

*TREASURY INSPECTOR GENERAL FOR TAX  
ADMINISTRATION*



**Controls Need to Be Improved to Ensure  
Accurate Direct Deposit of Tax Refunds**

**May 2003**

**Reference Number: 2003-40-108**

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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INSPECTOR GENERAL  
for TAX  
ADMINISTRATION

DEPARTMENT OF THE TREASURY  
WASHINGTON, D.C. 20220

May 9, 2003

MEMORANDUM FOR COMMISSIONER, WAGE AND INVESTMENT DIVISION

*Gordon C. Milbourn*

FROM: Gordon C. Milbourn III  
Acting Deputy Inspector General for Audit

SUBJECT: Final Audit Report - Controls Need to Be Improved to Ensure  
Accurate Direct Deposit of Tax Refunds (Audit # 200240058)

This report presents the results of our review to determine the effectiveness of controls to prevent the diversion of refunds claimed on paper filed tax returns to direct deposit<sup>1</sup> accounts not authorized by the taxpayers.

In Tax Year (TY) 1995, the Internal Revenue Service (IRS) began to offer taxpayers who file paper tax returns the option of having their tax refunds directly deposited. To obtain a tax refund via direct deposit, the taxpayer is required to provide the Routing Transit Number, Deposit Account Number, and type of account (checking or savings) on his or her tax return. This information is necessary for the IRS to identify the specific account to which the tax refund should be deposited. The tax return instructions caution taxpayers that the IRS is not responsible for a lost tax refund if a taxpayer enters the wrong account information on the tax return.

During TY 2001,<sup>2</sup> the IRS processed over 79 million paper filed individual income tax returns, of which over 56 million had claims for tax refunds totaling approximately \$100 billion. However, control weaknesses present opportunities for tax refunds claimed on paper tax returns to be directly deposited to unauthorized bank accounts.

For example, between Calendar Years \*\*\*\*\*  
\*\*\*\*\* b(3):26 U.S.C. 6103(b)(7)(C) \*\*\*\*\*  
\*\*\*\*\*

<sup>1</sup> Direct deposit is an electronic transfer of a tax refund to a bank account specified by the taxpayer on the tax return, instead of the issuance of a paper refund check.

<sup>2</sup> TY 2001 tax returns were processed in the Submission Processing sites from January 1, 2002, through August 5, 2002. Submission Processing sites are the data processing arm of the IRS. The sites process paper submissions, correct errors, and forward data to the computing centers for analysis and posting to taxpayer accounts.

\*\*\*\*\*  
\*\*\*\*\*(b)(3):26 U.S.C. 6103(b)(7)(C)\*\*\*\*\*  
\*\*\*\*\*

Control weaknesses in both the instructions for completing the United States Individual Income Tax Return (Form 1040) and the processing procedures for when the direct deposit fields are left blank expose each of these tax refunds to the risk that an IRS employee can divert the tax refund via direct deposit to an unauthorized bank account. Furthermore, diversions of tax refunds result in taxpayers being significantly burdened, as they do not timely receive the tax refunds to which they are entitled.

Implementation of our recommendations will reduce the risk of diversion and enable detection of employees who may be involved in future improprieties. These recommendations are considered to impose the least burden on the taxpayer and are cost beneficial to the IRS. Since the initiation of the audit, IRS management has taken actions as a result of our recommendations to implement guidance to detect, deter, and refer to the TIGTA Office of Investigations potential cases of diversion of taxpayer refunds by IRS employees via direct deposit.

For the TY 2003 Filing Season,<sup>3</sup> Form 1040 instructions should be revised to require taxpayers to line through the direct deposit fields on paper filed tax returns when they are left blank. The IRS should develop procedures to address those tax returns on which the taxpayers failed to line through blank direct deposit fields. Additionally, the IRS should work with tax software preparation companies to initiate modifications to the manner in which the direct deposit fields print out for those tax returns prepared via computer and sent to IRS as paper tax returns. These modifications should eliminate the printing of the direct deposit fields when the taxpayer elects to receive a paper tax refund check.

