

**The Internal Revenue Service Needs to  
Establish an Effective Process to Accurately  
Identify, Record, and Report Unemployment  
Trust Fund Administrative Expenses**

**March 2003**

**Reference Number: 2003-10-054**

**This report has cleared the Treasury Inspector General for Tax Administration disclosure review process and information determined to be restricted from public release has been redacted from this document.**



DEPARTMENT OF THE TREASURY  
WASHINGTON, D.C. 20220

INSPECTOR GENERAL  
for TAX  
ADMINISTRATION

March 27, 2003

MEMORANDUM FOR CHIEF FINANCIAL OFFICER

*Gordon C. Milbourn III*

FROM: Gordon C. Milbourn III  
Acting Deputy Inspector General for Audit

SUBJECT: Final Audit Report - The Internal Revenue Service Needs to Establish an Effective Process to Accurately Identify, Record, and Report Unemployment Trust Fund Administrative Expenses (Audit # 200210030)

This report presents the results of our review of the Internal Revenue Service's (IRS) accounting procedures for charges related to Unemployment Trust Fund (UTF) administrative activities. The overall objective of this review was to determine whether the IRS had established an effective process to accurately identify, record, and report expenses related to UTF administrative activities.

The IRS is authorized by law to collect a Federal employer tax used to fund the UTF. Further, the Secretary of the Treasury is directed to pay from the UTF the amount estimated to be expended by the Department of the Treasury, including the IRS, for this collection service. The IRS' expenses make up approximately 99 percent of the charges to the UTF. From Fiscal Year (FY) 1999 through the third quarter of FY 2002, the IRS reported a total of \$294,603,975 in UTF administrative expenses.

In summary, we found that administrative expenses reported to the Bureau of the Public Debt (BPD) could not be supported or replicated and that required reports were not always timely submitted or properly prepared. Because of these conditions, we were unable to substantiate the reported expenses or make any assurances that reported expenses were accurate, complete, or consistent. In addition, we believe that data may exist that could be used to estimate UTF administrative expenses, and that the IRS' recently adopted method of reporting trust fund administrative expenses based on a ratio of revenue collected might not be appropriate.

The submission of reports that do not comply with established directives or that are not supported or documented hinders the Secretary of the Treasury from properly fulfilling

his responsibility to charge the trust fund and reimburse the Department of the Treasury general fund for the IRS-incurred UTF expenses.

We recommended that the Chief Financial Officer (CFO) develop written procedures that would ensure the most reasonable and timely means of identifying and reporting all expenses associated with the administration of all trust fund taxes, and establish controls to ensure that any amounts reported to the BPD are reviewed and approved by a senior-level IRS executive. We also recommended that the CFO ensure that the ability to record and report trust fund administrative expenses, as currently envisioned in the Integrated Financial System (IFS) development plans, is properly implemented.

Management's Response: The IRS' CFO management agreed with the recommendations presented in the report. The CFO will coordinate the development of written policy guidance for the IRS business units that outlines a methodology to cost and report the expenses to the BPD. Also, the CFO is taking steps to ensure that all quarterly reports and adjustments are reviewed and approved prior to transmittal, with due dates being logged as a control item on the CFO internal control system. Further, the new IFS will provide greater traceability of financial data to the existing management information system data, thus providing for a more reliable source of expense data. Management's complete response to the draft report is included as Appendix VIII.

Copies of this report are also being sent to the IRS managers who are affected by the report recommendations. Please contact me at (202) 622-6510 if you have questions or Daniel R. Devlin, Assistant Inspector General for Audit (Headquarters Operations and Exempt Organizations Programs), at (202) 622-8500.

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### Background

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Section 904 of the Social Security Act<sup>1</sup> established the Unemployment Trust Fund (UTF). The UTF funds a portion of extended unemployment benefits during high unemployment, provides a loan fund for states when state unemployment funds are insufficient to pay state unemployment benefits, and funds Federal and state administrative costs for operating the Unemployment Insurance System.<sup>2</sup>

The Secretary of the Treasury is designated by law as the managing trustee for the UTF, which is funded by Federal Unemployment Tax Act (FUTA)<sup>3</sup> taxes. Responsibility for administering the FUTA tax program is shared between the Department of Labor (DOL) and the Department of the Treasury. The FUTA authorized the Internal Revenue Service (IRS) to collect a Federal employer tax used to fund the UTF.

The Social Security Act directs the Secretary of the Treasury to pay from the UTF the estimated costs incurred by the Department of the Treasury, including activities of the IRS, in connection with the administration of the fund. The Act also requires that if the estimated cost in any particular period subsequently appears to be too high or too low, appropriate adjustments should be made by the Secretary in future payments.

Treasury Directive 32-06, *Administrative Expenses for Trust Funds*, further requires each Department of the Treasury bureau that incurs expenses related to the administration of trust funds to submit the following reports to the Bureau of the Public Debt (BPD), Office of Public Debt Accounting:

- A quarterly report setting out estimates of trust fund administrative expenses to be incurred for the current quarter, adjusted by actual expenses for the

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<sup>1</sup> 42 U.S.C. § 1104 (a) (Supp. V 1999).

<sup>2</sup> The Unemployment Insurance System provides partial and temporary income replacement to unemployed and underemployed workers who lose their jobs through no fault of their own and who are able and available for work.

<sup>3</sup> I.R.C. § 3301.

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previous quarter, on or before the first day of the reporting quarter.

- A fiscal year-end report to summarize and adjust estimated expenses to actual expenses no later than January 1 of the fiscal year following the fiscal year covered by the report.
- A 10-year estimate of expenses to include past year actual expenses; current year actual and estimates by month; and annual estimates for the next 10 years, no later than December 1 of each fiscal year.

