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United States General Accounting Office
Washington, DC 20548

Accounting and Information
Management Division

B-283369

February 25, 2000

The Honorable Patricia A. Dalton
Acting Inspector General
Department of Labor

Subject: GAO Report on Applying Agreed-Upon Procedures: Federal
Unemployment Taxes

Dear Ms. Dalton:

We have performed the procedures contained in enclosure 1 to this letter, which we agreed to perform and to 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, 1999, is supported by the underlying records. As agreed upon with your office, we evaluated fiscal year 1999 UTF activity.

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 (AICPA). 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) a review of key reconciliations of IRS records to the Department of the Treasury records. Enclosure 1 contains the agreed-upon procedures and our findings from performing each of the procedures.

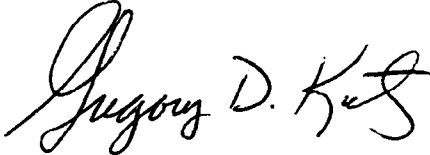
We were not engaged to, and did not, perform an audit, the objective of which would have been the expression of an opinion on the net amount of FUTA taxes distributed to the UTF. Accordingly, we do not express such an opinion. Had we performed additional procedures, other matters might have come to our attention that would have been reported to you. We completed the agreed-upon procedures on February 9, 2000.

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We provided a draft of this letter to IRS, along with its enclosure, for review and comment. IRS officials agreed with the contents of this report.

This report is intended for the use of the Office of Inspector General of the Department of Labor. However, this report is a matter of public record and its distribution is not limited. Consequently, copies are available to others upon request. If you have any questions, please call me at (202) 512-3406.

Sincerely yours,

A handwritten signature in cursive script that reads "Gregory D. Kutz". The signature is written in black ink and is positioned above the printed name.

Gregory D. Kutz
Associate Director, Governmentwide Accounting
and Financial Management Issues

Enclosure

<u>Agreed-upon procedures</u>	<u>Description of findings and results</u>
(A) General	
<p>(1) Compare fiscal year 1999 net FUTA collections per IRS' statement of custodial activity and related footnote disclosures to drafts of (a) Treasury's Bureau of Public Debt (BPD) financial statements for the Unemployment Trust Fund (UTF), and (b) the Department of Labor's (DOL) consolidated financial statements. Obtain explanations/support for significant variances.^a</p>	<p>(1) There were no significant variances between net FUTA collections per IRS' statement of custodial activity and BPD's financial statements for the UTF. Similarly, there were no significant variances between IRS' statement of custodial activity and related footnote disclosures and drafts of DOL's consolidated financial statements.</p>
(B) Sampling	
<p>(1) Obtain from IRS total FUTA collections and refunds reflecting the first 9 months of fiscal year 1999 posted to the master file.^b Determine if FUTA collections and refund data per the master file materially reconcile to the general ledger.</p>	<p>(1) Total FUTA collections and refunds for the first 9 months of fiscal year 1999 per the IRS master file materially reconciled to IRS' general ledger.</p>
<p>(2) Use Dollar Unit Sampling (DUS) to select a sample of combined FUTA collection and refund transactions from the master file for the first 9 months of fiscal year 1999, using a confidence level of 80 percent, a test materiality of \$320 million, and an expected aggregate error amount of \$160 million.</p>	<p>(2) Use of Dollar Unit Sampling with a confidence level of 80 percent, a test materiality of \$320 million, and an expected aggregate error amount of \$160 million resulted in a sample of 81 transactions for the first 9 months of fiscal year 1999. Of this total, 79 transactions represented collections and 2 transactions represented refunds.</p>

^aExcept where noted for certain procedures, significant or material is defined as \$320 million. This represents one percent of the Unemployment Trust Fund collections for fiscal year 1998.

^bThe master file is a detailed database containing taxpayer information.

(C) Detailed tests of transactions	
<p>(1) For each sampled FUTA tax collection transaction:</p> <ul style="list-style-type: none"> (a) Determine if collection amounts are accurately recorded by tracing collection transaction amounts from IRS' master files to deposit confirmation documents (e.g., federal tax deposit coupons). (b) Determine if amounts were posted to the appropriate period by reviewing the date on source documents. (c) Determine whether the transactions were properly categorized as FUTA receipts by reviewing source documentation maintained in IRS' files (e.g., tax returns). 	<p>(1) Based on supporting documentation, collection amounts were accurately recorded, posted to the appropriate period, and recorded in the correct tax class for all of the 79 sampled FUTA collection transactions.</p>
<ul style="list-style-type: none"> (d) Confirm FUTA transactions paid via the Electronic Federal Tax Payment System (EFTPS)^c to determine whether the recorded transactions are valid and reflect the proper amounts, are applied to the proper tax period, and are properly categorized as FUTA receipts. 	<p>Four of the 79 sampled FUTA receipt transactions were paid via EFTPS. For all 4 transactions, the bank confirmation showed a difference between bank records and IRS records related to posting the receipt to the proper tax period. However, a subsequent review of bank records and IRS master file data indicated that IRS posted all four transactions to the proper tax period and tax class and for the proper amounts.</p>

^cEFTPS is a system for initiating tax payments electronically.