Management's Response: IRS management agreed with the recommendations presented in the report and will take corrective action. Specifically, the 2003 instructions for completing Form 1040 will be changed to tell taxpayers to line through the direct deposit fields on the tax return if they are not requesting a direct deposit of a refund check. In addition, Submission Processing procedures will be changed to instruct Code and Edit function employees to line through this section if a taxpayer fails to follow the instructions. Also, the IRS will contact the software developers and request that they modify their programs so that the fields do not appear or cannot be altered if a taxpayer wishes to receive a paper refund check. These changes will be effective for TY 2003.

The IRS did not agree with the potential benefits presented in the report. Specifically, the IRS believed that our calculation did not consider the fact that over 8.6 million taxpayers filing paper tax returns used direct deposit to have over \$18.3 billion deposited into their accounts. Our benefit should not include these taxpayers in the

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<sup>3</sup> The filing season is the period from January through April when most individual income tax returns are filed.

calculation. Management's complete response to the draft report is included as Appendix V.

Office of Audit Comment: We appreciate management's recognition that the current procedures for direct deposit present opportunities for tax refunds claimed to be directly deposited to unauthorized bank accounts, along with their agreement to implement corrective actions, as the recommendations made in the report will substantially reduce the possibility of diversion. However, management disagreed with the potential benefits that our recommendations may have on the protection of revenue. This disagreement relates to the fact that our calculation includes tax refunds paid via direct deposit. We disagree with management's position that the benefits should be reduced by the amount of tax refunds paid via direct deposit. Our disagreement is based in the fact that control weaknesses reported present the opportunity for these tax refunds to also be potentially diverted to unauthorized bank accounts.

The TIGTA has designated this report as Limited Official Use (LOU) pursuant to Treasury Directive TD P-71-10, Chapter III, Section 2, "Limited Official Use Information and Other Legends" of the Department of Treasury Security Manual. Because this document has been designated LOU, it may only be made available to those officials who have a need to know the information contained within this report in the performance of their official duties. This report must be safeguarded and protected from unauthorized disclosure; therefore, all requests for disclosure of this report must be referred to the Disclosure Unit within the TIGTA's Office of Chief Counsel.

Copies of this report are also being sent to the IRS managers who are affected by the report recommendations. Please contact me at (202) 622-6510 if you have questions or Michael R. Phillips, Assistant Inspector General for Audit (Wage and Investment Income Programs), at (202) 927-0597.

**Controls Need to Be Improved to Ensure Accurate  
Direct Deposit of Tax Refunds**

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## TD P 15-71

### Controls Need to Be Improved to Ensure Accurate Direct Deposit of Tax Refunds

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#### Background

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In Tax Year (TY) 1995, the Internal Revenue Service (IRS) began to offer taxpayers who file paper tax returns the option of having their tax refunds directly deposited.<sup>1</sup> Tax refunds paid via direct deposit provide benefits to both the taxpayer and the IRS, including:

- Faster and more convenient receipt of the tax refund.
- Security of tax refund payment – no paper check to lose.
- Reduced refund issuance cost for the IRS when compared with issuing a paper tax refund check.

To obtain a tax refund via direct deposit, the taxpayer is required to enter the Routing Transit Number, Deposit Account Number, and type of account (checking or savings) on his or her tax return. This information is necessary for the IRS to identify the specific account to which the tax refund should be deposited. The tax return instructions caution taxpayers that the IRS is not responsible for a lost tax refund if the taxpayer enters the wrong account information on the tax return.

During TY 2001, the IRS processed over 79 million paper filed individual tax returns, of which over 56 million had claims for tax refunds totaling approximately \$100 billion, as shown in the following table.

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<sup>1</sup> Direct deposit is an electronic transfer of a tax refund to a bank account specified by the taxpayer on the tax return, instead of the issuance of a paper refund check.

