



*The Office of Professional Responsibility
Does Not Always Ensure Enrolled Agents Are
Qualified, and System Limitations Prevented
Identification of Ineligible Representatives*

September 29, 2006

Reference Number: 2006-10-170

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

3(d) = Identifying Information - Other Identifying Information of an Individual or Individuals

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TREASURY INSPECTOR GENERAL
FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY

WASHINGTON, D.C. 20220

September 29, 2006

MEMORANDUM FOR DIRECTOR, OFFICE OF PROFESSIONAL RESPONSIBILITY

Michael R. Phillips

FROM:

Michael R. Phillips
Deputy Inspector General for Audit

SUBJECT:

Final Audit Report – The Office of Professional Responsibility Does Not Always Ensure Enrolled Agents Are Qualified, and System Limitations Prevented Identification of Ineligible Representatives (Audit # 200510039)

This report presents the results of our evaluation of the effectiveness of the Office of Professional Responsibility's (OPR) administration of the Enrolled Agent (EA) Practitioner Program.

Impact on the Taxpayer

An EA is a Federally authorized tax practitioner who has technical expertise in the field of taxation. An EA may represent a taxpayer at hearings or meetings with the Internal Revenue Service (IRS) to resolve tax liabilities and other tax obligations and prepare and file documents for a taxpayer. The OPR does not have consistent criteria for issuing EA licenses, ensuring ethical behavior of the EAs, or identifying EAs who are no longer eligible to represent taxpayers. As a result, taxpayers do not have assurance that EAs are eligible to represent them before the IRS, have a broad range of technical skills, are compliant with their own tax obligations, and have not been convicted of a felony.

Synopsis

Because EAs can represent taxpayers before the IRS, it is important for the OPR to ensure taxpayers are protected from EAs who have not complied with their own Federal tax obligations or who may have criminal records. However, although the OPR verifies tax compliance when individuals submit their initial EA applications, it relies on the EAs' self-disclosure statements of compliance with Federal tax obligations and any criminal record when processing applications for renewal of EA authorizations. Our review of a random sample of 51 EAs who had renewed



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their licenses during 2005 determined that 3 (5.88 percent) of the EAs were potentially not in compliance with their Federal tax obligations and did not self-disclose the information when they filed for renewal.

In addition, IRS regulations state that persons with felony convictions may not be eligible to become EAs. In 2002, the IRS agreed with an outside consulting firm's recommendation that all EA candidates undergo a criminal Federal Bureau of Investigation background check; however, the OPR has not yet implemented a process to verify that candidates do not have the types of felony convictions that could render them ineligible for an EA license.

The OPR's current enrollment process for former IRS employees is time consuming and subjective. By licensing former employees using subjective criteria, the OPR does not have assurance that former employees have the minimal technical skills required of all other EAs for all areas of tax administration. In addition, because the criteria have changed, the IRS may have unfairly treated former employees denied an EA license under the old criteria who would qualify under the new criteria. Finally, IRS databases do not record EA data consistently.

Recommendations

We recommended the Director, OPR, implement processes for (1) conducting criminal background checks on persons who apply to become EAs, before approving their EA licenses, and (2) identifying EAs who are not compliant with their Federal tax obligations (both individual and business obligations) and addressing the noncompliance issues. We also recommended the Director, OPR, revise the Application for Renewal of Enrollment to Practice Before the Internal Revenue Service (Form 8554) to include Employer Identification Numbers so the IRS can verify whether EAs are compliant with their business and employment tax obligations. Further, we recommended the Director, OPR, require that all persons take the Special Enrollment Examination and cease allowing former IRS employees to become EAs based on experience. Finally, we recommended the Director, OPR, make correcting entries in the IRS database for the errors we identified and submit a request for computer programming changes to ensure appropriate IRS databases are updated with information on EAs who have failed to renew their licenses.

