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General Accounting Office  
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Accounting and Information  
Management Division

B-278610

159976

February 26, 1998

The Honorable Kenneth M. Mead  
Inspector General  
Department of Transportation

The Honorable Charles C. Masten  
Inspector General  
Department of Labor

Subject: Agreed-Upon Procedures: Excise Taxes

We have performed the procedures contained in enclosure II to this letter, which we agreed to perform solely to assist your offices in ascertaining whether the net excise tax collections and excise tax certifications reported by the Internal Revenue Service (IRS) for the fiscal year ended September 30, 1997, are supported by the underlying records. As agreed with your offices, we evaluated the fiscal year 1997 excise tax net collection activity. See enclosure I to this letter for a schedule of these amounts (unaudited).

This engagement to apply agreed-upon procedures was performed in accordance with standards established by the American Institute of Certified Public Accountants (AICPA). Accordingly, the adequacy of the procedures to meet your objectives is your responsibility and we make no representations in that respect. The procedures we agreed to perform included detailed tests of a sample of excise tax collection and refund transactions to check the validity of the transactions and their accurate accounting and reporting, a review of IRS excise tax certifications, and a review of key reconciliations of IRS to Department of the Treasury records. Enclosure II contains the agreed-upon procedures and our findings resulting from performing each of the procedures.

We were not engaged to, and did not, perform an audit, the objective of which would be the expression of an opinion on the accompanying schedule of excise tax net collections reflected in enclosure I. 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.

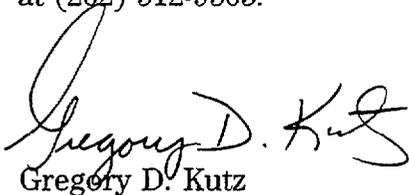
GAO/AIMD-98-78R Excise Tax Procedures

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We provided a draft of this letter to IRS, along with its enclosures, for review and comment. IRS' Deputy Commissioner agreed with the contents of this letter and its enclosures.

We completed the agreed-upon procedures on February 11, 1998. 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 AICPA. These standards also provide guidance when performing and reporting the results of agreed-upon procedures. This report is intended for the use of the Offices of Inspector General of the Department of Transportation and Department of Labor. Copies are available to others upon request. If you have any questions, please call me at (202) 512-9505.



Gregory D. Kutz

Associate Director, Governmentwide Accounting  
and Financial Management Issues

Enclosures

EXCISE TAXES  
SCHEDULE OF COLLECTIONS, REFUNDS, AND NET COLLECTIONS  
FOR THE FISCAL YEAR ENDED SEPTEMBER 30, 1997  
(Unaudited)

Collections	\$44,639,956,033
Refunds	<u>1,142,711,560</u>
Net Collections	<u>\$43,497,244,473</u>

<u>Agreed-upon procedures</u>	<u>Description of findings</u>
<b>(A) General</b>	
(1) Trace gross Excise tax collections and refunds on the Schedule of Collections, Refunds and Net Collections to IRS' fiscal year 1997 audited custodial financial statements and supplemental financial information.	(1) The gross Excise tax collections and refunds on the Schedule of Collections, Refunds and Net Collections agreed with IRS' fiscal year 1997 audited custodial financial statements and supplemental financial information.
(2) Review material <sup>a</sup> IRS post-closing adjustments to Excise tax collections and refunds to determine if they are adequately supported.	(2) There were no material post-closing adjustments to Excise tax collections. IRS initially misclassified about \$629 million of Excise tax credits/refunds as corporate and individual refund transactions in its financial statements. IRS subsequently revised its fiscal year 1997 financial statements to correct this misclassification.
<b>(B) Sampling</b>	
(1) Obtain data from IRS reflecting the first 9 months of fiscal year 1997 Excise tax collections and refunds posted to the master file. Determine if Excise tax collections and refund data per the master file materially reconcile to the general ledger.	(1) Excise tax collections and refund data for the first 9 months of fiscal year 1997 per the IRS master file materially reconciled with IRS' general ledger.

<sup>a</sup>As agreed upon with the Department of Transportation and Department of Labor Inspector Generals (IGs), test materiality for the agreed-upon procedures associated with Excise tax transactions was \$400 million.