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**Tax Refunds Issued by Type of Refund  
TY 2001 Paper Filed Tax Returns**

<b>Type of Refund</b>	<b>Refunds Issued</b>	<b>Dollars Refunded</b>
Paper Check	47.7 million	\$81.3 billion
Direct Deposit	8.6 million	\$18.3 billion
<b>Total</b>	<b>56.3 million</b>	<b>\$99.6 billion</b>

*Source: Treasury Inspector General for Tax Administration (TIGTA) Extract of TY 2001 Direct Deposit Database through June 2002 and Submission Processing Individual Master File<sup>2</sup> Refund Report through October 2002.*

The IRS generally processes a paper filed tax return within 6 weeks from the date the tax return is received. Subsequent to the 6-week period, taxpayers who do not receive their tax refunds can contact any of the various IRS Customer Service functions to inquire about their missing tax refunds. The IRS' Customer Service options include calling the toll-free telephone service, using the automated refund inquiry system, visiting a Taxpayer Assistance Center, sending in correspondence, and contacting the Taxpayer Advocate Service.<sup>3</sup> The identification of missing tax refunds is based solely on a taxpayer contacting the IRS, as the IRS has no process to proactively identify missing tax refunds.

Contacting the IRS through any of the above Customer Service options initiates the IRS' tax refund inquiry process. The IRS' Refund Inquiry Unit will work with the taxpayer to obtain pertinent information and perform research to determine what may have occurred with the missing tax refund. Based on the results of the Refund Inquiry Unit's research, the taxpayer could be reissued his or her tax refund or be provided with information as to why the IRS is

<sup>2</sup> The Individual Master File is the IRS database that maintains transactions or records of individual tax accounts.

<sup>3</sup> "Lost or stolen tax refunds" was ranked 11<sup>th</sup> out of 23 broadly defined reasons why taxpayers contacted the Taxpayer Advocate Service in Fiscal Year 2001.

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not responsible for the missing refund. For a taxpayer who does not receive a tax refund within 45 days after the date the IRS receives the tax return, the IRS will pay the taxpayer interest on the tax refund.

Audit testing was performed at the National Headquarters for Submission Processing (Cincinnati, Ohio, and Washington, D.C.) and the eight Submission Processing sites<sup>4</sup> that accept and process paper filed individual income tax returns. Audit work was performed between June and December 2002. The audit was conducted in accordance with *Government Auditing Standards*. Detailed information on our audit objective, scope, and methodology is presented in Appendix I. Major contributors to the report are listed in Appendix II.

**Control Weaknesses Present Opportunities for Tax Refunds Claimed on Paper Tax Returns to Be Directly Deposited to Unauthorized Bank Accounts**

Controls need to be improved to ensure that tax refunds are accurately directly deposited. Specifically, between Calendar Years 2000 and 2001, \*\*\*\*\*

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\*\*\*\*\*(b)(3):26 U.S.C. 6103(b)(7)(C) \*\*\*\*\*  
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\*\*\*\*\* b)(3):26 U.S.C. 6103(b)(7)(C)\*\*\*\*\*  
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<sup>4</sup> Submission Processing sites are located in Andover, Atlanta, Austin, Holtsville, Fresno, Kansas City, Memphis, and Philadelphia. Submission Processing sites are the data processing arm of the IRS. The sites process paper submissions, correct errors, and forward data to the computing centers for analysis and posting to taxpayer accounts.



**Controls Need to Be Improved to Ensure Accurate  
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We alerted IRS executives on June 25, 2002, to the control weaknesses in the processing of paper filed tax returns that provide opportunities for tax refunds claimed on paper filed tax returns to be directly deposited to bank accounts that were not authorized by the taxpayers. As a result of this alert, IRS management added this risk as a reportable condition to the tax processing Annual Assurance Process memorandum.<sup>5</sup> Further, the Submission Processing site functions developed an action plan to determine what controls were currently in place to prevent unauthorized direct deposits.

**Contributing factors**

Several factors contributed to the control weaknesses we identified.

*Instructions for completing the United States Individual Income Tax Return (Form 1040) do not require the taxpayer to void the direct deposit fields if the taxpayer does not use them.* When the direct deposit fields are left blank, the opportunity exists for IRS employees who work in the areas that receive and open tax returns,<sup>6</sup> review the tax returns for completeness,<sup>7</sup> and input the information from tax returns into IRS computers<sup>8</sup> to alter the fields. Specifically, the instructions do not require the taxpayer to take any preventive steps (e.g., lining through the direct deposit fields on the tax return to void them rather than leaving them blank) to ensure the fields cannot be manipulated subsequent to the filing of the tax return.