Response

IRS management agreed with our recommendations. The OPR will work with the Treasury Inspector General for Tax Administration Office of Investigations to determine if criminal background checks can be added to the tasks it performs and will revise Form 8554 to include the EA's Employer Identification Number. The OPR will continue to pursue the use of a unique identification number for tax practitioners to identify tax noncompliance and will conduct random sampling of all practitioners to review their tax compliance. In addition, the OPR will



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continue to conduct a study to assess the pros and cons of changing the regulation that permits the Director, OPR, to grant enrollment to former IRS employees by virtue of past service and technical experience in the IRS. The OPR is working with the computer programmers to refine the data that are currently exchanged between the Enrolled Practitioner Program System and Centralized Authorization File¹ so they will include the EA's status. Finally, the OPR will provide the Centralized Authorization unit with a list of the 59 EAs in terminated status we identified and request that their Centralized Authorization File accounts be placed in "Ineligible Status." Management's complete response to the draft report is included as Appendix V.

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 Nancy A. Nakamura, Acting Assistant Inspector General for Audit (Headquarters Operations and Exempt Organizations Programs), at (202) 622-8500.

¹ The Enrolled Practitioner Program System is the IRS database that stores information on EAs. The Centralized Authorization File is an IRS database that stores information on persons that are allowed to represent taxpayers as powers of attorney.



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Abbreviations

| | |
|------|---------------------------------------|
| CAF | Centralized Authorization File |
| EA | Enrolled Agent |
| EPPS | Enrolled Practitioner Program System |
| FY | Fiscal Year |
| IRS | Internal Revenue Service |
| OPR | Office of Professional Responsibility |



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Background

An Enrolled Agent (EA) is a Federally authorized tax practitioner who has technical expertise in the field of taxation. EAs, along with Certified Public Accountants and attorneys, are allowed to represent taxpayers before the Internal Revenue Service (IRS). This means they can act as a power of attorney¹ to represent a taxpayer at hearings or meetings with the IRS, prepare and file documents for a taxpayer, and communicate directly with the IRS on behalf of a taxpayer to resolve tax liabilities and other tax obligations. EAs are licensed by the IRS and are under the jurisdiction of the IRS Office of Professional Responsibility (OPR). One difference between EAs and return preparers is that there are no special licensing requirements for persons who only prepare tax returns. A return preparer who is not licensed as an EA can be any individual other than an attorney, Certified Public Accountant, EA, or enrolled actuary who prepares a taxpayer's return.

Currently, there are approximately 40,000 active EAs. There are two ways a person can become an EA: by passing a special examination or by virtue of past experience in certain job series with the IRS. Once a year, the IRS administered a Special Enrollment Examination to test a person's competencies in all facets of tax law. However, in January 2006, the IRS outsourced the Special Enrollment Examination to a private contractor that plans to begin administering the test in October 2006.

Former IRS employees may apply to become EAs without having to take the Special Enrollment Examination, if they held certain positions within the IRS. There are two types of designations the OPR grants former IRS employees: unlimited (unrestricted) enrollment or limited enrollment. The OPR grants limited enrollment if the former IRS employee had specialized knowledge in one area but not the overall technical knowledge required for unlimited enrollment.

EAs must renew their licenses every 3 years and pay an \$80 renewal fee.² If an EA fails to renew his or her license, the OPR will place the EA in inactive status. If an EA's license is not renewed after the next 3-year period, the EA will be placed in terminated status.

An OPR office in Detroit, Michigan, processes all initial EA applications, EA renewals, and applications for the Special Enrollment Examination. Figure 1 shows the volume of applications processed by employees at the Detroit Computing Center³ in Detroit, Michigan.

¹ A power of attorney is an individual recognized by the IRS to act on behalf of a taxpayer. A taxpayer designates a power of attorney by using a Power of Attorney and Declaration of Representative (Form 2848).

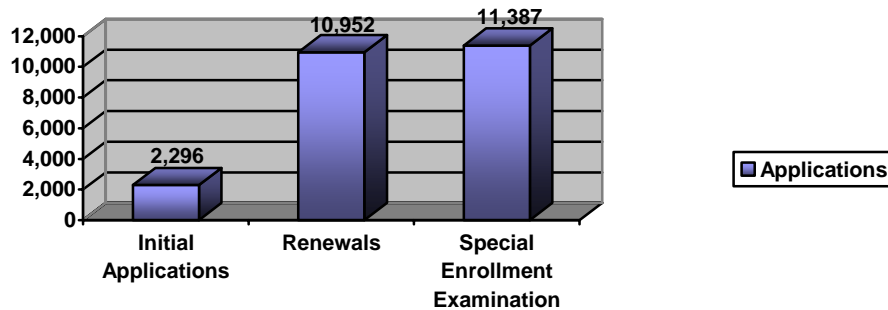
² The Department of the Treasury and the IRS published a notice of proposed rulemaking that would increase the renewal fee to \$125 (71 F.R. 51179 August 29, 2006).

