



Committee On Finance

Max Baucus, Chairman

NEWS RELEASE

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**Statement by Senator Max Baucus
Chairman Senate Committee on Finance
September 7, 2001
United States Senate**

NOTE: REPORT IS ATTACHED FOLLOWING STATEMENT

In a report to the Senate Committee on Finance, the Internal Revenue Service (IRS) states that an extensive investigation is still in progress into missing tax payments and documents from the lockbox operation in Pittsburgh. The IRS confirms that it is working closely with the Office of Treasury Inspector General for Tax administration (TIGTA) and has identified approximately 40,000 taxpayers to date with an associated dollar amount of \$810 million.

According to the Commissioner, the investigation has uncovered a possible motivating factor for the missing returns and payments but he refrained from revealing this information because it might jeopardize the outcome of the investigation. He also indicates that TIGTA has not yet determined whether all culpable parties have been identified, but states that no IRS employees have been implicated. The Commissioner also states that no particular tax form or payment was targeted. He writes, "whatever forms the guilty parties could remove for the staging areas with ease were taken, hidden, and some destroyed."

The Commissioner states, "all indications tell us this is not a nationwide problem" and is confined to taxpayers who live in the Northeast portion of the United States. He states that beginning with the new Lockbox agreement, effective January 2002, the IRS will require lockbox banks to upgrade their background check process.

The General Accounting Office (GAO) previously has raised concerns with respect to physical security over taxpayer receipts and taxpayer data at lockbox banks. GAO audits reveal that contracts with the lockbox banks do not prohibit the banks from allowing newly hired permanent employees to process taxpayer receipts prior to the banks' obtaining the results of fingerprint checks, nor do they require fingerprint checks of temporary employees. The Commissioner states that prior to entering duty, all temporary lockbox employees with access to taxpayer data and payments must pass a favorable FBI fingerprint check. Similarly, all full-time bank associates working with the lockbox organization must have an appropriate investigation determined by the IRS.

The Commissioner has assured the Committee that the agency is taking immediate steps

to contact those affected, advise them of the situation and work with them to minimize any fallout, including waving all interest and penalties and paying any bank fees incurred by taxpayers.

This is an intolerable situation that will burden and disrupt the lives of honest taxpayers for many months to come. Clearly, those responsible should be held accountable for their actions and the IRS and Treasury should do everything possible to ensure that appropriate safeguards are in place to prevent future occurrences.

The Committee expects a complete accounting and will begin a more comprehensive review of the IRS lockbox program.

(report follows)

September 7, 2001

The Honorable Max Baucus
Chairman, Committee on Finance
United States Senate
Washington, DC 20510-5200

Dear Mr. Chairman:

I am responding to your letter of August 16, 2001, on the status of our investigation into missing tax payments and documents from the Mellon Financial Corporation in Pittsburgh, the lockbox bank which services our Andover Submission Processing Center (ANSPC). I am deeply concerned about this situation, but believe my staff is doing everything possible to identify and assist affected taxpayers.

You asked for a detailed report on the scope of the problem and our efforts to resolve it. Because we have an extensive investigation still in progress, I cannot respond conclusively to all of your inquiries at this time. We are working closely with the Office of the Treasury Inspector General for Tax Administration (TIGTA) to minimize the impact on taxpayers. I can assure you resolution of this problem is my priority.

Background Information

Some background information on lockbox banks may help explain why we consider them beneficial - not only to our operations, but to taxpayers as well (the present situation notwithstanding). The Financial Management Service (FMS), a Bureau of the United States Department of Treasury, acquires lockbox collection services for the Internal Revenue Service. The primary goals of the lockbox network are to:

- 1) Effectively collect and process mail receipts on an accelerated schedule
- 2) Decrease the operating cost to the Government for collection processing
- 3) Accelerate the deposit of funds to Treasury

For similar reasons, many bill payment facilities, such as mortgage companies, utility companies, and large credit card companies find it practical and good business sense to use commercial banks to process their customers' payments.

Their employees are experienced in handling high-volume remittance processing. The lockbox network has served us well since 1985. The current breach of security has caused us all a great deal of distress. However, we do not view this isolated incident as a reason to discontinue our entire lockbox network relationship.

To address your specific issues about the nature and scope of the problem:

Cause(s) of the Problem

The investigation has uncovered a possible motivating factor for this problem. I respectfully refrain from revealing that information because it may jeopardize the outcome of TIGTA's investigation. At the end of a case, TIGTA usually issues a detailed Report of Investigation on their web site, which outlines their findings.

Parties Responsible for Creating the Problem

Pittsburgh Mellon Financial Corporation has fired a number of its employees following this incident. No IRS employees have been implicated. Unfortunately, I cannot state emphatically at this point that TIGTA has identified all culpable parties.

What Happened to the Missing Documents

A break in the investigation occurred the week of July 18. Mellon Corporate security personnel discovered boxes in a storage room within the processing floor of the bank. The boxes contained taxpayers' checks and tax returns from the April peak processing period. Mellon security immediately brought this to the attention of FMS, the ANSPC Lockbox Coordinator and the ANSPC Remittance Security Coordinator, who notified TIGTA. TIGTA has possession of the boxes, and is holding them as evidence. TIGTA provided ANSPC with a list of those taxpayers. ANSPC is notifying those taxpayers of the problem and giving them information on what they need to do to resolve their tax accounts.