Furthermore, IRS reports indicate that approximately 48 percent of paper filed tax returns are prepared on a computer using tax preparation software packages. When these tax returns are printed, the direct deposit fields are left

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<sup>5</sup> The Annual Assurance memorandum reports instances of waste, fraud, and abuse identified in the IRS' Submission Processing sites.

<sup>6</sup> Receipt and Control function, which is responsible for handling mail.

<sup>7</sup> Code and Edit function, which is responsible for marking returns for entry into IRS computer systems.

<sup>8</sup> Data Transcription function, which is responsible for entering tax return data into IRS computer systems.

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blank for those taxpayers who elect to receive a paper check tax refund. As with the hand-written paper Forms 1040, the direct deposit fields on these tax returns can be altered.

***Tax return processing controls do not minimize the risk of, or identify potential instances of, employee diversion of tax refunds via direct deposit to unauthorized bank accounts.***

There are no controls in place to minimize the risk of, or identify potential instances of, employee impropriety via direct deposit in the areas that receive and open tax returns, review the tax returns for completeness, and input the information from tax returns into IRS computers. Specifically, IRS procedures do not require actions to be taken upon the IRS' receipt of a paper tax return to minimize the possibility of an employee inputting unauthorized direct deposit information in fields left blank by the taxpayer.

***Procedures do not provide IRS employees with guidance on identifying and referring for investigation tax returns with suspicious direct deposits.*** Procedures were not developed and distributed to those employees who work in the areas that receive and open tax returns, review the tax returns for completeness, and input the information from tax returns into IRS computers informing them of the need to refer cases with potentially unauthorized direct deposits to the TIGTA Office of Investigations.

***When working refund inquiries, IRS employees did not consider the possibility of employee impropriety for those cases involving direct deposit.*** Employees in those functions that assist taxpayers who do not receive their refunds were not required to consider the possibility of employee impropriety when evaluating tax refund inquiries that involve direct deposits.

Prior to the initiation of this audit, IRS management presumed that most unauthorized direct deposit refunds

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were the result of IRS processing errors.<sup>9</sup> The IRS' position has been that in the case of direct deposits, the taxpayer has the burden to show that the tax refund was deposited to an account *other* than the one he or she designated on the tax return. An IRS Chief Counsel advice,<sup>10</sup> dated September 6, 2002, stated that in the context of direct deposit, the IRS satisfies its burden of proof by showing that it refunded to the bank account designated by the taxpayer on the tax return. If the taxpayer does not satisfy this proof, then the IRS does not have authority to replace the incorrectly deposited refund.

In April 2002, procedures to assist the IRS' Refund Inquiry Unit in identifying potential cases of employee impropriety via direct deposit were drafted by the Taxpayer Advocate Office of Systemic Advocacy. However, the procedures were not implemented until October 2002.

We alerted IRS senior executives on August 27, 2002, that no procedures were in place to create an awareness of the possibility of employee impropriety and to refer those cases that may involve fraudulent direct deposit of tax refunds to the TIGTA Office of Investigations. As a result, IRS management implemented revised guidelines to address our concerns.

**Impact of control weaknesses**

If adequate controls are not implemented, the opportunity for employee impropriety remains high. At risk is the protection of approximately \$100 billion in tax refunds claimed on over 56 million paper filed individual income tax returns.<sup>11</sup> If controls are not strengthened, IRS employees will continue to have the ability to divert tax

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<sup>9</sup> Processing errors may include erroneously entering the direct deposit data from another taxpayer's tax return or transposition of numbers in the direct deposit fields.

<sup>10</sup> A Chief Counsel Advice is written advice or instruction prepared by the Office of Chief Counsel that is issued to IRS employees. It conveys legal interpretation of internal revenue law either in general or as applied to specific taxpayers or groups of specific taxpayers.

<sup>11</sup> For more details on the calculations, see Appendix IV.

