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United States General Accounting Office  
Washington, DC 20548

November 20, 2003

The Honorable Kenneth M. Mead  
Inspector General  
Department of Transportation

Subject: *Applying Agreed-Upon Procedures: Highway Trust Fund Excise Taxes*

Dear Mr. Mead:

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 excise tax revenue distributed to the Highway Trust Fund (HTF) for the fiscal year ended September 30, 2003, is supported by the underlying records. As agreed with your office, we evaluated fiscal year 2003 activity affecting distributions to the HTF.

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 include (1) detailed tests of transactions that represent the underlying basis of amounts distributed to the HTF, (2) review of the Internal Revenue Service's (IRS) quarterly HTF certifications, (3) review of the Department of the Treasury Financial Management Service (FMS) adjustments to the HTF for fiscal year 2003, (4) review of IRS's precertification<sup>1</sup> of receipts for the third quarter of fiscal year 2003, (5) review of certain procedures of the Department of the Treasury Office of Tax Analysis' (OTA) process for estimating amounts to be distributed to the HTF for the fourth quarter of fiscal year 2003, and other procedures including (6) comparison of net excise tax distributions to the HTF during fiscal year 2003 and amounts reported in the draft financial statements prepared by the Bureau of the Public Debt (BPD) for

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<sup>1</sup>To accommodate the Department of Transportation's accelerated reporting date for fiscal year 2003, IRS performed a precertification of excise tax collections for the quarter ended June 30, 2003. The data are for information purposes only and the precertification does not constitute an official certification.

the HTF and the HTF's draft financial statements, (7) detailed tests of transactions that represent total IRS tax revenue receipts and refunds, and (8) review of key reconciliations of IRS records to 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 amount of net excise taxes distributed to the HTF. 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.<sup>2</sup> We completed the agreed-upon procedures on November 7, 2003.

We provided a draft of this report to IRS and OTA officials for review and comment. They agreed with the results and findings presented in this report. In response to our findings concerning errors in its estimates, OTA stated that it has instituted additional internal control procedures to promptly detect and correct any future errors.

This report is intended solely for the use of the Office of Inspector General of the Department of Transportation 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 purpose. 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 Internet Web site at <http://www.gao.gov>. If you have any questions, please call me at (202) 512-3406.

Sincerely yours,



Steven J. Sebastian  
Director  
Financial Management and Assurance

Enclosure

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<sup>2</sup>In our report on the results of our audit of IRS's fiscal year 2003 financial statements, we noted a material weakness in IRS's financial reporting process (U.S. General Accounting Office, *Financial Audit: IRS's Fiscal Years 2003 and 2002 Financial Statements*, GAO-04-126, November 13, 2003). A component of this process includes IRS's ability to allocate excise tax collections to the appropriate trust funds at the time deposits are made. This condition affects the adequacy of the distributions of federal excise tax revenue to recipient trust funds and is a continuation of an issue that we have reported on in prior years.

## Highway Trust Fund Excise Tax Procedures and Results

### **I. Detailed tests of transactions that represent the underlying basis of amounts distributed to the HTF in fiscal year 2003**

#### A. Nonrepresentative selection of tax returns from the quarter ended September 30, 2002<sup>3</sup>

1. For the quarter ending September 30, 2002, select the 30 largest excise tax returns containing excise taxes related primarily to the HTF and the Airport and Airway Trust Fund (AATF), on the basis of total tax liability<sup>4</sup> amount, from IRS's master file.<sup>5</sup>

#### Description of findings and results

We selected the 30 largest excise tax returns related primarily to the HTF and the AATF from the quarter ended September 30, 2002, for testing. The selection was based on the total tax liability amount and type of taxes owed, for each return, from IRS's master file.

The total tax liability amount related to these 30 returns was approximately \$8.6 billion, or 66 percent of the total excise tax liability amount—\$13 billion—for all excise tax types for the quarter ended September 30, 2002.

Of these 30 returns, 22 contained primarily HTF-related taxes and 8 contained primarily AATF taxes.

2. For each of the 22 returns related primarily to the HTF we performed the following procedures, which resulted in our testing approximately \$6.4

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<sup>3</sup>Since certifications are not completed until 6 months after the end of the quarter, the certification and corresponding FMS adjustment for the quarter ended September 30, 2002, were completed in March 2003, and thus affected fiscal year 2003 distributions to the HTF.