On September 21, 1999, the DOL Office of Inspector General (OIG) issued an audit report<sup>4</sup> on the Department of the Treasury's administrative charges to the UTF for Fiscal Years (FY) 1996, 1997, and 1998. The audit reported that the Department of the Treasury overcharged the UTF approximately \$48 million during the audit period because the IRS' estimated expenses had not been adjusted to actual expenses. The IRS' expenses represented approximately 99 percent of the Department of the Treasury's total administrative charges. The DOL OIG also reported that the IRS' method of calculating UTF administrative expenses was based on fragmented, ad hoc spreadsheet accounting, which was inefficient and cumbersome, and the process involved a variety of estimates and data from at least 10 individual management information systems.

The DOL OIG recommended, along with the repayment of the overcharge, that the IRS develop formal written procedures and provide backup documentation to ensure that amounts charged to the UTF are supported and adjusted to actual expenses in the next fiscal year. The DOL OIG further recommended the DOL's Assistant Secretary for Employment and Training establish a team to negotiate an alternative method of charging the IRS' administrative expenses.

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<sup>4</sup> *Audit of the Department of Treasury's Administrative Charges to the Unemployment Trust Fund - Fiscal Years 1996, 1997, and 1998* (Reference Number 06-99-012-03-315, dated September 21, 1999).

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The IRS disagreed with the DOL OIG conclusion that the UTF was overcharged, as the IRS believed that additional activity expenses were not included in the calculation. The IRS did agree to develop formal written procedures and was willing to participate on a team to explore the development of an alternative method of charging the IRS administrative expenses. However, the IRS had not taken any corrective action on either recommendation prior to or during our audit period.

This review was performed at the IRS National Headquarters in the office of the Chief Financial Officer (CFO), during the period July through October 2002, and covered the IRS' reporting of UTF administrative expenses from FY 1999 through the third quarter of FY 2002. Information to complete our audit objectives was also obtained from the BPD, Office of Public Debt Accounting.

We coordinated our efforts with the DOL OIG, which was also following up on its prior recommendations and subsequent UTF administrative expenses. The audit was conducted in accordance with *Government Auditing Standards*. Detailed information on our audit objectives, scope, and methodology is presented in Appendix I. Major contributors to the report are listed in Appendix II.

The IRS continues to experience difficulty in providing to the BPD reliable and timely information on the estimated costs to administer the UTF. From FY 1999 through the third quarter of FY 2002, the IRS reported to the BPD a total of \$294,603,975 in UTF administrative expenses as follows:

- FY 1999 - \$33,263,358.
- FY 2000 - \$87,731,361.
- FY 2001 - \$87,966,612.
- FY 2002 - \$85,642,644 (through the third quarter).

Our review of the IRS' UTF reporting showed that:

- Administrative expenses reported to the BPD could not be supported or replicated.

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### **The Internal Revenue Service Cannot Compute the Cost to Collect Trust Fund Taxes**

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- Data may exist that could be used to estimate UTF administrative expenses.
- Use of a cost ratio to report estimated UTF administrative expenses might not be appropriate.
- Required reports were not always timely submitted or properly prepared.

Because of these conditions, we were unable to substantiate the reported expenses or make any assurances that reported expenses were accurate, complete, or consistent.

These conditions occurred in part because the IRS did not establish written procedures or policies for the preparation of UTF administrative expense reports. Consequently, IRS personnel could not fully explain the processes used to prepare the reports, replicate the calculations included in the reports, or produce supporting documentation for the reports. As a further contributing factor, the responsibility for reporting the UTF administrative expenses was transferred from the CFO's office to the Small Business/Self-Employed Division during FY 2001, only to be transferred back during FY 2002, which caused delays in the IRS' reporting to the BPD.

IRS officials further informed us that, when considering competing priorities and limited resources, reporting the IRS' administrative expenses was given a lower priority. The IRS concentrated on a more permanent solution by applying its resources to the implementation of the new Integrated Financial System (IFS), which would include a cost accounting system. IRS senior management acknowledged that personnel responsible for identifying, recording, and reporting UTF administrative expenses received insufficient oversight from their direct supervisor, and that reports forwarded to the BPD were not reviewed or approved by responsible managers.

Another factor that contributed to the lower priority previously established by the IRS for UTF reporting is that the BPD's recording of administrative expenses to the Department of the Treasury general fund and the UTF accounts does not directly affect the IRS' appropriations (i.e., the administration of the UTF by the IRS is not a true



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cost-reimbursable service). This explanation was provided to us during our audit to put the reporting issue in context from a historical perspective. The CFO advised, in its response to the draft report, that this explanation does not reflect the current official position of the CFO.

Submitting reports that do not comply with established directives, or that are not supported by documented procedures and data, hinders the Secretary of the Treasury from properly fulfilling his responsibility to charge the trust fund and reimburse the Department of the Treasury general fund for the IRS-incurred UTF administrative expenses. Also, the IRS cannot ensure that reported UTF administrative expenses are accurate. Overstating these expenses lessens the amount available to the UTF and, by extension, to the states to pay unemployment benefits. Conversely, understating these expenses lessens the amount available to the Department of the Treasury general fund for other essential Federal Government services.

### **Administrative expenses reported to the BPD could not be supported or replicated**

The IRS informed us that its FY 2000 10-year estimate of expenses report, dated December 1999, was based on amounts presented in the DOL OIG's September 1999 audit report. The IRS, however, could not replicate the methodology or provide supporting documentation used to establish the estimates contained in the 10-year report. Further, the amounts shown on the FY 2000 10-year report became the basis for all the IRS' subsequent UTF quarterly expense reports for FY 2000 through the third quarter of FY 2002.