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refunds to unauthorized bank accounts with minimal risk of being detected. Additionally, with increased controls, fewer taxpayers who do not receive the timely refunds to which they are entitled may be burdened.

**Corrective actions implemented since the initiation  
of this audit**

IRS management has developed and issued guidance in response to audit recommendations made during the course of our review. This guidance alerts employees to refer to the TIGTA Office of Investigations tax returns meeting certain criteria that may indicate diversion of a tax refund via direct deposit.

Additionally, on November 27, 2002, IRS management issued a memorandum to all Submission Processing site Directors informing them of the need to be alert to suspected activities, to monitor tax returns that are waiting to be processed in staging areas, and to pay attention to work areas where writing instruments are restricted. Further, managers were advised to immediately notify the TIGTA Office of Investigations when a suspected diversion of a tax refund occurs.

We recognize the promptness of actions taken by IRS management to date to address weaknesses reported during the audit; however, additional improvements are needed to minimize risk and to more easily focus investigators to the area in which an impropriety may have taken place.

**Recommendations**

The identification of improprieties to date are minimal when compared with the over 79 million paper filed individual income tax returns the IRS processed in TY 2001. The following recommendations are designed to minimize the IRS' risk and enable detection of any employees who may be involved in future diversions of tax refunds via direct deposit. These recommendations have been discussed with

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IRS management and are considered to impose the least burden on the taxpayer and the least cost to the IRS. For the TY 2003 Filing Season,<sup>12</sup> the Commissioner, Wage and Investment Division, should:

1. Revise Form 1040 instructions to require the taxpayer to line through the direct deposit fields if he or she is requesting a paper refund check. Internal procedures should be developed to address those tax returns on which the taxpayers failed to line through the blank direct deposit fields.

Management's Response: The 2003 instructions for completing Form 1040 will be changed to tell taxpayers to line through the direct deposit fields on the tax return if they are not requesting a direct deposit of a refund check. Submission Processing procedures will be changed to instruct Code and Edit function employees to line through this section if a taxpayer fails to follow the instructions. The changes will be effective for TY 2003 returns.

2. Work with tax software preparation companies to initiate modifications to the manner in which the direct deposit fields print out for those tax returns prepared via computer and sent to the IRS as paper tax returns. Specifically, modifications should be made to eliminate the printing of the direct deposit fields when the taxpayer elects to receive a paper tax refund check.

Management's Response: The IRS will contact the software developers and request that they modify their programs so that the fields do not appear or cannot be altered if a taxpayer wishes to receive a paper refund check. The IRS will request that the software companies make this modification to the TY 2003 versions of their software packages.

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<sup>12</sup> The filing season is the period from January through April when most individual income tax returns are filed.

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

The overall objective of this review was to determine the effectiveness of controls to prevent the diversion of refunds claimed on paper filed tax returns to direct deposit<sup>1</sup> accounts not authorized by the taxpayers. To accomplish this objective, we conducted the following tests:

- I. Obtained and reviewed the Internal Revenue Service's (IRS) guidance relating to the processing of paper filed tax returns.
- II. Identified the process followed for processing paper filed tax returns.
  - A. Identified the filing requirements for taxpayers who request a direct deposit of their individual income tax refunds.
  - B. Performed a walk-through at the Memphis Submission Processing site<sup>2</sup> to determine how paper filed tax refunds are processed.
  - C. Held discussions with representatives from the Submission Processing function to identify controls in place for processing paper filed tax returns.
- III. Determined if the IRS has controls in place to ensure that tax refunds requested on paper filed tax returns are not directly deposited to unauthorized bank accounts.
  - A. Obtained a computer extract of all direct deposit individual income tax refunds for Tax Year 2001 for the period January through June 2002 from the IRS' Direct Deposit Database File.
  - B. Because testing identified tax refunds claimed on paper filed individual income tax returns are potentially being diverted to unauthorized bank accounts, we calculated the number of tax returns with direct deposits as well as the amount of the refunds issued.
- IV. Interviewed management to identify factors that contribute to the inadequacy of the IRS' controls to prevent unauthorized direct deposit tax refunds and what actions the IRS has taken to improve controls.
- V. Identified the process to assist taxpayers who may have had their refunds lost or stolen as a result of employee theft.

