



*Attestation Review of the Internal Revenue  
Service's Fiscal Year 2006 Annual  
Accounting of Drug Control Funds*

**February 1, 2007**

**Reference Number: 2007-10-046**

This report has cleared the Treasury Inspector General for Tax Administration disclosure review process and information determined to be restricted from public release has been redacted from this document.

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*Phone Number* | 202-927-7037

*Email Address* | [Bonnie.Heald@tigta.treas.gov](mailto:Bonnie.Heald@tigta.treas.gov)

*Web Site* | <http://www.tigta.gov>



TREASURY INSPECTOR GENERAL  
FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY  
WASHINGTON, D.C. 20220

February 1, 2007

**MEMORANDUM FOR CHIEF FINANCIAL OFFICER**

**FROM:** *Michael R. Phillips*  
Michael R. Phillips  
Deputy Inspector General for Audit

**SUBJECT:** Final Audit Report – Attestation Review of the Internal Revenue Service’s Fiscal Year 2006 Annual Accounting of Drug Control Funds (Audit # 200710032)

This report presents the results of our attestation review of the Internal Revenue Service’s (IRS) Fiscal Year (FY) 2006 Office of National Drug Control Policy (ONDCP)<sup>1</sup> detailed accounting submission. The purpose of this review was to express a conclusion about the reliability of each assertion made in the detailed accounting submission.

*Impact on the Taxpayer*

The IRS reported that it expended \$55.484 million on ONDCP-related activities in FY 2006. Reliable financial information is critical to the IRS’ ability to accurately report on the results of its operations to both internal and external stakeholders, including taxpayers.

*Synopsis*

We determined that the IRS’ FY 2006 ONDCP detailed accounting submission and assertions, submitted to us on January 11, 2007, did not include all required material information or a reasonably detailed explanation regarding the methodology used to calculate funds expended. Specifically, ONDCP reporting guidelines require that all funds expended on ONDCP-related activities during a fiscal year be clearly reported. However, the IRS simply re-reported the funding of \$55.028 million it had received for the ONDCP in FY 2006 and noted that funds actually expended were not materially different. ONDCP guidelines also require that the

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<sup>1</sup> The ONDCP was established in 1988 to set priorities, implement a national strategy, and certify Federal Government drug control budgets. Pub. L. No. 105-277 (Division C-Title VII), Section 707(d) (1988).



*Attestation Review of the Internal  
Revenue Service's Fiscal Year 2006 Annual  
Accounting of Drug Control Funds*

---

methodology used to calculate funds expended be fully explained. However, the IRS noted only that ONDCP funds expended were calculated based on direct investigative time without any detailed explanation regarding the methodology used to accomplish this calculation.

In fact, the only methodology clearly outlined by the Criminal Investigation (CI) function during our inquiries was the unit cost approach associated with the funding transfer, after rescission, of \$55.028 million. As part of our fieldwork, we did inquire as to whether funds expended during FY 2006 were considered in preparing the ONDCP report and were informed by the CI function at the time that this was not done.

On January 25, 2007, we provided a discussion draft audit report notifying the IRS that its ONDCP detailed accounting submission was materially incomplete. We also informed the IRS that the unit cost methodology was inadequate for the purpose of calculating funds expended in FY 2006, in the event it relied on this approach in any way.

In response to this report, the IRS indicated it had calculated funds expended on the ONDCP program in FY 2006 to be \$55.484 million. In addition, the IRS indicated that this calculation was based on the application of direct investigative time attributable to the ONDCP program to CI function funds expended in FY 2006. The IRS' response also noted that this calculation included a number of adjustments it had made to reflect costs specifically attributable to the ONDCP.

