agencies to provide reasonable assurance that:

- obligations and costs are in compliance with applicable laws
- funds, property and other assets are safeguarded against waste, loss, unauthorized use or misappropriation
- revenues and expenditures applicable to agency operations are properly recorded and accounted for permitting the preparation of accounts and reliable financial and statistical reports and maintaining accountability over its assets

The agency submits an annual assurance letter to Treasury which identifies material weaknesses and/or non-conformance with the act. In addition, the impact on agency operations and/or the public must be addressed including major milestones for corrective action. A summary of the IRS assurance letter to Treasury for fiscal year ending September 30, 1995 is discussed below.

Material Weaknesses

For fiscal year 1995, the IRS identified (through our own evaluation and the GAO fiscal year 1994 audit) eleven material weaknesses with Section 2 of the FMFIA. Two weaknesses which were identified in previous years were closed during this period. Namely, Employee Tax Assurance, and Seized Assets (CI). These closures were offset by two new material weaknesses, ie: Low Income Housing Credit and Tax Exempt Bond programs.

Material Non-Conformances

Under Section 4 of the FMFIA, seven material non-conformances were reported. Two weaknesses which were identified in previous years were closed during this period. Namely, Non-separation of Duties and Delayed Tax Deposits (both within the Fiscal Accounting System).

High Risk Areas

IRS has one item in this category, Management of Delinquent Debt, on which it continues to make good progress. For example, total dollars collected through June 1995 increased $1.2 billion, or 6.7% compared to June 1994.

Overall

Based on the results of Section 2 and 4 assessments as previously discussed, the IRS offered qualified assurance that, overall, its internal control systems are adequate and effective in achieving the objectives of the Integrity Act.

Supplemental Financial Information

Department of the Treasury

Internal Revenue Service

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Supplemental Financial Information
Fiscal Year 1995

INTERNAL REVENUE SERVICE
Supplemental Financial Information - Custodial
for the Fiscal Years Ended September 30, 1995 and 1994

Supplemental Revenue Information

Excise Tax Revenues *(Dollars in Millions)*

	1995	1994
General Fund Excise Taxes:		
Telephone Services	$3,826	$3,774
General Fund Portion of Highway Taxes	10,092	9,806
General Fund Portion of Airport/Airways	16	15
General Fund Portion of Leaking Underground Storage Tanks	205	190
General Fund Portion of Inland Waterways	23	21
Ozone Depleting Chemicals	571	611
Luxury Taxes	520	470
Exempt Organizations/Emp. Pension and Benefits	251	283
Miscellaneous Excise Taxes (1)	274	246
Trust Fund Excise Taxes:		
Highway Trust Fund	18,926	18,054
Mass Transit Account	2,215	2,150
Airport and Airways	5,721	5,484
Environmental Superfund	904	935
Black Lung Disability	602	597
Leaking Underground Storage Tanks	166	161
Oil Spill	1	---
Aquatic Resources	100	92
Earmarked	20	21
Vaccine Injury Compensation	177	205
Inland Waterways	105	91
Unclassified Excise Taxes	615	(705)
Total Excise Tax Revenues	45,330	42,501
Less: Refunds (2)	1,951	1,125
Net Excise Tax Revenues	$43,379	$41,376

Detailed information on the distribution of revenues between various excise taxes is based primarily on net tax liabilities reported on excise tax returns filed through December 31, 1995, rather than taxes collected. In general, these are the returns for four tax quarters ending September 30, 1995. The balance of the adjustment needed to report total excise tax revenues (collected) is included in Unclassified Excise Taxes.

(1) Miscellaneous taxes include cruiseship, foreign insurance, gas guzzler, wagering, Black Lung benefit trusts, regulated investment companies, and windfall profits taxes.

(2) Refunds consist of $1.101 billion certified to the Highway Trust Fund, $34 million certified to Airport and Airways and $816 million for other excise taxes.