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<sup>1</sup> Direct deposit is an electronic transfer of a tax refund to a bank account specified by the taxpayer on the tax return, instead of the issuance of a paper refund check.

<sup>2</sup> Submission Processing sites are the data processing arm of the IRS. The sites process paper submissions, correct errors, and forward data to the computing centers for analysis and posting to taxpayer accounts.

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- A. Identified the Refund Inquiry Unit process to assist taxpayers whose refunds are either inadvertently or intentionally diverted to incorrect bank accounts via direct deposit.
- B. Performed a walk-through at the Andover Submission Processing site to determine how taxpayers are assisted to obtain a replacement refund.
- C. Held discussions with representatives from the Accounts Management function to identify controls to identify potential cases of refunds diverted via direct deposit to bank accounts not authorized by the taxpayer.

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**Appendix II**

**Major Contributors to This Report**

Michael R. Phillips, Assistant Inspector General for Audit (Wage and Investment Income Programs)

Kerry Kilpatrick, Director

Russell Martin, Audit Manager

Edie Lemire, Senior Auditor

Grace Terranova, Senior Auditor

Mary Keyes, Auditor



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**Appendix III**

**Report Distribution List**

Commissioner N:C  
Deputy Commissioner N:DC  
Deputy Chief Financial Officer, Department of the Treasury  
Deputy Commissioner, Wage and Investment Division W  
Director, Electronic Tax Administration W:E  
Director, Strategy and Finance W:S  
Director, Accounts Management W:CAS:AM  
Director, Submission Processing W:CAS:SP

### **Outcome Measures**

This appendix presents detailed information on the measurable impact that our recommended corrective actions will have on tax administration. These benefits will be incorporated into our Semiannual Report to the Congress.

Type and Value of Outcome Measure:

- Revenue Protection – Potential; an estimated 56 million taxpayers who file a paper individual income tax return (see page 3).
- Revenue Protection – Potential; an estimated \$100 billion in tax refunds claimed by individual taxpayers who file a paper individual income tax return (see page 3).

Methodology Used to Measure the Reported Benefit:

The Internal Revenue Service (IRS) is required to process returns claiming a refund within 45 days of the date of receipt. Therefore, all timely received Tax Year (TY) 2001 returns<sup>1</sup> claiming a refund should have been processed and had refunds issued by June 1, 2002. The Submission Processing function did not have a report showing the number of paper filed individual income tax returns claiming a refund and the total refund amount.

Therefore, we determined (1) the potential number of taxpayers claiming a refund on paper filed individual income tax returns by identifying the number of TY 2001 individual income tax returns claiming a refund and (2) the potential amount of tax refunds claimed on paper filed individual income tax returns by identifying the refund amount on all TY 2001 individual income tax returns claiming a refund, based on an Individual Master File (IMF)<sup>2</sup> Refund Report provided by the Submission Processing function. We then subtracted the number of electronically filed (ELF) individual income tax returns claiming a refund and the refund amount of ELF individual income tax returns claiming a refund, based on information provided by the Electronic Tax Administration function (see the following calculation).

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<sup>1</sup> Taxpayers were required to file TY 2001 returns by April 15, 2002.

<sup>2</sup> The IMF is the IRS database that maintains transactions or records of individual tax accounts.

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	<b>Number of Refund Returns</b>	<b>Dollar Amount of Refunds</b>
Total Individual Taxpayer Returns With a Tax Refund Claim (ELF & Paper) <sup>3</sup>	99,904,833 returns	\$191,943,869,648
Less: Total IMF ELF Refunds Issued <sup>4</sup>	43,564,035 returns	\$92,422,294,124
<hr/> Total IMF Paper Refunds	<hr/> 56,340,798 returns	<hr/> \$99,521,575,524

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<sup>3</sup> Submission Processing TY 2001 IMF Refund Report dated August 5, 2002.

<sup>4</sup> Electronic Tax Administration TY 2001 statistics, provided by the Individual Electronic Filing Branch, dated October 20, 2002.