<u>Agreed-upon procedures</u>	<u>Description of findings</u>
(2) Use Dollar Unit Sampling to extract a sample of combined Excise tax collection and refund transactions from the master file for the first 9 months of fiscal year 1997, using a confidence level of 80 percent, a test materiality of \$400 million, and an expected error amount of \$200 million.	(2) Use of Dollar Unit Sampling with a confidence level of 80 percent, a test materiality of \$400 million, and an expected error amount of \$200 million resulted in a sample of 396 Excise tax transactions for the first nine months of fiscal year 1997. <sup>b</sup> Of this total, 390 transactions represented collections and 6 transactions represented refunds.
<b>(C) Collections testing</b>	
(1) Vouch sampled Excise tax collection transactions to source documents as follows:	

<sup>b</sup>The actual sample selected using Dollar Unit Sampling (DUS) was 415 items. However, because DUS selects dollars versus specific transaction items as the sampling unit, 19 items were selected twice. Consequently, 396 unique sample transactions were selected for testing.

<u>Agreed-upon procedures</u>	<u>Description of findings</u>
<p>(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, deposit tickets).</p> <p>– Determine if amounts were posted to the appropriate period by reviewing the date on source documents.</p> <p>– Determine whether the transactions were recorded in the correct tax class by reviewing source documentation maintained in IRS' files (e.g., tax returns).</p>	<p>(a) Based on supporting documentation, collection amounts were accurately recorded, posted to the appropriate period, and recorded in the correct tax class for 386 of the 390 sampled excise tax collection transactions. Three sample items, with a total collection amount of \$17,078,293, represented corrections of previous year misclassifications. As a result, fiscal year 1997 excise tax receipts were overstated, and correspondingly fiscal year 1996 excise tax receipts were understated by that amount.<sup>c</sup> For the other sample item, no documentation was available to establish the tax class or validity of the receipt of \$2,231. The projected net upper error limit for these four items was \$571 million, with a net most likely error of \$341 million at the 80 percent confidence level for the first 9 months of fiscal year 1997.</p>

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<sup>c</sup>This is considered a misstatement because collections of tax revenue are reported on the cash basis of accounting (i.e., when remittances are received).

<u>Agreed-upon procedures</u>	<u>Description of findings</u>
(2) Review the return related to each receipt sample for taxpayer signature.	(2) A taxpayer signature was present on each of the returns that we received.
<b>(D) Refunds testing</b>	
(1) Vouch sampled Excise tax refund transaction amounts to source documents as follows:	
<p>(a) – Determine if refund amounts are accurately recorded by tracing the refund transaction amounts from IRS' master files to Treasury's Financial Management Service (FMS) disbursement confirmation documents.</p> <p>– Determine if amounts were posted to the appropriate period by reviewing the date on the source documents.</p> <p>– Determine whether the transactions were recorded in the correct tax class by reviewing source documentation maintained in IRS' files (e.g., tax returns).</p>	<p>(a) Based on supporting documentation, refund amounts were accurately recorded, posted to the appropriate period, and recorded in the correct tax class for the six sampled excise tax transactions.</p>

<u>Agreed-upon procedures</u>	<u>Description of findings</u>
(b) Determine if IRS reduced the refund amount by any prior federal accounts receivable, <sup>d</sup> if applicable, by comparing the taxpayer account to other master file modules and IRS' Debtor master file.	(b) Comparison of the taxpayer accounts to the master files and the Debtor master file identified no prior federal accounts receivable. Accordingly, IRS did not reduce the refund amount for any prior federal accounts receivable for the six sampled excise tax refund transactions.
(c) Recalculate each tax refund to verify mathematical accuracy.	(c) The tax refunds for the six sampled excise tax refund transactions were verified as being mathematically correct.
(d) Verify that IRS did not issue refunds after the Refund Statute Expiration Date.	(d) For the six excise tax refunds, IRS issued the refund in advance of the Refund Statute Expiration Date.
(2) Determine if the refund claim related to each refund sample item has been signed by the taxpayer.	(2) Each refund claim was signed by the taxpayer.
(3) Determine if a revenue agent or tax examiner approved the refund for each refund sample item that required approval.	(3) Each refund that required approval was approved by a tax examiner or other approving official.

<sup>d</sup>Amounts owed to IRS or other applicable federal agencies.