INTERNAL REVENUE SERVICE
Supplemental Financial Information - Custodial
for the Fiscal Years Ended September 30, 1995 and 1994

Allocation of Revenue and Excise Taxes

Allocation of Revenue to Trust Funds and Transfers

Allocation of revenue to the general fund and trust funds is shown net of refunds. The source of data for transfers to trust funds is the Department of Treasury, Financial Management Service.

(Dollars in Millions)

	Revenue	Transfers
General Fund of the U.S. Treasury	$747,241	$743,398
Social Security Trust Funds (1)	465,861	464,646
Unemployment Trust Fund	5,694	5,229
Railroad Retirement Board Fund	4,264	4,330
Excise Tax Funds:		
Highway Trust Fund	17,825	22,612
Mass Transit Account	2,215	2,192
Airportand Airways	5,687	5,534
Environmental Superfund	904	1,479
Black Lung Disability	602	608
Leaking Underground Storage Tanks	166	165
Oil Spill	1	92
Aquatic Resources	100	306
Vaccine Injury Compensation	177	138
Inland Waterways	105	103
Earmarked	20	30
Totals	$1,250,862	$1,250,862

1) Social Security revenue is comprised of:

FICA	$430,598
SECA	26,126
Tax on Benefits	9,132
Refund Offsets	5
	$465,861

INTERNAL REVENUE SERVICE
Supplemental Financial Information - Custodial
for the Fiscal Years Ended September 30, 1995 and 1994

Excise Taxes - Assessments and Unpaid Balances

Under the trust fund provisions of the Internal Revenue Code, "...amounts equivalent to taxes received in the Treasury" are to be transferred to the trust funds . The IRS is responsible for certifying the correct amounts. For excise taxes reported on Form 720, Quarterly Excise Tax Return, the IRS certifies amounts based on tax liabilities (assessments) on the returns. There is a possibility of overfunding the trust funds if less than the full amount of the tax liability is collected.

The ratios in the last column of the table below were established by comparing total excise tax assessments on Forms 720 to current, remaining unpaid balances for tax years 1991-1994. Over the four year period, only .1 percent of trust fund excise taxes remain uncollected.

	1991		1992		1993		1994		1991-1994 Combined		
($ in Millions)	Assessed	Unpaid	Assessed	Unpaid	Assessed	Unpaid	Assessed	Unpaid	Assessed	Unpaid	Ratio
Highway Trust Fund	$16,097	$20	$16,329	$26	$18,633	$11	$17,322	$6	$68,381	$63	0.001
Mass Transit Account	1,613	2	1,694	2	1,792	1	2,195	0	7,294	5	0.001
Airport and Airways	4,665	9	4,649	4	5,309	8	5,482	7	20,105	28	0.001
Environmental Superfund	820	0	801	1	827	1	1,013	0	3,461	2	0.001
Black Lung Disability	629	7	623	5	566	3	607	4	2,425	19	0.008
Leaking Underground Storage Tanks	202	0	209	0	260	0	350	0	1,021	0	0.000
Oil Spill(1)	267	0	280	0	143	0	-	-	690	0	0.000
Aquatic Resources	75	0	84	0	88	0	93	0	340	0	0.000
Vaccine Injury Compensation	157	0	164	0	96	0	178	0	595	0	0.000
Inland Waterway	67	0	76	0	88	0	120	0	351	0	0.000
Earmarked	17	0	20	0	20	0	20	1	77	1	0.013
Totals	$24,609	$38	$24,929	$38	$27,822	$24	$27,380	$18	$104,740	$118	0.001

(1) No figures were available for 1994

INTERNAL REVENUE SERVICE
Supplemental Financial Information - Custodial
for the Fiscal Years Ended September 30, 1995 and 1994

Social Security Tax Assessments and Unpaid Ratios

As required by law, the IRS reports FICA taxes to the Social Security Administration (SSA) based on liabilities reported on the quarterly employer tax returns. SSA is responsible for certifying to Treasury the correct amount to be transferred to the Social Security trust funds. There is growing interest in knowing whether these transfers are fully supported by collections.

