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United States Government Accountability Office  
Washington, DC 20548

November 3, 2006

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, 2006, is supported by the underlying records. As agreed with your office, we evaluated fiscal year 2006 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 from performing each of the procedures.

We were not engaged to perform, and did not perform, an audit, the objective of which would have been the expression of an opinion on the net amount of FUTA taxes distributed to the UTF. Accordingly, we do not express such an opinion. Had we performed additional procedures, other matters might have come to our attention that would have been reported to you. We completed the agreed-upon procedures on October 26, 2006.

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 written in a cursive style with a large, stylized initial "S".

Steven J. Sebastian  
Director  
Financial Management and Assurance

Enclosure

## Federal Unemployment Tax 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 2006 posted to the master file.<sup>1</sup> Compare FUTA collections and refund data per the master file to determine if they agree in all material respects<sup>2</sup> to IRS's general ledger.

#### Description of findings and results

Total FUTA collections and refunds for the first 8 months of fiscal year 2006 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 2006, using a confidence level of 80 percent, a test materiality of \$465 million, and an expected aggregate error amount of \$140 million.

#### Description of findings and results

Use of DUS with a confidence level of 80 percent, a test materiality of \$465 million, and an expected aggregate error amount of \$140 million resulted in a sample of 38 transactions for the first 8 months of fiscal year 2006. All of the 38 transactions represented FUTA collections.<sup>3</sup>

- 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.

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<sup>1</sup>The master file is a detailed database containing taxpayer information.

<sup>2</sup>For this procedure, "material" is defined as \$465 million. This represents 1 percent of net Unemployment Trust Fund collections for fiscal year 2005.

<sup>3</sup>Consequently, procedures agreed to regarding refund transactions are not applicable.

## Enclosure I

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

### 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 class<sup>4</sup> for all 38 sampled FUTA collection transactions.

4. Confirm FUTA transactions paid via the Electronic Federal Tax Payment System (EFTPS)<sup>5</sup> 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 confirmation showed that all 32 transactions were valid and had been recorded to the proper tax period and tax class and for the proper amounts.

## **II. Analytical procedures**

- A. Perform a predictive test on FUTA revenue collections and refunds for the final 4 months of fiscal year 2006 and determine whether the predicted FUTA collection and refund amounts vary materially<sup>6</sup> from the actual FUTA revenue collection and refund amounts per IRS's records for this period.

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

<sup>5</sup>EFTPS 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.

<sup>6</sup>For this procedure, "material" is defined as \$465 million.

Description of findings and results

The predicted FUTA revenue collection and refund data amounts for the final 4 months of fiscal year 2006 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 2006, 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 2006.

- B. For each of the 12 months in fiscal year 2006, 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 2006.

- C. Compare fiscal year 2006 net FUTA collections per IRS's draft statement of custodial activity and related footnote disclosures to (1) the Department of the Treasury's Bureau of the Public Debt (BPD) accounting records for the UTF and (2) drafts of the Department of Labor's (DOL) consolidated financial statements to determine whether any significant<sup>7</sup> variances exist.

Description of findings and results

There were no significant variances between net FUTA collections per IRS's draft statement of custodial activity and BPD's accounting records for UTF. Similarly, there were no significant variances between IRS's draft statement of custodial activity and related footnote disclosures and drafts of DOL's fiscal year 2006 consolidated financial statements.

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<sup>7</sup>For this procedure, "significant" is defined as \$465 million.

**IV. Other procedures performed as part of the fiscal year 2006 IRS financial statement audit**

- A. From IRS's master files for the first 8 months of fiscal year 2006, 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 documents for 156 revenue receipts and 53 refund sample transactions were consistent with amounts recorded in IRS's master files.

- B. Obtain selected IRS service center campuses' monthly Department of the Treasury FMS 224 reconciliations<sup>8</sup> and determine whether IRS-reported revenue receipts and refunds were materially reconciled<sup>9</sup> to Department of the Treasury (Treasury) FMS records.

Description of findings and results

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

- C. Compare tax revenue receipt balances by tax class, including FUTA, and total refund balances recorded in IRS's general ledger with the master files 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, and total refund balances per IRS's general ledger materially agreed with IRS's master files and Treasury records.

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

<sup>9</sup>For the purpose of this procedure and procedure IV.C, we define "material" as \$23 billion. This represents 1 percent of the estimated gross tax revenue receipts to be collected by IRS in fiscal year 2006.

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