In general, we found the overall cost allocation methodology described in the IRS' response to our discussion draft report to be adequately explained and documented, with the exception of one matter. Specifically, the IRS adjusted its allocation-based estimate of ONDCP funds expended upwards by \$2 million primarily to reflect salary and benefits related to program management and analytical support staff costs it directly attributed to the program. However, the IRS did not provide an explanation as to why these types of costs were so unique that they would not also be incurred by other CI function programs and therefore already be reflected in the overall allocated cost calculation.

Based on our review, if the IRS' FY 2006 ONDCP report were adjusted to reflect the additional information and cost calculation methodology included in the IRS response to our discussion draft report, nothing came to our attention, with the exception of the matter discussed in the preceding paragraph, to indicate that the assertions are not presented in all material respects in accordance with ONDCP-established criteria.

### *Recommendation*

We recommended the Chief Financial Officer ensure future ONDCP reports use an analysis of current period financial activity in determining the funds expended.



*Attestation Review of the Internal  
Revenue Service's Fiscal Year 2006 Annual  
Accounting of Drug Control Funds*

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*Response*

The IRS agreed with our recommendation and, as discussed above, included in its response a description of the method used to calculate the FY 2006 drug resources based on current period funds expended. Management's complete response to the draft report is included as Appendix V.

Copies of this report are also being sent to the IRS managers affected by the report recommendation. Please contact me at (202) 622-6510 if you have questions or Nancy Nakamura, Assistant Inspector General for Audit (Headquarters Operations and Exempt Organizations Programs), at (202) 622-8500.



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*Attestation Review of the Internal  
Revenue Service's Fiscal Year 2006 Annual  
Accounting of Drug Control Funds*

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*Table of Contents*

<b>Background</b> .....	Page 1
<b>Results of Review</b> .....	Page 2
The Methodology Used to Calculate the Internal Revenue Service's Fiscal Year 2006 Annual Drug Control Funds Expended Was Generally Well Documented .....	Page 2
<u>Recommendation 1:</u> .....	Page 3
<b>Appendices</b>	
Appendix I – Detailed Objective, Scope, and Methodology .....	Page 5
Appendix II – Major Contributors to This Report .....	Page 6
Appendix III – Report Distribution List .....	Page 7
Appendix IV – Internal Revenue Service Fiscal Year 2006 Detailed Accounting Submission of Drug Control Funds.....	Page 8
Appendix V – Management's Response to the Draft Report .....	Page 11



*Attestation Review of the Internal  
Revenue Service's Fiscal Year 2006 Annual  
Accounting of Drug Control Funds*

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*Abbreviations*

CI	Criminal Investigation
FTE	Full-Time Equivalent
FY	Fiscal Year
IRS	Internal Revenue Service
ONDCP	Office of National Drug Control Policy



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*Attestation Review of the Internal  
Revenue Service's Fiscal Year 2006 Annual  
Accounting of Drug Control Funds*

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## *Background*

The Anti-Drug Abuse Act of 1988<sup>1</sup> establishes as a policy goal the creation of a drug-free America. A key provision of the Act is the establishment of the Office of National Drug Control Policy (ONDCP) to set priorities, implement a national strategy, and certify Federal Government drug control budgets. The Internal Revenue Service's (IRS) Narcotics Program supports the National Drug Control Strategy through continued support of the Organized Crime and Drug Enforcement Task Force.

***National Drug Control Program agencies are required to submit to the Director of the ONDCP, not later than February 1 of each year, a detailed accounting of all funds expended.***

This review was conducted as required by the National Drug Enforcement Policy (21 U.S.C. Section 1704(d)) and the ONDCP Circular entitled *Annual Accounting of Drug Control Funds*, dated April 18, 2003. The National Drug Control Program agencies<sup>2</sup> are required to submit to the Director of the ONDCP, not later than February 1 of each year, a detailed accounting of all funds expended (the ONDCP Circular requires amounts obligated) during the previous fiscal year. Further, it requires such accounting to be authenticated by the Inspector General of each agency prior to its submission.