<sup>4</sup>Although the certifications are based on amounts collected, we used the tax liability amounts to identify the taxpayers paying the largest amounts of excise taxes. Our review shows that these taxpayers generally pay their excise taxes in full each quarter.

<sup>5</sup>The master file is a detailed database containing taxpayer information.

billion in prorated collections<sup>6</sup> affecting fiscal year 2003 distributions to the HTF:

- (a) Trace the liability amount for abstracts<sup>7</sup> 59, 60, and 62 from the tax return to IRS's master file.

Description of findings and results

The liability amount for abstracts 59, 60, and 62 on the tax return agreed with IRS's master file for 22 of the 22 returns.

- (b) Check the mathematical accuracy of the taxpayer's calculations on the tax return for the selected abstracts.

Description of findings and results

The taxpayer's calculations on all 22 returns were mathematically correct.

- (c) Recompute the prorated collection amount for the selected abstracts based on information from the master file and compare this amount to the amount from the Collection Certification System audit file.<sup>8</sup>

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<sup>6</sup>IRS certifies to trust funds the amount of excise taxes collected. Because there are occasions in which taxpayers have not fully paid their tax liability, IRS must allocate the amount of payments actually received among the different excise taxes reported on the taxpayer's return. IRS's Collection Certification System prorates a taxpayer's payments proportionately among all taxes reported as owed on the tax return. For example, if a corporation reports that it owes \$4 million for gasoline tax, \$2 million for diesel fuel tax, and \$1 million for gasohol tax on its Form 720 Quarterly Federal Excise Tax Return, but has paid IRS only \$3.5 million at the time IRS performs its certification, the program prorates the \$3.5 million in the following manner: \$2 million to gasoline tax, \$1 million to diesel fuel tax, and \$500,000 to gasohol tax.

<sup>7</sup>The abstract numbers identify the tax type (e.g., gasoline and ticket tax) and are used as the basis for determining the distribution of the excise taxes to the various trust funds. Abstract numbers are preprinted on the Form 720 Quarterly Federal Excise Tax Return and are used by the taxpayer to report excise tax assessments. If the return was related to the HTF, we selected (1) tax on 10 percent gasohol (abstract 59), (2) diesel fuel tax (abstract 60), and (3) gasoline tax (abstract 62). If the return was related to the AATF, we selected (1) tax on transportation of persons by air (abstract 26), (2) tax on use of international air facilities (abstract 27), and (3) tax on transportation of property by air (abstract 28). The tax amounts related to the selected abstracts for each trust fund are the largest tax amounts reported on the taxpayer's excise tax return and make up over 86 percent of the total amount certified to the HTF and over 89 percent of the total amount certified to the AATF each quarter.

<sup>8</sup>The Collection Certification System produces what IRS refers to as "audit files." These audit files contain the individual prorated collections, by abstract and taxpayer identification number, that make up the certified total amounts for each abstract.

Description of findings and results

The recomputed prorated collection amounts for the three selected abstracts agreed with amounts in IRS's Collection Certification System audit file for all 22 of the returns.

B. Dollar unit sample (DUS) of transactions from the quarters ended December 31, 2002, and March 31, 2003

1. Sampling

- (a) Obtain excise tax assessments and collection data from IRS's master file for the first 6 months of fiscal year 2003. Determine if excise tax collections per the master file agree with IRS's general ledger. Reconcile total excise tax collections from the master file to total excise tax collections from the Collection Certification System audit files to determine if they materially<sup>9</sup> agree.

Description of findings and results

Excise tax collections for the first 6 months of fiscal year 2003 per the master file materially agreed with IRS's general ledger and with total excise tax collections from the Collection Certification System.

- (b) Select a random attribute sample of 78 excise tax assessments from IRS's master file.<sup>10</sup> Compare assessment and receipt information for each sample item from the master file to the assessment and receipt information in the Collection Certification System to determine if assessments and receipts from the master file are contained in the Collection Certification System.

Description of findings and results

For each sample item, assessments and receipts from the master file were contained in the Collection Certification System.

