



Highlights of GAO-03-299, a report to the Committee on Finance, U.S. Senate

IRS LOCKBOX BANKS

More Effective Oversight, Stronger Controls, and Further Study of Costs and Benefits Are Needed

Why GAO Did This Study

Lockbox banks are commercial banks that process certain taxpayer receipts on behalf of the Internal Revenue Service (IRS). Following an incident at a lockbox site during 2001, which involved the loss and destruction of about 78,000 tax receipts totaling more than \$1.2 billion, the Committee asked GAO to examine whether (1) provisions of the contracts under which lockbox banks operate address previously identified problems or might contribute to mishandling of tax receipts, (2) oversight of lockbox banks is adequate, (3) internal controls are sufficient, and (4) IRS and Treasury's Financial Management Service (FMS) had considered the costs and benefits of contracting out the functions performed by lockbox banks.

What GAO Recommends

GAO is making recommendations to improve oversight and internal controls at IRS lockbox banks. In addition, GAO is recommending that a study of the benefits and costs, including opportunity costs, of using lockbox banks to process tax receipts be completed before the current lockbox bank contracts expire in 2007.

In commenting on a draft of this report, FMS and IRS agreed with our recommendations and have initiated or plan to initiate actions to implement them.

www.gao.gov/cgi-bin/getrpt?GAO-03-299.

To view the full report, including the scope and methodology, click on the link above. For more information, contact Steven J. Sebastian (202-512-3406).

What GAO Found

FMS has contractual agreements with four lockbox banks, which operate 11 lockbox sites at nine locations on IRS's behalf. Of the more than \$2 trillion in tax receipts that IRS collected in fiscal year 2002, lockbox banks processed approximately \$268 billion.

The findings of GAO's study include the following:

- Nothing inherent in the lockbox contractual agreements would necessarily contribute to mishandling of tax receipts. Although a desire to avoid negative consequences, such as financial or other penalties allowed for by the agreements, could motivate bank employees to make poor decisions, penalty provisions are necessary to help the government address inadequate performance. The results of an ongoing investigation of the 2001 incident may help IRS and FMS determine whether new provisions or modifications to existing provisions are needed.
- Although IRS and FMS have significantly increased their presence at lockbox sites, oversight of lockbox banks during fiscal year 2002 was not fully effective to ensure that taxpayer data and receipts were adequately safeguarded and properly processed. Inadequate oversight resulted mainly from (1) a lack of clear oversight directives and policies, (2) failure to perform key oversight functions, and (3) conflicting roles and responsibilities of IRS personnel responsible for day-to-day oversight of lockbox banks.
- Internal controls, including physical security controls, need to be strengthened at IRS lockbox locations (see table below). In addition, the processing guidelines under which IRS lockbox banks operate need to be revised to improve receipt-processing controls, employment screening, and courier security.
- IRS and FMS have not performed a comprehensive study of the costs and benefits of using lockbox banks. The most recent study, in 1999, omitted some costs that may have affected the result. For example, the study did not consider opportunity costs—benefits forgone that might have resulted from alternative uses of the money. Because of these omissions and several changes that have affected costs and benefits, a new study will be needed before lockbox contracts expire in 2007.

Internal Control Issues Found at Lockbox Locations in Calendar Year 2002

Lockbox bank location	1	2	3	4	5	6	7	8	9
Physical security issues	X	X	X	X	X	X	X	X	X
Processing control issues	X	X	X	X	X	X	X	X	X
Courier security issues		X	X		X				
Employee screening issues	X	X	X				X	X	

Source: Findings based on reviews at the nine lockbox locations.