The IRS, in using the DOL OIG report amounts, provided data that were inconsistent with prior reported IRS expenses. The DOL OIG report only included supportable expenses for comparison purposes to determine over or undercharges to the UTF. In doing so, the audited amounts shown in the report totaled approximately \$213.4 million for the FYs 1996-1998 reviewed. For the same time period, the BPD recorded IRS UTF administrative expenses of approximately \$304.7 million, based on IRS estimates.

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In the report presentation, the DOL OIG limited its audited amounts (to what it categorized as actual expenses) to those expenses which the IRS was able to justify, and excluded those for which the IRS could not produce supporting documentation at the time of its audit. As a result, the amounts presented in the DOL OIG report did not include certain identifiable IRS costs such as investigative expenses, forms printing and storage, returns processing, Federal Tax Deposit (FTD)<sup>5</sup> processing, and FTD coupon (Form 8109)<sup>6</sup> expenses in certain situations. Therefore, the amounts used by the IRS in its 10-year and subsequent quarterly expense reports for FYs 1999 through the third quarter of 2002 were significantly less than what was reported to the BPD by the IRS in previous fiscal years.

We also noted that the yearly estimated expenses for FYs 2003 through 2010 have not been revised, since first reported in the FY 2000 10-year estimate of expenses report, to reflect changes in costs or IRS tax return processes.

Since the amounts included in the IRS' 10-year estimate of expenses and quarterly expense reports were not derived from any accounting system or recorded transactions, we were unable to substantiate the reported expenses. See Appendices IV, V, VI, and VII for IRS-reported and BPD-recorded UTF administrative expenses for FY 1999 through the third quarter of FY 2002.

### **Data may exist that could be used to estimate UTF administrative expenses**

As reported above, the IRS has not established a documented and repeatable process to provide reliable, timely information on the estimated costs to administer the UTF. Further, the IRS does not have a functional cost accounting system as required by the *Managerial Cost*

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<sup>5</sup> Deposit made to a depository bank that has a Treasury Tax and Loan Account with a Federal Reserve Bank or, in the case of a taxpayer required to deposit by Electronic Transfer Payment, to the Federal Government agent.

<sup>6</sup> Entities use IRS Form 8109 when remitting FTDs, including Federal unemployment taxes.

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*Accounting Standards and Concepts for the Federal Government* (Statement of Federal Financial Accounting Standards # 4). Therefore, the IRS does not have sufficient, comprehensive cost information on which to base estimated expenses of administering the UTF.

As an alternative, we believe that the IRS maintains sufficient budget information and functional operating statistics that could be used to provide a reasonable basis for estimating a majority of the UTF administrative expenses. For example, for three of the more prevalent UTF activities, we determined the following:

Returns Processing – The total number and costs to process paper and magnetic tape unemployment tax returns is maintained.

Examination – Information concerning the number of returns examined and hours expended is maintained.

Collection – Even though the reports on delinquent account and investigation activities no longer show data by specific tax form, the management information systems from which these reports are produced can still provide that information through database queries.

After considering the major activities used to administer the UTF, the remaining IRS costs could be considered as indirect or overhead expenses, and thus could be allocated based on a ratio related to quantity, revenue, costs, or other suitable factors.

### **Use of a cost ratio to report estimated UTF administrative expenses might not be appropriate**

Another alternative to the specific identification of UTF activities and related expenses, which was recommended in the DOL OIG's December 1999 report, is the use of a cost ratio based on IRS-collected revenue. In using such a ratio, IRS expenses, as reported in its audited financial statements, less any appropriated funds that are for specific purposes such as the Earned Income Tax Credit (EITC) program, would be allocated based on a percentage of net costs to revenue collected for the affected taxes.

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We believe that implementation of this methodology for UTF administrative expenses should also apply to similarly reported trust fund administrative expenses such as those related to the Federal Old-Age and Survivors Insurance (FOASI) Trust Fund.<sup>7</sup> Table 1 depicts the fund administrative expenses for FY 2001 using this methodology.

**Table 1: Collected Revenue Cost Ratio**  
(in Millions)

	<u>UTF</u>	<u>FOASI</u>
<b>Trust Fund Revenue</b>	\$7,000	\$670,000
<b>Total Tax Revenue</b>	\$2,124,000	\$2,124,000
<b>Percentage of Revenue</b>	0.33	31.54
<b>IRS Total Expenses Less EITC</b>	\$9,043	\$9,043
<b>Fund Administrative Expenses</b>	\$30	\$2,852

*Source: IRS' Fiscal Years 2001 and 2000 Financial Statements (GAO-02-414, dated February 2002) and Publication 55B, IRS 2001 Data Book, dated March 2002.*

The resulting \$30 million in UTF administrative expenses is about a third of the almost \$88 million reported by the IRS in FY 2001. Conversely, the resulting \$2.852 billion in FOASI Trust Fund administrative expenses is almost 12 times higher than the \$242 million reported by the IRS in FY 2001. Using a ratio based on revenue collected assumes that it costs the IRS the same amount to collect each dollar of revenue, which is unlikely due to the differences in complexity of the various types of tax that the IRS administers.

Though we can not attest to the validity and accuracy of historically reported IRS administrative expenses, the changes and impact to the respective trust fund accounts and the Department of the Treasury general fund that would result from the use of a ratio based on revenue collected

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<sup>7</sup> This category of trust fund administrative expenses also includes expenses for the Federal Disability Insurance and the Federal Hospital Insurance Trust Funds.