- (c) To determine if the Collection Certification System properly summarized the prorated collections, total the prorated collections for

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<sup>9</sup>For the purpose of this reconciliation, material is defined as 1 percent of the total Form 720-related excise tax collections, related to the quarters ended December 31, 2002, and March 31, 2003. For fiscal year 2003, the materiality amount was \$203 million for the two quarters combined.

<sup>10</sup>For this sample, if one or no errors were found in testing the 78 items, we would be 90 percent confident that the error rate in the population would not exceed 5 percent.

selected abstracts<sup>11</sup> from the audit files and compare these amounts to amounts in the *Reports of Excise Tax Collection*.<sup>12</sup>

Description of findings and results

The Collection Certification System properly summarized the prorated collections for all of the selected abstracts related to the HTF and the AATF. Prorated collections for the above-mentioned trust funds from the audit files agreed with the corresponding amounts in the *Reports of Excise Tax Collection*.

- (d) Separate the total population of prorated collections from the audit files into the following distinct populations: (1) HTF, (2) AATF, and (3) other excise tax abstracts. Use DUS to select a sample of prorated excise tax collections from the HTF population.

Description of findings and results

Use of DUS with a confidence level of 80 percent, a test materiality of \$322 million, and an expected aggregate error amount of \$96.6 million resulted in a sample of 96<sup>13</sup> prorated collections for HTF for the first 6 months of fiscal year 2003.

- (e) Select samples of prorated excise tax collections from the two non-HTF populations.

Description of findings and results

Use of DUS with a confidence level of 80 percent, a test materiality of \$89 million, and an expected aggregate error amount of \$26.7 million

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<sup>11</sup>The selected abstracts include the following: (1) tax on 10 percent gasohol (abstract 59), (2) diesel fuel tax (abstract 60), (3) gasoline tax (abstract 62), (4) tax on transportation of persons by air (abstract 26), (5) tax on use of international air facilities (abstract 27), (6) tax on transportation of property by air (abstract 28), and (7) tax on aviation fuel for commercial use (abstract 77). The tax amounts for the three HTF-related abstracts make up over 86 percent of the total amount certified to the HTF and the tax amounts for the four AATF-related abstracts make up over 95 percent of the total amounts certified to the AATF each quarter.

<sup>12</sup>The *Report of Excise Tax Collection* contains prorated collections, classified by abstracts that serve as the basis for IRS's quarterly trust fund certifications.

<sup>13</sup>The planned sample size using DUS was 143 items. DUS selects dollars versus specific transaction items by dividing the population by dollar intervals. The dollar interval for the HTF was \$118 million. Accordingly, any item with a dollar value matching or exceeding the sampling interval would be selected, whereas items less than the sampling interval might not be selected. For example, an item of \$236 million would cover two dollar-intervals, but represent one sample item. Due to large dollar items covering more than one interval, the 96 unique sampled transactions selected represent 143 dollar-intervals.

resulted in a sample of 67<sup>14</sup> prorated collections for the first 6 months of fiscal year 2003 for the AATF.

A random attribute sample of 45 items from the population of prorated tax collections, related to all excise taxes other than the HTF and the AATF, was selected for testing.<sup>15</sup>

2. Detailed tests of transactions

(a) For each prorated excise tax collection sampled from the HTF population:

- Check to see that the assessment amount on the tax return, for the sampled abstract, agrees with the amount recorded in IRS's master file.

Description of findings and results

The assessment amounts on the tax returns agreed with the amounts recorded in IRS's master file for all of the sampled abstracts.

- Check the mathematical accuracy of the taxpayers' calculations on the tax returns for the related abstract.

Description of findings and results

The taxpayers' calculations on the tax returns for the related abstracts were mathematically correct for all of the sampled abstracts.

- Recompute the prorated collection amount based on information from the master file and compare this amount to the sample items selected from the Collection Certification System audit file.<sup>16</sup>

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<sup>14</sup>The planned sample size using DUS was 132 items. As explained in footnote 13, DUS selects dollars versus specific transaction items by dividing the population by dollar intervals. The dollar interval for the AATF was \$33 million. Due to large dollar items covering more than one interval, the 67 unique sampled transactions selected represent 132 dollar-intervals.

<sup>15</sup>For this sample, if no errors are found in testing the 45 items, we would be 90 percent confident that the error rate in the population would not exceed 5 percent.