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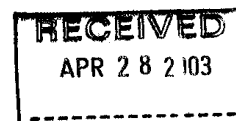
**Appendix V**

**Management's Response to the Draft Report**



DEPARTMENT OF THE TREASURY  
INTERNAL REVENUE SERVICE  
ATLANTA, GA 30308

APR 28 2003



MEMORANDUM FOR TREASURY INSPECTOR GENERAL FOR TAX  
ADMINISTRATION

FROM:

*John M. Dalrymple*  
John M. Dalrymple  
Commissioner, Wage and Investment Division

SUBJECT:

Draft Audit Report – Controls Need to Be Improved to Ensure  
Accurate Direct Deposit of Tax Refunds (Audit No. 200240058)

We recognize that the current procedures for direct deposit make them vulnerable to diversion by dishonest employees. As acknowledged in your report, the guidance we issued to our employees and managers will serve both as a deterrent to abuse and will increase the probability of detection. I believe that prompt detection, reporting, and vigorous prosecution of these offenses serve as the strongest deterrent to employee improprieties. I agree that implementing the two recommendations contained in the report will substantially reduce the possibility of employee diversion of refunds by direct deposit. The continued growth of direct deposit and expansion of electronic filing should further reduce the potential for diversion of refunds.

I disagree with the potential benefits listed in the report. Your calculation does not consider the fact that over 8.6 million taxpayers filing paper returns used direct deposit to have over 18.3 billion dollars deposited to their accounts. Your benefit calculation should not apply to those taxpayers who utilized the direct deposit feature in Tax Year 2001.

If you have any questions, please call me or Ronald S. Rhodes, Director, Customer Account Services, at (404) 338-8910.

Attachment

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Attachment

**RECOMMENDATION 1(A)**

Revise Form 1040 instructions to require the taxpayer to line through the direct deposit fields if he/she is requesting a paper refund check.

**CORRECTIVE ACTION**

We agree with this recommendation. The 2003 instructions for completing Form 1040 will be changed to tell taxpayers to line through the direct deposit fields on the tax return if they are not requesting a direct deposit of a refund check.

**IMPLEMENTATION DATE**

November 6, 2003

**RESPONSIBLE OFFICIALS**

Director, Tax Forms and Publications

**RECOMMENDATION 1(B)**

Internal procedures should be developed to line through the blank direct deposit fields if the taxpayer fails to do so.

**CORRECTIVE ACTION**

We agree with this recommendation. Submission Processing procedures will be changed to instruct the Code and Edit employees to line through this section if a taxpayer fails to follow the instructions. The changes will be effective for tax year 2003 returns.

**IMPLEMENTATION DATE**

January 15, 2004

**RESPONSIBLE OFFICIALS**

Director, Submission Processing  
Director, Customer Account Services

**CORRECTIVE ACTION MONITORING PLAN**

Completion of these corrective actions will be monitored through our normal internal control processes that cover annual updates to our tax forms and filing season processing changes made to the IRM (Internal Revenue Manual). Responsible managers will report any problems with implementation of these changes to the responsible executive. Implementation of these actions will reduce risk of refund diversion.

**RECOMMENDATION 2**

Work with tax software preparation companies to initiate modifications to the manner in which the direct deposit fields print out for those tax returns prepared via computer and sent to the IRS as a paper tax return. Specifically, modifications should be made

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to eliminate the printing of the direct deposit fields or render the fields visually unalterable when the taxpayer elects to receive a paper tax refund check.

**CORRECTIVE ACTION**

We agree with this recommendation. We will contact the software developers and request that they modify their programs so that the fields do not appear or cannot be altered if a taxpayer wishes to receive a paper refund check. We will request that the software companies make this modification to the tax year 2003 version of their software packages.

**IMPLEMENTATION DATE**

January 15, 2004

**RESPONSIBLE OFFICIALS**

Director, Electronic Tax Administration

**CORRECTIVE ACTION MONITORING PLAN**

Tax returns prepared using computer tax preparation software but printed and filed as paper returns are susceptible to alteration of the direct deposit fields. Modifications made by software companies to deter alteration to the direct deposit fields will reduce the risk of refund diversion.