The following table compares total FICA assessed on Forms 941, 942, and 943 with the current, remaining unpaid balances for tax years 1991-1994.

(Dollars in Millions)

	1991	1992	1993	1994	Cumulative 1991-1994
FICA Assessed	$356,322	$373,413	$385,276	$411,713	$1,526,724
FICA Unpaid	863	813	773	917	3,366
Unpaid Ratio	.0024	.0022	.0020	.0022	.0022

Variance Analysis-Custodial Activities, Revenue

Tax Revenues

Tax revenues increased approximately 7.1% over fiscal year 1994 levels. This was due to the effect of improved economic conditions as described below.

Tax Revenues, Net of Refunds:

	FY 1995	FY 1994	% Change
Payroll taxes	$924,672	$874,518	5.7
Individual income taxes	103,495	89,683	15.4
Corporate income taxes	155,351	137,727	12.8
Excise taxes	43,379	41,760	3.9
Estate and gift taxes	14,136	15,166	(6.8)
Railroad retirement	4,264	4,107	3.8
Federal unemployment taxes	5,694	5,458	4.3
Unclassified	(129)	0	---
	$1,250,862	$1,168,419	7.1

Economic Conditions

Economic factors are presented by a comparison of the percentages in the table to primary economic indicators: GDP, Personal Income and Corporate Profits. Payroll taxes and individual income taxes increased 5.7% and 15.4%, respectively, or 6.6% when taken as a whole. This compares to the growth in personal income during calendar 1995 of 6.2%. Corporate income taxes increased 12.8%, compared to the growth in corporate profits during calendar 1995 of 14.0%. Excise taxes increased 3.9%, compared to growth in GDP of 4.7%.

INTERNAL REVENUE SERVICE
Appendix 1
for the Fiscal Years Ended September 30, 1995 and 1994

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The Chief Financial Officer's staff would also like to recognize the following individuals from both Taxpayer Services (TPS) and Information Systems (IS) who materially assisted in the preparation of the Custodial section:

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Reports Issued as a Result of GAO's Audit of IRS' Fiscal Year 1992, 1993, and 1994 Financial Statements and Status of Recommendations

The results of our efforts to audit IRS' fiscal year 1992, 1993, and 1994 Principal Financial Statements were presented in our reports entitled 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), and Financial Audit: Examination of IRS' Fiscal Year 1994 Financial Statements (GAO/AIMD-95-141, August 4, 1995). The system and internal control weaknesses identified in the 1992 report and recommendations to correct them were discussed in more detail in six reports. In fiscal year 1993, we issued one report that included the system and internal control weaknesses and recommendations. For fiscal year 1994, we issued one report that contained no new recommendations.

We determined the status of the following recommendations based on our audit work at IRS during fiscal year 1995 and on our discussions with IRS officials. Our assessments of IRS' actions for the most significant recommendations are discussed in the report. However, we have not fully assessed the appropriateness or effectiveness of all of the responses identified in the following table. We plan to update our assessment of IRS' responses as part of our fiscal year 1996 audit.

Reports/recommendations	Action complete	Action in progress	Action in planning or planning complete	No specific action planned
Financial Audit: IRS Significantly Overstated Its Accounts Receivable (GAO/AFMD-93-42, May 6, 1993)				
Provide the IRS Chief Financial Officer authority to ensure that IRS accounting system development efforts meet its financial reporting needs. At a minimum, the Chief Financial Officer's approval of related system designs should be required.	X			

(continued)