The Transportation, Treasury, Housing and Urban Development, the Judiciary, the District of Columbia, and Independent Agencies Appropriations Act, 2006,<sup>3</sup> was enacted on November 30, 2005. Within this law is a specific appropriation of \$55.584 million to fund the IRS Criminal Investigation (CI) function drug enforcement actions.

This review was performed in the IRS Headquarters offices of the Chief Financial Officer and Chief, CI, in Washington, D.C., during the period December 2006 through January 2007. Our review was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants. An attestation review is substantially less in scope than an examination, the objective of which is the expression of an opinion on the ONDCP detailed accounting submission assertions. Accordingly, we do not express such an opinion.

Detailed information on our audit objective, scope, and methodology is presented in Appendix I. Major contributors to the report are listed in Appendix II.

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<sup>1</sup> Pub. L. No. 105-277 (Division C-Title VII), Section 707(d) (1988).

<sup>2</sup> National Drug Control Program Agencies are defined as any agency that is responsible for implementing any aspect of the National Drug Control Strategy.

<sup>3</sup> Pub. L. No. 109-115 (2005).



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*Attestation Review of the Internal  
Revenue Service's Fiscal Year 2006 Annual  
Accounting of Drug Control Funds*

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*Results of Review*

***The Methodology Used to Calculate the Internal Revenue Service's  
Fiscal Year 2006 Annual Drug Control Funds Expended Was Generally  
Well Documented***

We reviewed the IRS ONDCP detailed accounting submission and assertions for Fiscal Year (FY) 2006, which ended September 30, 2006 (see Appendix IV). This submission, including the assertions made, was prepared pursuant to 21 U.S.C. § 1704(d) and the ONDCP Circular *Annual Accounting of Drug Control Funds*, and is the responsibility of the IRS. The assertions, as required by Section 5.b. of the ONDCP Circular, include statements that the methodology used is reasonable and accurate, including explanations and documentation of estimation assumptions used; the methodology disclosed was the actual methodology used; and the data presented are associated with obligations against a financial plan that reflects changes, if made. The ONDCP Circular also requires that such accounting be authenticated by the Inspector General of each agency prior to its submission.

In FY 2006, ONDCP funding became a permanent part of the IRS' budget. In prior years, IRS-related ONDCP funds expended were reimbursed by the Department of Justice. The IRS noted in its FY 2006 ONDCP report that, in conjunction with this change in funding structure, the Department of Justice transferred 329 Full-Time Equivalents (FTE)<sup>4</sup> and associated funding of \$55.584 million to the IRS in FY 2006. This amount was reduced by a subsequent 1 percent Department of the Treasury budget rescission to \$55.028 million and 326 FTEs. The IRS also noted in its FY 2006 ONDCP report that the resources associated with this transfer were calculated by multiplying the FTEs transferred by a unit cost rate.

Overall, we found the IRS' FY 2006 ONDCP Report, which was submitted to us on January 11, 2007, did not include all required material information or a reasonably detailed explanation regarding the methodology used to calculate funds expended. Specifically, ONDCP reporting guidelines require that all funds expended on ONDCP-related activities during a fiscal year be clearly reported. However, the IRS simply re-reported the funding of \$55.028 million it had received for the ONDCP in FY 2006 and noted that funds actually expended were not materially different. ONDCP guidelines also require that the methodology used to calculate funds expended be fully explained. However, the IRS noted only that ONDCP funds expended were calculated based on direct investigative time without any detailed explanation regarding the methodology used to accomplish this calculation.

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<sup>4</sup> A measure of labor hours in which 1 FTE is equal to 8 hours multiplied by the number of compensable days in a particular fiscal year. For FY 2006, 1 FTE was equal to 2,080 staff hours.



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*Attestation Review of the Internal  
Revenue Service's Fiscal Year 2006 Annual  
Accounting of Drug Control Funds*

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In fact, the only methodology clearly outlined by the CI function during our inquiries was the unit cost approach associated with the funding transfer, after rescission, of \$55.028 million. As part of our fieldwork, we did inquire as to whether funds expended during FY 2006 were considered in preparing the ONDCP report and were informed by the CI function at the time that this was not done.

