



*Payments Processed Through the
Remittance Strategy for Paper Check
Conversion Are Posted Accurately, but
Deposit Timeliness Needs Improvement*

April 16, 2010

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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.

Redaction Legend:

1 = Tax Return/Return Information



TREASURY INSPECTOR GENERAL
FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

April 16, 2010

MEMORANDUM FOR COMMISSIONER, WAGE AND INVESTMENT DIVISION

Nancy A. Nakamura

FROM: (for) Michael R. Phillips
Deputy Inspector General for Audit

SUBJECT: Final Audit Report – Payments Processed Through the Remittance Strategy for Paper Check Conversion Are Posted Accurately, but Deposit Timeliness Needs Improvement (Audit # 200940007)

This report presents the results of our review to determine the timeliness and accuracy of processing paper remittances through the Remittance Strategy for Paper Check Conversion (RS-PCC) and to determine whether it is functioning as intended. The RS-PCC is a system that electronically processes paper checks. This audit was included in the Treasury Inspector General for Tax Administration's Fiscal Year 2009 Annual Audit Plan under the major management challenge of Providing Quality Taxpayer Service Operations.

Impact on the Taxpayer

The RS-PCC is a system being implemented to electronically process taxpayers' checks. It is expected to result in reduced staff hours needed to process remittances, a decrease in the Lost Opportunity Cost¹ on payments, and a decrease in mail costs. The RS-PCC is expected to reduce the number of instances where personally identifiable information is inadvertently disclosed. Remittances are being accurately processed through the RS-PCC, but only 13 percent of the 770,504 payments are being deposited the next business day. The Lost Opportunity Cost associated with the deposits not being timely is \$696,115. Taxpayers lose the benefit of the interest earned on timely deposits that is credited to the Department of the Treasury.

¹ Lost Opportunity Cost measures the interest value of money not deposited by close of business the day after receipt. Each \$1,000,000 of deposits not processed within 24 hours or 1 business day has the opportunity to lose 8 percent interest on that specific deposit amount. The interest lost is the basis of Lost Opportunity Cost. This rate is used for comparability to prior years and is not intended to represent the current interest rate.



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Synopsis

In Fiscal Year 2005, the Internal Revenue Service (IRS) began working toward the ability to electronically process paper checks. The IRS expects this will eliminate the need to manually transport and process paper checks. To move toward electronic check processing, the IRS has implemented the RS-PCC. Paper checks presented for payment of any tax obligation at an IRS Consolidated Processing Center² are scanned with a desktop scanner and the data are converted to an electronic format. Using a secure transmission over the Internet, the IRS transmits the detailed remittance information to the Financial Management Service, a bureau of the Department of the Treasury that provides central payment services to Federal agencies. The Federal Reserve Bank then debits the taxpayer’s bank account.

The information is also sent to the Electronic Federal Tax Payment System for posting to the taxpayer’s IRS account. The RS-PCC interfaces with the Electronic Federal Tax Payment System to post taxpayer payment information overnight to the Master File.³ The scanned checks are maintained for 14 days and then destroyed as classified waste.

The RS-PCC is expected to result in reduced staff hours needed to process remittances, a decrease in the Lost Opportunity Cost on payments, and a decrease in mail costs. The RS-PCC is expected to reduce the number of instances where personally identifiable information is inadvertently disclosed. The quality performance indicator for the RS-PCC is Deposit Timeliness as measured by Lost Opportunity Cost. Deposit Accuracy and Timeliness measures are also expected to improve.

Based on a sample of 469 payments, checks are generally being posted accurately and secured both before and after processing. In addition, checks are being appropriately retained for the required 14 days.

The system that maintains the archived images of RS-PCC checks is reliable. A review of archived check images for 253 payments showed the correct archived check image for 251 (99 percent) of 253 payments. *****1*****

² Electronic filing has significantly reduced the number of paper tax returns received each year by the IRS, requiring fewer Submission Processing Centers to process paper returns. The Andover, Massachusetts; Brookhaven, New York; Philadelphia, Pennsylvania; and Memphis, Tennessee, Submission Processing Centers have been consolidated (closed). The work previously performed by Submission Processing at those sites is now done in other Submission Processing Centers or by the Accounts Management function in Andover, Brookhaven, Memphis, and Philadelphia.

³ The IRS database that stores various types of taxpayer account information. This database includes individual, business, and employee plans and exempt organizations data.



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Finally, from a sample of 253 payments, 83 check images included a taxpayer notation on how the payment should be applied to the taxpayer's account. In all 83 cases, the payment was applied per the taxpayers' requests.

However, the codes used to track electronic payments need enhancements. The IRS uses various codes to trace and track batches of checks and individual electronic payments. One of the codes is the Remittance Processing System Identification number, which is assigned to a batch of checks in the RS-PCC unit and allows the IRS to follow the batch as it moves through payment processing. After the data from batches are uploaded to the Financial Management Service, the RS-PCC units receive a reconciliation report that indicates the status of the batch information that the Financial Management Service received. The items on the reconciliation report are not broken out or identified by RS-PCC unit. The reconciliation report also does not include the Remittance Processing System Identification number. The lack of specific batch coding makes it difficult for the IRS to know which locations are processing the most payments received from taxpayers or to identify when there is a problem with a particular location's processing of payments.

The lack of specific batch coding makes it difficult for the IRS to know when there is a problem with a particular location's processing of payments.

An Electronic Funds Transfer Number is also assigned to individual electronic payments and allows the IRS to track a specific payment. A test of 901,455 RS-PCC payments processed between January 22, 2008, and July 22, 2009, identified 130,951 payments (15 percent) that were inaccurately coded. Because payments were not coded according to established criteria, other payment types were erroneously included in the population and we could not identify all RS-PCC payments. The IRS stated it realized the guidance for identifying the RS-PCC payments was inaccurate so it used other ways to identify these payments.

Though checks are being accurately processed, only 13 percent of payments are being deposited the next business day through the Financial Management Service. The IRS' expectation is that all funds be deposited within 24 hours.⁴ Analysis of the 770,504 payments processed through RS-PCC from January 22, 2008, through July 22, 2009, showed that only 99,828 payments (13 percent) met the next business day standard. The remaining 670,676 payments (87 percent) were deposited in a time period more than the next business day. The Lost Opportunity Cost associated with these deposits not being timely is \$696,115. The RS-PCC Lost Opportunity Cost is \$449.79 per \$1 million in payments. This amount is more than 2 times the cost per

⁴ Payments must be deposited within 24 hours (next business day). Payments received on Saturday, Sunday, and holidays need not be deposited until the next business day (the day following the weekend or holiday). Also, payments of \$100,000 or more must be deposited the same day as received.