Reports/recommendations	Action complete	Action in progress	Action in planning or planning complete	No specific action planned
Take steps to ensure the accuracy of the balances reported in IRS financial statements. In the long term, this will require modifying IRS systems so that they are capable of (1) identifying which assessments currently recorded in the Master File System represent valid receivables and (2) designating new assessments that should be included in the receivables balance as they are recorded. Until these capabilities are implemented, IRS should rely on statistical sampling to determine what portion of its assessments represent valid receivables.		X		
Clearly designate the Chief Financial Officer as the official responsible for coordinating the development of performance measures related to receivables and for ensuring that IRS financial reports conform with applicable accounting standards.	X			
Modify the IRS methodology for assessing the collectibility of its receivables by —including only valid accounts receivable in the analysis; —eliminating, from the gross receivables balance, assessments determined to have no chance of being collected; —including an analysis of individual taxpayer accounts to assess their ability to pay; —basing group analyses on categories of assessments with similar collection risk characteristics; and —considering current and forecast economic conditions, as well as historical collection data, in analyses of groups of assessments.		X		

(continued)

Reports/recommendations	Action complete	Action in progress	Action in planning or planning complete	No specific action planned
Once the appropriate data are accumulated, IRS may use modeling to analyze collectibility of accounts on a group basis, in addition to separately analyzing individual accounts. Such modeling should consider factors that are essential for estimating the level of losses, such as historical loss experience, recent economic events, and current and forecast economic conditions. In the meantime, statistical sampling should be used as the basis for both individual and group analyses.				
IRS Information Systems: Weaknesses Increase Risk of Fraud and Impair Reliability of Management Information (GAO/AIMD-93-34, September 22, 1993)				
Limit access authorizations for individual employees to only those computer programs and data needed to perform their duties and periodically review these authorizations to ensure that they remain appropriate.		X		
Monitor efforts to develop a computerized capability for reviewing user access activity to ensure that it is effectively implemented.		X		
Establish procedures for reviewing the access activity of unit security representatives.		X		
Use the security features available in IRS' operating systems software to enhance system and data integrity.		X		
Require that programs developed and modified at IRS headquarters be controlled by a program librarian responsible for (1) protecting such programs from unauthorized changes including recording the time, date, and programmer for all software changes, and (2) archiving previous versions of programs.		X		

(continued)

Reports/recommendations	Action complete	Action in progress	Action in planning or planning complete	No specific action planned
Establish procedures requiring that all computer program modifications be considered for independent quality assurance review.	X			
Formally analyze Martinsburg Computing Center's computer applications to ensure that critical applications have been properly identified for purposes of disaster recovery.	X			
Test the disaster recovery plan.		X		
Monitor service center practices regarding the development, documentation, and modification of locally developed software to ensure that such software use is adequately controlled.			X	
Review the current card key access system in the Philadelphia Service Center to ensure that only users who need access to the facilities protected by the system have access and that authorized users each have only one unique card key.	X			
Establish physical controls in the Philadelphia Service Center to protect computers with access to sensitive data that are not protected by software access controls.		X		

(continued)

Reports/recommendations	Action complete	Action in progress	Action in planning or planning complete	No specific action planned
Financial Management: IRS' Self-Assessment of Its Internal Control and Accounting Systems Is Inadequate (GAO/AIMD-94-2, October 13, 1993)				
The Senior Management Council should coordinate, monitor, or oversee activities to (1) establish and implement proper written procedures that provide for the identification, documentation, and correction of material weaknesses, (2) provide classroom training and guidance materials to all review staff, (3) develop effective corrective action plans that address the fundamental causes of the weaknesses, and (4) verify the effectiveness of corrective actions before removing reported weaknesses from IRS' records.		X		
Financial Management: Important IRS Revenue Information Is Unavailable or Unreliable (GAO/AIMD-94-22, December 21, 1993)				
Develop a method to determine specific taxes collected by trust fund so that the difference between amounts assessed and amounts collected is readily determinable and excise tax receipts can be distributed as required by law. This could be done by obtaining specific payment detail from the taxpayer, consistent with our April 1993 FTD report. Alternatively, IRS might consider whether allocating payments to specific taxes based on the related taxpayer returns is a preferable method.		X		
Determine the trust fund revenue information needs of other agencies and provide such information, as appropriate. If IRS is precluded by law from providing needed information, IRS should consider proposing legislative changes.		X		

