



United States  
General Accounting Office  
Washington, D.C. 20548

Accounting and Information  
Management Division

159975

B-278609

February 26, 1998

The Honorable Charles C. Masten  
Inspector General  
Department of Labor

Subject: Agreed-Upon Procedures: Federal Unemployment Taxes

Dear Mr. Masten:

We have performed the procedures contained in enclosure II to this letter, which we agreed to perform solely to assist your office in ascertaining whether the net federal unemployment tax (FUTA) collected by the Internal Revenue Service (IRS) for the fiscal year ended September 30, 1997, are supported by the underlying records. As agreed upon with your office, we evaluated fiscal year 1997 FUTA 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 (1) detailed tests of a sample of FUTA collection and refund transactions to check the validity of the transactions and their accurate accounting and reporting and (2) 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 FUTA 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.

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

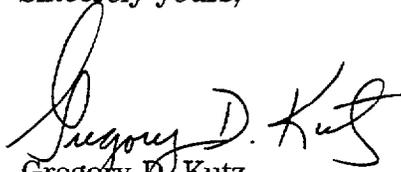
GAO/AIMD-98-79R FUTA Procedures

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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 Office of Inspector General of the Department of Labor. Copies are available to others upon request. If you have any questions, please call me at (202) 512-9505.

Sincerely yours,

A handwritten signature in black ink, appearing to read "Gregory D. Kutz". The signature is written in a cursive style with a large initial "G".

Gregory D. Kutz

Associate Director, Governmentwide Accounting  
and Financial Management Issues

Enclosures

FEDERAL UNEMPLOYMENT TAX ("FUTA")  
SCHEDULE OF COLLECTIONS, REFUNDS, AND NET COLLECTIONS  
FOR THE FISCAL YEAR ENDED SEPTEMBER 30, 1997  
(Unaudited)

Collections	\$ 6,176,366,479
Refunds	<u>\$ 110,051,017</u>
Net collections	<u>\$ 6,066,315,462</u>

<u>Agreed-upon procedures</u>	<u>Description of findings</u>
<b>(A) General</b>	
(1) Trace gross FUTA 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 FUTA 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 FUTA collections and refunds to determine if they are adequately supported.	(2) There were no material post-closing adjustments to FUTA collections and refunds.
<b>(B) Sampling</b>	
(1) Obtain data from IRS reflecting the first 9 months of fiscal year 1997 FUTA collections and refunds posted to the master file. Determine if FUTA collections and refund data per the master file materially reconcile to the general ledger.	(1) FUTA 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 Labor's Office of Inspector General, test materiality for the agreed-upon procedures associated with FUTA transactions was \$230 million.

<u>Agreed-upon procedures</u>	<u>Description of findings</u>
(2) Use Dollar Unit Sampling to extract a sample of combined FUTA 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 \$230 million, and an expected error amount of \$115 million.	(2) Use of Dollar Unit Sampling with a confidence level of 80 percent, a test materiality of \$230 million, and an expected error amount of \$115 million resulted in a sample of 119 FUTA transactions for the first 9 months of fiscal year 1997. Of this total, 117 transactions represented collections and 2 transactions represented refunds.
<b>(C) Collections testing</b>	
(1) Vouch sampled FUTA tax collection transactions to source documents as follows:	
<ul style="list-style-type: none"> <li>- 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).</li> <li>- Determine if amounts were posted to the appropriate period by reviewing the date on source documents.</li> <li>- Determine whether the transactions were recorded in the correct tax class by reviewing source documentation maintained in IRS' files (e.g., tax returns).</li> </ul>	Based on supporting documentation, collection amounts were accurately recorded, posted to the appropriate period, and recorded in the correct tax class for 116 of the 117 sampled FUTA collection transactions. The remaining sample item, with a collection amount of \$6,377,595, was inappropriately classified as a FUTA receipt, resulting in a projected most likely error of about \$50 million and an upper error limit of about \$148 million at the 80 percent confidence level for the first 9 months of fiscal year 1997. The error was subsequently corrected in fiscal year 1998.