³ IRS Computing Centers support tax processing and information management through a data processing and telecommunications infrastructure.



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Figure 1: Inventory Processed in Fiscal Year (FY) 2005



Source: Enrolled Practitioner Program Current Inventory Report, dated September 24, 2005.

This review was performed at the OPR offices in the IRS National Headquarters in Washington, D.C., and at the Detroit Computing Center during the period January through July 2006. 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.



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Results of Review

Criminal Background Checks Were Not Conducted for Enrolled Agent Applicants, and Tax Compliance Was Not Checked for Enrolled Agents Renewing Their Licenses

EAs are persons authorized by the IRS OPR to represent taxpayers in resolving their tax issues with the IRS. Therefore, it is important for the OPR to ensure taxpayers are protected from EAs who have not complied with their own Federal tax obligations or who may have criminal records. Although the OPR verifies tax compliance when individuals submit their initial EA applications, it relies on the EAs' self-disclosure statements when processing applications for renewal of EA authorizations. Our review of a random sample of 51 EAs who had renewed their licenses during 2005 determined that 3 (5.88 percent) were potentially not in compliance with their Federal tax obligations.

In addition, IRS regulations state that persons with felony convictions may not be eligible to become EAs. In 2002, the IRS agreed with an outside consulting firm's recommendation that all EA candidates undergo a criminal Federal Bureau of Investigation background check; however, the OPR has not yet implemented a process to verify that candidates do not have the types of felony convictions that could render them ineligible for an EA license.

Criminal background checks were not conducted on EA applicants

Each year, the OPR processes applications from the approximately 2,000 persons who either pass the Special Enrollment Examination or are former IRS employees. While the OPR reviews tax compliance of these applicants, it does not conduct criminal background checks to determine whether potential EAs have felony convictions.

IRS regulations⁴ clearly state that persons with felony convictions may be censured, suspended, or disbarred from practice before the IRS. Because EAs have access to taxpayers' Social Security Numbers, Employer Identification Numbers,⁵ bank account numbers, and other personal information, there is a risk that unscrupulous preparers could engage in identity theft activities. Therefore, it is important that the IRS limit enrollment to those persons who can pass a criminal background check.

⁴ Treasury Department Circular No. 230 (Rev. 6-2005), Section 10.51.

⁵ An Employer Identification Number, also known as a Federal Identification Number, is used to identify a business entity.



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OPR management advised us the cost of a criminal background check is approximately \$35 per person. Because the OPR charges user fees for processing an EA application, it could pass on the cost of criminal background checks to candidates who apply to become EAs. The American Bar Association and many States that license Certified Public Accountants require applicants to pass criminal background checks.

During 2001 and 2002, the IRS contracted with an independent consulting firm to review the OPR's operation. In January 2002, the consultant recommended the OPR require that all candidates undergo a criminal Federal Bureau of Investigation background check. The IRS agreed with the recommendation and considered contracting out the requirement for criminal background checks, but this action had not been taken by the end of our fieldwork. OPR management advised us this action was dependent on other recommendations made by the consultant, which were not adopted. Also, the OPR office was working on higher priority projects (such as the replacement of its information system and outsourcing of the enrollment examination) and did not have the resources to implement the recommendation to conduct background investigations. However, some of the higher priority projects have been completed and OPR management believes it may now have the resources to consider this recommendation.

The OPR did not conduct tax checks before renewing the licenses of EAs

The OPR requires all EAs to renew their licenses every 3 years and pay a fee of \$80. EAs are required to certify (self-disclose) the following by checking a box on the renewal form:⁶

- They have not been convicted of any violation of law (excluding minor traffic violations).
- They were not disciplined for alleged misconduct by any professional body or licensing authority.
- They complied with all of their individual and business Federal tax obligations during the current year and preceding 3 years.

Unlike initial applications, the OPR generally does not conduct any background research on renewal applications and relies on EAs to self-disclose their compliance with the requirements shown above. An exception is made for applications and renewal forms of EAs who self-disclose they have been sanctioned by a State or Federal Government regulatory authority.

