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United States Government Accountability Office
Washington, DC 20548

November 3, 2008

The Honorable Calvin L. Scovel III
Inspector General
Department of Transportation

Subject: *Applying Agreed-Upon Procedures: Fiscal Year 2008 Highway Trust
Fund Excise Taxes*

Dear Mr. Scovel:

We have performed the procedures described in the enclosure to this letter, which we agreed to perform and with which you concurred, solely to assist your office in ascertaining whether the net excise tax revenue distributed to the Highway Trust Fund (HTF) for the fiscal year ended September 30, 2008, is supported by the underlying records. As agreed with your office, we evaluated fiscal year 2008 activity affecting distributions to the HTF.

We conducted the engagement in accordance with U.S. generally accepted government auditing standards, which incorporate financial audit and attestation standards established by the American Institute of Certified Public Accountants. You are responsible for the adequacy of these agreed-upon procedures to meet your objectives, and we make no representation in that respect. The procedures we agreed to perform were related to (1) transactions that represent the underlying basis of amounts distributed to the HTF during fiscal year 2008, (2) the Internal Revenue Service's (IRS) quarterly HTF receipt certifications during fiscal year 2008, (3) the Department of the Treasury's Financial Management Service adjustments to the HTF during fiscal year 2008, (4) the Department of the Treasury's Office of Tax Analysis's (OTA) process for estimating excise tax amounts to be distributed to the HTF for the fourth quarter of fiscal year 2008, (5) adjustments to the HTF for tax on kerosene used in aviation during fiscal year 2008, and (6) the amount of net excise taxes distributed to the HTF during fiscal year 2008. The enclosure provides more detail on the agreed-upon procedures and our results.

We were not engaged to perform, and did not perform, an examination, the objective of which would have been to express an opinion on the amount of net excise taxes distributed to the HTF during fiscal year 2008. Accordingly, we do not express such an opinion. Had we performed additional procedures, other matters might have come to our attention that we would have reported to you. We completed the agreed-upon procedures on October 27, 2008.

We provided a draft of this letter, along with the enclosure, to IRS and OTA officials for review and comment. IRS agreed with the results and findings presented in the enclosure. OTA agreed with the results and findings presented in the enclosure relating to its responsibilities, that is, the procedures performed in the estimation process for the quarter ended September 30, 2008.

This report is intended solely for the use of the Office of Inspector General of the Department of Transportation and should not be used by those who have not agreed to the procedures or have not taken responsibility for the sufficiency of the procedures for their purposes. However, the report is a matter of public record, and its distribution is not limited; thus, we will post the report on our Web site at <http://www.gao.gov> and provide copies upon request.

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

Sincerely yours,

A handwritten signature in black ink that reads "Steven J. Sebastian". The signature is written in a cursive style with a large, stylized initial "S".

Steven J. Sebastian
Director
Financial Management and Assurance

Enclosure

Highway Trust Fund Excise Tax Procedures and Results

I. Procedures on transactions that represent the underlying basis of amounts distributed to the Highway Trust Fund (HTF) in fiscal year 2008

- A. Nonstatistical selection of tax returns from the quarters ended June 30, 2007,¹ and September 30, 2007²
1. For each of the quarters ending June 30, 2007, and September 30, 2007, select the 30 largest excise tax returns containing excise taxes related primarily to the HTF and the Airport and Airway Trust Fund (AATF) on the basis of total tax liability amount³ from the Internal Revenue Service's (IRS) master file.⁴

Description of findings and results

We selected the 30 largest excise tax returns related primarily to the HTF and the AATF from each of the two quarters for testing. The selection was based on the total tax liability amount and type of taxes owed for each return from IRS's master file.

The total tax liability amount related to the 30 returns from the quarter ended June 30, 2007, was approximately \$10 billion or 71 percent of the total tax liability amount of \$14.1 billion for all excise tax returns for the quarter. Of these 30 returns, 20 contained primarily HTF-related taxes and 10 contained primarily AATF taxes.

The total tax liability amount related to the 30 returns from the quarter ended September 30, 2007, was approximately \$9.9 billion or 71 percent of the total tax liability amount of \$14 billion for all excise tax returns for the quarter. Of these 30 returns, 20 contained primarily HTF-related taxes and 10 contained primarily AATF taxes.