<u>Agreed-upon procedures</u>	<u>Description of findings</u>
<b>(E) Analytical tests</b>	
<p>(1) Perform a predictive test on Excise tax revenue collection and refund data for the final 3 months of the fiscal year to determine if reported fiscal year 1997 revenue collections and refunds appear consistent and reasonable. Project the expected fourth quarter Excise tax revenue collection and refund amounts for fiscal year 1997, based on fiscal year 1996 quarterly amounts, and compare projection to actual revenue collections and refunds. If a material variance exists, discuss with IRS to obtain an explanation/support.</p>	<p>(1) – The predicted fourth quarter Excise tax revenue collection amounts for fiscal year 1997 materially varied from the actual amount of revenue collections during this period. IRS was unable to provide an explanation for the variance.</p> <p>– The predicted fourth quarter Excise tax refund amounts for fiscal year 1997 did not materially vary from the actual amount of revenue collections and refunds during this period.</p>
<p>(2) Determine if IRS made any material adjustments to Excise tax revenue collections and refunds during the 3-month roll-forward period. If so, review support for adjustments.</p>	<p>(2) – IRS did not make any material adjustments to Excise tax collections during the 3-month roll-forward period.</p> <p>– A material Excise tax refund adjustment was made. The adjustment was adequately supported.</p>

<u>Agreed-upon procedures</u>	<u>Description of findings</u>
<b>(F) Other tests performed as part of the IRS financial statement audit</b>	
(1) Perform detailed sample transactional tests on non-Excise tax collection and refund populations for the first 9 months of fiscal year 1997 to determine if they contain any Excise tax transactions that were misclassified.	(1) Detailed testing of a total of 719 non-Excise tax collection and refund sample transactions did not reveal any instances of misclassified Excise tax transactions.
(2) Perform attribute test procedures on a sample of IRS-asserted non-revenue transactions for the first 9 months of fiscal year 1997 to ensure that these transactions were appropriately excluded from the revenue collection and refund sample populations.	(2) IRS-asserted non-revenue transactions were appropriately excluded from the revenue collection and refund sample populations.

<u>Agreed-upon procedures</u>	<u>Description of findings</u>
<p>(3) Review selected IRS service centers' monthly Treasury 224 reconciliations to determine if IRS-reported Excise tax revenue collections 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 reconcile to Treasury FMS records.<sup>e</sup></p>	<p>(3) – Excise tax revenue collections reported by IRS service centers via the monthly Treasury 224 reconciliation process were properly classified and materially agreed with Treasury FMS records.</p> <p>– Total refunds reported by IRS service centers via the monthly Treasury 224 reconciliation process materially agreed with Treasury FMS records.</p>
<p>(4) Perform a proof of cash for fiscal year 1997, to determine whether year-end Excise tax collection balances per the general ledger materially agree to IRS' master files and to Treasury records. For refunds, perform a comparison of total refund balances between the master file, the general ledger, and Treasury. Also, compare Excise tax refunds per the master file to the general ledger.</p>	<p>(4) – Fiscal year-end Excise tax collection balances per IRS' general ledger materially agreed with IRS' master files and with Treasury records.</p> <p>– Fiscal year-end total refund balances per IRS' general ledger materially agreed with the master file and with Treasury records.</p> <p>– Fiscal year-end Excise tax refund balances per IRS' general ledger materially agreed with the master file.</p>

<sup>e</sup>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 IRS with a Statement of Differences (TFS-6652) which reports differences between the total refunds reported by IRS on the SF-224 and the total refunds per Treasury records.

<u>Agreed-upon procedures</u>	<u>Description of findings</u>
<b>(G) Excise Tax Certifications - Receipts</b>	
(1) For the fiscal year 1997 excise tax certifications <sup>f</sup> for the Highway/Mass Transit Trust Fund, Airport and Airways Trust Fund, and the Black Lung Disability Trust Fund, perform the following steps:	
(a) Review the certification letters for authorizing signature.	(a) The certification letters had authorizing signatures.

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<sup>f</sup>During fiscal year 1997, IRS completed excise tax certifications for the quarters ending June, September, and December of 1996 and March of 1997.