We selected a random sample of 51 EAs who had renewed their licenses during 2005 to determine if they were compliant with their Federal tax obligations. Of these 51 EAs, 3 (5.88 percent) had potential noncompliance tax issues. The three EAs in our sample did not disclose on their renewal forms that they were not in compliance with their tax requirements. Because the OPR does not verify tax compliance, it renewed the licenses of the three EAs but did not identify the potential tax noncompliance issues. Based on the results from our sample, we

⁶ Application for Renewal of Enrollment to Practice Before the Internal Revenue Service (Form 8554).



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estimate 644 EAs who renewed their licenses in 2005 may not have complied with their personal Federal tax obligations.

We were unable to verify whether the EAs were in compliance with their business tax obligations because the OPR does not require EAs to supply the Employer Identification Numbers of their businesses on the renewal form. EAs who operate as corporations or partnerships, or who have employees, must use Employer Identification Numbers rather than their Social Security Numbers when filing business tax returns.

To protect the quality of representation provided to taxpayers, the OPR can sanction, suspend, disbar, or censure EAs who fail to comply with their tax responsibilities.⁷ Consequently, during the renewal cycle, the OPR should identify EAs who have not complied with their personal and business tax obligations and should appropriately address any noncompliance issues to ensure the EAs are brought back into compliance.

Recommendations

Recommendation 1: The Director, OPR, should implement a process to conduct criminal background checks on persons who apply to become EAs, before approving their EA licenses.

Management's Response: IRS management agreed with the recommendation and will work with the Treasury Inspector General for Tax Administration Office of Investigations to determine if criminal background checks can be added to the tasks it performs. If this is not possible, IRS management will consider alternative processes, taking into account resource constraints.

Recommendation 2: The Director, OPR, should revise the renewal form (Form 8554) to require that EAs provide their Employer Identification Numbers so the IRS can verify compliance with their business and employment tax obligations.

Management's Response: IRS management agreed with the recommendation and will revise the Form 8554 to require that EAs provide their Employer Identification Numbers.

Recommendation 3: The Director, OPR, should develop a process and guidelines for identifying EAs who are not compliant with their Federal tax obligations (both individual and any business obligations) when they submit their renewal forms and should address the noncompliance issues.

Management's Response: IRS management agreed with the recommendation and will continue to pursue the use of a Preparer Tax Identification Number to identify tax noncompliance among tax professionals. In the interim, IRS management will continue to

⁷ Treasury Department Circular No. 230 (Rev. 6-2005), Section 10.51.



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conduct random sampling of all practitioners to review their tax compliance. EAs will be randomly sampled after each renewal cycle.

The Enrollment Process for Former Internal Revenue Service Employees Is Inconsistent and Time Consuming

The IRS requires persons who are not former IRS employees to demonstrate their competence by passing a comprehensive test, the Special Enrollment Examination. When the IRS administered the Examination prior to 2006, it consisted of four tax areas: (1) individual income tax; (2) sole proprietorships and partnerships; (3) corporations including S corporations,⁸ fiduciaries, estate and gift tax returns, and trusts; and (4) ethics, record keeping procedures, appeal procedures, exempt organizations, retirement plans, practitioner penalty provisions, research materials, and collection matters.

The OPR allows certain former IRS employees to become EAs without taking the Special Enrollment Examination. The OPR bases this decision primarily on the former employee's prior job experience as shown in standardized position descriptions, as well as input on the employee's performance from his or her former supervisor. Former IRS employees generally must have a minimum of 5 continuous years with the IRS and show they regularly engaged in applying and interpreting the Internal Revenue Code and Regulations. Former IRS employees must submit their applications for enrollment within 3 years of separation from the IRS. Since October 2002, the OPR has licensed approximately 1,331 former IRS employees as EAs.

The OPR office in Washington, D.C., consisting of attorneys and paralegals, reviews all applications from former IRS employees. The OPR may grant full (unlimited) enrollment status; grant limited enrollment status that allows a former IRS employee to represent taxpayers only in certain types of tax matters, such as collection issues; or deny a former IRS employee's application.

