United States General Accounting Office
Washington, DC 20548

July 30, 2001

The Honorable Charles O. Rossotti
Commissioner of Internal Revenue

Subject: Management Letter: Improvements Needed in IRS' Accounting Procedures and Internal Controls

Dear Mr. Rossotti:

In March 2001, we issued our report on the results of our audit of the Internal Revenue Service's (IRS) financial statements and on the effectiveness of its internal controls as of, and for the fiscal year ending, September 30, 2000.[1] We also reported our conclusions on IRS' compliance with significant provisions of selected laws and regulations and on whether IRS' systems substantially comply with requirements of the Federal Financial Management Improvement Act of 1996. We are in the process of preparing a separate report addressing the significant internal control and compliance issues identified and highlighted in our March 2001 audit report.

The purpose of this letter is to report additional matters identified during our fiscal year 2000 audit regarding accounting procedures and internal controls that could be improved. These matters are not considered material in relation to the financial statements; however, they warrant management's consideration.

Results in Brief

During fiscal year 2000, IRS had several immaterial internal control issues that affected financial reporting. These issues concern policies and procedures over (1) reimbursable activity, (2) property and equipment (P&E) purchased through the Department of the Treasury's working capital fund (WCF),[2] (3) oversight of financial reporting-related contractor support, and (4) transfers of funds between appropriations.

Specifically, we found the following.

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[1] *Financial Audit: IRS' Fiscal Year 2000 Financial Statements* (GAO-01-394, Mar. 1, 2001).

[2] The WCF is a revolving fund established to provide centralized administrative services to be used by more than one bureau or agency. Although the bureaus and agencies provide the funds that finance it, the WCF owns the property and equipment purchased.

- IRS was unable to determine if its costs for reimbursable activities were accurate and whether it was recouping the costs of the goods or services it provided. Also, IRS' records regarding reimbursable amounts not yet paid (reimbursable receivables) were not reliable.

- IRS did not have procedures in place to properly record its WCF prepaid expenses. The lack of such procedures resulted in IRS understating its assets and overstating its expenses by $7.3 million in fiscal year 2000.

- IRS accepted information from its contractors for inclusion in its year-end financial reporting without sufficient oversight or review. This allowed uncorrected data related to P&E and undelivered orders to be included in the generation of IRS' financial statements that, without audit adjustments, could have led to erroneous information being reported by IRS.

- IRS did not always follow standard procedures with respect to the transfer of funds between appropriations. Specifically, IRS recorded a transfer of budgetary authority in its general ledger 7 months before Treasury processed the transfer.

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

In responding to a draft of this letter, IRS agreed with portions of the letter, but disagreed with the issues regarding prepaid expenses and lack of contractor oversight. At the end of our discussion of each of the issues in this letter, we have summarized IRS' related comments and provided our evaluation. The complete text of IRS' response is included in enclosure I to this letter.

Scope and Methodology

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

We conducted our fiscal year 2000 audit in accordance with U. S. generally accepted government auditing standards. Further details on our scope and methodology are included in our March 2001 report on the results of our fiscal year 2000 financial statement audit.[3]

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[3]GAO-01-394, Mar. 1, 2001.

IRS Needs Procedures to Properly Track and Report Reimbursable Activity

During our fiscal year 2000 financial audit, we noted a number of issues related to IRS' tracking and reporting of reimbursable activity.[4] These issues resulted in both IRS' inability to provide accurate cost information and in misstatements in accounts used to record and report reimbursable activity. We reported on inaccuracies in reimbursable activity records last year.[5]

U.S. generally accepted accounting principles (GAAP) recognize that reliable information on costs of federal programs and activities is crucial for effective management of government operations and is especially important to assess operating performance.[6] Specifically, the accounting standards require that when an entity provides goods or services to another entity, regardless of whether full reimbursement is received, the providing entity should recognize in its accounting records the full cost of those goods or services. The full costs of the goods or services should also be reported to the receiving entity by the providing entity. Regarding the need to maintain accurate records, GAO's *Standards for Internal Control in the Federal Government*[7] states that internal control should generally be designed to assure that ongoing monitoring occurs in the course of normal operations. This includes regular management and supervisory activities, comparisons, reconciliations, and other actions people take in performing their duties.