<p>(e) Recalculate each tax return to check mathematical accuracy.</p>	<p>The tax returns associated with 78 of 79 FUTA collection sampled transactions were mathematically correct. For one sample item, IRS was unable to provide the tax return and consequently, we were unable to check the mathematical accuracy.</p>
<p>(2) For each sampled FUTA tax refund transaction:</p> <p>(a) 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 posted to the appropriate period and tax class.</p>	<p>(a) For both of the FUTA refund transactions sampled, confirmation with Treasury's FMS showed that the amount of the refund was correct and that it was posted to the appropriate period and tax class.</p>
<p>(b) Recalculate each tax return to check mathematical accuracy.</p>	<p>(b) The tax returns for the two FUTA refund transactions were mathematically correct.</p>
<p>(c) For FUTA tax returns, determine whether the taxpayer provided a written explanation for exempt payments, and whether the explanation meets IRS' criteria for FUTA exempt wage payments.</p>	<p>(c) For one of the two FUTA refund transactions sampled, the taxpayer claimed exempt wage payments requiring an explanation. The taxpayer provided a written explanation meeting IRS' criteria for FUTA exempt wage payments.</p>
<p>(d) For manual refunds, check to see that the appropriate supporting documentation is attached and that individuals who approved manual refunds were authorized to do so.</p>	<p>(d) Neither of the two sampled FUTA refund transactions were manual refunds.</p>

(D) Analytical procedures	
(1) Perform a predictive test on FUTA revenue collection and refund data for the final 3 months of the fiscal year to determine if reported fiscal year 1999 revenue collections and refunds appear consistent and reasonable. Project the expected fourth quarter FUTA revenue collection and refund amounts for fiscal year 1999, based on fiscal year 1998 quarterly amounts, and compare the projection to actual revenue collections and refunds. If a material variance exists, discuss with IRS to obtain an explanation/support.	(1) The predicted fourth quarter FUTA revenue collection and refund amounts for fiscal year 1999 did not materially vary from the actual amount of revenue collections and refunds during this period.
(2) Perform an analytical test comparing reported FUTA net revenue collections as of the interim test period (June 30, 1999) and as of the end of the fiscal year (September 30, 1999) to the respective prior periods. Discuss with Treasury's Office of Tax Analysis (OTA) to obtain an explanation/support for any material variances.	(2) FUTA net revenue collections as of the interim test period and the fiscal year ended September 30, 1999, did not materially increase from the respective prior periods.
(E) Other FUTA procedures	
(1) For each of the 12 months in fiscal year 1999, 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 FMS.	(1) Documentation supported the monthly FUTA reclassification adjustment amount transmitted to Treasury's FMS for all 12 months of fiscal year 1999.

<p>(2) For each of the 12 months in fiscal year 1999, obtain and review supporting documentation for the monthly entry of FUTA refund data onto the Government Online Accounting Link System (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 on GOALS.</p>	<p>(2) Documentation supported the monthly FUTA refund amount entered on GOALS to charge the Unemployment Trust Fund for FUTA tax refunds issued for all 12 months of fiscal year 1999.</p>
<p>(F) Other procedures performed as part of the fiscal year 1999 IRS financial statement audit</p>	
<p>(1) Use DUS to select statistical samples of (1) total revenue receipts and (2) refunds from IRS master files for the first 9 months of fiscal year 1999. For each item in the samples of revenue receipts and refunds, test that the collection or refund amount and tax class from source documentation agree with amounts recorded in IRS master files.</p>	<p>(1) Detailed testing of a total of 272 revenue receipts and 131 refund sample transactions did not reveal any instances of misclassifications related to FUTA.</p>

<p>(2) Review selected service centers' monthly Treasury 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 224 reconciliations to determine if IRS-reported total refunds (all tax classes) materially reconciled to Treasury FMS records.^d</p>	<p>(2) Tax revenue receipts reported by selected IRS service centers via the monthly Treasury 224 reconciliation process were properly classified and materially^e agreed with Treasury FMS records.</p> <p>Total refunds reported by the selected IRS service centers via the monthly Treasury 224 reconciliation process materially agreed with Treasury FMS records.</p>
<p>(3) Perform a proof of cash for fiscal year 1999 to determine whether revenue receipt balances by tax class^f, including FUTA, per the general ledger materially agree with IRS' master files and Treasury records. For refunds, perform a comparison of total refund balances between the master file, the general ledger, and Treasury records. Also, compare FUTA refunds per the master file to the general ledger.</p>	<p>(3) Fiscal year-end tax receipt balances for all tax classes, including FUTA, per IRS' general ledger materially agreed with IRS' master files and with Treasury records.</p> <p>Fiscal year-end refund balances per IRS' general ledger materially agreed with the master file and with Treasury records.</p>

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^dIRS 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 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 per Treasury records.

^eFor the purpose of this section, we define material as \$19 billion.

^fIRS assigns a tax class number to specific types of taxes. FUTA taxes are Tax Class 8.

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