<sup>16</sup>The purpose of this test is to determine whether the Collection Certification System prorates correctly. This test is not intended to determine whether amounts provided to the system are correct.

Description of findings and results

The recomputed prorated collection, based on information from the master file, agreed with the amounts for all of the sampled items.

- (b) Perform detailed testing on the two samples of prorated collections from the non-HTF populations to determine if they contain any HTF excise tax collections.

Description of findings and results

The two samples of prorated collections from the non-HTF populations did not contain any HTF excise tax collections.

- (c) Evaluate the results of conducting steps (a) and (b).

Description of findings and results

As noted in the results from steps (a) and (b), we found no errors.

**II. Review of IRS's quarterly HTF certifications**

A. Receipt certifications

Perform the following steps on IRS's HTF receipt certifications for the quarters ended September 30, 2002, December 31, 2002, and March 31, 2003:

1. Inspect the certification letters<sup>17</sup> for authorizing signatures.

Description of findings and results

The HTF certification letters for all three quarters had authorizing signatures.

2. Determine if evidence exists that the supervisor or another analyst checked the certification letters and supporting worksheets.

Description of findings and results

There was evidence that another analyst and a supervisor checked the certification letters and supporting worksheets for all three quarters.

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<sup>17</sup>IRS prepares two certification letters for HTF each quarter: one for the Highway Account and the other for the Mass Transit Account.

3. Recalculate the totals on the certification letters to determine if they are mathematically correct.

Description of findings and results

The totals on the certification letters for all three quarters were mathematically correct.

4. Trace the certified amounts for diesel fuel tax (abstract 60), gasoline tax (abstract 62), and tax on 10 percent gasohol (abstract 59)<sup>18</sup> from the certification letters back to the *Reports of Excise Tax Collection*<sup>19</sup> and *Treasury 90 Report*.<sup>20</sup>

Description of findings and results

The certified amounts for diesel fuel tax (abstract 60), gasoline tax (abstract 62), and tax on 10 percent gasohol (abstract 59) per the certification letters agreed with the related *Reports of Excise Tax Collection* for all three quarters.

However, on IRS's receipt certification for the quarter ended December 31, 2002, the IRS analyst used excise tax credit information from the *Treasury 90 Report* for the quarter ended September 30, 2002, rather than the *Treasury 90 Report* for the quarter ended December 31, 2002. As a result, IRS understated certified receipts to the Highway Account by approximately \$12.4 million and understated certified receipts to the Mass Transit Account by approximately \$1.7 million. IRS discovered the error after it had sent the certification letter to the FMS, and FMS had already recorded the true-up adjustment for using the certification letters. IRS corrected this error on the receipt certification for the following quarter ended March 31, 2003. Therefore, this error had no net effect on fiscal year 2003 distributions to the HTF.

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<sup>18</sup>The certified amounts for diesel fuel tax (abstract 60), gasoline tax (abstract 62), and tax on 10 percent gasohol (abstract 59), along with the heavy vehicle use tax (traced separately), make up over 89 percent of the total amount certified to the HTF each quarter.

<sup>19</sup>IRS uses data from two of these reports, covering sequential processing intervals, for each quarterly certification. Collections are classified by abstract on the report when the related Form 720 tax return has been recorded in IRS's master file during the processing interval covered by the report. The second of the two reports used may contain collections related to previous quarters not classified by abstract until the current quarter because the related return was not recorded on the master file until the current quarter.

<sup>20</sup>During fiscal year 2002, IRS changed its process of recording and summarizing excise tax credits related to taxpayers' Form 720 tax returns. As a result, IRS now obtains this excise tax credit information from the applicable *Treasury 90 Report*. The *Treasury 90 Report* summarizes excise tax credit information and is produced quarterly by IRS submission processing campus systems. IRS has 10 submission processing campuses that receive and process tax returns and payments.

5. Review the distribution rates used by IRS to determine whether the distribution rates for diesel fuel tax (abstract 60), gasoline tax (abstract 62), and tax on 10 percent gasohol (abstract 59) agree with the applicable laws.<sup>21</sup>

Description of findings and results

The distribution rates used by IRS for diesel fuel tax (abstract 60), gasoline tax (abstract 62), and tax on 10 percent gasohol (abstract 59) agreed with the applicable laws in effect during all three quarters.