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\$1 million in payments processed through a Submission Processing Center for Fiscal Year 2009 (\$203).

Payments of \$100,000 or more are considered timely deposited if the payments are deposited the same day as received. Of the 670,676 payments deposited untimely, 910 payments were for \$100,000 or more. None of the 910 payments were deposited on the same day as received. The Lost Opportunity Cost associated with these deposits not being timely deposited is \$316,021. While these 910 payments are less than 1 percent of the total volume of payments processed, they account for about 45 percent of the Lost Opportunity Cost.

The IRS has also not determined if the RS-PCC has reduced the staff hours needed to process remittances, decreased the Lost Opportunity Cost on payments, or decreased mail costs. The IRS stated that it plans to make this determination after Release Two has been implemented. Therefore, it could not provide us with any calculations or figures to determine if the RS-PCC is making payment processing more efficient or cost effective.

Recommendations

We recommended that the Commissioner, Wage and Investment Division, further refine the RS-PCC codes to be able to track batches of payments down to the location where the batches of payments were processed and revise the internal guidelines to clarify the criteria used to identify RS-PCC payments to ensure they are properly coded.

The Commissioner should also monitor Lost Opportunity Cost and other costs such as labor and mail costs associated with the RS-PCC as it is implemented and develop a strategy to improve timeliness and reduce the Lost Opportunity Cost associated with processing payments through the RS-PCC at the Consolidated Processing Centers.

Response

The IRS agreed with all of our recommendations. It has submitted a Unified Work Request for deployment of RS-PCC Release Two. Release Two will have the ability to track payments to the specific processing location and monitor costs associated with the RS-PCC, such as labor and mail costs. The IRS reviewed and revised internal guidelines for identifying the RS-PCC payments. It will also develop an action plan to improve timeliness of payments processed at Consolidated Processing Centers and to reduce Lost Opportunity Cost associated with processing payments through the RS-PCC. Management's complete response to the draft report is included as Appendix IV.

Copies of this report are also being sent to the IRS managers affected by the report recommendations. Please contact me at (202) 622-6510 if you have questions or



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Michael E. McKenney, Assistant Inspector General for Audit (Returns Processing and Account Services), at (202) 622-5916.



***Payments Processed Through the Remittance Strategy for Paper
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Abbreviations

| | |
|--------|--|
| IRS | Internal Revenue Service |
| RPSID | Remittance Processing System Identification |
| RS-PCC | Remittance Strategy for Paper Check Conversion |



Payments Processed Through the Remittance Strategy for Paper Check Conversion Are Posted Accurately, but Deposit Timeliness Needs Improvement

Background

The Internal Revenue Service (IRS) accepts billions of dollars in payments every year from taxpayers paying estimated tax payments in advance of filing their tax returns, submitting payments with their tax returns, and paying past due taxes. Most of these payments are made with paper checks. In Fiscal Year 2005, the IRS began working toward the ability to electronically process paper checks. The IRS expects this will eliminate the need to manually transport and process paper checks.

The RS-PCC is designed to:

- Create and utilize digitized images of the front and back of the remittances/checks.
- Provide the capability to capture taxpayer information through manual operator entry and to capture remittance data through scanning.
- Transmit remittance transactions to the Financial Management Service Electronic Verification and Imaging System¹ to facilitate deposit of the remittance.
- Interface with the Electronic Federal Tax Payment System² to enable the crediting of taxpayer accounts and receive a Document Locator Number and a Trace Identifier for each transaction.
- Transmit all information necessary for long-term storage to the Remittance Transaction Research system.
- Retain data and images for 14 days on the server to accommodate downstream balancing and correction activities.

To move toward electronic check processing, the IRS has implemented the Remittance Strategy for Paper Check Conversion (RS-PCC). Paper checks presented for payment of any tax obligation at an IRS Consolidated Processing Center³ are scanned with a desktop scanner and the data are converted to an electronic format. Using a secure transmission over the Internet, the IRS transmits the detailed remittance information to the Financial Management Service, a bureau of the Department of the Treasury that provides central payment services to Federal agencies. The Federal Reserve Bank then debits the taxpayer's bank account.

The information is sent to the Electronic Federal Tax Payment System for posting to the taxpayer's IRS account. The RS-PCC interfaces with the Electronic Federal Tax Payment System to post taxpayer payment

¹ The host application where all check images are stored.

² A tax payment system provided free by the United States Department of the Treasury to allow individuals to pay Federal taxes electronically via the Internet or telephone.

³ Electronic filing has significantly reduced the number of paper tax returns received each year by the IRS, requiring fewer Submission Processing Centers to process paper returns. The Andover, Massachusetts; Brookhaven, New York; Philadelphia, Pennsylvania; and Memphis, Tennessee, Submission Processing Centers have been consolidated (closed). The work previously performed by Submission Processing at those sites is now done in other Submission Processing Centers or by the Accounts Management function in Andover, Brookhaven, Memphis, and Philadelphia.



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information overnight to the Master File.⁴ The scanned checks are maintained for 14 days and then destroyed as classified waste.

The RS-PCC is expected to result in reduced staff hours needed to process remittances, a decrease in the Lost Opportunity Cost⁵ on payments, and a decrease in mail costs. The RS-PCC is expected to reduce the number of instances where personally identifiable information is inadvertently disclosed. The quality performance indicator for it is Deposit Timeliness as measured by Lost Opportunity Cost. Deposit Accuracy and Timeliness measures are also expected to improve. Although the IRS stated in its business case that RS-PCC would bring about a decrease in Lost Opportunity Cost on payments and chose Deposit Timeliness as its quality performance indicator, it stated this measure does not accurately reflect the performance of the RS-PCC. However, it continues to calculate the Lost Opportunity Cost for comparability purposes.

The IRS has stated that the delays in depositing taxpayer payments result in \$13 million annually of Lost Opportunity Cost. After full implementation, annual savings on mail costs are expected to be approximately \$2.8 million. Annual savings in labor costs are expected to be 144 Full-Time Equivalents⁶ or \$6.4 million (calculated using Fiscal Year 2006 data).

After implementation of the RS-PCC, the IRS expects to save \$13 million annually in Lost Opportunity Cost, \$2.8 million in mail costs, and \$6.4 million in labor costs.