IRS' accounting systems did not track or report cost information at the level necessary to determine the actual cost of reimbursable activities as required by federal accounting standards. For reimbursable activity, IRS bills customers using estimates of costs for the goods or services it provides. Although the use of estimates is a valid accounting practice, IRS' systems did not adequately capture the actual cost of these goods and services they provide. Because of this, IRS was unable to determine if its estimates were accurate and whether it was recouping the costs of the goods or services it provided. Additionally, this prevented IRS from reporting reliable cost information to program managers, the Congress, and other interested parties.

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

[5]*Management Letter: Suggested Improvements in IRS' Accounting Procedures and Internal Controls* (GAO/AIMD-00-162R, June 14, 2000).

[6]Statement of Federal Financial Accounting Standards (SFFAS) No. 4 (para.108).

[7]*Standards for Internal Control in the Federal Government* (GAO/AIMD-00-21.3.1, Nov. 1999), contains the internal control standards to be followed by executive agencies in establishing and maintaining systems of internal control as required by 31 U.S.C. sec. 3512 (commonly referred to as the Federal Managers' Financial Integrity Act).

We also found that the records IRS maintains regarding reimbursable amounts not yet paid (reimbursable receivables) were not reliable. IRS did not routinely age or analyze its receivables to ensure their validity. We tested a nonrepresentative selection of six reimbursable receivables at the end of fiscal year 2000 and found errors in the records for five of the accounts. Specifically, we found that three of the receivables (50 percent) in our nonrepresentative selection had already been paid and were therefore no longer valid receivables. The other two receivables had been outstanding for several years and had previously been identified by IRS as uncollectible. Although they should have been written off in the detailed records, these items were still recorded as valid receivables. This is consistent with our findings reported in last year's management letter, in which we noted that 54 percent of the reimbursable receivables we tested were no longer valid.

Because IRS did not routinely review its reimbursable receivables, it was unable to identify invalid or inaccurate receivables and make the needed corrections. Proper analysis through aging and reconciliation of IRS' records is a part of good management practice and could have identified these inaccuracies and allowed IRS to correct its records of reimbursable receivables. Additionally, providing accurate general and subsidiary ledger balances reflecting only valid receivables would better support management in its collection efforts and provide for more reliable and easily verifiable reporting to management.

Recommendations

To allow the proper reporting of the cost of reimbursable activity, we recommend that you ensure that IRS personnel

- develop a mechanism to track and report the actual costs associated with reimbursable activities.

To provide for more accurate records and better management of reimbursable activity, we recommend that you ensure that IRS personnel

- establish procedures to periodically reconcile the subsidiary records to the control account for reimbursable receivables to ensure that the balance is adequately supported and

- routinely age and review currently open reimbursable receivable accounts to identify accounts that are no longer valid or collectible.

IRS' Comments and Our Evaluation

In its comments, IRS noted that, with few exceptions, it does not bill its customers in advance of providing goods or services. We agree, and have modified the language accordingly. IRS did not address our recommendations that it track the actual costs of reimbursable activity or that it establish procedures to reconcile its records of reimbursable receivables and routinely review the status of those receivables.

IRS Needs Procedures to Properly Account for Prepaid Expenses and Treasury Working Capital Fund Assets

During our fiscal year 2000 audit, we continued to find issues with respect to IRS' accounting procedures for certain assets paid for in one year but used for several years. GAAP[8] define such payments as prepayments and require agencies to record them as assets (prepaid expenses) in the year of payment because the cost of the goods and services will benefit the entity in future years. Recording an asset in this way and expensing the cost systematically over the asset's useful life is necessary in order to match the expense with the period in which the benefit is received. Doing so gives management reliable information on the cost of federal programs—an important part of assessing operating performance.

However, IRS recorded the entire cost as an expense at the time of purchase. IRS purchases a significant portion of its telecommunications services through Treasury's WCF. The WCF purchases and retains ownership of capital items (such as telephone routers) for IRS and bills IRS for the full cost of these items in the year of purchase. Although the equipment is located at IRS offices and IRS benefits from the purchase for a number of years, IRS has been recognizing the full cost of these items as an expense in the first year.

