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United States Government Accountability Office
Washington, DC 20548

November 4, 2005

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, 2005, is supported by the underlying records. As agreed with your office, we evaluated fiscal year 2005 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 relate to (1) transactions that represent the underlying basis of amounts distributed to the UTF and (2) 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 and results from performing each of the procedures.

We were not engaged to and did not conduct an examination, 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, 2005.

We provided a draft of this report to IRS for review and comment. IRS 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. 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, reading "Steven J. Sebastian". The signature is fluid and cursive, with the first name "Steven" and last name "Sebastian" clearly legible.

Steven J. Sebastian
Director
Financial Management and Assurance

Enclosure

Unemployment Trust Fund Procedures and Results

I. Procedures on detailed 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 2005 posted to the master file.¹ Compare FUTA collections and refund data per the master file to determine if they agree in all material respects² to IRS's general ledger.

Description of findings and results

Total FUTA collections and refunds for the first 8 months of fiscal year 2005 per IRS's master file materially agreed with 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 2005, using a confidence level of 80 percent, a test materiality of \$428 million, and an expected aggregate error amount of \$128 million.

Description of findings and results

Use of DUS with a confidence level of 80 percent, a test materiality of \$428 million, and an expected aggregate error amount of \$128 million resulted in a sample of 38 transactions for the first 8 months of fiscal year 2005. All of the 38 transactions represented FUTA collections.³

- C. For each sampled FUTA tax collection transaction:
1. Trace collection transaction amounts from IRS's master files to supporting documents (e.g., federal tax deposit coupons) to determine whether collection amounts are accurately recorded.

Description of findings and results

Based on supporting documentation, collection amounts were accurately recorded for all 38 sampled FUTA collection transactions.

2. Compare the date in the master file with the date on source documents to determine whether amounts were recorded to the appropriate period.

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

²For this procedure, "material" is defined as \$428 million. This represents 1 percent of net Unemployment Trust Fund collections reported for fiscal year 2004.

³Consequently, procedures agreed to regarding refund transactions are not applicable.

Description of findings and results

Based on supporting documentation, collection amounts were recorded to the appropriate period for all 38 sampled FUTA collection transactions.

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

Description of findings and results

Based on supporting documentation, collection amounts were recorded in the correct tax class⁴ for 37 of the 38 sampled transactions. One sampled transaction, which was mistakenly reported as a FUTA receipt by the taxpayer, should have been reported as a Federal Insurance Contributions Act (FICA) tax payment (tax class 1). 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 2005 is \$155 million. The net upper error limit is \$451 million.

4. Confirm FUTA transactions paid via the Electronic Federal Tax Payment System (EFTPS)⁵ 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 38 sampled FUTA collection transactions, 32 were paid via EFTPS. The bank confirmations showed that 31 of the 32 transactions were valid and had been recorded to the proper tax period and tax class and for the proper amounts. The remaining sampled EFTPS transaction, which was mistakenly reported as a FUTA receipt by the taxpayer, should have been reported as a FICA tax payment (tax class 1). IRS discovered the error and made the correction after our sample cutoff date but before the end of the fiscal year. This is the same error noted above in procedure I.C.3.

⁴IRS assigns a tax class number to specific types of taxes. FUTA taxes are tax class 8.

⁵EFTPS 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.

II. Analytical procedures

- A. Perform a predictive test on FUTA revenue collections and refunds for the final four months of fiscal year 2005 and determine whether the predicted FUTA collection and refund amounts vary materially⁶ from the actual FUTA revenue collection and refund amounts per IRS's records for this period.

Description of findings and results

The predicted FUTA revenue collection and refund data amounts for the final 4 months of fiscal year 2005 did not materially vary from the amounts for 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 2005, obtain supporting documentation for monthly revenue reclassification adjustments transmitted by IRS to the Financial Management Service (FMS). Compare the supporting documentation with the reclassification adjustments transmitted to FMS.

Description of findings and results

Documentation was consistent with the monthly FUTA reclassification adjustment amount transmitted to FMS for all 12 months of fiscal year 2005.

- B. For each of the 12 months in fiscal year 2005, obtain 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. Compare the supporting documentation with the monthly entries reported on GOALS.

Description of findings and results

Documentation was consistent with the monthly FUTA refund amount entered into GOALS to charge the UTF for FUTA tax refunds issued for all 12 months of fiscal year 2005.

- C. Compare fiscal year 2005 net FUTA collections per IRS's draft statement of custodial activity and related footnote disclosures to (a) the Department of the Treasury's Bureau of the Public Debt (BPD) accounting records for UTF and (b) drafts of the Department of Labor's (DOL) consolidated financial statements to determine whether any significant variances exist.

⁶For this procedure, "material" is defined as \$428 million.

Description of findings and results

There were no significant variances⁷ 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 2005 consolidated financial statements.

IV. Other procedures performed as part of the fiscal year 2005 IRS financial statement audit

- A. From IRS's master files for the first 8 months of fiscal year 2005, use DUS to select statistical samples of (1) total tax revenue receipts and (2) refunds. For each sample item, compare the receipt or refund amount, tax period, and tax class from source documentation with those recorded in IRS's master files.

Description of findings and results

The receipt or refund amount, tax period, and tax class from source documentation for 158 revenue receipts and 48 refund sample transactions were consistent with those recorded in IRS's master files.

- B. Obtain selected IRS service center campuses' monthly Treasury FMS 224 reconciliations⁸ and determine whether IRS-reported revenue receipts were properly classified and materially⁹ reconciled to Treasury FMS records. For refunds, obtain selected IRS service center campuses' monthly Treasury FMS 224 reconciliations and determine whether IRS-reported total refunds (all tax classes) materially reconciled to Treasury FMS records.

Description of findings and results

Tax revenue receipts reported by selected IRS service center campuses through the monthly Treasury FMS 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 FMS 224 reconciliation process materially reconciled to Treasury FMS records.

⁷For this procedure, "significant" is defined as \$428 million.

⁸At the end of each month, each IRS campus provides Treasury its FMS 224 (Statement of Transactions) generated from IRS's general ledger reporting receipts and refunds journalized during the month. Treasury reconciles the amounts on the FMS 224 with its records and provides IRS a Statement of Differences for any differences identified.

⁹For this procedure and procedure IV.C, we define "material" as \$20 billion. This represents 1 percent of the estimated total tax revenue receipts to be collected by IRS in fiscal year 2005.

Enclosure I

- C. Compare tax revenue receipt balances by tax class, including FUTA, recorded in IRS's general ledger with IRS's master files and Treasury records to determine if they agree in all material respects. For refunds, compare total refund balances between the master files, the general ledger, and Treasury records to determine if they agree in all material respects.

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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