¹In October 2007, the Internal Revenue Service (IRS) completed its certification to the HTF for the quarter ended June 30, 2007, and the Department of the Treasury's Financial Management Service (FMS) recorded the corresponding adjustment to transfer funds between the general fund and the trust fund. HTF administrators recorded the adjustment amount on the HTF financial statements for fiscal year 2007.

²The IRS certification and corresponding FMS adjustment for the quarter ended September 30, 2007, were completed in February 2008, and thus affected distributions to the HTF during fiscal year 2008.

³Although the certifications are based on amounts collected, we used the tax liability amounts to identify the taxpayers paying the largest amounts of excise taxes. These taxpayers generally pay their excise taxes in full each quarter.

⁴The master file is a detailed database containing taxpayer information.

2. For each of the 40 returns related primarily to the HTF from the quarters ended June 30, 2007, and September 30, 2007, we performed the following procedures, which encompassed approximately \$14.7 billion in prorated collections⁵ affecting fiscal year 2008 distributions to the HTF:

- (a) Compare the assessment amounts for abstracts⁶ 60 and 62 from the tax return to IRS's master file for agreement.

Description of findings and results

The assessment amounts for abstracts 60 and 62 on the tax return agreed with the master file for all 40 returns.

- (b) Calculate the assessment amounts on the tax return for the selected abstracts to determine whether they are mathematically correct.

Description of findings and results

The assessment amounts for the selected abstracts were mathematically correct on all 40 returns.

- (c) Calculate the prorated collection amount for the selected abstracts based on information from the master file and compare this amount to the amount in the Collection Certification System audit files⁷ for agreement.

⁵IRS certifies to trust funds the amount of excise taxes collected. Because taxpayers have sometimes not fully paid their tax liability, IRS must allocate the amount of payments actually received among the different excise taxes reported on the taxpayers' returns. IRS's Collection Certification System prorates a taxpayer's payments proportionately among all taxes reported as owed on the tax return. For example, if a corporation reports that it owes \$4 million for gasoline tax, \$2 million for diesel fuel tax, and \$1 million for kerosene tax on its Form 720, Quarterly Federal Excise Tax Return, but has paid IRS only \$3.5 million at the time IRS performs its certification, the program prorates the \$3.5 million in the following manner: \$2 million to gasoline tax, \$1 million to diesel fuel tax, and \$500,000 to kerosene tax.

⁶The abstract numbers identify the tax type (e.g., gasoline and ticket tax) and are used as the basis for determining the distribution of the excise taxes to the various trust funds. Abstract numbers are preprinted on Form 720, Quarterly Federal Excise Tax Return, and are used by the taxpayer to report excise tax assessments. If the return was related to the HTF, we selected (1) diesel fuel tax (abstract 60), and (2) gasoline tax (abstract 62). If the return was related to the AATF, we selected (1) tax on transportation of persons by air (abstract 26), (2) tax on the use of international air travel facilities (abstract 27), and (3) tax on transportation of property by air (abstract 28). The tax amounts related to the selected abstracts for each trust fund are the largest tax amounts reported on the taxpayer's excise tax return and made up over 85 percent of the total amount certified to the HTF and over 92 percent of the total amount certified to the AATF for the quarters ended June 30, 2007, and September 30, 2007.

⁷The Collection Certification System produces what IRS refers to as audit files. These audit files contain the individual prorated collections by abstract and taxpayer identification number. The certified amounts to the trust funds are calculated by subtracting credits from prorated collections and then multiplying the difference by the applicable trust fund distribution rates.

Description of findings and results

The independently calculated prorated collection amounts for the selected abstracts agreed with amounts in the Collection Certification System audit files for all 40 returns.

B. Statistical selection of attribute and monetary unit samples (MUS) from the quarters ended December 31, 2007, and March 31, 2008

1. Sampling and other procedures

- (a) Compare excise tax collections from the master file with excise tax collections from the Collection Certification System audit files for the first two quarters of fiscal year 2008 to determine if they materially agree.⁸

Description of findings and results

Excise tax collections from the master file materially agreed with the Collection Certification System for the first two quarters of fiscal year 2008.