<u>Agreed-upon procedures</u>	<u>Description of findings</u>
<b>(D) Refunds testing</b>	
(1) Vouch sampled FUTA 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 both of the sampled FUTA transactions.</p>

<u>Agreed-upon procedures</u>	<u>Description of findings</u>
<p>(b) Determine if IRS reduced the refund amount by any prior federal accounts receivable,<sup>b</sup> if applicable, by comparing the taxpayer account to other master file modules and IRS' Debtor master file.</p>	<p>(b) Comparison of the taxpayer accounts to the master file and the Debtor master file identified no prior federal accounts receivable. Accordingly, IRS did not reduce the refund amount for any prior federal account receivable for both sampled FUTA refund transactions.</p>
<p>(c) Recalculate each tax return to verify mathematical accuracy.</p>	<p>(c) The tax returns for both sampled FUTA refund transactions were verified as being mathematically correct.</p>
<p>(d) For FUTA tax returns, determine whether the taxpayer provided a written explanation for exempt wage payments, and whether the explanation meets IRS' criteria for FUTA exempt wage payments.</p>	<p>(d) For both sampled FUTA refund transactions, the taxpayer did not claim any exempt wage payments that would have required an explanation.</p>
<p>(e) Verify that IRS did not issue refunds after the Refund Statute Expiration Date.</p>	<p>(e) For both sampled FUTA refunds, IRS issued the refund in advance of the Refund Statute Expiration Date.</p>

<sup>b</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 FUTA 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 FUTA 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 FUTA revenue collection and 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 FUTA 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 FUTA collections and refunds during the 3 month roll-forward period.</p>
<b>(F) Other FUTA tests</b>	
<p>(1) For each of the 12 months in fiscal year 1997, obtain and review supporting documentation for monthly revenue reclassification adjustments transmitted by IRS to Treasury's FMS. Determine whether the supporting documentation agrees with the reclassification adjustment transmitted to FMS.</p>	<p>(1) Documentation supported the monthly FUTA reclassification adjustment amount transmitted to Treasury's FMS for all 12 months of fiscal year 1997.</p>