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would have to be carefully weighed by all agencies involved.

Subsequent to completion of our initial audit work, the IRS adopted the use of such a ratio, but used a “Complexity Adjustment” to compensate for the significant increase in the resulting charges to the FOASI Trust Fund. Upon investigation, IRS officials informed us that the basis for the complexity adjustment was the selection of an amount that, when multiplied by the ratio result (i.e., \$2.852 billion from the above chart), would bring the reportable expense amount back to what was historically reported by the IRS (i.e., \$240 million). Since the ratio result for the UTF administrative expenses was within the range of what was expected by the IRS, no complexity adjustment was applied.

We believe that the use of a complexity adjustment for one class of administrative expenses and not another, which is likewise affected by processing complexities, is inconsistent and not defensible as a valid allocation method.

### **Required reports were not always timely submitted or properly prepared**

As shown in Table 2 below, the IRS did not fully comply with Treasury Directive 32-06, which hindered the BPD from timely and accurately recording transactions to charge the UTF and reimburse the Department of the Treasury general fund for IRS-incurred administrative expenses.

**Table 2: UTF Report Summary**

<b>Report Type</b>	<b>Quarterly</b>	<b>Year End</b>	<b>10-Year</b>
Required Reports	15	4	4
Submitted Reports	11	0	4
Submitted on Time	7	NA	0
Submitted Late	4	NA	4
Complete Information	2	NA	1

*Source: IRS UTF administrative expense reports for FY 1999 through the third quarter of FY 2002.*

Because the BPD did not receive or did not timely receive the required reports, adjusting entries had to be made that

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significantly affected the UTF account and the Department of the Treasury general fund. Such significant adjusting entries could prevent financial managers from making timely informed decisions.

For example, since the IRS did not submit FY 1999 first or second quarter expense reports, BPD officials informed us that they recorded and charged the UTF estimated amounts for these two quarters based on prior IRS reporting. In the subsequent third and fourth quarter expense reports, the IRS included amounts for the first two quarters. This required the BPD to record adjusting entries, the largest of which was a credit entry of about \$71.5 million. This large adjustment was required because the IRS reported approximately \$23 million for the first 2 quarters, when historically it had been reporting approximately \$95 million for these expenses. The IRS could not explain this reduction in reported expenses nor provide supporting documentation for the expenses reported.

We also noted that because of the FY 1999 adjusting entries, the BPD recorded a net amount of \$431,081 in excess of what the IRS had reported. See Appendix IV for details.

In another example, since the IRS did not timely submit FY 2002 first and second quarter expense reports, BPD officials informed us that they recorded and charged the UTF an estimated amount based on IRS historical data for the first quarter. The BPD did not record expenses for the second quarter. When the BPD received the first 3 quarterly expense reports in April 2002, it was required to record an adjusting entry of approximately \$58 million during the third quarter. See Appendix VII for details.

### **Recommendations**

1. The CFO should develop written procedures documenting a methodology, including the identification of all systems and sources of information, that would ensure the most reasonable and timely means of identifying and reporting all expenses associated with the IRS' administration of all trust fund taxes.

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Management's Response: The CFO will coordinate the development of written policy guidance for the IRS business units that outlines a methodology to cost and report the expenses to the BPD.

2. The CFO should establish controls to ensure that any amounts reported to the BPD are reviewed and approved by a senior level IRS executive.

Management's Response: The CFO is taking steps to ensure that all quarterly reports and any adjustments to previously submitted data are reviewed and approved prior to transmittal to the BPD. The quarterly due dates will be logged as control items on the CFO internal control system, with specific assignment to the Associate CFO for Internal Financial Management.

3. The CFO should ensure that the ability to record and report trust fund administrative expenses, as currently envisioned in the IFS development plans, is properly implemented.

Management's Response: The new IFS is scheduled to become operational on October 1, 2003. The IFS will contain a cost accounting module that will provide greater traceability of financial data to the existing management information system data, thus providing for a more reliable source of expense data. It is anticipated that the first expense data report will be issued for the first quarter FY 2004 by January 31, 2004.

**Detailed Objectives, Scope, and Methodology**

The overall objective of this review was to determine whether the Internal Revenue Service (IRS) had established an effective process to accurately identify, record, and report expenses related to Unemployment Trust Fund (UTF) administrative activities. We also attempted to verify the accuracy of reported administrative expenses for Fiscal Years (FY) 1999, 2000, 2001, and 2002 (through the third quarter) and to identify a reasonable method in which the IRS could more accurately report its administrative expenses. To accomplish these objectives, we:

- I. Documented procedures to identify, record, and report UTF administrative expenses, including internal controls established to ensure accuracy. Assessed the methodology for reasonableness based on cost accounting principles and issued guidance.
- II. Attempted to verify the accuracy of reported administrative expenses for FYs 1999, 2000, 2001, and 2002 (through the third quarter) and to trace reported expenses to supporting documentation. Compared IRS-reported expenses, both estimated and actual, to Bureau of the Public Debt (BPD)-recorded administrative expenses.
- III. Assessed corrective actions on prior Department of Labor Office of Inspector General audit findings related to UTF administrative expenses.
- IV. Assessed the IRS' compliance with Department of the Treasury reporting requirements when submitting expenses to the BPD by comparing the IRS' quarterly reports, fiscal year end reports, and 10-year estimate of expenses reports to guidance provided in Treasury Directive 32-06, *Administrative Expenses for Trust Funds*.
- V. Attempted to identify a reasonable method that could be used to more accurately report administrative expenses based on information that is currently collected and reported by the IRS. Also assessed the use of IRS-reported statistics, as well as audited amounts contained in its annual financial statements, as a way of realistically estimating expenses as an accepted substitute for a structured cost accounting system.