Currently, the RS-PCC is converting paper remittances received only at Consolidated Processing Centers. The following centers are currently using the RS-PCC:

- The Philadelphia, Pennsylvania, Consolidated Processing Center began use on January 14, 2008, to process insolvency trustee checks for single cases and on May 20, 2008, to process perfect payments.⁷
- The Brookhaven, New York, Consolidated Processing Center began use on May 28, 2008, to process perfect payments and on October 22, 2008, to process Offer in Compromise payments.

⁴ The IRS database that stores various types of taxpayer account information. This database includes individual, business, and employee plans and exempt organizations data.

⁵ Lost Opportunity Cost measures the interest value of money not deposited by close of business the day after receipt. Each \$1,000,000 of deposits not processed within 24 hours or 1 business day has the opportunity to lose 8 percent interest on that specific deposit amount. The interest lost is the basis of Lost Opportunity Cost. This rate is used for comparability to prior years and is not intended to represent the current interest rate.

⁶ A measure of labor hours in which 1 Full-Time Equivalent is equal to 8 hours multiplied by the number of compensable days in a particular Fiscal Year. For Fiscal Year 2009, 1 Full-Time Equivalent was equal to 2,088 staff hours.

⁷ A perfect payment is a payment received for one taxpayer with one Taxpayer Identification Number for one amount and one tax period.



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- The Memphis, Tennessee, Consolidated Processing Center began use on June 10, 2008, to process perfect payments and on October 20, 2008, to process Offer in Compromise payments.
- The Andover, Massachusetts, Consolidated Processing Center began use on June 29, 2009, to process perfect payments.

In Fiscal Year 2010, the IRS will begin expanding the use of the RS-PCC to IRS walk-in offices called Taxpayer Assistance Centers.

The RS-PCC is being implemented in phases called releases

The pilot, called Release One, has been implemented at the Brookhaven, Memphis, and Philadelphia Consolidated Processing Centers; Brookhaven and Memphis Centralized Offer in Compromise Operations; and Philadelphia Centralized Insolvency Operations. Release One provides the capacity of single check processing. A portion of Release One of the RS-PCC was deployed June 2009 at the Andover Consolidated Processing Center.

The IRS recently received funding to begin Release Two activities and is currently updating the schedule to reflect a new start date and update additional pilot sites. Release Two will:

- Process split remittances (one check received for more than one return/document and/or more than one tax period) and multiple payments (two or more remittances received with a single return/document).
- Be piloted at 10 Taxpayer Assistance Centers beginning in April 2010. The pilot will provide Release One functionality within the following Taxpayer Assistance Centers: San Francisco, California; Hartford, Connecticut; Detroit, Michigan; Kansas City, Missouri; Las Vegas, Nevada; Newark, New Jersey; Charlotte, North Carolina; Guaynabo, Puerto Rico; Dallas, Texas; and San Antonio, Texas.
- Equip all Taxpayer Assistance Centers with the RS-PCC Release Two functionality to process remittances. The RS-PCC will be fully deployed at all Taxpayer Assistance Centers between November 2010 and February 2011.

Currently, the IRS field offices are not equipped to process and deposit checks. Checks received in field locations must be logged and mailed to a Submission Processing Center for processing. The receiving site verifies the payments received in the mail and forwards the checks for processing. This process of mailing the remittances can take 3 or more days; thus the checks are not deposited within 24 hours. The Wage and Investment and Small Business/Self-Employed Division Collection functions are in the planning stage of developing RS-PCC functionality for the Small Business/Self-Employed Division Collection function field offices in Release Three.

This review was performed at the IRS Submission Processing Center in Ogden, Utah, and the Consolidated Processing Centers in Philadelphia, Pennsylvania, and Memphis, Tennessee, during the period July through December 2009. We conducted this performance audit in



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accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective. 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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Results of Review

Payments Are Being Accurately Posted to Taxpayer Accounts and Maintained in a Secure Environment

The RS–PCC Release One has been implemented at the planned Consolidated Processing Centers. Based on a sample of 469 payments,⁸ checks are generally being posted accurately and secured both before and after processing. In addition, checks are being appropriately retained for the required 14 days.

The processing workflow

Several times a day checks extracted from the mail are delivered to the RS–PCC unit for processing. The checks are sorted into various categories, such as payments from individual taxpayers or businesses, or single checks without a posting document. Batches of 20 to 25 checks are created. The batch number is entered on a batch sheet and the batch is placed on a cart, indicating it is ready to be scanned.

Employees in the RS–PCC unit sign out a batch from the cart by initialing the batch sign-out sheet. From the signed-out batch, the employee manually enters the following items into the RS–PCC system for each check:

- Received Date.
- Name Control.
- Taxpayer Identification Number Type.⁹
- Remittance Processing System Identification (RPSID) Number.
- Tax Period.

⁸ The sample included: 1) a statistical sample of 203 payments; 2) all 14 payments equal to or greater than \$2.5 million; 3) a sample of 50 payments equal to or greater than \$100,000 but less than \$2.5 million; 4) a sample of 50 payments equal to or less than \$5; 5) 76 payments pulled from 3 batches of perfect payments during our visit to Memphis; and 6) 76 payments pulled from 4 batches (3 batches of perfect payments and 1 batch of insolvency payments) during our visit to Philadelphia. See Appendix I for details of our sampling method.

⁹ The IRS associates taxpayers with tax records using a Taxpayer Identification Number, be it an Individual Taxpayer Identification Number, Social Security Number, or Employer Identification Number. An Employer Identification Number is a Federal Tax Identification Number used to identify a business entity, including estates and trusts.