On January 25, 2007, we provided a discussion draft audit report notifying the IRS that the January 11, 2007, FY 2006 ONDCP Report was materially incomplete. We also informed the IRS that the unit cost methodology was inadequate for the purpose of calculating funds expended in FY 2006, in the event it relied on this approach in any way.

Specifically, although historical costs were used by the IRS in developing the unit cost rate for special agents, this rate was subsequently inflated by numerous material, unsupported adjustments. For example, the unit cost rate calculation for special agent-related indirect costs such as rent, supplies, and other services was subsequently increased by 75 percent by the IRS CI function as part of the ONDCP calculation process. The CI function was unable to provide any detailed analysis or documentation to support any of these adjustments.

In response to the discussion draft report, the IRS indicated it had calculated funds expended on the ONDCP program in FY 2006 to be \$55.484 million. In addition, the IRS indicated that this calculation was based on the application of direct investigative time attributable to the ONDCP program to CI function funds expended in FY 2006. The IRS' response also noted that this calculation included a number of adjustments it had made to reflect costs specifically attributable to the ONDCP.

In general, we found the overall cost allocation methodology described in the IRS' response to our discussion draft report to be adequately explained and documented, with the exception of one matter. Specifically, the IRS adjusted its allocation-based estimate of ONDCP funds expended upwards by \$2 million primarily to reflect salary and benefits related to program management and analytical support staff costs it directly attributed to the program. However, the IRS did not provide an explanation as to why these types of costs were so unique that they would not also be incurred by other CI function programs and therefore already be reflected in the overall allocated cost calculation.

Based on our review, if the IRS' FY 2006 ONDCP report were adjusted to reflect the additional information and cost calculation methodology included in the IRS response to our discussion draft report, nothing came to our attention, with the exception of the matter discussed in the preceding paragraph, to indicate that the assertions are not presented in all material respects in accordance with ONDCP-established criteria.

## ***Recommendation***

***Recommendation 1:*** The Chief Financial Officer should ensure future ONDCP reports use an analysis of current period financial activity in determining the funds expended.



*Attestation Review of the Internal  
Revenue Service's Fiscal Year 2006 Annual  
Accounting of Drug Control Funds*

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**Management's Response:** The IRS agreed with our recommendation and included in its response a description of the method used to calculate the FY 2006 drug resources based on current period funds expended.

\* \* \* \* \*

While this report is an unrestricted public document, the information it contains is intended solely for the use of the IRS, the United States Department of the Treasury, the ONDCP, and Congress. It is not intended to be, and should not be, used by anyone other than these specified parties.



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*Attestation Review of the Internal  
Revenue Service's Fiscal Year 2006 Annual  
Accounting of Drug Control Funds*

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## **Appendix I**

### *Detailed Objective, Scope, and Methodology*

The overall objective of this review was to perform an attestation review of the IRS' reporting of FY 2006 ONDCP obligations for the purpose of expressing a conclusion on the reliability of the assertions made in the detailed accounting submission. To accomplish our objective, we:

- I. Obtained an understanding of the process used to prepare the IRS FY 2006 ONDCP detailed accounting submission.
  - A. Discussed the process to record and report ONDCP expenditures with responsible IRS personnel.
  - B. Obtained any documents such as the detailed accounting submission, written procedures, supporting worksheets, and recording modifications that evidence the methodology used.
- II. Evaluated the reasonableness of the drug methodology process.
  - A. Reviewed data supporting the detailed accounting submission to establish its relationship to the amounts being reported.
  - B. Reviewed the estimation methods used for consistency with reported amounts.
- III. Performed sufficient verifications of reported obligations to support our conclusion on the reliability of the assertions.
  - A. Verified whether the detailed accounting submission includes all of the required elements.
  - B. Verified the mathematical accuracy of the obligations presented, traced the information to the supporting documentation, and reviewed the supporting documentation for reasonableness.