- (b) Compare excise tax collections from the master file with excise tax collections from IRS's general ledger for the first 9 months of fiscal year 2008 to determine if they materially agree.⁹

Description of findings and results

Excise tax collections from the master file materially agreed with IRS's general ledger for the first 9 months of fiscal year 2008.

- (c) Select a random attribute sample of 78 excise tax returns from the master file.¹⁰ Compare assessment and receipt information for each return from the master file to the Collection Certification System.

⁸For the purpose of this procedure, "material" is defined as 1 percent of the excise tax collections for the quarters ended December 31, 2007, and March 31, 2008.

⁹This reconciliation is performed as part of the fiscal year 2008 IRS financial statement audit. It is a reconciliation of all excise tax collections that posted to the master file and general ledger during the first 9 months of fiscal year 2008 and is not limited to the first two quarters. For the purpose of this procedure, "material" is defined as 1 percent of the excise tax collections for the first 9 months of fiscal year 2008.

¹⁰For this sample, if one or no errors were found in testing the 78 items, we would be 90 percent confident that the error rate in the population would not exceed 5 percent.

Description of findings and results

For all 78 returns, assessment and receipt information from the master file was contained in the Collection Certification System.

- (d) Sum the prorated collections for selected abstracts¹¹ from the audit files and compare these amounts to amounts in the *Report of Excise Tax Collection*¹² to determine if the Collection Certification System properly summarized the prorated collections.

Description of findings and results

The Collection Certification System properly summarized the prorated collections for all of the selected abstracts. Prorated collections from the audit files for the selected abstracts agreed with the corresponding amounts in the *Report of Excise Tax Collection*.

- (e) Separate the total population of prorated collections from the audit files into the following distinct populations: (1) HTF, (2) AATF, and (3) other excise tax abstracts. Use MUS to select a sample of prorated excise tax collections from the HTF population using a confidence level of 80 percent, a tolerable misstatement of \$391 million, and an expected aggregate error amount of \$117 million.

Description of findings and results

Use of MUS with a confidence level of 80 percent, a tolerable misstatement of \$391 million, and an expected aggregate error amount of \$117 million resulted in a sample of 91¹³ prorated collections for the HTF for the first two quarters of fiscal year 2008.

¹¹The selected abstracts are (1) diesel fuel tax (abstract 60), (2) gasoline tax (abstract 62), (3) tax on transportation of persons by air (abstract 26), (4) tax on the use of international air travel facilities (abstract 27), (5) tax on transportation of property by air (abstract 28), and (6) tax on kerosene for use in commercial aviation (abstract 77). The tax amounts for the two HTF-related abstracts made up over 92 percent of the total amount certified to the HTF, and the tax amounts for the four AATF-related abstracts made up over 97 percent of the total amount certified to the AATF for the quarters ended December 31, 2007, and March 31, 2008.

¹²The *Report of Excise Tax Collection* contains prorated collections, classified by abstracts, which serve as the basis for IRS's quarterly trust fund certifications.

¹³The planned sample size using MUS was 135 items. MUS selects dollars versus specific transaction items by dividing the population by dollar intervals. The dollar interval for the HTF was \$143 million. Accordingly, any item with a dollar value matching or exceeding the interval would be selected, whereas items less than the interval might not be selected. For example, an item of \$286 million would cover 2 dollar intervals, but represent 1 sample item. Because large-dollar items cover more than one interval, the 91 unique sampled transactions selected represented 135 dollar intervals.

- (f) Select samples of prorated excise tax collections from the two non-HTF populations. Use MUS to select a sample of prorated excise tax collections from the AATF population using a confidence level of 80 percent, a tolerable misstatement of \$119 million, and an expected aggregate error amount of \$36 million. Select a random attribute sample of 45 items from the population of prorated tax collections related to all excise taxes other than the HTF and the AATF.¹⁴

Description of findings and results

Use of MUS with a confidence level of 80 percent, a tolerable misstatement of \$119 million, and an expected aggregate error amount of \$36 million resulted in a sample of 65¹⁵ prorated collections for the AATF for the first two quarters of fiscal year 2008.