The OPR has not developed an Internal Revenue Manual section to document how to process applications from former IRS employees. The Internal Revenue Manual is the single official source for IRS policies, directives, guidelines, and procedures for use by IRS employees in processing workload. Most information in the Internal Revenue Manual is also available to the public and tax practitioners on the IRS web site (IRS.gov).⁹ Instead of an official manual, the OPR uses procedures it has developed internally to determine if former IRS employees qualify to become EAs. However, over time, the OPR has changed its procedures from those used by the former office of the Director of Practice and has begun allowing full enrollment status to certain positions that were previously granted limited enrollment or were denied enrollment. The OPR

⁸ An eligible domestic corporation can avoid double taxation to shareholders and to the corporation by electing to be treated as an S corporation.



⁹ Some information in the Internal Revenue Manual is classified as "official use only" and is not available to the public.



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advised us it uses judgment to determine which positions within the IRS qualify for enrollment and it does not have written documentation of the basis for the decision-making process.

To evaluate the OPR's process, we reviewed applications from former IRS employees who were granted full status, granted limited status, or denied enrollment during FYs 2002 through 2005. We reviewed a sample of 50 former IRS employees granted full (unlimited) enrollment and identified 10 persons (20 percent) that appeared either to lack the technical expertise based on OPR procedures or to have had ethical issues when they were employed by the IRS. It also appears the OPR's treatment of former IRS employees was not always objective or consistent. We identified the following examples in our sample:

- 1 
- 3(d) 

In addition, we reviewed the applications of all 47 former IRS employees who were denied enrollment by the OPR. In the majority of cases, the OPR denied enrollment because it determined the former IRS employees lacked technical expertise or because of an integrity issue, such as violating the IRS' Unauthorized Access of Federal Tax Information policy. However, 7 (15 percent) of 47 persons were denied enrollment for lack of technical expertise based on OPR procedures in place at the time of the applications. It appears these seven persons would now qualify for either full or limited enrollment based on current OPR procedures.

The OPR's process to enroll former IRS employees is highly subjective and can lead to inconsistent treatment of former IRS employees. In addition, the OPR's process may not ensure all EAs are sufficiently qualified to represent taxpayers in all tax matters. We could not verify whether any former IRS employees possessed the knowledge required in all four parts of the Special Enrollment Examination by reviewing position descriptions. We believe a position description is not adequate and should not be used to assess a person's overall knowledge of tax law and procedures. For example, the OPR grants full enrollment status to former special agents with the Criminal Investigation function and revenue officers. However, these positions are highly specialized. Revenue officers possess expertise in collection matters, while special agents are law enforcement officials who conduct criminal investigations involving tax fraud. After reviewing the position descriptions for special agents and revenue officers, we concluded former IRS employees in these two positions may not have had exposure to or expertise in all four areas of the Special Enrollment Examination.



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The allowance of limited enrollment status for former IRS employees is inconsistent and cannot be enforced

The second type of EA designation for former IRS employees is a limited enrollment status, which restricts an EA to representing taxpayers in a specific field(s) of expertise. The limited enrollment status includes the following areas of expertise:

- Collection matters.
- Individual income tax matters.
- Exempt organization matters.
- Employee plans matters.
- Engineering and valuation matters.
- Estate and gift tax matters.
- International tax matters.

We reviewed a sample of applications from 50 former IRS employees granted limited enrollment and determined 29 were former revenue officers who had been allowed to represent taxpayers only in collection matters at the time they received their EA licenses. However, on February 15, 2005, the OPR changed its procedures to allow former revenue officers above a certain grade level full (unlimited) enrollment status, provided they met other qualifications, such as satisfactory performance and no disqualifying conduct. We reviewed the revenue officer position descriptions but could not determine the reason the OPR revised its procedures. It appeared the revenue officer requirements had not been changed to now incorporate a wider knowledge of issues beyond collection matters. We also found several inconsistencies in the OPR's determinations involving former IRS employees who were revenue agents. OPR management advised us they had updated the criteria for those former IRS employees who qualified for unlimited enrollment as a result of periodically reviewing current IRS position descriptions and changing the definition from strictly technical knowledge to broader criteria based on the type of IRS experience employees may have gained. OPR management believed its revised criteria was appropriate to qualify former IRS employees to represent taxpayers.

