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United States General Accounting Office
Washington, DC 20548

November 14, 2003

The Honorable Gordon S. Heddell
Inspector General
Department of Labor

Subject: *Applying Agreed-Upon Procedures: Federal Unemployment Taxes*

Dear Mr. Heddell:

We have performed the procedures contained in the enclosure to this report, which we agreed to perform and with which you concurred, solely to assist your office in ascertaining whether the net federal unemployment tax (FUTA) revenue distributed to the Unemployment Trust Fund (UTF) for the fiscal year ended September 30, 2003, is supported by the underlying records. As agreed with your office, we evaluated fiscal year 2003 activity affecting distributions to the UTF.

In performing the agreed-upon procedures, we conducted our work in accordance with generally accepted government auditing standards, which incorporate financial audit and attestation standards established by the American Institute of Certified Public Accountants. These standards also provide guidance when performing and reporting the results of agreed-upon procedures.

The adequacy of the procedures to meet your objectives is your responsibility and we make no representation in that respect. The procedures we agreed to perform include (1) detailed tests of transactions that represent the underlying basis of amounts distributed to the UTF and (2) review of key reconciliations of the Internal Revenue Service (IRS) records to the Department of the Treasury records. The enclosure contains the agreed-upon procedures and our findings from performing each of the procedures.

We were not engaged to perform, and did not perform, an audit, the objective of which would have been the expression of an opinion on the net amount of FUTA taxes distributed to the UTF. Accordingly, we do not express such an opinion. Had we performed additional procedures, other matters might have come to our attention that would have been reported to you. We completed the agreed-upon procedures on October 31, 2003.

We provided a draft of this report to IRS officials, along with its enclosure, for review and comment. They agreed with the results and findings presented in this report. In response to our finding concerning an error on monthly FUTA refund data entered into the Government Online Accounting Link System (GOALS), IRS stated that it has

instituted additional internal control procedures to promptly detect and correct any future errors.

This report is intended solely for the use of the Office of Inspector General of the Department of Labor and should not be used by those who have not agreed to the procedures and have not taken responsibility for the sufficiency of the procedures for their purposes. However, this report is a matter of public record and its distribution is not limited. Copies are available to others upon request. This report is also available at no charge on GAO's home page at <http://www.gao.gov>. If you have any questions, please call me at (202) 512-3406.

Sincerely yours,

A handwritten signature in black ink that reads "Steven J. Sebastian". The signature is written in a cursive style with a prominent initial "S" and a long, sweeping underline.

Steven J. Sebastian
Director
Financial Management and Assurance

Enclosure

Unemployment Trust Fund Procedures and Results

I. Detailed tests of transactions

- A. Obtain from IRS total FUTA collections and refunds activity posted to the master file for the first 8 months of fiscal year 2003.¹ Determine if FUTA collections and refund data per the master file materially reconcile to the general ledger.²

Description of findings and results

Total FUTA collections and refunds for the first 8 months of fiscal year 2003 per IRS's master file materially reconciled to IRS's general ledger.

- B. Use dollar unit sampling (DUS) to select a sample of combined FUTA collection and refund transactions from the master file for the first 8 months of fiscal year 2003, using a confidence level of 80 percent, a test materiality of \$333 million, and an expected aggregate error amount of \$99.9 million.

Description of findings and results

Use of DUS with a confidence level of 80 percent, a test materiality of \$333 million, and an expected aggregate error amount of \$99.9 million resulted in a sample of 45 transactions for the first 8 months of fiscal year 2003. Of this total, 44 transactions represented collections and 1 transaction represented refunds.

- C. For each sampled FUTA tax collection transaction:

1. Determine if collection amounts are accurately recorded by tracing collection transaction amounts from IRS's master files to supporting documents (e.g., federal tax deposit coupons).

Description of findings and results

Based on supporting documentation, collection amounts were accurately recorded for all 44 sampled FUTA collection transactions.

2. Determine if amounts were recorded to the appropriate period by reviewing the date on source documents.

¹The master file is a detailed database containing taxpayer information.

²Except where noted for certain procedures, significant or material is defined as \$333 million. This represents 1 percent of the UTF collections made by federal and state government agencies for fiscal year 2002.

Description of findings and results

Based on supporting documentation, collection amounts were recorded to the appropriate period for all 44 sampled FUTA collection transactions.

3. Determine whether the transactions were properly classified as FUTA receipts by reviewing source documentation maintained in IRS's files (e.g., tax returns).

Description of findings and results

Based on supporting documentation, collection amounts were recorded in the correct tax class³ for all 44 sampled FUTA collection transactions.

4. Confirm FUTA transactions paid via the Electronic Federal Tax Payment System (EFTPS)⁴ to determine whether the recorded transactions are valid and reflect the proper amounts, are applied to the proper tax period, and are properly classified as FUTA receipts.

Description of findings and results

Thirty-eight of the 44 sampled FUTA receipt transactions were paid via the EFTPS. The bank confirmation showed that all 44 transactions were valid and had been recorded to the proper tax period and tax class and for the proper amounts.

D. For each sampled FUTA tax refund transaction:

1. Confirm sampled FUTA refund transactions with Treasury's Financial Management Service (FMS) by checking that the amount of the refund is correct and that it was recorded to the appropriate period and tax class.

Description of findings and results

For the one sampled FUTA refund transaction, confirmation with Treasury's FMS showed that the amount of the refund was correct and that it was recorded to the appropriate period and tax class.

³IRS assigns a tax class number to specific types of taxes. FUTA taxes are tax class 8.