<u>Agreed-upon procedures</u>	<u>Description of findings</u>
<p>(b) For the final quarter of fiscal year 1997, determine if the rates used to allocate assessments between the trust fund and the general fund are adequately supported. Determine if the amounts were allocated based on these rates.</p>	<p>(b) - The rates used to allocate assessments between the trust funds and the general fund agreed to support with the exception of the following. According to IRS, for the quarters ending December 1996 and March 1997, incorrect application rates were used to allocate gasohol taxes, resulting in an overstatement to the Highway Trust Fund, and a corresponding understatement to the general fund, of \$88,873. IRS has indicated it will correct this error in its March 1998 certification.</p>

<u>Agreed-upon procedures</u>	<u>Description of findings</u>
	<ul style="list-style-type: none"> <li>- IRS misapplied the application rates between the Highway Account and Mass Transit Account for diesel fuel inventory in the certifications for the quarters ending December 1996 and March 1997. This resulted in a net understatement of the Highway Account, and a corresponding net overstatement of the Mass Transit Account, of \$19,445. IRS has indicated it will correct this error in its March 1998 certification.</li> </ul>
	<ul style="list-style-type: none"> <li>- Tax assessment amounts of \$1,000 and \$7,000 listed on the Highway Trust Fund certification schedules for the quarters ending December 1996 and March 1997 were not certified by IRS because of an omission of the application rate formula on the certification schedules. IRS has indicated it will correct these errors in its March 1998 certification.</li> </ul>

<u>Agreed-upon procedures</u>	<u>Description of findings</u>
<p>(c) Trace the certified amounts for each abstract<sup>g</sup> from the certification schedule back to the Automated Quarterly Excise Tax Listing (AQETL)<sup>h</sup> Report. (The AQETL contains excise tax data extracted from the master file. This system is used by IRS to assist tax examiners in monitoring excise tax assessments reported on Form 720.)</p>	<p>(c) The amounts listed on the certification schedule agreed with the AQETL Report. However, more than \$550,000 of assessments for compressed natural gas were omitted from the Highway Trust Fund certification schedule for certifications for the quarters ending December 1996 and March 1997. The omission was subsequently corrected by IRS in the fiscal year 1998 certification made in December 1997.</p>
<p>(d) Verify the mathematical accuracy of the AQETL Summary Report for the fiscal year 1997 certifications.</p>	<p>(d) The AQETL Report was verified as being mathematically correct.</p>

<sup>g</sup>The abstract numbers identify the tax type (e.g., Diesel Fuel Tax) and are used as a basis to determine the distribution of the excise taxes to the various Trust Funds. Abstract numbers are pre-printed on the Form 720, used by taxpayers to report excise tax assessments.

<sup>h</sup>The AQETL Report refers to the Adjustment by Abstract Number Report which is generated by the Automated Quarterly Excise Tax Listing (AQETL) system.

<u>Agreed-upon procedures</u>	<u>Description of findings</u>
<p>(e) Heavy vehicle use taxes, which go to the Highway Trust Fund, are reported on the Form 2290 and are not included in the AQETL. Trace this amount from the certification to the master file.</p>	<p>(e) Heavy vehicle use tax per the certification schedule agreed to the master file for all but one of the quarters reviewed. In this case, source documentation reflected an assessment amount of \$195,416,084, but the amount certified was \$128,022,000. As a result, the Highway Trust Fund certified amount was understated by \$67,394,084 for fiscal year 1997. The error was subsequently identified by IRS and corrected in the fiscal year 1998 certification made in December of 1997.</p>
<p>(2) Perform the following steps in order to determine the reliability of the key data inputs used in the excise tax certification.</p>	

<u>Agreed-upon procedures</u>	<u>Description of findings</u>
<p>(a) Recalculate the excise tax assessments on the 230 tax returns associated with the sample of excise tax collections<sup>i</sup> based on the information provided on the returns (e.g., number of gallons of fuel multiplied by the tax rate equals the assessed tax).</p>	<p>(a) In 13 of the 230 taxpayer returns reviewed, assessment amounts recalculated based on information contained in the return differed from the tax assessment reported on the return or all the required information was not included on the return.</p>

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<sup>i</sup>The 390 sample collection transactions were payments made on assessments associated with 230 returns. We reviewed only 230 returns, because in some instances more than one receipt transaction related to the same return.

<u>Agreed-upon procedures</u>	<u>Description of findings</u>
<p>(b) Verify that the excise tax assessment amounts, by abstract number, on the tax return related to each item from the sample of excise tax collections and refunds are accurately recorded in the IRS master file and in the AQETL report. For one abstract, trace the amounts from the master file to the AQETL report which is used in the certification process.</p>	<p>(b) – All or a portion of the assessment amounts for 13 of the 230 taxpayer returns reviewed were recorded in the incorrect abstract number in the master file. In another case, a tax assessment amount was incorrectly recorded as a tax credit. These errors, which totalled about \$179 million, were not corrected in the excise tax certifications in fiscal year 1997. IRS has indicated it will correct these errors in its March 1998 certification.</p> <p>– For the abstract selected, the assessment amounts per the master file agreed to the AQETL report.</p>
<p>(c) Select several of the largest adjustments made to the fourth quarter excise tax certifications. Through inquiry, review of information in AQETL, and review of supporting documentation, determine if the adjustments were reasonable.</p>	<p>(c) Based on inquiry and review of supporting documentation, the adjustments were reasonable.</p>