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**Appendix II**

**Major Contributors to This Report**

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Thomas Brunetto, Audit Manager

Gwen Bryant-Hill, Auditor

Thomas Dori, Auditor

Bobbie Draudt, Auditor

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**Appendix III**

**Report Distribution List**

Acting Commissioner N:C  
Deputy Chief Financial Officer N:CFO  
Director, Assistance and Review N:CFO:AR  
Chief Counsel CC  
National Taxpayer Advocate TA  
Director, Legislative Affairs CL:LA  
Director, Office of Program Evaluation and Risk Analysis N:ADC:R:O  
Office of Management Controls N:CFO:AR:M  
Audit Liaison: Chief Financial Officer N:CFO

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**Appendix IV**

**Internal Revenue Service’s Fiscal Year 1999 Unemployment Trust Fund Expenses**

For Fiscal Year (FY) 1999, the Internal Revenue Service (IRS) chose to report Federal Tax Deposit<sup>1</sup> (FTD) expenses and FTD Coupon (Form 8109)<sup>2</sup> expenses to the Bureau of the Public Debt (BPD) separately from all other Unemployment Trust Fund (UTF) expenses. IRS staff could not fully explain the meaning or differentiation of these two categories, as the categories were established by staff no longer involved with UTF reporting.

**Administrative Expenses**

<b>Quarter</b>	<b>IRS-Reported</b>	<b>BPD-Recorded</b>	<b>Difference</b>
<i>FY 1999 1<sup>st</sup></i>	\$1,442,483 <sup>1</sup>	\$3,103,913 <sup>2</sup>	\$1,661,430
<i>FY 1999 2<sup>nd</sup></i>	\$21,148,828 <sup>3</sup>	\$92,633,964 <sup>2</sup>	\$71,485,136
<i>FY 1999 3<sup>rd</sup></i>	\$6,507,522	\$4,846,092 <sup>4</sup>	(\$1,661,430)
<i>FY 1999 4<sup>th</sup></i>	\$2,588,943	(\$68,896,193) <sup>5</sup>	(\$71,485,136)
<i>Total</i>	\$31,687,776	\$31,687,776	\$0.00

**FTD Expenses**

<b>Quarter</b>	<b>IRS-Reported</b>	<b>BPD-Recorded</b>	<b>Difference</b>
<i>FY 1999 1<sup>st</sup></i>	\$0.00 <sup>6</sup>	\$9,349 <sup>2</sup>	\$9,349
<i>FY 1999 2<sup>nd</sup></i>	\$332,487 <sup>7</sup>	\$297,644 <sup>2</sup>	(\$34,843)
<i>FY 1999 3<sup>rd</sup></i>	\$332,487	\$332,487	\$0.00
<i>FY 1999 4<sup>th</sup></i>	\$344,826	\$667,964 <sup>8</sup>	\$323,138
<i>Total</i>	\$1,009,800	\$1,307,444	\$297,644

Table Notes are shown on pages 16 and 17.

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<sup>1</sup> Deposit made to a depository bank that has a Treasury Tax and Loan Account with a Federal Reserve Bank or, in the case of a taxpayer required to deposit by Electronic Transfer Payment, to the Federal Government agent.

<sup>2</sup> Entities use IRS Form 8109 when remitting FTDs, including Federal unemployment taxes.

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**FTD Coupon Expenses**

<b>Quarter</b>	<b>IRS-Reported</b>	<b>BPD-Recorded</b>	<b>Difference</b>
<i>FY 1999 1<sup>st</sup></i>	\$0.00 <sup>6</sup>	\$3,116 <sup>2</sup>	\$3,116
<i>FY 1999 2<sup>nd</sup></i>	\$193,101 <sup>7</sup>	\$133,437 <sup>2</sup>	(\$59,664)
<i>FY 1999 3<sup>rd</sup></i>	\$193,101	\$193,101	\$0.00
<i>FY 1999 4<sup>th</sup></i>	\$179,580	\$369,565 <sup>9</sup>	\$189,985
<i>Total</i>	\$565,782	\$699,219	\$133,437

**Total FY 1999 Expenses**

<b>Type</b>	<b>IRS-Reported</b>	<b>BPD-Recorded</b>	<b>Difference</b>
<i>Administrative</i>	\$31,687,776	\$31,687,776	\$0.00
<i>FTD Expenses</i>	\$1,009,800	\$1,307,444	\$297,644
<i>FTD Coupons</i>	\$565,782	\$699,219	\$133,437
<i>Total</i>	\$33,263,358	\$33,694,439	\$431,081 <sup>10</sup>

Table Notes:

<sup>1</sup> The IRS did not report first quarter expenses. However, the IRS did report a first quarter expense of \$1,442,483 in its third quarter report.

<sup>2</sup> The BPD recorded first and second quarter amounts based on prior IRS 10-year estimate of expenses reports.

<sup>3</sup> The IRS did not report second quarter expenses. However, the IRS did report a first and second quarter cumulative expense of \$22,591,311 in its fourth quarter report. The \$21,148,828 reflects the \$22,591,311 less the first quarter expense of \$1,442,483 that was reported in the third quarter.

<sup>4</sup> The BPD adjusted the IRS' third quarter estimated expense by (\$1,661,430). This is the difference between the IRS' first quarter reported expense of \$1,442,483 and the BPD's first quarter recorded expense of \$3,103,913.

<sup>5</sup> The BPD adjusted the IRS' fourth quarter estimated expense by (\$71,485,136). This is the difference between the IRS' second quarter reported expense of \$21,148,828 and the BPD's second quarter recorded expense of \$92,633,964.