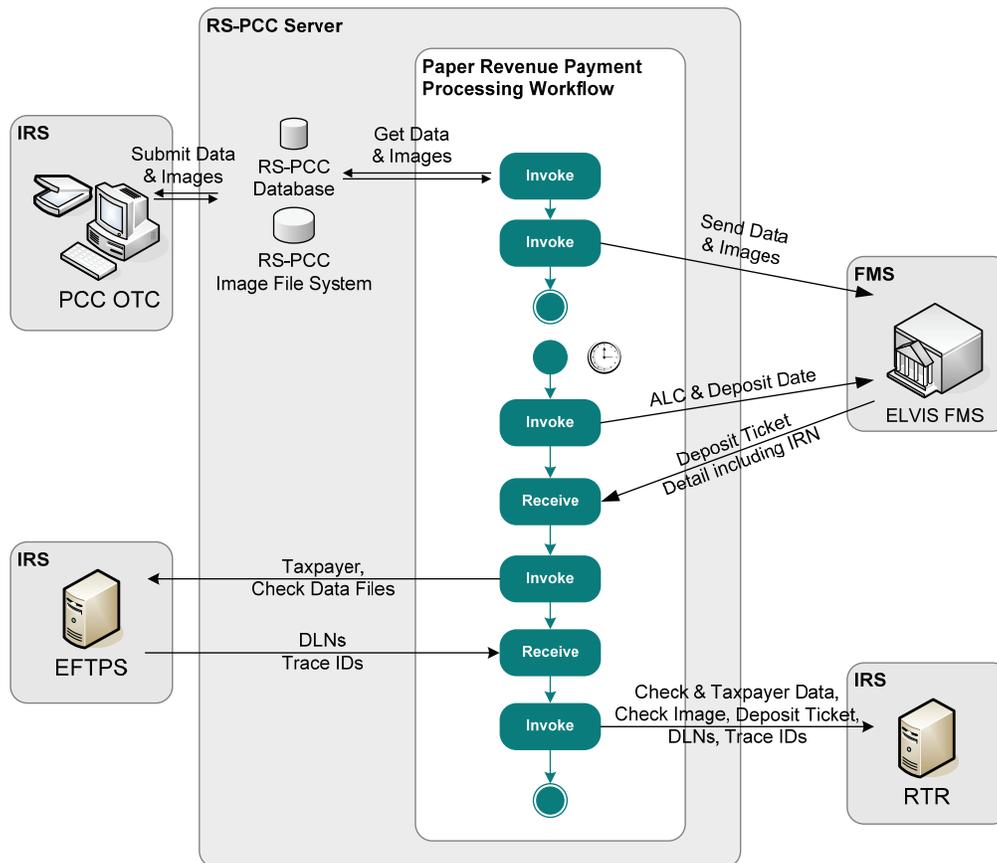


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- Master File Code (obtained from the source document or job aid).
- Primary Transaction Code.

Figure 1 shows the various systems that interact to process checks through the RS-PCC.

Figure 1: Paper Revenue Payment Processing Workflow



Source: RS-PCC, IRS Briefing, June 29, 2009. ALC = Agency Location Code, ID = Identification Number, DLN = Document Locator Number, IRN = Item Reference Number, ELVIS = Electronic Verification and Imaging System, EFTPS = Electronic Federal Tax Payment System, PCC OTC = Paper Check Conversion Over The Counter, FMS = Financial Management Service, RTR = Remittance Transaction Research.

Each check is inserted into the scanning unit where it is imprinted with the notation “Electronically Processed” after scanning is complete. Once the employee has scanned all the items in a batch, a calculator tape is run from the amount on the checks and attached to the batch sheet. The employee places the batch back on a cart to be reviewed. Once the batch has been reviewed for accuracy, the check information is uploaded to the bank through the Financial Management Service. When a batch of payments is transmitted to the Financial Management



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Service, each payment in the batch is given a deposit date of the next day, regardless of the payment amount. Although the system allows data uploads at any time, the Consolidated Processing Centers have been asked to upload data at specific times to avoid overloading the system. Payment amounts are generally posted to the taxpayers' accounts within 3 days. The payment is considered processed at that point.

The RS-PCC unit employees strive to work the batches of checks when received or by the next business day. However, this does not always occur because the volume of checks received might be more than the unit can process in 1 day. For example, at 1 site visited, the batches were not processed until 3 days after receipt. These checks were received on the day after a holiday. The batches are to be worked on a first-in, first-out method. The RS-PCC unit may transship the checks to a processing campus¹⁰ if the decision is made that the unit can not timely work the checks.

The IRS stated the Consolidated Processing Centers have processed as much as 80 percent of the checks received, transshipping the remaining 20 percent to a Submission Processing Center. However, the Consolidated Processing Centers process an average of 50 percent of the checks received. The IRS stated it expects this percentage of checks worked to increase as more locations implement the RS-PCC.

While posting timeliness is not a performance measure, working the batches quickly helps ensure that deposits will be timely. Of the 469 checks reviewed, all had posted to the taxpayers' account,

*****1*****

Of the 469 checks reviewed, all were posted to the taxpayers' accounts.

Checks are properly secured during RS-PCC processing. A proxy card with the proper authorization or code is required to enter the RS-PCC unit and no personal belongings are allowed in the unit. Employees have access to lockers outside the unit to store their personal belongings. Visitors must also leave their belongings outside the RS-PCC unit and remain with an escort while in the RS-PCC unit.

Each batch of paper checks is maintained by the unit for 14 days. At the end of the 14 days, the documents are shredded. The shredder is located in the same area where the checks are stored. Shredding usually occurs daily; the shredded checks and documents are bagged and placed in a classified dumpster.

¹⁰ The data processing arm of the IRS. The campuses process paper and electronic submissions, correct errors, and forward data to the Computing Centers for analysis and posting to taxpayer accounts.

¹¹ A cycle refers to a processing week that transactions post to the Master File.



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Scanned images may not always reflect the data on the paper check

*****1*****

However, if the scanners misread the magnetic ink check number, there is an inherent risk that they could also misread the magnetic ink bank account or bank routing numbers. This could result in the payment being drawn on the wrong bank account. Additional IRS resources would then need to investigate and resolve the error and could result in additional taxpayer burden. The IRS is aware that the scanned image may not always reflect the data on the paper checks but stated that these occurrences are rare. It stated that the Financial Management Service checks the validity of corresponding bank account and bank routing numbers so the risk is very low that a payment would be drawn on an incorrect bank account. Further, the Financial Management Service would correct any errors resulting from the scanner incorrectly reading the magnetic information on the check without notifying the IRS.

As soon as a check is scanned and the image is available, image quality tests are performed on the check. If a check passes the image quality tests, processing continues. It is vitally important that the scanned check be fully visible and legible. The image on the screen is the image that is submitted to the bank for collection. It is also stored in the archives for future retrieval purposes once the check is returned to the customer or destroyed. If the IRS is unable to collect payment with the image that has been submitted, the debit reverts back to the IRS and collection becomes the IRS' responsibility.

The system that maintains the archived images of RS-PCC checks is reliable. A review of archived check images for 253 payments showed the correct archived check image for 251 (99 percent) of 253 payments. *****1*****

Finally, from a sample of 253 payments, 83 check images included a taxpayer notation on how the payment should be applied to the taxpayer's account. In all 83 cases, the payment was applied per the taxpayers' requests.