<u>Agreed-upon procedures</u>	<u>Description of findings</u>
<p>(d) Each quarter, IRS reverses out the prior certification's adjustments in determining the amount to certify. Trace the "Reversals" amount on the current AQETL report to the "Adjustment" amount on the prior quarters AQETL report.</p>	<p>(d) The "reversal" amounts agreed to the "adjustment" amounts on the prior quarters' AQETL reports in all but one case. For an air transportation tax assessment on the AQETL report, IRS reversed out \$70,593,515 for the third quarter of calendar year 1996, while the prior quarter's adjustment amount was \$70,793,515. As a result, the Airport and Airways Trust Fund was understated by \$200,000. IRS has indicated it will correct this error in its March 1998 certification.</p>
<p><b>(H) Excise Tax Certifications - Refunds/Credits</b></p>	
<p>(1) For the fiscal year 1997 excise tax refund and credit certifications for the Highway/Mass Transit Trust Fund and Airport and Airways Trust Fund,<sup>j</sup> perform the following steps: (Note: refund and credit certifications are only applicable to the Highway/Mass Transit Trust Fund and Airport and Airways Trust Fund.)</p>	

<sup>j</sup>IRS completed refund and credit certifications during fiscal year 1997 for the quarters ending December 1996 and March, June, and September 1997.

<u>Agreed-upon procedures</u>	<u>Description of findings</u>
<p>(a) Review the certification letters for authorizing signatures.</p>	<p>(a) The certification letters had authorizing signatures.</p>
<p>(b) For the schedules attached to the certification letters, perform the following:</p> <ul style="list-style-type: none"> <li>- Verify the mathematical accuracy.</li> <li>- Trace the refund and credit amounts for each tax type back to summary refund/credit schedule(s). These refund/credit schedules summarize credit/refund data obtained from service center records.</li> </ul>	<p>(b) The schedules attached to the certification letters were verified as being mathematically correct and the refund/credit amounts agreed with supporting schedules.</p>
<p>(c) For the quarter ending September 30, 1997, perform the following on the summary refund/credit schedules:</p> <ul style="list-style-type: none"> <li>- Verify the mathematical accuracy.</li> <li>- Trace the Net Tax Refund Report (NTRR) amounts listed on the schedule back to the Net Tax Refund Report (The NTRR is generated from the Interim Revenue Accounting Control System (i.e, the general ledger) which lists manual refunds and credits not captured on the Treasury 90 report).</li> </ul>	<p>(c) The summary refund/credit schedule(s) attached to the certification letter for the quarter ending September 30, 1997, was mathematically accurate and refund/credit amounts agreed with the NTRR and Treasury 90 reports.</p>

<u>Agreed-upon procedures</u>	<u>Description of findings</u>
<ul style="list-style-type: none"> <li>- Trace the refund/credit amounts listed on the schedule back to the Treasury 90 report for all 10 service centers (The Treasury 90 reports list by abstract type refund and credit claims information processed by the service centers during the quarter).</li> </ul>	
<p>(2) Perform the following steps in order to determine the reliability of the key data inputs used in the excise tax refund certification.</p>	
<p>(a) Determine if credit reference numbers/abstract numbers and amounts for the claim related to each of the six Excise tax refund sample items are accurately recorded in IRS' master files. The credit reference numbers/abstract numbers identify the tax type (e.g, Diesel Fuel Tax) and are used as a basis to determine the charge back to the various Trust Funds.</p>	<p>(a) Each of the six Excise tax refund sample items were accurately recorded in IRS master files.</p>

<u>Agreed-upon procedures</u>	<u>Description of findings</u>
<p>(b) Review the individual and corporate tax returns related to our collection and refund sample transactions to identify any returns that included Excise tax refunds/credits. Determine if these refund/credit items were included in the Treasury 90 report used by the National Office in its certification of fiscal year 1997 Excise tax refunds and credits.</p>	<p>(b) One Excise tax refund item was identified from our collection and refund sample transactions. This item was included in the Treasury 90 report.</p>

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