*Attestation Review of the Internal  
Revenue Service's Fiscal Year 2006 Annual  
Accounting of Drug Control Funds*

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**Appendix II**

*Major Contributors to This Report*

Nancy Nakamura, Assistant Inspector General for Audit (Headquarters Operations and Exempt Organizations Programs)  
John R. Wright, Director  
Anthony J. Choma, Audit Manager  
Mildred Rita Woody, Lead Auditor  
Robert Beel, Senior Auditor  
Kanika Kals, Auditor  
Richard Loudon, Auditor



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*Attestation Review of the Internal  
Revenue Service's Fiscal Year 2006 Annual  
Accounting of Drug Control Funds*

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**Appendix III**

*Report Distribution List*

Commissioner C  
Office of the Commissioner - Attention: Chief of Staff C  
Deputy Commissioner for Operations Support OS  
Deputy Commissioner for Services and Enforcement SE  
Chief, Criminal Investigation SE:CI  
Deputy Chief, Criminal Investigation SE:CI  
Deputy Chief Financial Officer OS:CFO  
Chief Counsel CC  
National Taxpayer Advocate TA  
Director, Office of Legislative Affairs CL:LA  
Director, Office of Program Evaluation and Risk Analysis RAS:O  
Office of Internal Control OS:CFO:CPIC:IC  
Audit Liaisons:  
    Chief, Criminal Investigation SE:CI  
    Chief Financial Officer OS:CFO



*Attestation Review of the Internal  
Revenue Service's Fiscal Year 2006 Annual  
Accounting of Drug Control Funds*

**Appendix IV**

*Internal Revenue Service Fiscal Year 2006 Detailed  
Accounting Submission of Drug Control Funds*



CHIEF FINANCIAL OFFICER

DEPARTMENT OF THE TREASURY  
INTERNAL REVENUE SERVICE  
WASHINGTON, D.C. 20224

January 11, 2007

MEMORANDUM FOR MICHAEL PHILLIPS  
DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: Janice Lambert *Janice Lambert*  
Chief Financial Officer

SUBJECT: Internal Revenue Service's (IRS) Fiscal Year (FY) 2006  
Detailed Accounting Submission of Drug Control Funds

The Internal Revenue Service (IRS) is submitting this report to the Treasury Inspector General for Tax Administration (TIGTA) to comply with Section 7, Inspector General Authentication, of the Office of National Drug Control Policy (ONDCP) Circular: Drug Control Accounting, dated April 18, 2003. This circular requires TIGTA to perform an attestation review of this report before the IRS submits it to ONDCP. After the IRS receives TIGTA's conclusion as to the reliability of each assertion made in the report, I will forward this document to the ONDCP.

If you have any questions, please contact me at (202) 622-6400, or have a member of your staff contact Pamela J. LaRue, Associate Chief Financial Officer for Corporate Performance Budgeting at (202) 622-4663.

Attachment

cc: Tony Choma



*Attestation Review of the Internal  
Revenue Service's Fiscal Year 2006 Annual  
Accounting of Drug Control Funds*

Attachment – 12/29/06

**INTERNAL REVENUE SERVICE  
ANNUAL ACCOUNTING OF DRUG CONTROL FUNDS**

**DETAILED ACCOUNTING SUBMISSION**

A. Table of FY 2006 Drug Control Obligations

<b>Drug Resources by Function</b>	(\$000)
Investigations	<u>\$55,028</u>
Total	\$55,028
<b>Drug Resources by Decision Unit</b>	
Narcotics Crimes	<u>\$55,028</u>
Total	\$55,028

