TAXPAYER EXHIBIT
B11
February 25, 2014
David R. Mills
715376

STATE BOARD OF EQUALIZATION

Appeal Name: David R. Mills
Case ID: 715376 ITEM #: B11
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TP FTB DEPT PUBLIC COMMENT

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GAO
Accountability * Integrity * Reliability
United States Government Accountability Office
Washington, D.C. 20548

November 10, 2011

The Honorable Timothy F. Geithner
Secretary of the Treasury

Dear Mr. Secretary:

The accompanying report presents the results of our audits of the financial statements of the Internal Revenue Service (IRS) as of, and for the fiscal years ending, September 30, 2011, and 2010. We performed our audit in accordance with authority granted by the Chief Financial Officers Act of 1990, as expanded by the Government Management Reform Act of 1994. This report contains our (1) unqualified opinions on IRS's financial statements, (2) opinion that IRS's internal control over financial reporting was not effective as of September 30, 2011, (3) conclusion that IRS did not comply with one of the legal provisions we tested, and (4) conclusion that IRS's financial management systems were not in substantial compliance with the requirements of the Federal Financial Management Improvement Act of 1996, as of September 30, 2011. The accompanying report also discusses other significant issues that we identified in performing our audit that we believe should be brought to the attention of IRS management, those charged with governance, and users of IRS's financial statements.

During fiscal year 2011, IRS continued to make progress in addressing its financial management challenges. Specifically, IRS formed cross-functional working groups to identify and remediate specific information security control areas identified as being at risk and made progress in integrating the principles of cost-based decision making into its business units.

However, despite these actions, deficiencies in internal control we identified over unpaid tax assessments and information security continued to constitute material weaknesses[1] in IRS's internal control. In addition, IRS also faces significant challenges in resolving a significant deficiency[2] in internal control over tax refund disbursements and in fully integrating return on investment–based decision-making into its tax collection enforcement operations.

In fiscal year 2011, IRS continued to have a material weakness in its internal control over unpaid tax assessments. We found a continuing deficiency in IRS's ability to maintain a subsidiary ledger for unpaid tax assessments supporting federal taxes receivable on its balance sheet and the related compliance assessments and write-off amounts in its required supplementary information. To compensate for this deficiency, IRS continued to rely on a resource-intensive statistical sampling process to estimate these amounts. As a result, IRS could not trace related amounts reported in its financial statements and required supplementary information through its general ledger back to underlying source documents on a transaction-by-transaction basis.

Also in fiscal year 2011, IRS continued to have a material weakness in internal control over information security. In particular, it had deficiencies in its controls over access to the automated systems and software applications it relies upon to process its financial transactions, produce its internal and external financial reports, and safeguard related sensitive information. As a result, IRS was limited in its ability to provide reasonable assurance that (1) its financial statements, taken as a whole, were fairly presented; (2) the financial information IRS relied on to make decisions on

[1]A material weakness is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. Materiality represents the magnitude of an omission or misstatement of an item in a financial report that, when considered in light of surrounding circumstances, makes it probable that the judgment of a reasonable person relying on the information would have been changed or influenced by the inclusion or correction of the item.

[2]A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit the attention of those charged with governance.

a daily basis was accurate, complete, and timely; and (3) proprietary financial and taxpayer information was appropriately safeguarded.

In addition to these material weaknesses, IRS continued to have a significant deficiency in internal control over tax refund processing during fiscal year 2011. We continued to find deficiencies in internal control over the processing of manually prepared tax refunds and in the processing of claims for the First-time Homebuyer Credit that led to erroneous refund disbursements. These deficiencies in internal control over tax refund disbursements increased the risk of duplicate or otherwise erroneous tax refund payments being disbursed.

During fiscal year 2011, IRS also continued to experience challenges with respect to developing full cost information across all of its programs and activities, institutionalizing the use of cost accounting agencywide, and developing and routinely using cost-based (and where appropriate enforcement revenue-based) performance metrics to assist it in measuring the results of its efforts and in making resource allocation decisions. It is important that IRS continue to expand the availability and reliability of cost-benefit information, especially return on investment information, to its managers and to aggressively pursue the integration of such data and related performance metrics into both its long-term strategic and short-term routine decision-making processes in order to assist it in effectively managing its resources and to achieve comprehensive and lasting financial management reform.

We are sending copies of this report to the Chairmen and Ranking Members of the Senate Committee on Appropriations; Senate Committee on Finance; Senate Committee on Homeland Security and Governmental Affairs; Subcommittee on Financial Services and General Government, Senate Committee on Appropriations; Subcommittee on Federal Financial Management, Government Information, Federal Services, and International Security, Senate Committee on Homeland Security and Governmental Affairs; House Committee on Appropriations; House Committee on Ways and Means; House Committee on Oversight and Government Reform; Subcommittee on Financial Services and General Government, House Committee on Appropriations; and Subcommittee on Government Management, Organization, and Procurement, House Committee on Oversight and Government Reform. We are also sending copies of this report to the Chairman and Vice Chairman of the Joint Committee on Taxation, the Commissioner of Internal Revenue, the

Director of the Office of Management and Budget (OMB), the Chairman of the IRS Oversight Board, and other interested parties. The report is available at no charge on GAO's website at http://www.gao.gov.

If you have any questions concerning this report, please contact me at (202) 512-3406 or sebastians@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report.

Sincerely yours,

Steven J. Sebastian
Director
Financial Management and Assurance

Management's Report on Internal Control over Financial Reporting

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

COMMISSIONER

November 4, 2011

Mr. Steven J. Sebastian
Director, Financial Management and Assurance
U.S. Government Accountability Office
441 G Street, N.W.
Room 5474
Washington, DC 20548

Dear Mr. Sebastian:

The Internal Revenue Service (IRS) internal control over financial reporting is a process affected by those charged with governance, management, and other personnel, the objectives of which are to provide reasonable assurance that (1) transactions are properly recorded, processed and summarized to permit the preparation of financial statements in accordance with U.S. generally accepted accounting principles, and assets are safeguarded against loss from unauthorized acquisition, use, or disposition; and (2) transactions are executed in accordance with the laws governing the use of budget authority and other laws and regulations that could have a direct and material effect on the financial statements.

IRS management is responsible for establishing and maintaining effective internal control over financial reporting. IRS management evaluated the effectiveness of IRS internal control over financial reporting as of September 30, 2011, based on the criteria established under 31 U.S.C. 3512, commonly known as the Federal Managers' Financial Integrity Act (FMFIA).

Based on our evaluation, IRS has two material weaknesses in its internal control over financial reporting, specifically (1) unpaid tax assessments and (2) information security. IRS financial management systems do not substantially comply with the requirements of the Federal Financial Management Improvement Act (FFMIA). On this basis, management provides qualified assurance that as of September 30, 2011, IRS internal control over financial reporting was effective.

Douglas H. Shulman
Commissioner

November 4, 2011
Date

Pamela J. LaRue
Chief Financial Officer

November 4, 2011
Date