A random attribute sample of 45 items was selected from the population of prorated tax collections related to all excise taxes other than the HTF and the AATF.

2. Procedures on transactions

- (a) For each prorated excise tax collection sampled from the HTF population:

- Compare the assessment amount for the sampled item from the tax return to IRS's master file for agreement.

Description of findings and results

The assessment amount on the tax return agreed with the master file for all of the sampled items.

- Calculate the assessment amount on the tax return for the sampled item to determine whether it is mathematically correct.

Description of findings and results

The assessment amount on the tax return was mathematically correct for all of the sampled items.

¹⁴For this sample, if no errors were found in testing the 45 items, we would be 90 percent confident that the error rate in the population would not exceed 5 percent.

¹⁵The planned sample size using MUS was 130 items. As explained in footnote 13, MUS selects dollars instead of specific transaction items by dividing the population by dollar intervals. The dollar interval for AATF was \$43 million. Because large-dollar items cover more than 1 interval, the 65 unique sampled transactions selected represented 130 dollar intervals.

- Calculate the prorated collection amount for the sampled item based on information from the master file and compare this amount to the amount in the Collection Certification System audit files for agreement.¹⁶

Description of findings and results

The independently calculated prorated collection amount agreed with the amount in the Collection Certification System audit files for all of the sampled items.

- (b) Inspect the tax returns and master file information for the two samples of prorated collections from the non-HTF populations to determine if they contain any HTF excise tax collections.

Description of findings and results

The two samples of prorated collections from the non-HTF populations did not contain any HTF excise tax collections.

- (c) Evaluate the results of conducting steps (a) and (b).

Description of findings and results

For the first two quarters of fiscal year 2008, the net most likely error is \$0 with an upper error limit of \$234 million at the 80 percent confidence level.

II. Procedures on IRS's quarterly HTF receipt certifications

Perform the following procedures on IRS's HTF receipt certifications for the quarters ended September 30, 2007, December 31, 2007, March 31, 2008, and June 30, 2008:

- A. Inspect the certification letters¹⁷ for authorizing signatures.

Description of findings and results

The certification letters for all four quarters had authorizing signatures.

¹⁶The purpose of this procedure is to determine whether the Collection Certification System prorates correctly. This procedure is not intended to determine whether amounts provided to the system are correct.

¹⁷IRS prepares two certification letters for the HTF each quarter: one for the Highway Account and the other for the Mass Transit Account.

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- B. Inspect the certification letters and supporting worksheets to determine if evidence exists that they were reviewed by the supervisor or another analyst.

Description of findings and results

There was evidence that the supervisor or another analyst reviewed the certification letters and supporting worksheets for all four quarters.

- C. Calculate the totals on the certification letters to determine if they are mathematically correct.

Description of findings and results

The totals on the certification letters for all four quarters were mathematically correct.

- D. Trace the certified amounts for diesel fuel tax (abstract 60) and gasoline tax (abstract 62)¹⁸ from the certification letters back to the *Report of Excise Tax Collection*¹⁹ and the *Treasury 90 Report*²⁰ for agreement.

Description of findings and results

The certified amounts for diesel fuel tax (abstract 60) and gasoline tax (abstract 62) from the certification letters agreed with the related *Report of Excise Tax Collection* and the *Treasury 90 Report* for all four quarters.

- E. Compare the distribution rates used by IRS for diesel fuel tax (abstract 60) and gasoline tax (abstract 62) for agreement with the applicable laws.

Description of findings and results

The distribution rates used by IRS for diesel fuel tax (abstract 60) and gasoline tax (abstract 62) agreed with the applicable laws in effect during all four quarters.

¹⁸The certified amounts for diesel fuel tax (abstract 60) and gasoline tax (abstract 62), along with the heavy vehicle use tax (traced separately), made up over 92 percent of the total amount certified to the HTF for the quarters ended September 30, 2007, December 31, 2007, March 31, 2008, and June 30, 2008.