When we identified this issue in the previous year's audit, IRS corrected the problem for fiscal year-end financial reporting. To do so, IRS used a contractor to estimate its prepaid expenses by statistically projecting the net book value of WCF assets at IRS locations in order to properly reflect prepaid expenses on its balance sheet as of September 30, 1999. The contractor physically inventoried a sample of WCF assets at IRS locations and then projected the value of the assets. As a result of this projection, IRS made a $21.7 million adjustment to reflect this amount as a prepaid expense on its September 30, 1999, balance sheet. Although we suggested in last year's management letter that IRS develop procedures to record prepayments as assets in future periods, IRS still did not have such procedures in place to properly record its WCF prepaid expenses for fiscal year 2000. The lack of such procedures resulted in IRS understating its assets and overstating its expenses by $7.3 million in fiscal year 2000.

In last year's audit, we identified two additional issues related to the WCF. In a separate management letter,[9] we made several suggestions to help IRS strengthen its procedures and controls in this area. We found during this year's audit that IRS had implemented corrective action based on one of these suggestions. Specifically, IRS

[8] SFFAS No. 1, *Accounting for Selected Assets and Liabilities*, provides accounting standards for selected assets and liabilities. Paragraph 58 of SFFAS No. 1 defines prepayments (prepaid expenses) and paragraph 59 states prepayments should be recorded as assets. Statement of Accounting Standards No. 4, *Managerial Cost Accounting Standards,* (paras. 5 to 11) provides concepts and standards aimed at providing reliable and timely information on the full cost of federal programs and their activities and outputs.

[9] GAO/AIMD-00-162R, June 14, 2000.

agreed with our suggestion to remove multiple property tags from property at IRS locations.[10] During this year's audit we did not identify any instances of property with multiple tags. We also found during this year's audit that IRS has removed WCF items from its records, thus addressing the underlying issue that gave rise to our suggestion.

Recommendation

We recommend that IRS develop and implement procedures to require that prepayments be recorded as assets routinely at the time the cost is incurred in accordance with GAAP. Services that are provided to IRS that will benefit IRS for more than 1 year should be established as prepaid expenses and amortized over the period of the benefit.

IRS' Comments and Our Evaluation

In commenting on this section, IRS stated that it records Online Payment and Collection billings from the WCF as a prepaid asset and then decides how much of the asset to charge to expense based on reports it receives from the WCF. However, most of the equipment purchased by the WCF, which is used by IRS, is expensed by the WCF in the year of purchase due to its capitalization threshold. Therefore, by using the WCF reports as a basis for determining how much of the cost should be expensed, IRS effectively expenses this equipment in the year of purchase even though it will benefit IRS for more than 1 year. The accounting treatment of these items by the WCF should not affect how IRS accounts for the amounts paid for the use of the equipment. Because procedures were not in place to properly account for these costs, IRS understated its assets and overstated its expenses by $7.3 million in fiscal year 2000.

IRS Needs Better Oversight of Financial Reporting-Related Contractor Support

In previous years, and again this year, we noted a number of errors and discrepancies in IRS financial records that could have been avoided or corrected by greater management oversight and review. During fiscal year 1999, we reported that IRS did not perform sufficient supervisory review to detect and eliminate errors and thus ensure that transactions were properly recorded and adequately supported and that reports were properly prepared.[11] We suggested that IRS revise its policies and procedures to require documented and sufficiently detailed supervisory reviews of transactions to ensure that transactions are correct and adequately supported and

[10] The suggestion arose because we found that many of the telecommunication equipment items we observed at IRS facilities had both IRS and WCF tags. Having multiple tags made it difficult to determine whether these items should have been recorded in IRS or Treasury WCF records.

[11] GAO/AIMD-00-162R, June 14, 2000.

that reports are properly prepared before information is summarized and reported externally.

During fiscal year 2000, IRS contracted out several activities that directly supported its year-end financial reporting process. However, it did not maintain sufficient oversight of these contractors to ensure that their work was reliable. This hampered IRS' ability to ensure reasonable controls existed over the accuracy of its reported financial information.

GAO's *Standards for Internal Control in the Federal Government* requires that supervisory personnel perform sufficient review to detect and eliminate errors, and thus ensure that transactions are properly recorded and adequately supported and that reports are properly prepared.[12] Contracting out financial activities in support of year-end financial reporting does not relieve IRS of its responsibility to maintain accurate records or to adequately review financial information.

