



Treasury Inspector General for Tax Administration Office of Audit

INADEQUATE CONTROLS OVER DISHONORED CHECKS PUT MILLIONS OF DOLLARS AT RISK FOR ERRONEOUS REFUND ISSUANCE

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Highlights

Highlights of Report Number: 2009-40-143 to the Internal Revenue Service Commissioner for the Wage and Investment Division.

IMPACT ON TAXPAYERS

In some instances a taxpayer's payment cannot be processed by the bank. The Internal Revenue Service (IRS) refers to an unprocessed payment as a "dishonored check." Our analysis determined the IRS generated refunds resulting from dishonored check overpayments totaling approximately \$53 million to 15,192 taxpayers during the period January through July 17, 2008. TIGTA estimates the IRS was unable to stop more than \$20 million in refunds from being erroneously issued to 13,891 taxpayers (91 percent).

WHY TIGTA DID THE AUDIT

The objective of this review was to assess the efficiency and effectiveness of the processing of dishonored checks. This review was initiated as a result of the prosecution of an individual who sent 150 dishonored checks totaling more than \$3.3 million to the IRS and was able to successfully receive more than \$107,000 in erroneous refunds as a result of the IRS not timely stopping the issuance of the refunds.

WHAT TIGTA FOUND

Although the number of payments that are dishonored represents less than 1 percent of the payments processed by the IRS, weaknesses in the IRS' dishonored check processing put millions of dollars at risk.

Our review of a statistically valid sample of 268 taxpayer accounts (294 refunds) identified:

- 130 (55 percent) of the 236 dishonored checks subject to the 21-day standard were not worked within 21 days. In general, it took the IRS approximately 40 days from the date of the original payment to reverse the payment as dishonored.
- Tax Examiners did not prepare and forward necessary documentation to the IRS' Erroneous Refund Unit as required in 193 (79 percent) of the

245 dishonored check refunds in our sample that were erroneously issued to taxpayers.

Establishing an effective process to identify and stop dishonored check overpayments from refunding until the IRS is reasonably sure the related payment has cleared the bank would protect more than \$20 million a year, almost \$102 million over the next 5 years, from erroneously being issued to taxpayers. In addition, the IRS could redirect resources costing \$119,308 per year (\$596,540 over 5 years) currently used in the Erroneous Refund Unit to recover these refunds.

Finally, the IRS has the opportunity to enhance its systemic controls to prevent the erroneous issuance of refunds resulting from a dishonored check as it modernizes its payment processing in the Submission Processing sites.

WHAT TIGTA RECOMMENDED

TIGTA recommended the Commissioner, Wage and Investment Division, establish a systemic process to identify and stop refunds of dishonored check overpayments and identify refunds issued to taxpayers in Calendar Years 2008 and 2009 that were not referred to the Erroneous Refund Unit and initiate recovery of the refunds. In the long term, the Commissioner should modify the IRS' payment processing modernization project to include converting paper checks to electronic fund withdrawals.

In their response to the report, IRS officials agreed to three of the four recommendations. The IRS plans to develop a process to systemically stop refunds of dishonored check overpayments and stated they plan to initiate recovery of Calendar Years 2008 and 2009 refunds not previously referred to the Erroneous Refund Unit. The IRS did not agree with our recommendation to modify its payment processing modernization project to convert paper checks to electronic fund withdrawals because of limitations with its current system.

TIGTA recognizes the current limitations the IRS has regarding the conversion of paper checks to electronic fund withdrawals. No process has been established to convert paper checks to an electronic payment for transmission to the bank. The Electronic Federal Tax Payment System does not have the functionality to allow for this. As the IRS moves forward with its payment modernization, consideration should be given to develop such a process.

READ THE FULL REPORT

To view the report, including the scope, methodology, and full IRS response, go to:

<http://www.treas.gov/tigta/auditreports/2009reports/200940143fr.pdf>.

Email Address: inquiries@tigta.treas.gov
Web Site: <http://www.tigta.gov>

Phone Number: 202-622-6500