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United States Government Accountability Office
Washington, DC 20548

November 5, 2004

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, 2004, is supported by the underlying records. As agreed with your office, we evaluated fiscal year 2004 activity affecting distributions to the UTF.

In performing the agreed-upon procedures, we conducted our work 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. These standards also provide guidance for 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 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 27, 2004.

We provided a draft of this report to IRS officials for review and comment. They agreed with the results and findings presented in this report.

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 Web site 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 large, prominent initial "S".

Steven J. Sebastian
Director
Financial Management and Assurance

Enclosure

Unemployment Trust Fund Procedures and Results

I. Detailed tests of transactions

- A. Obtain from the Internal Revenue Service (IRS) total Federal Unemployment Tax (FUTA) collections and refunds reflecting the first 8 months of fiscal year 2004 posted to the master file.¹ Determine whether 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 2004 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 2004, using a confidence level of 80 percent, a test materiality of \$374 million, and an expected aggregate error amount of \$112 million.

Description of findings and results

Use of DUS with a confidence level of 80 percent, a test materiality of \$374 million, and an expected aggregate error amount of \$112 million resulted in a sample of 40 transactions for the first 8 months of fiscal year 2004. All of the 40 transactions represented collection sample items.

- C. For each sampled FUTA tax collection transaction:
1. Determine whether 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 40 sampled FUTA collection transactions.

2. Determine whether 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 \$374 million. This represents 1 percent of net Unemployment Trust Fund collections for fiscal year 2003.

Description of findings and results

Based on supporting documentation, collection amounts were recorded to the appropriate period for all 40 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 39 of the 40 sampled transactions. One sampled transaction, which was classified as a FUTA receipt, should have been classified as a corporate tax payment (tax class 3). IRS discovered the error and made the correction after our sample cutoff date but before the end of the fiscal year.

Based on our testing results, the net most likely error for the first 8 months of fiscal year 2004 is \$141 million. The net upper error limit is \$414 million.

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

Of the 40 sampled FUTA collection transactions, 33 were paid via EFTPS. The bank confirmations showed that all 33 transactions were valid and had been recorded to the proper tax period and tax class and for the proper amounts.

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 whether reported fiscal year 2004 revenue collections and refunds appear reasonable.

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

⁴EFTPS is a Financial Management Service system maintained by two financial agents for the government. EFTPS is used for initiating tax payments electronically. Employers who make federal tax deposits exceeding \$200,000 must use 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 EFTPS.

Description of findings and results

We performed a predictive test on the final 4 months of fiscal year 2004 FUTA revenue collection and refund data. The predicted FUTA revenue collection and refund data amounts for the final 4 months of fiscal year 2004 did not materially vary from the actual amount of revenue collections and refunds per IRS's records for this period.

III. Other FUTA procedures

- A. For each of the 12 months in fiscal year 2004, obtain and review supporting documentation for monthly revenue reclassification adjustments transmitted by IRS to the Department of the Treasury's Financial Management Service (FMS). Check to see whether the supporting documentation agrees with the reclassification adjustment transmitted to FMS.

Description of findings and results

Documentation supported the monthly FUTA reclassification adjustment amount transmitted to FMS for all 12 months of fiscal year 2004.

- B. For each of the 12 months in fiscal year 2004, obtain and review supporting documentation for the monthly entry of FUTA refund data into the Government Online Accounting Link System (GOALS) to charge back the Unemployment Trust Fund (UTF) account for FUTA tax refunds issued. Check to see whether the supporting documentation agrees with the monthly entries reported on GOALS.

Description of findings and results

Documentation supported the monthly FUTA refund amount entered into GOALS to charge the UTF for FUTA tax refunds issued for all 12 months of fiscal year 2004.

- C. Compare fiscal year 2004 net FUTA collections per 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.

Description of findings and results

There were no significant variances between net FUTA collections per IRS's draft statement of custodial activity and BPD's accounting records for UTF. Similarly, there were no significant variances between IRS's draft statement of custodial activity and related footnote disclosures and drafts of DOL's fiscal year 2004 consolidated financial statements.

IV. Other procedures performed as part of the fiscal year 2004 IRS financial statement audit

- A. From IRS's master files for the first 8 months of fiscal year 2004, use DUS to select statistical samples of (1) total tax revenue receipts and (2) refunds. For each sample item, test whether the collection or refund amount, tax period, and tax class from source documentation agree with those recorded in IRS's master files.

Description of findings and results

Detailed testing of 135 revenue receipts and 48 refund sample transactions showed that the collection or refund amount, tax period, and tax class from source documentation agreed with those recorded in IRS's master files.

- B. Review selected IRS service center campuses' monthly Treasury SF-224 reconciliations to determine whether IRS-reported revenue receipts were properly classified and reconciled to Treasury FMS records. For refunds, review selected IRS service center campuses' monthly Treasury SF-224 reconciliations to determine whether IRS-reported total refunds (all tax classes) materially⁵ reconciled to Treasury FMS records.⁶

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 reconciled to Treasury FMS records.

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

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

⁵For the purpose of this procedure and procedure IV.C, we define "material" as \$20 billion. This represents 1 percent of the estimated total tax revenue receipts collected by IRS in fiscal year 2004.

⁶IRS maintains records of refund balances by tax class in its master file and reports this information monthly to Treasury on the SF-224. Treasury provides IRS with a Statement of Differences (TFS-6652), which reports differences between total refunds reported by IRS on the SF-224 and the total refunds in Treasury records.

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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 Treasury records.

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

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