6. Review the *Reports of Excise Tax Collection* used in the certification to determine if they contain significant<sup>22</sup> collections from prior quarters.

Description of findings and results

The *Reports of Excise Tax Collection* supporting IRS's certification to HTF for the quarter ended September 30, 2002, contained approximately \$261 million in net HTF excise tax collections related to prior quarters. This consisted of approximately \$262 million from the quarter ended June 30, 2002 and (\$1 million)<sup>23</sup> from prior quarters. IRS attributed the delay in classifying the June quarter amounts to two taxpayers who did not file timely and five tax returns with processing delays due to taxpayer or IRS errors.

The *Reports of Excise Tax Collection* supporting IRS's certification to HTF for the quarter ended December 31, 2002, contained approximately \$330 million in net HTF excise tax collections related to prior quarters. Of this amount, approximately \$253 million was from the quarter ended September 30, 2002. IRS attributed this delay to three taxpayers who did not file timely and two tax returns with processing delays due to taxpayer or IRS errors.

The *Reports of Excise Tax Collections* supporting IRS's certification to the HTF for the quarter ended March 31, 2003, did not contain significant prior quarter collections.

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<sup>21</sup>IRS calculates certified collections to the Highway Account and the Mass Transit Account using the total prorated collection amount, tax rate, and distribution rates applicable to each account.

<sup>22</sup>For this test, "significant" is defined as \$170 million. This represents approximately 2 percent of the quarterly total certified to the HTF.

<sup>23</sup>Negative amounts occur due to taxpayer amendments or IRS corrections.

7. Heavy vehicle use taxes, which go to the HTF, are reported on Form 2290 and are not included in the Collection Certification System. Trace the heavy vehicle use tax amounts from the Highway Account certification letters to the master file.

Description of findings and results

Heavy vehicle use tax per the Highway Account certification letters agreed with the master file for all three quarters.

B. Refund/credit reclassification<sup>24</sup>

Perform the following steps on IRS's HTF refund/credit certifications for the quarters ended December 31, 2002, March 31, 2003, June 30, 2003, and September 30, 2003:<sup>25</sup>

1. Inspect the certification letters for authorizing signatures.

Description of findings and results

The certification letters for all four quarters had authorizing signatures.

2. Determine if evidence exists that a supervisor or another analyst checked the certification letters and accompanying schedules.<sup>26</sup>

Description of findings and results

There was evidence that another analyst and a supervisor checked the certification letters and accompanying schedules for all four quarters.

3. Recalculate the totals on the certification letters and accompanying schedules to determine if they are mathematically correct.

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<sup>24</sup>IRS performs a quarterly reclassification of excise tax refunds and credits originally entered into its master file as a personal or corporate refund/credit. IRS refers to these reclassifications as "refund/credit certifications." These amounts do not represent the total excise tax refund/credit activity to the trust funds. Other routine excise tax refunds and credits (e.g., overpayments), which are claimed on taxpayers' Form 720 excise tax returns, are included in IRS's excise tax receipt certification to trust funds.

<sup>25</sup>In order to meet certain reporting deadlines, IRS certified refunds and credits for the fourth quarter of fiscal year 2003 as of September 5, 2003.

<sup>26</sup>IRS attaches a separate schedule to the HTF refund/credit certification letter that includes the detailed excise tax amounts that support the total amount shown on the letter. IRS compiles the amounts on these schedules from submission processing campus systems and its Interim Revenue Accounting Control System. IRS has 10 submission processing campuses that process tax returns and taxpayer receipts.

Description of findings and results

The totals on the certification letters and accompanying schedules were mathematically correct for all four quarters.

4. Trace the refund and credit amounts for gasoline tax and diesel tax<sup>27</sup> from the schedules accompanying the certification letters to other summary refund/credit schedules. These other refund/credit summary schedules summarize refund and credit data obtained from submission processing campuses' records.

Description of findings and results

The refund and credit amounts for gasoline tax and diesel tax on the schedules accompanying the certification letters agreed with the amounts on the summary schedules for all four quarters.

**III. Review of FMS adjustments**

Perform the following steps on FMS adjustments to the HTF excise tax distributions for the quarters ended September 30, 2002, December 31, 2002, and March 31, 2003.