Because the error rate was low for scanned images not reflecting the data on the paper payment (1 of 152 payments or less than 1 percent) and the archive system retrieving incorrect images (2 of 253 payments or less than 1 percent), we are not making any recommendations.

Codes Used to Track Electronic Payments Need Enhancements

The IRS uses various codes to trace and track batches of checks and individual electronic payments. A RPSID is assigned to a batch of checks in the RS-PCC unit and allows the IRS to follow the batch as it moves through payment processing. A separate batch identification code is also assigned that is unrelated to the RPSID. An Electronic Funds Transfer Number is assigned to individual electronic payments and allows the IRS to track a specific payment.



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Assigned batch codes from the Financial Management Service do not relate to IRS codes

A RPSID is a six-digit code that is used to control batches or remittances and is used to designate which categories of checks are processed through the RS-PCC. Figure 2 shows the RPSID ranges assigned to the different payment types.

Figure 2: RPSID Ranges

| Category | Range |
|---|--|
| Insolvency | 000000 (Philadelphia only) |
| Perfect Misdirected Remittances | 000001 - 489999 |
| Offer in Compromise | 590000 - 599999 (Brookhaven and Memphis only) |
| Payment Perfection Imperfect Misdirected | 610000 - 764999 |

Source: IRS internal guidelines.

Problems occur when errors in the batches are identified. For example, after the data from batches are uploaded to the Financial Management Service, the RS-PCC units receive a reconciliation report that indicates the status of the batch information that the Financial Management Service received. This report is generated several times a day and contains data for all four RS-PCC campuses. The items on the reconciliation report are not broken out or identified by RS-PCC unit. The reconciliation report also does not include the RPSID number. Instead, the reconciliation report includes a 32-digit alphanumeric batch identification code generated by the Financial Management Service software. If the report indicates that there was a problem with one of the batches (status is anything except “sent for deposit”) each campus must review all batches to determine if it processed the batch. Employees compare the batch counts and amounts submitted with those on the reconciliation report. The processing RS-PCC unit must then review the batch to determine what the problem was and resolve it. Also, the lack of specific coding makes it difficult for the IRS to know which locations are processing the most payments received from taxpayers or to identify when there is a problem with a particular location’s processing of payments.

If there is a problem with one of the batches of processed checks, each campus must review all batches to determine if it processed the batch.



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Control activities are the policies, procedures, techniques, and mechanisms that enforce management’s directives and help ensure that actions are taken to address risks. The reconciliation report is an important control but its effectiveness is diminished when the processing location can not identify its batches.

RS–PCC payments were improperly coded

The Electronic Funds Transfer Number for RS–PCC payments is a unique 17-digit number assigned to each electronic payment and is used to track electronic payments.

- Positions 1-2 are the code for the Submission Processing Center.
- Position 3 is the Financial Agent identification number (5 = RS–PCC).
- Position 4 is the payment method (2 = Automated Clearinghouse Debit).
- Position 5 is a Combined Payment Indicator.
- Positions 6-9 are the Year Digit/Julian Date.
- Positions 10-11 are the Bulk Provider Number (Type of Payment and Location).
- Positions 12-17 are the Electronic Funds Transfer Sequence Number.

RS–PCC payments should have “520” in the 3rd through 5th positions. Further, the 10th and 11th positions designate the type of payment and location. Figure 3 provides the location and types of payments and assigned codes.

Figure 3: Assigned Codes for RS–PCC Payments

| Location and Type | Code | Location and Type | Code |
|---------------------------|------|--|------|
| Philadelphia – Insolvency | 01 | Brookhaven – Centralized Offer in Compromise | 09 |
| Philadelphia – Perfect | 02 | Memphis – Centralized Offer in Compromise | 10 |
| Brookhaven – Perfect | 05 | Andover – Perfect | 11 |
| Memphis – Perfect | 07 | | |

Source: IRS internal guidelines.

A test of 901,455 RS–PCC payments processed between January 22, 2008, and July 22, 2009, identified 130,951 payments (15 percent) with a “520” in the 3rd through 5th positions of the Electronic Funds Transfer Number and with “00” as the location code. The “00” is not an assigned location code. Further, 9,083 RS–PCC payments (1 percent) were identified with “521” in the 3rd through 5th positions of the Electronic Funds Transfer Number. The incorrect “521” coding was used for a limited number of payments processed between January 22 and May 6, 2008. The IRS stated it realized the guidance for identifying the RS–PCC payments was



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inaccurate so it used other ways to identify these payments. Because payments were not coded according to the established criteria, other payment types were erroneously included in the population and we could not identify all RS–PCC payments.

The IRS is aware that its systems do not allow it to identify where all payments have been processed. During the Fiscal Year 2008 financial audit of the IRS,¹² the Government Accountability Office found that information on the total number and dollar amount of taxpayer receipts received at the IRS' Taxpayer Assistance Centers was not readily available to IRS management. Specifically, the Government Accountability Office found that the IRS did not track the total number or dollar amount of taxpayer receipts received at Taxpayer Assistance Centers at the individual Taxpayer Assistance Center, group, territory, area, or nationwide level. Because this financial information was not tracked and therefore not readily available, IRS managers lacked financial information that would be useful in making operating decisions and assessing risk at the Taxpayer Assistance Centers.

Program managers need financial data to determine whether they are effectively and efficiently using resources. The volume of receipts processed by a specific location would be useful in making informed operating decisions, such as determining how to manage effectively the risks associated with receiving tax receipts and taxpayer information. For example, the volume and amount of receipts may affect decisions on staffing levels and service hours at the Taxpayer Assistance Centers. Because the IRS does not track the dollar amounts and volumes of taxpayer receipts received at Taxpayer Assistance Centers and does not routinely report this information to allow for periodic monitoring of risk, it lacks certain information which could assist in managing the risk associated with receiving tax receipts and taxpayer information at its Taxpayer Assistance Center facilities. The Government Accountability Office recommended that the IRS establish procedures to track and routinely report the total dollar amounts and volumes of receipts collected by individual Taxpayer Assistance Center location, group, territory, area, and nationwide. The IRS agreed to do so, contingent on the availability of funding, by October 2012.

Recommendations

The Commissioner, Wage and Investment Division, should:

Recommendation 1: Further refine the RS–PCC codes to be able to track batches of payments down to the location where the batches of payments were received and processed.

Management's Response: IRS management agreed with this recommendation. The ability to track payments by location has always been part of the design for the RS-PCC system. As such, an update occurred during late March 2010, which provided enhancements to the RS-PCC daily and weekly reports. As a result of these

¹² *Management Report: Improvements Are Needed to Enhance IRS's Internal Controls and Operating Effectiveness* (GAO-09-513R, dated June 2009).