In fiscal year 2000, we found that IRS accepted information from its contractors for inclusion in its year-end financial reporting without sufficient oversight or review. For example, during fiscal year 2000 IRS hired a contractor to extract and analyze from IRS' records major system acquisitions and purchases to derive the amounts that it should capitalize as P&E on its financial statements. IRS then recorded adjusting entries provided by the contractor to transfer these P&E acquisitions to the appropriate general ledger account. However, information provided by the contractor was not always accurate and IRS did not review the data to ensure their reliability. For example,

- 8 of 60 transactions we tested, totaling $879,000, were inappropriately identified by the contractor as P&E for fiscal year 2000, and two of the 8 transactions were actually purchases of P&E that should have been reported in fiscal year 1999, while the remaining 6 transactions should have remained as expenses, and

- the contractor's calculation of fiscal year 2000 depreciation expense totaling $359 million contained errors of $61 million (17 percent).

IRS had similar problems with contractor-developed adjustments for undelivered orders.[13] In prior years and again in fiscal year 2000, we found that IRS did not always reduce the balance of undelivered orders when goods and services were received. This resulted in IRS overstating its undelivered orders and understating its accrued expenses since IRS had already received the goods and services and should have decreased its undelivered orders accordingly. In response to a recommendation we made after our fiscal year 1999 audit that IRS periodically analyze outstanding balances to determine their status and whether any adjustments are necessary, IRS hired a contractor to review its accrued expenses as of September 30, 1999.

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[12] GAO/AIMD-00-21.3.1, Nov. 1999.

[13] Undelivered orders represent the value of goods and services that were ordered and obligated but have not been received.

However, during our fiscal year 2000 audit, we noted that several of the contractor-developed adjustments were erroneous. We also found that IRS had accepted the adjustments without reviewing them for appropriateness.

Financial information provided by contractors was not always correct, and IRS did not detect the errors as a result of its lack of sufficient oversight. This allowed uncorrected data to be included in the generation of IRS' financial statements and, without audit adjustments, could have led to erroneous information being reported by IRS.

Recommendation

We recommend that you ensure that IRS personnel maintain effective oversight of the completeness and accuracy of contractor-generated information.

IRS' Comments and Our Evaluation

In commenting on this section, IRS stated that it reviewed the deliverables and supporting workpapers provided by the contractor relating to property and equipment and made adjustments. IRS further stated that it did not and should not be expected to review every transaction to determine if an exception occurred. While we do not expect that IRS should review every transaction, we do expect that effective review and oversight should result in material problems being identified. Our detailed testing of 60 transactions, in which we found 8 errors, was based on a statistical sample. Based on our work, we estimate the most likely overstatement of the P&E balance as a result of transactions incorrectly recorded as fiscal year 2000 P&E was $61 million, with an upper error limit of $106 million. This exceeded our test materiality.[14]

IRS also stated that the other issue we raised with respect to P&E was the result of a change we made to the life expectancy of certain assets. There was no change in life expectancy of assets from fiscal year 1999 through fiscal year 2000. However, we did find cases in which the contractor did not correctly use the life expectancies established in fiscal year 1999.

With respect to the discussion of accrued expenses in this section, IRS stated that it performed a thorough review of the contractor's work in reviewing accrued expenses as of September 30, 1999. However, we question the adequacy of this review. We found that in a number of instances the contractor did not go beyond summary level information in determining accrual amounts. For example, IRS allocated $209,500 of the total invoice cost of $260,130 related to an information services contract to fiscal year 1999, and the remaining $50,630 to fiscal year 2000. However, based on the terms of the service contract, we determined that only $1,724 of the invoice cost related to services for fiscal year 1999, while the remaining $258,406 related to services to be rendered in fiscal year 2000. It appears the contractor did not go beyond the first page of the invoice in determining the accrual amount, while the

[14]Our estimate is based on a 95 percent confidence level and the use of a test materiality of $87 million.

supporting pages of the invoice clearly broke out the fiscal year 1999 costs. In testing a statistical sample of accrued expenses recorded at the end of fiscal year 1999, we identified errors in 36 percent of the sample cases. We believe an appropriate review would have caught much of these errors.