¹⁹The *Report of Excise Tax Collection* is produced by the Collection Certification System. Collections are classified by abstract on the report when the related Form 720 tax return has been posted to IRS's master file during the processing interval covered by the report. IRS uses data from two of these reports, covering sequential processing intervals, for each quarterly certification. The two reports used may contain collections related to prior quarters that IRS certifies as part of the current quarter's collections because the related return was not posted to the master file until the processing intervals covered by these reports.

²⁰The *Treasury 90 Report* summarizes excise tax credit information and is produced quarterly by IRS submission processing campus systems. IRS has seven submission processing campuses that receive and process tax returns and payments.

- F. Inspect the *Report of Excise Tax Collection* used in the certification to determine if it contains significant²¹ collections from prior quarters.

Description of findings and results

The *Report of Excise Tax Collection* used in the certification for all four quarters did not contain significant collections from prior quarters.

- G. Trace heavy vehicle use tax amounts from the Highway Account certification letters to the master file and *Treasury 90 Report*.²²

Description of findings and results

The heavy vehicle use tax amounts from the Highway Account certification letters agreed with the master file and *Treasury 90 Report* for the quarters ended September 30, 2007, and June 30, 2008. For the quarters ended December 31, 2007, and March 31, 2008, the heavy vehicle use tax amounts from the Highway Account certification letters agreed with the master file but not with the *Treasury 90 Report*. The heavy vehicle use tax amounts from the Highway Account certification letters for both quarters were not reduced for related credits totaling approximately \$3.5 million from the *Treasury 90 Report*. As a result, IRS overstated certified receipts to the Highway Account for the quarters ended December 31, 2007, and March 31, 2008, by approximately \$3.5 million. After we brought this to the attention of IRS officials, IRS corrected the errors in a revised certification to the Highway Account for the quarter ended March 31, 2008. Since the corrections were made prior to the end of the fiscal year, the errors did not have an effect on fiscal year 2008 distributions to the HTF.

III. Procedures on Financial Management Service adjustments

Perform the following procedures on Financial Management Service (FMS) adjustments to HTF excise tax distributions for the quarters ended September 30, 2007, December 31, 2007, March 31, 2008, and June 30, 2008:

²¹For this procedure, “significant” is defined as \$185 million, which represents approximately 2 percent of the total amount certified to the HTF for the quarters ended September 30, 2007, December 31, 2007, March 31, 2008, and June 30, 2008.

²²These taxes, which go to the HTF, are reported on Form 2290 and are not included in the Collection Certification System.

- A. Calculate the FMS adjustment amounts based on the Office of Tax Analysis (OTA) transfer forms²³ and IRS certification letters to determine if they are mathematically correct.

Description of findings and results

The FMS adjustment amounts for all four quarters were mathematically correct. For the Highway Account, the adjustment amounts were²⁴

- (\$46,681,000) for the quarter ended September 30, 2007;
- (\$782,653,000) for the quarter ended December 31, 2007;
- (\$631,189,000) for the quarter ended March 31, 2008; and
- (\$152,952,000) for the quarter ended June 30, 2008.

For the Mass Transit Account, the adjustment amounts were

- \$44,674,000 for the quarter ended September 30, 2007;
- (\$46,913,000) for the quarter ended December 31, 2007;
- (\$42,373,000) for the quarter ended March 31, 2008; and
- (\$12,479,000) for the quarter ended June 30, 2008.

IV. Procedures on excise tax distributions to the HTF for the quarter ended September 30, 2008

- A. Determine if OTA's process for identifying and incorporating the effect of new legislation on excise tax receipts into its trust fund estimates²⁵ was in place during the quarter ended September 30, 2008.

Description of findings and results

OTA's process for identifying and incorporating into its trust fund estimates the effect of new legislation on excise tax receipts was in place during the quarter ended September 30, 2008. OTA prepares a tax rate table to capture information relating to legislation that affects tax rates, tax basis, accounts, and deposit rules in effect during the quarter.

²³The transfer forms denote the amounts estimated by OTA for transferring excise taxes to the trust funds.

²⁴A positive amount indicates that the FMS adjustment increased excise taxes distributed to the trust fund. A negative amount, shown in parentheses, indicates that the FMS adjustment decreased excise taxes distributed to the trust fund.