(1) Drug Methodology

- The Internal Revenue Service's (IRS) Drug Control Budget contains the Criminal Investigation (CI) Narcotics-Related Financial Crime Program. The Office of National Drug Control Policy (ONDCP) requires Criminal Investigation to only report on the Organized Crime and Drug Enforcement Task Force (OCDETF) portion of our Narcotics program.
- During FY 2006, IRS-CI dedicated 8.8% of its Direct Investigative Time (DIT) to the OCDETF Program. This amount, when applied to the total realized FTE in FY 2006, resulted in approximately 248 special agent FTE and 89 support FTE for a total of 337 FTE. Since this was less than a 5% change to our estimate of 326 FTE, we determined that we would use our allocated 326 FTE and related dollar amount for our year-end reporting.
- Fiscal Year 2006 was the first year that the OCDETF funding became a permanent part of the CI regular budget. In the past, OCDETF was a reimbursable program and was reimbursed and reported by the Department of Justice (DOJ).
- In FY 2006, DOJ transferred 329 FTE (254 special agent FTE and 75 support FTE) to CI. The resources associated with this transfer of FTE were computed by multiplying the number of FTE by a Unit Cost Rate for the type of employee FTE that was being transferred. These Unit Cost Rates are costs that are computed annually and include all costs that apply when an employee is newly hired or is already on-board. These costs are adjusted annually for changes in business practices and cost of living adjustments.
- In FY 2006, the resources transferred with the 329 FTE were \$55,584,000. This amount was reduced by an across the board 1% rescission made by Treasury which



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*Attestation Review of the Internal  
Revenue Service's Fiscal Year 2006 Annual  
Accounting of Drug Control Funds*

---

reduced our OCDETF resources down to \$55,028,000 and 326 FTE (252 special agent FTE and 74 support FTE).

- (2) **Methodology Modifications.** As authorized in the IRS 2006 Appropriations, CI Narcotics-Related Financial Crime Program did reprogram funds into the IRS Information Systems appropriation in FY 2006.
- (3) **Material Weaknesses or Other Findings.** None
- (4) **Reprogramming or Transfers.** As acknowledged above, \$500K was reprogrammed to the IRS Information Systems appropriation.
- (5) **Other Disclosures.** None

**B. Assertions**

- 1) **Drug Methodology.** The methodology used to calculate obligations of prior year budgetary resources is reasonable and accurate.
  - (a) **Data**

Data is retrieved from the Criminal Investigation Management Information System (CIMIS) to determine the number of FTE's used in drug control activities. Special agents submit CIMIS time reports monthly detailing their activities relating to investigations (direct investigative time or DIT). Each investigation is associated with a specific program and sub-program area. The percentage of DIT used on each program area is calculated monthly with a final annual percentage determined after the close of the fiscal year. The annual percentage of DIT used for Narcotics-Related Financial Crimes program is applied to realized FTE as calculated by CIMIS to determine the number of FTE expended on the complete Narcotics program. The Narcotics Program DIT is split out into sub-programs which included OCDETF, among other Narcotics related programs. OCDETF DIT is used to determine the OCDETF FTE expended on the OCDETF program and is computed separately.
  - (b) **Other Estimation Methods.** Planned FTE utilization determined the distribution of non-labor funds to CI field offices.
  - (c) **Completeness.** The Internal Revenue Service Drug Control Budget contains only the Criminal Investigation Organized Crime and Drug Enforcement Task Force Program.
  - (d) **Financial Systems.** The Service's Integrated Financial System (IFS) is the final authority for the IRS resource obligations. The Criminal Investigation Management Information System (CIMIS) is the final authority for the Direct Investigative Time reporting.
- 2) **Application of Methodology.** The methodology disclosed in this section is the actual methodology used to generate the table required by Section 6A of the Office of National Drug Control Policy Circular: Drug Control Accounting. Calculations are sufficiently well documented to independently reproduce this date and ensure consistency between reporting years.
- 3) **Financial Plan-Including Reprogramming or Transfers.** The data presented is associated with obligations against a financial plan and properly reflects any revisions occurring during the fiscal year.