IRS Needs to More Closely Adhere to Treasury Requirements Regarding Transferring Funds Between Appropriations

During our fiscal year 2000 financial audit, we found that IRS did not always follow standard procedures with respect to the transfer of funds between appropriations. IRS recorded a transfer of budgetary authority[15] in its general ledger before Treasury processed the transfer in response to obtaining the congressional approval provided for in the Treasury Department Appropriations Act, 2000. Section 2035 of the *Treasury Financial Manual* (TFM) requires that agencies record such nonexpenditure transfers[16] in the same month as they are processed by the Treasury.

During our fiscal year 2000 audit, we determined that IRS transferred funds between accounts in its general ledger about 7 months before Treasury processed the same transaction. Specifically, in October 1999, IRS transferred appropriated amounts of $100 million out of the Tax Law Enforcement fund balance account, of which $60 million was transferred to the Processing, Assistance, and Management fund balance account and $40 million was transferred to the Information Systems fund balance account.

Section 101 of the Treasury Department Appropriations Act, 2000, provides that up to 5 percent of an IRS appropriation may be transferred to another IRS appropriation upon advance approval of the Senate and House Committees on Appropriations. IRS, through Treasury, did not request this approval until March 2000. The transfer was approved in April 2000, and Treasury recorded the transfer in May 2000. However, IRS had administratively recorded the transfer in its general ledger in October 1999—7 months before Treasury processed the transaction.

Although we did not identify any instances of IRS' expenditures exceeding approved funding levels in fiscal year 2000, IRS violated section 2035 of the TFM by recording the transfer of appropriations before the transfer was processed by Treasury.

Recommendation

We recommend that you direct IRS management to ensure that it complies with Treasury regulations requiring that all transfers of funds between appropriations be properly approved and documented prior to recording them in the financial records.

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[15]Budgetary authority is the authority the Congress grants federal agencies to incur obligations and to make payments out of the Treasury for specified purposes. An appropriation act is the most common form of budgetary authority.

[16]Nonexpenditure transfers of appropriations increase or decrease appropriation amounts between appropriation and fund accounts as a result of legislation.

IRS' Comments and Our Evaluation

IRS did not address the transfer of funds issue discussed in this section.

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This letter contains recommendations to you. The head of a federal agency is required by 31 U.S.C 720 to submit a written statement on actions taken on these recommendations. You should submit your statement to the Senate Committee on Governmental Affairs and the House Committee on Government Reform within 60 days of the date of this letter. A written statement must also be sent to the House and Senate Committees on Appropriations with the agency's first request for appropriations made more than 60 days after the date of the letter.

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

We acknowledge and appreciate the cooperation and assistance provided by IRS officials and staff during our audit of IRS' fiscal year 2000 financial statements. If you have any questions or need assistance in addressing these matters, please contact Steven J. Sebastian, Acting Director, at (202) 512-9521. Additional contacts and staff acknowledgments are provided in enclosure II.

Sincerely yours,

Jeffrey C. Steinhoff
Managing Director
Financial Management and Assurance

Enclosures

Comments From the Internal Revenue Service

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

CHIEF FINANCIAL OFFICER

July 25, 2001

Mr. Jeffrey C. Steinhoff, Managing Director
Financial Management and Assurance
U.S. General Accounting Office
441 G Street, NW
Washington, DC 20548

Dear Mr. Steinhoff:

This letter transmits IRS' comments to your draft management letter, GAO-01-880R. I agree with some of the comments, but request that you make several changes before finalizing the letter. Specifically, we believe the following sections should be removed from the letter: Procedures Needed to Properly Account for Prepaid Expenses and Treasury Working Capital Fund Assets and IRS Needs Better Oversight of Financial Reporting-Related Contractor Support. In addition, we ask that you make revisions to the section, Procedures Needed To Properly Track and Report Reimbursable Activity. Our rationale for these requests follows.

Procedures Needed to Properly Account for Prepaid Expenses on Treasury Working Capital Fund Assets

This section states incorrectly that "the WCF purchases and retains ownership of capital items for the IRS and bills IRS for the full cost of these items in the year of purchase," and that "the IRS recorded the entire cost as an expense at the time of purchase." As noted below, IRS records an expense for depreciation, not the full cost of the asset. Written procedures issued by the IRS Chief Financial Officer in FY 1999 instructed IRS accounting and budget offices to record OPAC billings from the WCF as a prepaid asset. At the same time, we established transactions in the Automated Financial System (AFS) to record the prepayment and the expensing of the asset.