(continued)

Reports/recommendations	Action complete	Action in progress	Action in planning or planning complete	No specific action planned
Identify reporting information needs, develop related sources of reliable information, and establish and implement policies and procedures for compiling this information. These procedures should describe any (1) adjustments that may be needed to available information and (2) analyses that must be performed to determine the ultimate disposition and classification of amounts associated with in-process transactions and amounts pending investigation and resolution.		X		
Establish detailed procedures for (1) reviewing manual entries to the general ledger to ensure that they have been entered accurately and (2) subjecting adjusting entries to supervisory review to ensure that they are appropriate and authorized.	X			
Monitor implementation of actions to reduce the errors in calculating and reporting manual interest, and test the effectiveness of these actions.		X		
Give a priority to the IRS efforts that will allow for earlier matching of income and withholding information submitted by individuals and third parties.		X		
Financial Management: IRS Does Not Adequately Manage Its Operating Funds (GAO/AIMD-94-33, February 9, 1994)				
Monitor whether IRS' new administrative accounting system effectively provides managers up-to-date information on available budget authority.	X			
Promptly resolve differences between IRS and Treasury records of IRS' cash balances and adjust accounts accordingly.		X		
Promptly investigate and record suspense account items to appropriate appropriation accounts.		X		

(continued)

Reports/recommendations	Action complete	Action in progress	Action in planning or planning complete	No specific action planned
Perform periodic reviews of obligations, adjusting the records for obligations to amounts expected to be paid, and removing expired appropriation balances from IRS records as stipulated by the National Defense Authorization Act for Fiscal Year 1991.		X		
Monitor compliance with IRS policies requiring approval of journal vouchers and enforcing controls intended to preclude data entry errors.		X		
Review procurement transactions to ensure that accounting information assigned to these transactions accurately reflects the appropriate fiscal year, appropriation, activity, and sub-object class.	X			
Provide (1) detailed written guidance for all payment transactions, including unusual items such as vendor credits, and (2) training to all personnel responsible for processing and approving payments.	X			
Revise procedures to require that vendor invoices, procurement orders, and receipt and acceptance documentation be matched prior to payment and that these documents be retained for 2 years.	X			
Revise 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.		X		
Revise document control procedures to require IRS units that actually receive goods or services to promptly forward receiving reports to payment offices so that payments can be promptly processed.		X		
Monitor manually computed interest on late payments to determine whether interest is accurately computed and paid.			X	

(continued)

Reports/recommendations	Action complete	Action in progress	Action in planning or planning complete	No specific action planned
Enforce existing requirements that early payments be approved in accordance with OMB Circular A-125.	X			
Require payment and procurement personnel, until the integration of AFS and the procurement system is completed as planned, to periodically (monthly or quarterly) reconcile payment information maintained in AFS to amounts in the procurement records and promptly resolve noted discrepancies.		X		
Require the description and period of service for all invoiced items to be input in AFS by personnel responsible for processing payments, and enhance the edit and validity checks in AFS to help prevent and detect improper payments.	X			
Establish procedures, based on budget categories approved by OMB, to develop reliable data on budget and actual costs.	X			
Use AFS' enhanced cost accumulation capabilities to monitor and report costs by project in all appropriations.		X		
Financial Management: IRS Lacks Accountability Over Its ADP Resources (GAO/AIMD-93-24, August 5, 1993)				
Provide the agency's CFO with the authority to ensure that data maintained by IRS' ADP inventory system meet its management and reporting needs.	X			
Provide that any software purchases, development, or modifications related to this system are subject to the CFO's review and approval.	X			

(continued)