Payments Processed Through the Remittance Strategy for Paper Check Conversion Are Posted Accurately, but Deposit Timeliness Needs Improvement

enhancements, the IRS is now able to track payments to the location the payment was received and processed. This will allow for tracking at Consolidated Processing Centers and Taxpayer Assistance Center pilot sites.

On November 19, 2009, the Wage and Investment Division submitted a Unified Work Request for deployment of RS-PCC Release Two. The ability to track payments to the specific processing location will be included in the RS-PCC Release Two. Deployment is scheduled to occur between November 2010 and February 2011. Since the requested action will be subject to available funding and resource prioritization by the Modernization and Information Technology Services organization, the submission of Unified Work Request completes the corrective action.

Recommendation 2: Revise the internal guidelines to clarify the criteria used to identify RS-PCC payments to ensure they are properly coded.

Management's Response: IRS management agreed with this recommendation. They reviewed and revised internal guidelines for identifying the RS-PCC payments in March 2010.

Funds Are Not Being Deposited Within 24 Hours

Though checks are being accurately processed, only 13 percent of payments are being deposited through the Financial Management Service within 24 hours.¹³ The IRS expectation is that all funds be deposited within 24 hours. The IRS was not aware that funds were not being deposited within 24 hours because it has not been monitoring deposit timeliness as measured by Lost Opportunity Cost for the RS-PCC. The IRS stated that the Financial Management Service policy of assigning the deposit date as the next day causes the failure to meet the 24-hour time standard.

Analysis of the 770,504 payments processed through RS-PCC from January 22, 2008, through July 22, 2009, showed that only 99,828 payments (13 percent) met the 24-hour deposit standard. The remaining 670,676 payments (87 percent) were deposited in a time period more than 24 hours. The Lost Opportunity Cost associated with the deposits not being timely is \$696,115. Taxpayers lose the benefit of the interest earned on timely deposits that is credited to the Department of the Treasury. The RS-PCC Lost Opportunity Cost is \$449.79 per \$1 million in payments. This amount is more than 2 times the cost per \$1 million in payments processed through a Submission Processing Center for Fiscal Year 2009 (\$203). This results in a difference of \$247 per \$1 million in payments between Consolidated Processing Centers and Submission Processing Centers.

¹³ Payments must be deposited within 24 hours (next business day). Payments received on Saturday, Sunday, and holidays need not be deposited until the next business day (the day following the weekend or holiday). Also, payments of \$100,000 or more must be deposited the same day as received.

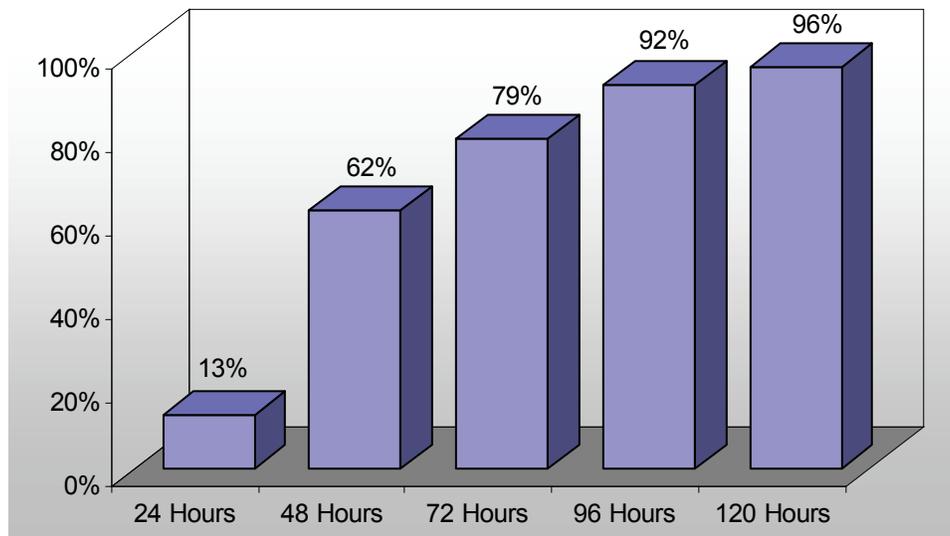


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Payments of \$100,000 or more are timely deposited if the payments are deposited the same day as received. Of the 670,676 payments untimely deposited, 910 payments were for \$100,000 or more. None of these 910 payments were deposited on the same day as received. The Lost Opportunity Cost associated with these deposits not being timely deposited is \$316,021. While these 910 payments are less than 1 percent of the total volume of payments processed, they account for about 45 percent of the Lost Opportunity Cost.

A significantly higher percentage of payments (62 percent) were deposited within 48 hours or 2 business days. By 120 hours or 5 business days, 96 percent of the payments were deposited. Figure 4 shows the percentage of payments processed through the RS-PCC in 1 to 5 business days.

Figure 4: Percentage of Payments Processed in 1 to 5 Business Days



Source: Our analysis of RS-PCC payments.

The delay in deposits occurred because batches of checks were not worked quickly enough for the check images to be delivered to the Financial Management Service on the same day. In addition, when a payment is transmitted, the Financial Management Service automatically gives a deposit date of the next day, regardless of the payment amount. This practice does not explain why the remaining 38 percent of the payments did not meet the 24-hour time standard, taking 72 hours or more to be processed.

Each campus has specific times at which it uploads data to the Financial Management Service. There are two major components owned by the Financial Management Service and used to process a check from receipt to collection.



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- The first major component is the Electronic Verification and Imaging System used for researching check images.
- The second major component is a software package installed on the IRS' computers called Point of Sale that processes check transactions.

The employee takes the check and inserts it into the Point of Sale scanner which reads the Magnetic Ink Character Recognition line on the bottom of the check and captures the image of the check into the Point of Sale computer. The bank account information from the Magnetic Ink Character Recognition line is transmitted to the Federal Reserve Bank of Cleveland for processing. The paper check is no longer sent to the bank. The Federal Reserve Bank of Cleveland provides the electronic deposit tickets and debit vouchers for IRS retrieval through the Electronic Verification and Imaging System. Any payment received by 9:30 P.M. Eastern Standard Time is recorded by the Financial Management Service as deposited the next day.