Since FY 1999, the IRS has been recording WCF OPAC billings, which estimate annual expenses, as a prepaid asset at the beginning of the fiscal year. At the end of the fiscal year we make a determination, based on reports from the WCF, as to how much of the prepaid asset we should expense. Included in the expenses is the depreciation of capitalized assets allocated by the WCF to the

IRS. Public Law 97-258, September 13, 1982, 96 Stat. 881, states that "the WCF shall be reimbursed, or credited with advance payments . . . for . . . expenses of operation, including the depreciation of plant and equipment." The WCF does not charge the IRS for the full cost of property and equipment in the year of purchase, nor does the IRS record the full cost in any one year. Accordingly, we ask you to remove this section from the management letter.

IRS Needs Oversight of Financial Reporting-Related Contractor Support

This section states "IRS accepted information from its contractors for inclusion in its year-end financial reporting without sufficient oversight or review. For example, during fiscal year 2000 IRS hired a contractor to extract and analyze from IRS records major systems acquisitions and purchases. . .IRS then recorded adjusting entries provided by the contractor to transfer these P&E acquisitions to the appropriate general ledger account. However, information provided by the contractor was not always accurate and IRS did not review the data to ensure its reliability." IRS requests that you remove this statement from the management letter.

The management letter gives two specific examples where IRS did not perform adequate review of contractor supplied information relating to P&E. The first instance was a result of detail sample testing of 60 transactions where 8 we found to be errors. The IRS provided the files, the methodology and identified the deliverables to the contractor. The IRS then reviewed the deliverables and supporting workpapers from the contractor and made adjustments. The IRS did not, and should not be expected to, review every transaction to determine if an exception occurred. The second instance cited in the management letter is based on a recommended change in life expectancy from GAO. This was a change in methodology that additional IRS oversight of contractor's work would not have identified.

This section of the management letter also states "IRS hired a contractor to review its accrued expenses as of September 30, 1999. However, during our fiscal year 2000 audit, we noted that several of the contractor-developed adjustments were erroneous. We also found that IRS had accepted the adjustments without reviewing them for appropriateness."

Contrary to these statements, IRS performed a thorough review of the contractor's work. IRS contracted with an outside consultant to assist in re-determination of FY 1999 accruals. IRS created the work plan, set up the procedures, extracted the subsequent disbursements, and trained the contractor's staff. IRS staff in Beckley, along with staff from the National Office, were on site to provide supervision during the initial stages of the review. IRS then established procedures to review the accuracy of the outside consultant's results. The IRS examined a sample of 100 undelivered orders to verify that the

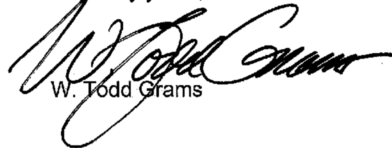
outside consultant had made the correct determination. Specifically, we rechecked subsequent disbursements against the undelivered orders, if any, to see if the contractor had accrued them in the correct fiscal year. The sample included 14 inter-governmental undelivered orders and 86 commercial undelivered orders. As a result of IRS' oversight, the contractor's review of inter-governmental accruals unacceptable, and the required firm to re-perform the work in its entirety. The IRS' review of the contractor's work on commercial accruals indicated that the work was satisfactory and accepted the results. In conclusion, the IRS showed due diligence in planning, supervising, and reviewing the work of the outside contractor in this area.

Procedures Needed to Properly Trace and Report Reimbursable Activity

This section states "IRS bills customers in advance using estimates of costs for the goods or services it will provide." Although IRS bills its customers based on estimates rather than actual costs, we do not bill the customer, with few exceptions, in advance of the providing of goods or services.

If you have questions or comments, please contact me at 202.622.4255, or call Eileen Powell, Director, Administrative Accounting, at 301.492.5400, extension 320.

Sincerely yours,



W. Todd Grams

cc: Steven J. Sebastian

GAO Contacts and Staff Acknowledgments

GAO Contacts

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Acknowledgments

Staff making key contributions to this letter were Paul Caban, John H. Davis, Meafelia Gusukuma, Angel Sharma, and Leonard Zapata.

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