<sup>6</sup> The IRS did not report first quarter expenses.

## **The Internal Revenue Service Needs to Establish an Effective Process to Accurately Identify, Record, and Report Unemployment Trust Fund Administrative Expenses**

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### Table Notes: (Continued)

<sup>7</sup> The IRS did not report second quarter expenses. However, the IRS did report a first and second quarter cumulative expense in its third quarter report as shown.

<sup>8</sup> The BPD recorded an amount that was in excess of the IRS-reported amount by \$323,138. This occurred because the BPD used the IRS-reported first and second quarter cumulative expense of \$332,487 as the BPD-recorded first quarter expense instead of the actual BPD-recorded amount of \$9,349 in figuring cumulative costs through the third quarter. This action resulted in a total excess charge to the UTF of \$323,138 for the quarter and a net excess charge of \$297,644 for the year.

<sup>9</sup> The BPD adjusted the IRS' fourth quarter estimated expense by \$189,985. This occurred because the BPD used the IRS-reported first and second quarter cumulative expense of \$193,101 as the BPD-recorded first quarter expense instead of the actual BPD-recorded amount of \$3,116 in figuring cumulative costs through the third quarter. This action resulted in a total excess charge to the UTF of \$189,985 for the quarter and a net excess charge of \$133,437 for the year.

<sup>10</sup> This figure reflects a net charge to the UTF for FY 1999 that was in excess of what the IRS reported to the BPD; specifically, FTD expense of \$297,644 and FTD coupon expense of \$133,437.

**The Internal Revenue Service Needs to Establish an Effective Process to Accurately Identify, Record, and Report Unemployment Trust Fund Administrative Expenses**

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**Appendix V**

**Internal Revenue Service's Fiscal Year 2000 Unemployment Trust Fund Expenses**

For Fiscal Year (FY) 2000, the Internal Revenue Service (IRS) chose to report Federal Tax Deposit<sup>1</sup> (FTD) expenses and FTD Coupon (Form 8109)<sup>2</sup> expenses to the Bureau of the Public Debt (BPD) separately from all other Unemployment Trust Fund (UTF) expenses. IRS staff could not fully explain the meaning or differentiation of these two categories, as the categories were established by staff no longer involved with UTF reporting.

**Administrative Expenses**

<b>Quarter</b>	<b>IRS-Reported</b>	<b>BPD-Recorded</b>	<b>Difference</b>
<i>FY 2000 1<sup>st</sup></i>	\$1,876,170	\$1,876,170	\$0.00
<i>FY 2000 2<sup>nd</sup></i>	\$77,170,071	\$77,170,071	\$0.00
<i>FY 2000 3<sup>rd</sup></i>	\$4,716,393	\$4,716,393	\$0.00
<i>FY 2000 4<sup>th</sup></i>	\$1,965,939	\$1,965,939	\$0.00
<i>Total</i>	\$85,728,573	\$85,728,573	\$0.00

**FTD Expenses**

<b>Quarter</b>	<b>IRS-Reported</b>	<b>BPD-Recorded</b>	<b>Difference</b>
<i>FY 2000 1<sup>st</sup></i>	\$334,356	\$334,356	\$0.00
<i>FY 2000 2<sup>nd</sup></i>	\$231,447	\$231,447	\$0.00
<i>FY 2000 3<sup>rd</sup></i>	\$344,727	\$344,727	\$0.00
<i>FY 2000 4<sup>th</sup></i>	\$357,516	\$357,516	\$0.00
<i>Total</i>	\$1,268,046	\$1,268,046	\$0.00

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<sup>1</sup> Deposit made to a depository bank that has a Treasury Tax and Loan Account with a Federal Reserve Bank or, in the case of a taxpayer required to deposit by Electronic Transfer Payment, to the Federal Government agent.

<sup>2</sup> Entities use IRS Form 8109 when remitting FTDs, including Federal unemployment taxes.

**The Internal Revenue Service Needs to Establish an Effective Process to Accurately Identify, Record, and Report Unemployment Trust Fund Administrative Expenses**

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**FTD Coupon Expenses**

<b>Quarter</b>	<b>IRS-Reported</b>	<b>BPD-Recorded</b>	<b>Difference</b>
<i>FY 2000 1<sup>st</sup></i>	\$197,577	\$197,577	\$0.00
<i>FY 2000 2<sup>nd</sup></i>	\$141,621	\$141,621	\$0.00
<i>FY 2000 3<sup>rd</sup></i>	\$204,948	\$204,948	\$0.00
<i>FY 2000 4<sup>th</sup></i>	\$190,596	\$190,596	\$0.00
<i>Total</i>	\$734,742	\$734,742	\$0.00

**Total FY 2000 Expenses**

<b>Type</b>	<b>IRS-Reported</b>	<b>BPD-Recorded</b>	<b>Difference</b>
<i>Administrative</i>	\$85,728,573	\$85,728,573	\$0.00
<i>FTD Expenses</i>	\$1,268,046	\$1,268,046	\$0.00
<i>FTD Coupons</i>	\$734,742	\$734,742	\$0.00
<i>Total</i>	\$87,731,361	\$87,731,361	\$0.00

**The Internal Revenue Service Needs to Establish an Effective Process to Accurately Identify, Record, and Report Unemployment Trust Fund Administrative Expenses**

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**Appendix VI**

**Internal Revenue Service's Fiscal Year 2001 Unemployment Trust Fund Expenses**

For Fiscal Year (FY) 2001, the Internal Revenue Service (IRS) chose to report Federal Tax Deposit<sup>1</sup> (FTD) expenses and FTD Coupon (Form 8109)<sup>2</sup> expenses to the Bureau of the Public Debt (BPD) separately from all other Unemployment Trust Fund (UTF) expenses. IRS staff could not fully explain the meaning or differentiation of these two categories, as the categories were established by staff no longer involved with UTF reporting.