The IRS is committed to ensuring a 24-hour deposit standard stating it is of the utmost importance to deposit the largest amount of money in the shortest possible time period in order to maintain good cash management practices. Payments received on Saturday, Sunday, and holidays need not be deposited until the next business day (the day following the weekend or holiday). All payments of \$50,000 to \$99,999 must be deposited by the next business day (excluding Saturdays and Sundays). Payments of \$100,000 or more must be deposited on the same day as received.

The IRS has not determined if the RS-PCC is meeting expectations

The IRS has also not determined if the RS-PCC has reduced the staff hours needed to process remittances, decreased the Lost Opportunity Cost on payments, or decreased mail costs. The IRS stated that it plans to make this determination after Release Two has been implemented. Therefore, it could not provide us with any calculations or figures to determine if the RS-PCC is making payment processing more efficient or cost effective.

Recommendations

The Commissioner, Wage and Investment Division, should:

Recommendation 3: Monitor Lost Opportunity Cost and other costs such as labor and mail costs associated with the RS-PCC as it is implemented.

Management's Response: IRS management agreed with this recommendation. Monitoring of other costs associated with the RS-PCC, such as labor and mail costs, are included in RS-PCC Release Two. The Unified Work Request to initiate deployment of Release Two was submitted on November 19, 2009. Deployment is scheduled to occur between November 2010 and February 2011. Since the requested action will be subject to available funding and resource prioritization by the Modernization and Information



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Technology Services organization, the submission of the Unified Work Request completes the corrective action.

Recommendation 4: Develop a strategy to improve timeliness and reduce the Lost Opportunity Cost associated with processing payments through the RS-PCC at the Consolidated Processing Centers.

Management's Response: IRS management agreed with this recommendation. The RS-PCC Project Team will meet with representatives from the Wage and Investment Division Accounts Management function to develop an action plan to improve timeliness of payments processed at Consolidated Processing Centers and to reduce Lost Opportunity Cost associated with processing payments through the RS-PCC.



Payments Processed Through the Remittance Strategy for Paper Check Conversion Are Posted Accurately, but Deposit Timeliness Needs Improvement

Appendix I

Detailed Objective, Scope, and Methodology

Our overall objective was to determine the timeliness and accuracy of processing paper remittances through the RS–PCC and to determine whether it is functioning as intended. To accomplish this objective, we:

- I. Determined the method the IRS used to measure the success of the RS–PCC pilot prior to further implementation.
- II. Identified the controls in place to ensure that paper remittances are properly and timely processed.
 - A. Reviewed the Internal Revenue Manual to identify the controls.
 - B. Discussed with IRS management the controls at the Consolidated Processing Centers.¹
 - C. Conducted walkthroughs to determine whether the Consolidated Processing Centers are following the controls over the RS–PCC as stated in the Internal Revenue Manual.
- III. Identified the controls in place at the Ogden Submission Processing Center to ensure RS–PCC payments that did not post to the taxpayers’ account are corrected, including dishonored checks.
 - A. Discussed with IRS management the controls at the Ogden Submission Processing Center Accounting function.
 - B. Conducted a walkthrough of the Ogden Submission Processing Center Accounting function to determine how the IRS handles RS–PCC payments that did not post to taxpayer accounts.
- IV. Selected a sample of 469 paper remittances to determine whether they were properly processed (scanned, transmitted, and payments posted to the taxpayer account).

¹ Electronic filing has significantly reduced the number of paper tax returns received each year by the IRS, requiring fewer Submission Processing Centers to process paper returns. The Andover, Massachusetts; Brookhaven, New York; Philadelphia, Pennsylvania; and Memphis, Tennessee, Submission Processing Centers have been consolidated (closed). The work previously performed by Submission Processing at those sites is now done in other Submission Processing Centers or by the Accounts Management function in Andover, Brookhaven, Memphis, and Philadelphia.



Payments Processed Through the Remittance Strategy for Paper Check Conversion Are Posted Accurately, but Deposit Timeliness Needs Improvement

- A. The sample included: 1) a statistical sample of 203 payments from the 770,504 payments on the Master File processed from January 22, 2008, through July 22, 2009 (we used a 5 percent expected error rate with a 95 percent confidence level and ± 3 percent precision); 2) all 14 payments equal to or greater than \$2.5 million; 3) a random sample of 50 payments from the 896 payments equal to or greater than \$100,000 but less than \$2.5 million; 4) a random sample of 50 payments from the 8,480 payments equal to or less than \$5; 5) all 76 payments pulled from 3 batches of perfect payments ranging from \$2.50 to \$260,780 at the Memphis Consolidated Processing Center; and 6) all 76 payments pulled from 4 batches (3 batches of perfect payments and 1 batch of insolvency payments) ranging from \$.23 to \$198,651 at the Philadelphia Consolidated Processing Center. We validated the reliability of the computer-processed data by selecting a sample of 50 payments and compared the data to the data obtained from the Integrated Data Retrieval System.²
- B. Obtained and analyzed Integrated Data Retrieval System data for the payments from the sample and identified any payment that was not accurately posted to the taxpayer's account.
- C. Compared the payment received date and the deposit date to determine whether the payment was deposited timely. For the payments identified as being deposited untimely, we calculated the Lost Opportunity Cost (interest value) of the money received by the IRS but not deposited by the next business day.
- V. Determined whether processed remittance information is available from the archive system when needed and whether the archive system is reliable.
- A. For 253 of the 469 payments of the sample in Step IV., we determined if the image was available from the archive system and was readable.
- B. For 253 of the 469 payments of the sample in Step IV., we determined if the taxpayer expressed any intentions on how to apply the payment and determined if the IRS followed the intent of the taxpayer.

Internal controls methodology

Internal controls relate to management's plans, methods, and procedures used to meet their mission, goals, and objectives. Internal controls include the processes and procedures for planning, organizing, directing, and controlling program operations. They include the systems for measuring, reporting, and monitoring program performance. We determined the following internal controls were relevant to our audit objective: Campus Support function policies,

² IRS computer system capable of retrieving or updating stored information; it works in conjunction with a taxpayer's account records.



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procedures, and practices for processing remittances through the work streams in campus operations. We evaluated these controls by conducting a walkthrough of the RS–PCC process, interviewing management, and reviewing processed remittances.