- A. Compare the FMS adjustments made to the HTF for fiscal year 2003 with original OTA estimates and IRS-certified amounts to see if they agree with the supporting schedules.<sup>28</sup>

Description of findings and results

For the FMS adjustments made to the HTF accounts (Highway and Mass Transit), the original OTA estimates and IRS-certified amounts agreed with the supporting schedules for all three quarters.

- B. Recompute the difference between the OTA estimates and final IRS-certified amounts to see if the amounts agree with the differences computed by FMS.

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<sup>27</sup>The certified refund/credit amounts for gasoline and diesel make up at least 91 percent of the total certified refund/credit amount for the HTF.

<sup>28</sup>An FMS accountant compiles this schedule, called "Subsidiary Quarterly Account of Estimates and Actual Related Taxes Appropriated to the Highway Account." The schedule computes the difference between IRS-certified amounts and the OTA estimate for excise taxes, individually and in total, that relate to the Highway Account. A similar schedule is prepared for the Mass Transit Account. The schedules, along with OTA transfer forms and IRS certifications, support the FMS adjustment.

Description of findings and results

The independently recalculated differences between the OTA estimates and the final IRS-certified amounts for the Highway Account agreed with the differences computed by FMS for all three quarters.

These amounts were<sup>29</sup>

- for the quarter ended September 30, 2002, \$636,666,000;
- for the quarter ended December 31, 2002, (\$319,825,000); and
- for the quarter ended March 31, 2003, \$205,901,000.

The independently recalculated differences between the OTA estimates and the final IRS-certified amounts for the Mass Transit Account agreed with the differences computed by FMS for all three quarters.

These amounts were

- for the quarter ended September 30, 2002, \$16,750,000;
- for the quarter ended December 31, 2002, (\$17,123,000); and
- for the quarter ended March 31, 2003, \$48,083,000.

**IV. Review of IRS precertification for the quarter ended June 30, 2003<sup>30</sup>**

- A. Determine if evidence exists that the supervisor or another analyst checked the results and supporting worksheets.

Description of findings and results

There was evidence that another analyst and a supervisor checked the results and supporting worksheets.

- B. Recalculate the totals on the precertification to determine if they are mathematically correct.

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<sup>29</sup>A positive amount indicates that the FMS adjustment increased excise taxes distributed to the trust fund. A negative amount, shown in parentheses, indicates that the FMS adjustment decreased excise taxes distributed to the trust fund. Since the adjustment amount is the difference between OTA's estimate and IRS's certified amount, it may be significantly affected by IRS's ability to certify receipts in the appropriate quarter.

<sup>30</sup>To accommodate the Department of Transportation's accelerated reporting date for fiscal year 2003, IRS performed a precertification of excise tax collections for the quarter ended June 30, 2003. The data are for information purposes only and the precertification does not constitute an official certification.

Description of findings and results

The totals on the precertification were mathematically correct.

- C. Trace the amounts for diesel fuel tax (abstract 60), gasoline tax (abstract 62), and tax on 10 percent gasohol (abstract 59)<sup>31</sup> from the precertification back to the *Reports of Excise Tax Collection* and *Treasury 90 Report*.

Description of findings and results

The amounts for diesel fuel tax (abstract 60), gasoline tax (abstract 62), and tax on 10 percent gasohol (abstract 59) per the precertification agreed with the related *Reports of Excise Tax Collection* and *Treasury 90 Report*.

- D. Review the distribution rates used by IRS to determine whether the distribution rates for diesel fuel tax (abstract 60), gasoline tax (abstract 62), and tax on 10 percent gasohol (abstract 59) agree with the applicable laws.

Description of findings and results

The distribution rates used by IRS for diesel fuel tax (abstract 60), gasoline tax (abstract 62), and tax on 10 percent gasohol (abstract 59) agreed with the applicable laws in effect during the quarter ended June 30, 2003.

- E. Review the *Reports of Excise Tax Collection* used in the precertification to determine if they contain significant<sup>32</sup> collections from prior quarters.

Description of findings and results

The *Reports of Excise Tax Collection* supporting IRS's precertification for the quarter ended June 30, 2003, did not contain significant prior quarter collections.