**Administrative Expenses**

<b>Quarter</b>	<b>IRS-Reported</b>	<b>BPD-Recorded</b>	<b>Difference</b>
<i>FY 2001 1<sup>st</sup></i>	\$1,346,859	\$1,346,859	\$0.00
<i>FY 2001 2<sup>nd</sup></i>	\$77,853,516	\$77,853,516	\$0.00
<i>FY 2001 3<sup>rd</sup></i>	\$4,725,591	\$4,725,591	\$0.00
<i>FY 2001 4<sup>th</sup></i>	\$1,969,771	\$1,969,771	\$0.00
<i>Total</i>	\$85,895,737	\$85,895,737	\$0.00

**FTD Expenses**

<b>Quarter</b>	<b>IRS-Reported</b>	<b>BPD-Recorded</b>	<b>Difference</b>
<i>FY 2001 1<sup>st</sup></i>	\$345,723	\$345,723	\$0.00
<i>FY 2001 2<sup>nd</sup></i>	\$239,316	\$239,316	\$0.00
<i>FY 2001 3<sup>rd</sup></i>	\$356,445	\$356,445	\$0.00
<i>FY 2001 4<sup>th</sup></i>	\$369,669	\$369,669	\$0.00
<i>Total</i>	\$1,311,153	\$1,311,153	\$0.00

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<sup>1</sup> Deposit made to a depository bank that has a Treasury Tax and Loan Account with a Federal Reserve Bank or, in the case of a taxpayer required to deposit by Electronic Transfer Payment, to the Federal Government agent.

<sup>2</sup> Entities use IRS Form 8109 when remitting FTDs, including Federal unemployment taxes.



**The Internal Revenue Service Needs to Establish an Effective Process to Accurately Identify, Record, and Report Unemployment Trust Fund Administrative Expenses**

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**FTD Coupon Expenses**

<b>Quarter</b>	<b>IRS-Reported</b>	<b>BPD-Recorded</b>	<b>Difference</b>
<i>FY 2001 1<sup>st</sup></i>	\$204,297	\$204,297	\$0.00
<i>FY 2001 2<sup>nd</sup></i>	\$146,436	\$146,438 <sup>1</sup>	\$2.00
<i>FY 2001 3<sup>rd</sup></i>	\$211,914	\$211,914	\$0.00
<i>FY 2001 4<sup>th</sup></i>	\$197,075	\$197,075	\$0.00
<i>Total</i>	\$759,722	\$759,724	\$2.00

**Total FY 2001 Expenses**

<b>Type</b>	<b>IRS-Reported</b>	<b>BPD-Recorded</b>	<b>Difference</b>
<i>Administrative</i>	\$85,895,737	\$85,895,737	\$0.00
<i>FTD Expenses</i>	\$1,311,153	\$1,311,153	\$0.00
<i>FTD Coupons</i>	\$759,722	\$759,724	\$2.00
<i>Total</i>	\$87,966,612	\$87,966,614	\$2.00

Table Notes:

<sup>1</sup>The BPD second quarter entry contained a \$2 data input error causing the difference between the IRS' estimated quarterly expenses and the reimbursement to the Department of the Treasury general fund.

**The Internal Revenue Service Needs to Establish an Effective Process to Accurately Identify, Record, and Report Unemployment Trust Fund Administrative Expenses**

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**Appendix VII**

**Internal Revenue Service's Fiscal Year 2002 Unemployment Trust Fund Expenses**

For Fiscal Year (FY) 2002, the Internal Revenue Service (IRS) chose not to report Federal Tax Deposit<sup>1</sup> (FTD) expenses and FTD Coupon (Form 8109)<sup>2</sup> expenses to the Bureau of the Public Debt (BPD) separately from all other Unemployment Trust Fund (UTF) expenses.

**Administrative Expenses**

<b>Quarter</b>	<b>IRS-Reported</b>	<b>BPD-Recorded</b>	<b>Difference</b>
<i>FY 2002 1<sup>st</sup></i>	\$1,901,595	\$22,046,368.50 <sup>1</sup>	\$20,144,773.50
<i>FY 2002 2<sup>nd</sup></i>	\$78,433,928	\$0.00 <sup>1</sup>	(\$78,433,928)
<i>FY 2002 3<sup>rd</sup></i>	\$5,307,121	\$63,596,275.50 <sup>2</sup>	\$58,289,154.50
<i>Total</i>	\$85,642,644	\$85,642,644	\$0.00

Table Notes:

<sup>1</sup>The IRS did not report first and second quarter expenses until April 2002. This caused the BPD to charge the UTF based on prior IRS historical data for the first quarter and not to make an entry for the second quarter.

<sup>2</sup>The BPD adjusted the IRS' third quarter estimated expense by \$58,289,154.50. This is the difference between the IRS' first and second quarter reported expenses of \$80,335,523 and the BPD's first and second quarter recorded expenses of \$22,046,368.50.

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<sup>1</sup> Deposit made to a depository bank that has a Treasury Tax and Loan Account with a Federal Reserve Bank or, in the case of a taxpayer required to deposit by Electronic Transfer Payment, to the Federal Government agent.

<sup>2</sup> Entities use IRS Form 8109 when remitting FTDs, including Federal unemployment taxes.