*Attestation Review of the Internal  
Revenue Service's Fiscal Year 2006 Annual  
Accounting of Drug Control Funds*

**Appendix V**

*Management's Response to the Draft Report*



CHIEF FINANCIAL OFFICER

DEPARTMENT OF THE TREASURY  
INTERNAL REVENUE SERVICE  
WASHINGTON, D.C. 20224

January 30, 2007

MEMORANDUM FOR MICHAEL PHILLIPS  
DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: Janice Lambert *Janice Lambert*  
Chief Financial Officer

SUBJECT: Comments and Response to Discussion Draft Audit Report –  
Attestation Review of the Internal Revenue Service's Fiscal  
Year 2006 Annual Accounting of Drug Control Funds  
(Audit # 200710032)

The Internal Revenue Service (IRS) appreciates the opportunity to respond to the findings of TIGTA audit 200710032 - Attestation Review of the Internal Revenue Service's Fiscal Year 2006 Annual Accounting of Drug Control Funds.

In preparing the FY 2006 Office of National Drug Control Policy (ONDCP) report, the IRS relied on the same methodology that was used when the OCDETF program was operated on a reimbursable basis with the Department of Justice. We agree with the TIGTA recommendation that ONDCP reports should use "current period financial activity in determining funds expended." In fact, the IRS did use the actual Organized Crime Drug Enforcement Task Force (OCDETF) activity to calculate the FY 2006 OCDETF expenditures. The Direct Investigative Time (DIT) spent by agents on OCDETF-related programs is regularly reported through the Criminal Investigation (CI) Division's timekeeping system and is used to calculate the number of full-time equivalent (FTE) applied to OCDETF through the course of the fiscal year. However, during the attestation review we think a miscommunication led to a misinterpretation of the methodology employed by the IRS to document OCDETF resource utilization. TIGTA raised the following issues:

- "Overall, we found the IRS' FY 2006 ONDCP report does not include all required material information, and the methodology used to calculate the IRS' cost per unit contains a number of material unsupported cost estimates."
- "Specifically, although historical costs were used by the IRS in developing the unit cost rate for special agents, we found that this rate was subsequently inflated by numerous material unsupported adjustments when applied to estimated and realized FTEs to determine the total funds budgeted and expended."



*Attestation Review of the Internal  
Revenue Service's Fiscal Year 2006 Annual  
Accounting of Drug Control Funds*

2

P.L. 109-115 transferred \$55.6 million from the Department of Justice to the IRS as direct funding to support the OCDETF Program. As noted in the TIGTA report, this amount was reduced by the 1 percent budget rescission to \$55.028 million and 326 FTEs. The FTE unit cost rate and the adjustments as described above were used to establish the initial receipt of the \$55.028 million OCDETF funding for CI in the Integrated Financial System (IFS). This initial IFS allocation of the \$55.028 million, however, is not the methodology used for determining how the funds were expended.

As recommended by TIGTA, CI applies its DIT spent on OCDETF cases, which was 8.8 percent of all DIT in FY 2006, to derive the special agent, labor, and non-labor costs charged to the OCDETF program. In addition, CI headquarters (HQ) staff dedicated full-time to the OCDETF program and OCDETF information technology (IT) costs are included in the actual OCDETF expenditures. The FY 2006 OCDETF funds were spent as follows:

Labor and non-labor support costs:	\$53,625,529
(8.8% DIT x total CI expenditures net of HQ staff and IT OCDETF costs)	
HQ staff dedicated to OCDETF:	\$ 1,358,194
IT costs:	<u>\$ 500,000</u>
Total OCDETF	\$55,483,723

If you have any questions or require additional assistance, please contact Dawn Mertz, Acting Director of Planning and Strategy at (202) 622-8469 or Senior Analyst Darryl Williams at 202-622-3214.