- F. Review the Collection Certification System information to determine whether IRS omitted any significant returns<sup>33</sup> from the precertification. If so, report for the Highway Account and the Mass Transit Account: (1) the average amount of

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<sup>31</sup>The amounts for diesel fuel tax (abstract 60), gasoline tax (abstract 62), and tax on 10 percent gasohol (abstract 59), along with the heavy vehicle use tax (traced separately), make up over 89 percent of the precertified total to the HTF.

<sup>32</sup>For this test, "significant" is defined as \$170 million, which represents approximately 2 percent of the precertified total to the HTF.

<sup>33</sup>For this test, "significant returns" are defined as those from taxpayers with a total quarterly excise tax liability equal to or greater than \$10 million during each of the prior four quarters. Tax returns related specifically to HTF from taxpayers with liabilities equal to or greater than \$10 million have, in the aggregate, historically accounted for over 91 percent of distributions certified to HTF.

HTF-related excise taxes from these taxpayers' returns that were included in IRS's certification from the four previous quarters and (2) the amount of HTF-related excise taxes from these taxpayers' returns that were included in IRS's certification for the quarter ended June 30, 2002.

Description of findings and results

IRS did not omit any returns of historically significant excise tax taxpayers from its precertification to the HTF.

- G. Heavy vehicle use taxes, which go to the HTF, are reported on Form 2290 and are not included in the Collection Certification System. Trace these amounts from the Highway Account precertification letter to the master file.

Description of findings and results

Heavy vehicle use tax per the Highway Account precertification agreed with the master file.

**V. Procedures performed on excise tax distributions to the HTF for the quarter ended September 30, 2003**

- A. Determine if OTA's process for identifying and incorporating into its trust fund estimates<sup>34</sup> the effect of new legislation on excise tax receipts was in place during fiscal year 2003.

Description of findings and results

OTA's process for identifying and incorporating into its trust fund estimates the effect of new legislation on excise tax receipts was in place during fiscal year 2003. OTA prepares a tax rate table<sup>35</sup> to capture information relating to legislation that affects tax rates, tax basis, accounts, and deposit rules in effect during the tax period.

- B. Determine if there is evidence of review of the transfer forms and supporting schedules.

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<sup>34</sup>OTA makes semimonthly estimates of excise tax collections for transfer to trust funds. There are five semimonthly estimates for the quarter ended September 30, 2003, which affect fiscal year 2003 distributions to the HTF.

<sup>35</sup>OTA communicates this information to interested parties at Treasury, the Federal Highway Administration, the Federal Transit Administration, and the Department of Transportation. IRS uses the tax and distribution rates from this table in its subsequent certification of collections to trust funds.

Description of findings and results

There was evidence that another OTA economist reviewed the transfer forms and supporting schedules for the semimonthly transfers affecting distributions to the HTF for the quarter ended September 30, 2003.

- C. Recalculate the totals on the transfer forms to determine if they are mathematically correct.

Description of findings and results

The totals on the transfer forms affecting distributions to the HTF for the quarter ended September 30, 2003, were mathematically correct.

- D. Trace the transfer amounts for diesel fuel tax (abstract 60), gasoline tax (abstract 62), tax on 10 percent gasohol (abstract 59), and heavy vehicle use tax,<sup>36</sup> from the transfer forms, through the supporting schedules and back to the related source documents.<sup>37</sup>

Description of findings and results

The transfer amounts for diesel fuel tax (abstract 60), gasoline tax (abstract 62), tax on 10 percent gasohol (abstract 59), and heavy vehicle use tax from the transfer forms did not agree with the supporting schedules and source documents on the first two semimonthly estimates affecting distributions to the HTF for the quarter ended September 30, 2003. An error on one of OTA's electronic spreadsheets resulted in the collection percentages for all tax types being miscalculated. After we brought this to its attention, OTA corrected the spreadsheet error so it did not affect the remaining estimates for the quarter. However, since the effect of this error on the total quarterly estimate would be only a fraction of a percent, OTA did not correct for the effects of this error on the two affected semimonthly estimates. Consequently, OTA understated its estimate for these four taxes to the HTF by approximately \$4.2 million.

In addition, there was another error affecting distributions to the HTF that was not directly related to the tax types selected for review. An error on OTA's

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<sup>36</sup>The transfer amounts for diesel fuel tax (abstract 60), gasoline tax (abstract 62), tax on 10 percent gasohol (abstract 59), and heavy vehicle use tax make up over 92 percent of the total amount transferred quarterly to the HTF.