Number and Location of Taxpayers Affected

Taxpayers affected include those who:

- 1) Mailed their Federal tax returns and payments in April 2001 to the Pittsburgh lockbox address:
P. O. Box 371361

Pittsburgh, PA 15250-7361

2) Reside in: Connecticut, Maine, Massachusetts, New Hampshire, Rhode Island, Vermont and New York (all counties except Nassau, Rockland, Suffolk and Westchester, and New York City)

Number of Tax Payments (including dollar amounts)

As noted in the Senate Finance Committee's press release of August 29, we have identified approximately 40,000 taxpayers to date, with an associated dollar amount of \$810 million. We will not know exact numbers until TIGTA has completed its investigation.

Returns and Other Documents Missing

We authorized the lockbox banks to process payments and vouchers attached to the following IRS forms (which are most often balance due returns with payments):

Form 1040	Estimated Tax
Form 1040	U.S. Individual Income Tax Return
Form 1040-NR	U.S. Non-resident Alien Income Tax Return
Form 1040-PR	U.S. Self-employment Tax Return for Puerto Rico
Form 1040-SS	U.S. Self-employment Tax Return for the Virgin Islands/American Samoa
Form 1041	Estimated Tax
Form 940	Employer's Annual Federal Unemployment Tax Return
Form 940-EZ	Short Form Employer's Federal Unemployment Tax Return
Form 941	Employer's Quarterly Tax Return
Form 943	Employer's Annual Tax for Agricultural Employees Return
Form 945	Payer's Annual Tax Return
Form 2290	Heavy Vehicle Use Tax Return
Form 4868	Application for Automatic Extension of Time to File U.S. Individual Income Tax Return
Form 8855	Form 1040 Telefile Voucher
Notice CP-521	Installment Agreement
Notice CP-523	Installment Agreement

No particular form or notice was targeted for this scheme, as evidenced by the various documents found hidden in the boxes. It appears that whatever forms the guilty parties could remove from the staging areas with ease were taken, hidden, and some destroyed.

When and How the Problem was Discovered

On May 15, 2001 the ANSPC Lockbox Coordinator and Remittance Security Coordinator (RSC) began receiving telephone calls asking if there were any systemic problems with Mellon Bank's processing. The impetus for the calls was that our toll-free telephone Customer Service Representatives (CSR) noticed a significant influx of calls from taxpayers whose tax payment

checks had not cleared their banks. After research indicated no apparent systemic processing problems, the Lockbox Coordinator notified the ANSC Remittance Security Coordinator and TIGTA of the potential problem.

Additionally, the RSC alerted the CSRs to refer future affected callers to a special unit formed solely to maintain, monitor, and resolve the accounts of these taxpayers. The RSC is responsible for centralized control, coordination, and protection of taxpayers affected by potential embezzlement and theft cases. Each of our ten submission processing campuses must have a RSC.

Actions Taken by the IRS to Address Issues Raised by this Problem. We have several procedures in place to identify the affected taxpayers and work with them to expeditiously resolve their cases.

Actions by the special unit include:

- 1) Crediting replacement checks and documents as received by the due date
- 2) Abating erroneous penalty and interest
- 3) Holding notices or any collection activity
- 4) Facilitating reimbursement of related bank fees
- 5) Giving taxpayers a telephone number and contact name in case they receive additional letters or have questions about their accounts

I have enclosed a flowchart titled IRS Process for Centralized Management of Cases to give you an in-depth overview of the processes we have in place.

The Remittance Security Coordinator and the special unit are staffed throughout the year. We anticipate that the recovery process outlined on the flowchart will continue into the next income tax filing season.

Whether the Problem is Occurring at Other Locations

All indications tell us this is not a nationwide problem. The investigation shows that taxpayers whose accounts were compromised live in the Northeast portion of the United States, and submitted Federal tax returns and payments to the Pittsburgh lockbox address in April 2001.

Actions Taken by IRS to Prevent Future Occurrences

Due to this breach of security, FMS terminated the contractual agreement with the Pittsburgh Mellon Financial Corporation effective August 20, 2001.

Since the lockbox operation is an extension of the processing performed at our ten submission processing centers, lockbox banks are held to the same stringent security guidelines of the Office of Security Oversight and Management, and adopted by the IRS and Treasury.

Those guidelines include specific requirements for: building perimeter security, secured space, automated entry systems, key and combination controls, guard services, badges, and surveillance camera videotape retention.

Unannounced and announced security reviews are performed at each site using a checklist developed from the security requirements. These security safeguards have yielded valuable evidence for TIGTA's investigation. Additionally, we have ten Submission Processing Lockbox Coordinators who work with the banks on a daily basis and are onsite during major peak periods (January, April, June and September) to perform quality reviews of the operation.

Beginning with the new Lockbox agreement, effective January 2002, we will require lockbox banks to upgrade their background check process. Prior to entering on duty, all temporary lockbox employees with access to taxpayer data and payments must pass a favorable FBI fingerprint check with disposition information. Similarly, all full-time bank associates working with the lockbox organization must have an appropriate investigation determined by the IRS Personnel Security Officer. We have updated the security checklist to include the 2002 Lockbox security standards. A certification team of IRS Program Analysts and Security Analysts and FMS' Security staff will perform a security certification of each site in the new Lockbox network. We are constantly seeking ways to improve our detection and deterrence of fraud. However, we cannot totally eradicate crime.

I hope this information will reassure you, your constituents, and Committee Members that we are making every effort to rectify this situation. I am sensitive to the frustration our customers are experiencing and the violation of the public's trust. I would be happy to meet with you to discuss this further. If I can be of further service, please call me at (202) 622-9511. Or, please call John Dalrymple, Commissioner, Wage and Investment Division, at (202) 622-6860, or Jimmy Smith, Director, Submission Processing, at (513) 684-6333.

Sincerely,

Charles O. Rossotti

Enclosure

(END)

Contact:202.224.4371