**The Internal Revenue Service Needs to Establish an Effective Process to Accurately Identify, Record, and Report Unemployment Trust Fund Administrative Expenses**

**Appendix VIII**

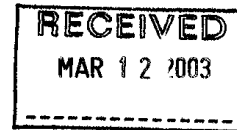
**Management's Response to the Draft Report**



CHIEF FINANCIAL OFFICER

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

March 12, 2003



MEMORANDUM FOR GORDON C. MILBOURN III  
ACTING DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: W. Todd Grams   
Chief Financial Officer

SUBJECT: Draft Audit Report – The Internal Revenue Service Needs to Establish an Effective Process to Accurately Identify, Record, and Report Unemployment Trust Fund Administrative Expenses (Audit #200210030)

Thank you for the opportunity to respond to your draft report (hereinafter "draft report" or "report") entitled, "The Internal Revenue Service Needs to Establish an Effective Process to Accurately Identify, Record, and Report Unemployment Trust Fund Administrative Expenses." The draft report reviews our compliance with Treasury Directive 32-06, *Administrative Expenses for Trust Funds*. Directive 32-06 requires the Service to report expenses incurred for the administration of trust funds to the Bureau of the Public Debt (BPD), Office of Public Debt Accounting.

I share your concern that the Treasury reimbursement data has not been accurate or reported in a timely manner. Furthermore, I am troubled by inappropriate comments made by one of the senior IRS officials your staff interviewed.

As your report indicates, the information needed to compile the administrative costs for these trust funds currently resides in at least ten Management Information Systems (MIS) that are used to provide functional operating statistics. This situation will continue for the foreseeable future. My staff will work with the owners of these systems to address the accuracy of the MIS data used to support the expense calculations.

I agree with your recommendation that written procedures are necessary to ensure reasonable and timely reporting of the administration of all trust fund taxes, and I have directed my staff to begin development of procedures that will adequately address and correct the errors identified during your review. Furthermore, to address the lack of executive review of the data prior to submission, I am establishing a set of controls that will ensure all reported amounts are reviewed and approved by a senior level executive.

## The Internal Revenue Service Needs to Establish an Effective Process to Accurately Identify, Record, and Report Unemployment Trust Fund Administrative Expenses

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I wish to address the last paragraph on page 4 of the draft report. The paragraph includes the personal views of one of our officials concerning the decision to delay revising the methodology used in determining the trust fund's administrative expenses. According to that IRS official, one of the factors considered was the lack of impact the recording of these expenses has on the IRS' appropriations. This statement was inaccurate and careless. It does not reflect the official position of my office. The IRS is concerned about the accurate and timely recording of all expenses, regardless of their source. We have made great strides over the past two years in improving the timeliness and accuracy of our accounting information at the IRS. This success has been recognized by the General Accounting Office in their annual audit. I assure you that neither I nor anyone else on the current CFO leadership team shares this executive's view of this matter. For these reasons, I respectfully request that this paragraph be removed from the report.

Thank you again for the opportunity to comment on the draft report. Attached to this memorandum is the detailed information outlining the corrective actions to address your recommendations. If you have any questions, please contact me at 202.622.6400, or have a member of your staff contact L. Philip Mahler, Acting Associate CFO for Corporate Planning and Performance at 202.622.4909.

Attachment

## The Internal Revenue Service Needs to Establish an Effective Process to Accurately Identify, Record, and Report Unemployment Trust Fund Administrative Expenses

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Attachment

**Finding:** The Internal Revenue Service cannot compute the cost to collect Trust Fund Taxes

**Recommendation:** The CFO should develop written procedures documenting a methodology, including the identification of all systems, and sources of information that would ensure the most reasonable and timely means of identifying and reporting all expenses associated with the IRS' administration of all trust fund taxes.

**Corrective Action:** The CFO (Internal Financial Management Office) will coordinate the development of written policy guidance for the IRS business units that outlines a methodology to cost and report the expenses to the Bureau of Public Debt.

**Implementation Date:**

Proposed Date: January 31, 2004

Responsible Official: Chief Financial Officer

**Finding:** Administrative expenses reported to the Bureau of Public Debt could not be supported or replicated.

**Recommendation:** The CFO should establish controls to ensure that any amounts reported to the BPD are reviewed and approved by a senior level IRS executive.

**Corrective Action:** The CFO is taking steps to ensure that all quarterly reports and any adjustments to previously submitted data are reviewed and approved prior to transmittal to BPD. The quarterly due dates will be logged as control items on the CFO internal control system, with specific assignment to the Associate CFO for Internal Financial Management. This internal control system within the CFO organization is an established system with a proven record of success that has been in place for more than two years. The CFO will hold the Associate CFO responsible for the quality of the data and the ability to re-create information should the need arise.

**Implementation Date:**

Proposed Date: January 31, 2004

Responsible Official: Chief Financial Officer

## The Internal Revenue Service Needs to Establish an Effective Process to Accurately Identify, Record, and Report Unemployment Trust Fund Administrative Expenses

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Attachment

**Finding:** The Internal Revenue Service cannot accurately compute the cost to collect Trust Fund Taxes

**Recommendation:** The CFO should ensure that the ability to record and report trust fund administrative expenses, as currently envisioned in the Integrated Financial System development plans, is properly implemented.

**Corrective Action:** The new Integrated Financial System (IFS) is scheduled to become operational on October 01, 2003. IFS will contain a cost accounting module that will provide greater traceability of financial data to the existing MIS data, thus providing for a more reliable source of expense data. It is anticipated that the first expense data report will be issued for the first quarter FY 2004 by January 31, 2004.

**Implementation Date:**

Proposed Date: January 31, 2004

Responsible Official: Chief Financial Officer