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Appendix II

Major Contributors to This Report

Michael E. McKenney, Assistant Inspector General for Audit (Returns Processing and Account Services)

Augusta R. Cook, Director

Paula W. Johnson, Audit Manager

Jackie E. Forbus, Lead Auditor

Sharon Shepherd, Senior Auditor

Jerome Antoine, Auditor

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Appendix III

Report Distribution List

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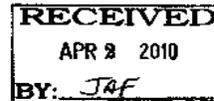
Appendix IV

Management's Response to the Draft Report



DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
ATLANTA, GA 30308

APR - 1 2010



MEMORANDUM FOR MICHAEL R. PHILLIPS
DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: Richard Byrd, Jr. *Richard Byrd, Jr.*
Commissioner, Wage and Investment Division

SUBJECT: Draft Audit Report – Payments Processed Through the Remittance Strategy for Paper Check Conversion Are Posted Accurately, but Deposit Timeliness Needs Improvement (Audit # 200940007)

I reviewed the subject draft report and appreciate your acknowledgement that the Remittance Strategy for Paper Check Conversion (RS-PCC) is accurately processing paper remittances to taxpayer accounts. The purpose of the RS-PCC project is to provide the IRS with a method to employ current industry standards (i.e., Paper Check Conversion and Check Truncation) for remittance processing.

The RS-PCC positions the IRS to achieve efficiencies in remittance processing while improving overall financial management by decreasing the lag time between IRS receipt of funds and their deposit to the U.S. Treasury. Taxpayer service is markedly improved by eliminating the risk of compromising personally identifiable information, inherent with mailing taxpayer checks from field locations to processing sites, and this important benefit cannot be understated. In short, RS-PCC is an E-Government initiative that improves both quality and service delivery.

As stated in your report, the Financial Management Service (FMS) Bureau automatically assigns a deposit date of the next day when RS-PCC payments are transmitted. In contrast, deposits processed at Submission Processing campuses are assigned a deposit date of the same day as bank receipt, even though the funds are made available to the U.S. Treasury at the same time. We appreciate your recognition of the impact this discrepancy has on the Lost Opportunity Cost (LOC) associated with RS-PCC and agree to review the calculation of the LOC associated with these payments to account for the differences in assignment of deposit dates.



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However, because of the inconsistency in the assignment of deposit dates, we disagree with your characterization that only 13 percent of the 770,504 RS-PCC payments were deposited within 24 hours of receipt, and that the LOC associated with the deposits is \$696,115. If FMS had assigned the deposit dates for these payments in the same manner they assign deposit dates for payments processed by the Submission Processing Centers, RS-PCC would have processed 483,588 of the total payments covered by this audit, or 62 percent of the remittances within 24 hours.

A truer assessment would be to compare the LOC achieved through RS-PCC to the LOC of Field Office payments mailed to Submission Processing Centers for processing. The LOC for RS-PCC payments processed during the period covered by the audit is \$258 per million compared to \$356 per million for Field Office payments mailed to Submission Processing Centers.

We will develop a strategy to improve the calculation of LOC to better reflect funds availability. This will provide a more accurate measure of deposit timeliness for RS-PCC payments processed at Consolidated Processing Centers.

Our comments to your recommendations are attached. If you have any questions, please contact me, or a member of your staff may contact Peter J. Stipek, Director, Customer Account Services, Wage and Investment Division, at (404) 338-8910.

Attachment



Payments Processed Through the Remittance Strategy for Paper Check Conversion Are Posted Accurately, but Deposit Timeliness Needs Improvement

Attachment

The Commissioner, Wage and Investment Division, should:

RECOMMENDATION 1

Further refine the RS-PCC codes to be able to track batches of payments down to the location where the batches of payments were received and processed.

CORRECTIVE ACTION

We agree with this recommendation. The ability to track payments by location has always been part of the design for the Remittance Strategy for Paper Check Conversion (RS-PCC) system. As such, an update occurred during late March, 2010, which provided enhancements to the RS-PCC daily and weekly reports. As a result of these enhancements, we are now able to track payments to the location the payment was received and processed. This will allow for tracking at Consolidated Processing Centers and Taxpayer Assistance Center (TAC) pilot sites.

The Wage and Investment (W&I) Division submitted a Unified Work Request (UWR) on November 19, 2009, for deployment of RS-PCC Release 2. The ability to track payments to the specific processing location (Consolidated Processing Center or TAC pilot site) will be included in the RS-PCC Release 2. Deployment is scheduled to occur between November 2010 and February 2011. Since the requested action will be subject to available funding and resource prioritization by Modernization and Information Technology Services (MITS), the submission of the UWR completes the correction action.

IMPLEMENTATION DATE

N/A

RESPONSIBLE OFFICIAL

N/A

CORRECTIVE ACTION MONITORING PLAN

N/A

RECOMMENDATION 2

Revise the internal guidelines to clarify the criteria used to identify RS-PCC payments to ensure they are properly coded.

CORRECTIVE ACTION

We agree with this recommendation. We reviewed and revised internal guidelines for identifying RS-PCC payments in Internal Revenue Manual (IRM) 21.1.7, *Accounts Management and Compliance Services, Campus Support*, and IRM 3.17.278, *Paper*



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Check Conversion (PCC) System, in March 2010.

IMPLEMENTATION DATE

N/A

RESPONSIBLE OFFICIAL

N/A

CORRECTIVE ACTION MONITORING PLAN

N/A

The Commissioner, Wage and Investment Division, should:

RECOMMENDATION 3

Monitor Lost Opportunity Cost and other costs such as labor and mail costs associated with the RS-PCC as it is implemented.

CORRECTIVE ACTION

We agree with this recommendation. Monitoring of other costs associated with RS-PCC, such as labor and mail costs, are included in RS-PCC Release 2. The UWR to initiate deployment of Release 2 was submitted on November 19, 2009. Deployment is scheduled to occur between November 2010 and February 2011. Since the requested action will be subject to available funding and resource prioritization by MITS, the submission of the UWR completes the correction action.

IMPLEMENTATION DATE

N/A

RESPONSIBLE OFFICIAL

N/A

CORRECTIVE ACTION MONITORING PLAN

N/A

RECOMMENDATION 4

Develop a strategy to improve timeliness and reduce the Lost Opportunity Cost associated with processing payments through the RS-PCC at the Consolidated Processing Centers.

CORRECTIVE ACTION

We agree with this recommendation. The RS-PCC Project Team will meet with



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representatives from the W&I Division, Accounts Management Office to develop an action plan to improve timeliness of payments processed at Consolidated Processing Centers and to reduce Lost Opportunity Cost associated with processing payments through the RS-PCC.

IMPLEMENTATION DATE

August 15, 2010

RESPONSIBLE OFFICIAL

Director, Submission Processing, Customer Account Services, Wage and Investment Division

CORRECTIVE ACTION MONITORING PLAN

We will monitor this corrective action as part of our internal management control system.