⁴The EFTPS is a system for initiating tax payments electronically. Employers who make federal tax deposits exceeding \$200,000 must use the EFTPS to pay their FUTA taxes. The \$200,000 threshold includes all federal tax deposits, such as deposits for employment tax, excise tax, and corporate income tax. Taxpayers who are not required to make electronic deposits may voluntarily participate in the EFTPS.

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2. For FUTA tax returns, determine whether the taxpayer provided a written explanation for exempt payments and whether the explanation meets IRS's criteria for FUTA exempt wage payments.

Description of findings and results

For the one sampled FUTA refund transaction, the taxpayer did not claim an exempt wage payment.

3. For manual refunds,⁵ check to see that the appropriate supporting documentation is attached and that individuals who approved the manual refunds were authorized to do so.

Description of findings and results

The one sampled FUTA refund transaction was not a manual refund.

II. Analytical Procedures

- A. Perform analytical procedures on FUTA revenue collection and refund data for the period not subject to detailed tests of transactions to determine if reported fiscal year 2003 revenue collections and refunds appear reasonable.

Description of findings and results

We performed a predictive test on the final 4 months of fiscal year 2003 FUTA revenue collection and refund data. The predicted FUTA revenue collection and refund data amounts for the final 4 months of fiscal year 2003 did not materially vary from the actual amount of revenue collections and refunds per the IRS's records for this period.

III. Other FUTA Procedures

- A. For each of the 12 months in fiscal year 2003, obtain and review supporting documentation for monthly revenue reclassification adjustments transmitted by IRS to Treasury's FMS. Check to see that the supporting documentation agrees with the reclassification adjustment transmitted to the FMS.

⁵A manual refund is a refund manually processed by an IRS employee rather than through the IRS's manual automated process.

Description of findings and results

Documentation supported the monthly FUTA reclassification adjustment amount transmitted to Treasury's FMS for all 12 months of fiscal year 2003.

- B. For each of the 12 months in fiscal year 2003, obtain and review supporting documentation for the monthly entry of FUTA refund data onto the GOALS to charge back the Unemployment Trust Fund account for FUTA tax refunds issued. Check to see that the supporting documentation agrees with the monthly entries reported in the GOALS.

Description of findings and results

Documentation supported the monthly FUTA refund amount entered in GOALS to charge the UTF for FUTA tax refunds issued for 11 of the 12 months of fiscal year 2003. For the month of May 2003, IRS incorrectly charged the cumulative refund amount for the year through May 2003 of \$73 million to the UTF instead of the amount for May 2003 of \$11 million.

We brought this to the attention of the IRS and they made an adjustment for May 2003. The adjustment was made during September 2003. Therefore, there was no impact on FUTA reported amounts on the financial statements.

- C. Compare fiscal year 2003 net FUTA collections per the IRS's draft statement of custodial activity and related footnote disclosures to (a) the Treasury's Bureau of the Public Debt (BPD) accounting records for the UTF and (b) drafts of the Department of Labor's (DOL) consolidated financial statements. Obtain explanations/support for material variances.

Description of findings and results

There were no significant variances between net FUTA collections per the IRS's draft statement of custodial activity and the BPD's accounting records for the UTF. Similarly, there were no significant variances between IRS's draft statement of custodial activity and related footnote disclosures and drafts of the DOL's fiscal year 2003 consolidated financial statements.

IV. Other procedures performed as part of the fiscal year 2003 IRS financial statement audit

- A. From the IRS's master files for the first 8 months of fiscal year 2003, use DUS to select statistical samples of (a) total tax revenue receipts and (b) refunds. For each item in the samples of tax revenue receipts and refunds, test that the collection or refund amount and tax class from source documentation agrees with amounts recorded in IRS's master files.

Description of findings and results

Detailed testing of 169 revenue receipts and 50 refund sample transactions showed that the collection or refund amount, tax period, and tax class from source documents agreed with those recorded in the IRS master files.

- B. Review selected IRS campuses' monthly Treasury SF-224 reconciliations to determine if IRS-reported revenue receipts were properly classified and reconciled to Treasury FMS records. For refunds, review selected IRS service centers' monthly Treasury SF-224 reconciliations to determine if IRS-reported total refunds (all tax classes) materially⁶ reconciled to Treasury FMS records.⁷

Description of findings and results

Tax revenue receipts reported by selected IRS service center campuses through the monthly Treasury SF-224 reconciliation process were properly classified and materially agreed with Treasury FMS records.

Total refunds reported by the selected IRS service center campuses through the monthly Treasury SF-224 reconciliation process materially agreed with Treasury FMS records.

- C. Perform procedures to determine whether revenue receipt balances by tax class per the general ledger materially agree with IRS's master files and Treasury records. For refunds, perform a comparison of total refund balances between the master file, the general ledger, and Treasury records.

Description of findings and results

Tax receipt balances for all tax classes, including FUTA, per IRS's general ledger, materially agreed with IRS's master files and with Treasury records.

Refund balances per IRS's general ledger materially agreed with the master file and with Treasury records.

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⁶For the purpose of this procedure and procedure IV.C, we define material as \$20 billion. This represents approximately 1 percent of the total tax revenue receipts collected by the IRS in fiscal year 2003.

⁷The IRS maintains records of refund balances by tax class in its master file, and reports this information monthly to Treasury via the SF-224. Treasury provides the IRS with a Statement of Differences (TFS-6652), which reports differences between total refunds reported by the IRS on the SF-224 and the total refunds per Treasury records.