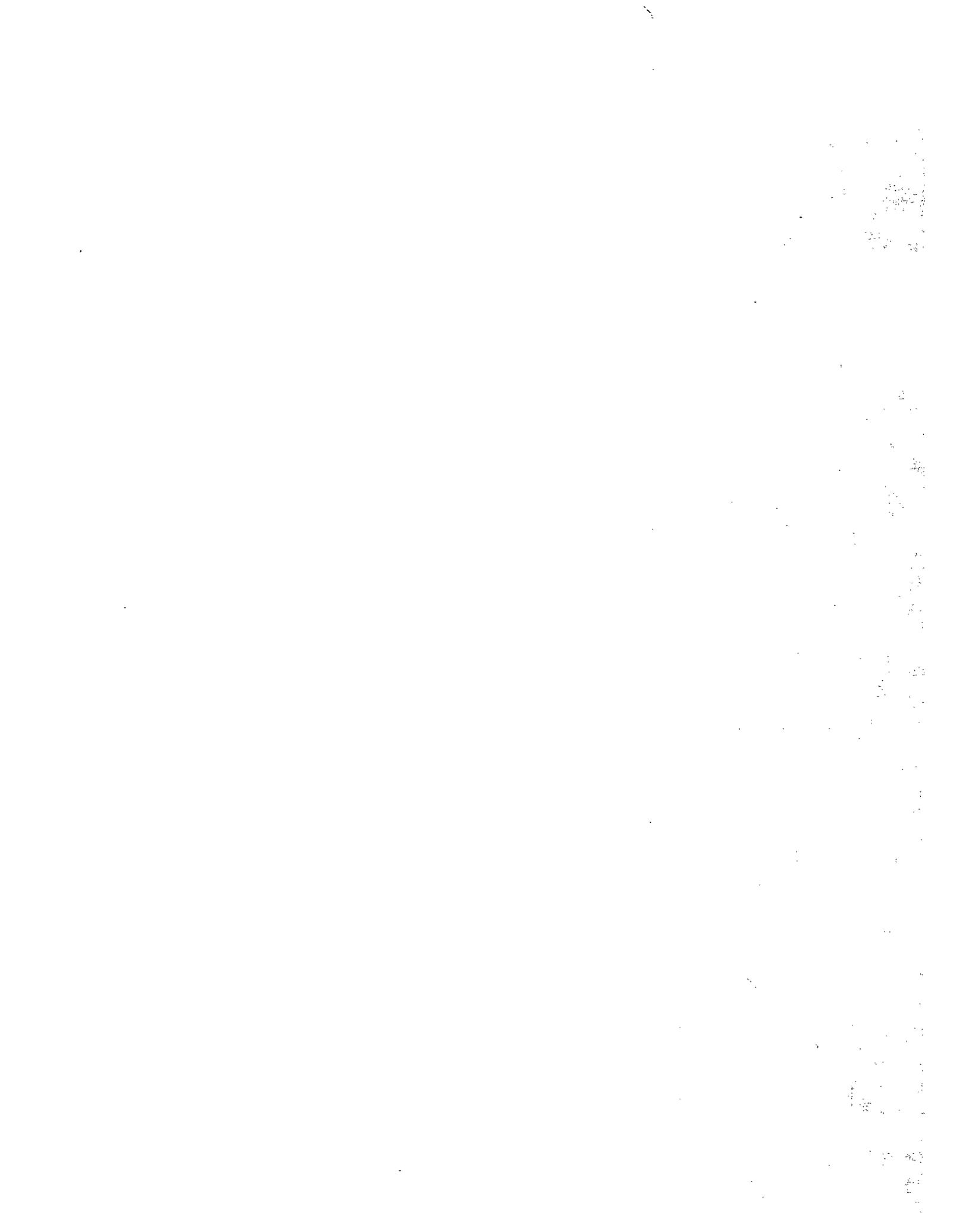
<u>Agreed-upon procedures</u>	<u>Description of findings</u>
<p>(2) For each of the 12 months in fiscal year 1997, obtain and review supporting documentation for monthly entry of FUTA refund data onto the Government Online Accounting Link System (GOALS) to charge back the Unemployment Trust Fund account for FUTA tax refunds issued.</p> <p>Determine whether 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 1997.</p>
<p>(3) Compare total fiscal year 1997 FUTA net collections per IRS' audited custodial financial statements with FUTA net collections reported in the federal Unemployment Trust Fund administered by the Department of Labor. If a material variance exists, discuss with Treasury to obtain explanation/support for the difference.</p>	<p>(3) The net fiscal year 1997 FUTA collection amount reported in IRS' audited custodial financial statements materially agreed with the net collection amount reported in the Unemployment Trust Fund by the Department of Labor.</p>
<p><b>(G) Other tests performed as part of the IRS financial statement audit</b></p>	
<p>(1) Perform detailed sample transactional tests on non-FUTA collection and refund populations for the first 9 months of fiscal year 1997 to determine if they contain any FUTA transactions that were misclassified.</p>	<p>(1) Detailed testing of a total of 996 non-FUTA collection and refund sample transactions did not reveal any instances of misclassified FUTA transactions.</p>

<u>Agreed-upon procedures</u>	<u>Description of findings</u>
(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 sample population.
(3) Review selected IRS service centers' monthly Treasury 224 reconciliations to determine if IRS-reported FUTA 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 reconciled to Treasury FMS records. <sup>c</sup>	(3) <ul style="list-style-type: none"> <li data-bbox="824 721 1435 982">– FUTA revenue collections reported by IRS service centers via the monthly Treasury 224 reconciliation process were properly classified and materially agreed with Treasury FMS records.</li> <li data-bbox="824 1017 1435 1197">– Total refunds reported by IRS service centers via the monthly Treasury 224 reconciliation process materially agreed with Treasury FMS records.</li> </ul>

<sup>c</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 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>
<p>(4) Perform a proof of cash for fiscal year 1997, to determine whether year-end FUTA 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 records. Also, compare FUTA refunds per the master file to the general ledger.</p>	<p>(4) – Fiscal year-end FUTA collection balances per IRS' general ledger materially agreed to IRS' master files and to Treasury records.</p> <p>– Fiscal year-end total refund balances per IRS' general ledger materially agreed to the master file and to Treasury records.</p> <p>– Fiscal year-end FUTA refund balances per IRS' general ledger materially agreed to the master file.</p>

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