Reports/recommendations	Action complete	Action in progress	Action in planning or planning complete	No specific action planned
Develop and implement standard operating procedures that incorporate controls to ensure that inventory records are accurately maintained. Such controls should include — establishing specific procedures to ensure the prompt and accurate recording of acquisitions and disposals in IRS' ADP fixed asset system, including guidance addressing the valuation of previously leased assets; — reconciling accounting and inventory records monthly as an interim measure until the successful integration of inventory and accounting systems is completed as planned; and — implementing mechanisms for ensuring that annual physical inventories at field locations are effectively performed, that discrepancies are properly resolved, and that inventory records are appropriately adjusted.		X		
Oversee IRS efforts for ensuring that property and equipment inventory data, including telecommunications and electronic filing equipment, is complete and accurate.		X		
Determine what information related to ADP resources, such as equipment condition and remaining useful life, would be most useful to IRS managers for financial management purposes and develop a means for accounting for these data.		X		
Develop an interim means to capture relevant costs related to in-house software development.				X

(continued)

Reports/recommendations	Action complete	Action in progress	Action in planning or planning complete	No specific action planned
Financial Audit: Examination of IRS' Fiscal Year 1993 Financial Statements (GAO/AIMD-94-120, June 15,1994)				
Tax Collection Activities				
Ensure that system development efforts provide reliable, complete, timely, and comprehensive information with which to evaluate the effectiveness of its enforcement and collection programs;		X		
Establish and implement procedures to analyze the impact of abatements on the effectiveness of assessments from IRS' various collection programs; and		X		
Reconcile detailed revenue transactions for individual taxpayers to the master file and general ledger.		X		
Establish and implement procedures to proactively identify errors that occur during processing of data, and design and implement improved systems and controls to prevent or detect such errors in the future.		X		
Management of Operating Funds				
Monitor its systems and controls to regularly identify problems as they occur by establishing clear lines of responsibility and communication from top management to the lowest staff levels,		X		
Develop action plans that are agreed upon by all affected groups and individuals to correct problems identified, and		X		
Continuously monitor corrective actions to ensure that progress is achieved.		X		
Periodically compare information in payroll records to supporting personnel information,	X			
Use current information to periodically update estimated future TSM costs, and		X		

(continued)

Reports/recommendations	Action complete	Action in progress	Action in planning or planning complete	No specific action planned
Develop reliable detailed information supporting its reported accounts payable balances.		X		
Seized Assets				
Develop and implement systems and standard operating procedures that incorporate controls to ensure that seized asset inventory records are accurately maintained, which include		X		
Establishing specific procedures to ensure the prompt and accurate recording of seizures and disposals, including guidance addressing the valuation of seized assets;		X		
Reconciling accounting and inventory records monthly as an interim measure until the successful integration of inventory and accounting systems is completed; and		X		
Implementing mechanisms for ensuring that annual physical inventories at field locations are effectively performed, that discrepancies are properly resolved, and that inventory records are appropriately adjusted.		X		
Determine what information related to seized assets, such as proceeds and liens and other encumbrances, would be most useful to IRS managers for financial management purposes and develop a means for accounting for these data.	X			

Comments From the Internal Revenue Service

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

COMMISSIONER

June 17, 1996

The Honorable Charles A. Bowsher
Comptroller General of the United States
Washington, D.C. 20548

Dear Mr. Bowsher:

We would like to thank you for the opportunity to comment on the General Accounting Office's draft report Examination of IRS' Fiscal Year 1995 Financial Statements. We appreciate your staff's effort in conducting the fourth financial statement audit of the Service as required by the Chief Financial Officer's Act of 1990. As you know, the Internal Revenue Service has long supported the CFO Act and the audit process. We have reviewed your draft audit report and generally agree with the facts as stated.

We have committed our executives and significant resources to the improvement of our financial management and revenue accounting systems. We are proud of the progress we have made to get to where we are today. We also recognize that additional work remains to be done to ensure the integrity of our financial statement data, and I am fully committed to this effort. My goal is to ensure that the IRS operates within the highest quality financial management environment. I appreciate your support of our efforts and your willingness to partner with us in improving our financial management processes. We look forward to continuing our close and cooperative working relationship.

Sincerely,

Margaret Milner Richardson

Margaret Milner Richardson

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