²⁵OTA makes semimonthly estimates of excise tax collections for transfer to trust funds. There are five semimonthly estimates for the quarter ended September 30, 2008, which affect fiscal year 2008 distributions to the HTF.

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- B. Inspect the transfer forms and supporting schedules to determine if there is evidence of review.

Description of findings and results

There was evidence that another OTA economist reviewed the transfer forms and supporting schedules affecting distributions to the HTF for the quarter ended September 30, 2008.

- C. Calculate the totals on the transfer forms to determine if they are mathematically correct.

Description of findings and results

The totals on the transfer forms affecting distributions to the HTF for the quarter ended September 30, 2008, were mathematically correct.

- D. Trace the transfer amounts for diesel fuel tax (abstract 60), gasoline tax (abstract 62), and heavy vehicle use tax²⁶ from the transfer forms back to the related source documents²⁷ for agreement.

Description of findings and results

The transfer amounts for diesel fuel tax (abstract 60), gasoline tax (abstract 62), and heavy vehicle use tax from the transfer forms agreed with the related source documents for the quarter ended September 30, 2008.

V. Other procedures

- A. Determine if adjustments to the HTF for tax on kerosene used in aviation were made during fiscal year 2008 and calculate the adjustment amounts to determine if they are mathematically correct.²⁸

²⁶The transfer amounts for diesel fuel tax (abstract 60), gasoline tax (abstract 62), and heavy vehicle use tax made up over 93 percent of the total amount transferred to the HTF for the fourth quarter of fiscal year 2008.

²⁷The source documents include the IRS report of excise taxes used to derive the percentages applied to reported receipts, the Daily Treasury Statement, the Monthly Treasury Statement, and the excise tax rate table.

²⁸Section 11161 of Pub. L. No. 109-59 (2005), Treatment of Kerosene for Use in Aviation, taxes all kerosene taxpayers at the standard kerosene rate, unless a taxpayer had removed the kerosene from a refinery or terminal directly into an aircraft's fuel tank and thus qualified for the lower aviation kerosene tax rate. Amounts received under the standard kerosene tax are initially deposited in the HTF. If a taxpayer subsequently used the kerosene in aviation, the taxpayer is eligible for the lower tax rate associated with aviation kerosene and can request a refund. The amount of this refund is transferred from the HTF to the general fund. The amount of the kerosene tax collected from the taxpayer, net of refunds, is transferred from the HTF to the AATF.

Description of findings and results

Adjustments to the HTF for tax on kerosene used in aviation were made during fiscal year 2008 and were mathematically correct. For the Highway Account, the adjustment amounts were²⁹

- (\$197,258,000) for the quarter ended September 30, 2007;
- (\$181,940,000) for the quarter ended December 31, 2007;
- (\$162,108,000) for the quarter ended March 31, 2008;
- (\$164,202,000) for the quarter ended June 30, 2008; and
- (\$172,346,000) for the quarter ended September 30, 2008.

For the Mass Transit Account, the adjustment amounts were

- (\$26,315,000) for the quarter ended September 30, 2007;
- (\$24,271,000) for the quarter ended December 31, 2007;
- (\$21,626,000) for the quarter ended March 31, 2008;
- (\$21,904,000) for the quarter ended June 30, 2008; and
- (\$22,991,000) for the quarter ended September 30, 2008.

- B. Using IRS's quarterly certifications, OTA's estimated distributions, and any adjustments, compile and report the amount of net excise taxes distributed to the HTF in fiscal year 2008.

Description of findings and results

Based on a compilation of IRS's quarterly certifications, OTA's estimations, and adjustments, the amount of net excise taxes distributed to the HTF in fiscal year 2008 was \$36,469,761,000.

(196179)

²⁹The adjustments for the quarters ended September 30, 2007, December 31, 2007, March 31, 2008, and June 30, 2008, were included in the IRS receipt certifications, and the adjustment for the quarter ended September 30, 2008, was included in the OTA estimates. The adjustment amounts, shown in parentheses, represent excise taxes transferred from the HTF to the AATF and general fund.

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