<sup>37</sup>The source documents include the IRS report of excise taxes used to derive the percentages applied to reported receipts, the Daily Treasury Statement, the Monthly Treasury Statement, and the excise tax rate tables.

electronic spreadsheets resulted in the omission of the estimated amounts for retail tax on trucks (abstract 33) from its estimates to the Highway Account for the first four semimonthly periods of the quarter. As a result, OTA understated its estimates to the HTF by approximately \$305 million. OTA corrected for the effects of this error through its final semimonthly estimate affecting fiscal year 2003 distributions to the HTF. Consequently, this error had no net effect on fiscal year 2003 distributions to the HTF.

## VI. Other procedures

- A. Compare total fiscal year 2003 excise taxes distributed to the HTF with drafts of (1) HTF's fiscal year 2003 financial statements and (2) BPD's fiscal year 2003 financial statements for the HTF to determine if they agree.

### Description of findings and results

The \$34.1 billion of fiscal year 2003 excise taxes distributed to the HTF agreed with the amount reported on the draft HTF financial statements but did not agree with the amount reported on the draft BPD fiscal year 2003 financial statements for the HTF. The BPD fiscal year 2003 financial statements for the HTF reported excise tax distributions to the HTF of \$33.7 billion. The difference is due to FMS's \$388.6 million downward adjustment for the quarter ended June 30, 2002—a \$378.9 million adjustment to the Highway Account and a \$9.7 million adjustment to the Mass Transit Account—which FMS recorded in December 2002. The trust fund's administrator included this transaction as part of the fiscal year 2002 distributions to the HTF because the HTF had time to record the adjustment on its fiscal year 2002 financial statements, which were issued in January 2003. However, BPD included this transaction as part of the fiscal year 2003 distributions because it was recorded after the November 1, 2002, issuance date of BPD's fiscal year 2002 financial statements for the HTF.

- B. Procedures performed as part of the fiscal year 2003 IRS financial statement audit:
  1. From IRS's master files for the first 8 months of fiscal year 2003, use DUS to select statistical samples of (1) total tax revenue receipts and (2) refunds. For each sample item, test that the collection or refund amount, tax period, and tax class<sup>38</sup> from source documentation agree with those recorded in IRS's master files.

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<sup>38</sup>IRS assigns a tax class number to specific types of taxes. Excise taxes are tax class 4.

Description of findings and results

Detailed testing of 169 revenue receipts and 50 refund sample transactions showed that the collection or refund amount, tax period, and tax class from source documents agreed with those recorded in IRS's master files.

2. Review selected IRS submission processing campuses' monthly Treasury SF-224 reconciliations to determine if IRS-reported revenue receipts were properly classified and reconciled to Treasury FMS records. For refunds, review selected IRS submission processing campuses' monthly Treasury SF-224 reconciliations to determine if IRS-reported total refunds (all tax classes) materially<sup>39</sup> reconciled to Treasury FMS records.<sup>40</sup>

Description of findings and results

Tax revenue receipts reported by selected IRS submission processing campuses through the monthly Treasury SF-224 reconciliation process were properly classified and materially agreed with Treasury FMS records.

Total refunds reported by the selected IRS submission processing campuses through the monthly Treasury SF-224 reconciliation process materially agreed with Treasury FMS records.

3. Perform procedures to determine whether tax revenue receipt balances by tax class, including excise taxes, per IRS's general ledger, materially agree with IRS's master files and Treasury records. For refunds, perform a comparison of total refund balances between the master file, the general ledger, and Treasury records.

Description of findings and results

Tax receipt balances for all tax classes, including excise taxes, per IRS's general ledger, materially agreed with IRS's master files and with Treasury records.

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<sup>39</sup>For the purpose of this procedure and procedure VI.B.3, we define material as \$20 billion. This represents approximately 1 percent of the total tax revenue receipts collected by IRS in fiscal year 2003.

<sup>40</sup>IRS maintains records of refund balances by tax class in its master file and reports this information monthly to Treasury on 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.

Enclosure

Refund balances per IRS's general ledger materially agreed with the master file and with Treasury records.

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