Another difficulty with the limited enrollment status is the OPR does not have a practical way to enforce the limited enrollment status and monitor the type of tax issues in which EAs engage. A taxpayer may be unaware that the EA he or she has hired can represent the taxpayer in only a limited capacity. When taxpayers engage an EA to represent them, they must sign a Form 2848 designating the EA as their power of attorney. However, Form 2848 does not indicate whether the EA has limited status and can represent taxpayers in only certain types of tax matters.

To verify that a tax practitioner has a valid power of attorney to represent a taxpayer, IRS employees query a database, the Centralized Authorization File (CAF); however, this database does not identify EAs who are limited to representing taxpayers in only certain types of tax matters. In addition, the limited enrollment status is not widely known among IRS employees because it is not mentioned in any of the Internal Revenue Manuals for Collection, Examination,



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or Appeals function employees. Consequently, current IRS employees may not be aware they should not be working with and disclosing taxpayer information to certain EAs with the limited status. OPR management advised us they had recognized these limitations and were planning to phase out the limited enrollment status and either grant full enrollment or deny applications in the future.

The time to process applications from former IRS employees should raise concern within the OPR

The OPR has established a performance goal of 90 calendar days in which to process initial EA applications. We calculated the time it took the OPR to process the applications of the former IRS employees in our 3 samples and found it took the OPR an average of 6 months to process the applications of the 100 former IRS employees granted full or limited enrollment.

In addition, it took the OPR an average of 329 calendar days to process the applications of the 47 former IRS employees whose applications for enrollment were denied. Persons denied enrollment by the Director, OPR, may appeal. The authority to decide enrollment appeals was delegated to the Associate Chief Counsel (Procedure and Administration) on April 9, 2004.¹⁰ In our sample, 6 former IRS employees used the appeal process, which took an average of 235 calendar days. Overall, it took the OPR an average of 573 calendar days to deny the applications from these 6 former IRS employees. OPR management advised us former IRS employee applications will take longer to process because the OPR field office conducts additional research, including reviewing position descriptions and sometimes contacting former managers, before approving the applications. In addition, all former IRS employee applications are reviewed in the OPR Washington, D.C., office. Regarding the length of time to process denials, OPR management advised us they will allow former IRS employees additional time to address deficiencies so they could then qualify for an EA license.

Based on these various factors, we believe the OPR's current enrollment process for former IRS employees is time consuming and too subjective. By licensing former IRS employees using subjective criteria applied on a case-by-case basis and without documentation of the basis for the decision, the OPR does not have assurance that these former IRS employees have the broad range of technical skills required for full enrollment. Consequently, the EA license does not give taxpayers assurance that the EAs have experience in their particular tax matter(s) or have the technical aptitude required by IRS regulations. OPR management believes it is the responsibility of EAs, as professionals, to decline engagements if they do not have the ability to perform them. The IRS also does not have a practical method for enforcing limited enrollment status, such as assuring that EAs will represent taxpayers only in the tax matters within their limited enrollment authority. In addition, because the OPR criteria have changed, the IRS may have unfairly treated

¹⁰ Prior to April 2004, the Senior Counselor to the Commissioner reviewed the OPR Director's decision and made the final agency determination regarding enrollment appeals.



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former employees who were denied an EA license under the old criteria but may qualify for full enrollment under the new criteria.

A private consulting firm had also reviewed the OPR's process for enrolling former IRS employees during 2001 and 2002 and found the OPR's process was inefficient. The consulting firm recommended the IRS require that all applicants pass the Special Enrollment Examination before they are allowed to represent taxpayers. The consulting firm also recommended the OPR eliminate the limited enrollment status for former IRS employees. At that time, both the former Director of Practice and the former IRS Commissioner decided not to implement the consulting firm's recommendation to require former IRS employees to pass the Special Enrollment Examination, citing harm to current IRS employees. However, as previously discussed, the former Director of Practice applied more restrictive criteria, which significantly limited the number of former IRS employees who qualified for an EA license. With the expanded criteria currently being used, we believe it is in the best interest of taxpayers for the OPR to reconsider the consulting firm's recommendations to require all persons to take and pass the Special Enrollment Examination and to eliminate the limited enrollment status.

Recommendation

Recommendation 4: The Director, OPR, should cease allowing former IRS employees to become EAs based on experience and should require all persons to take and pass the Special Enrollment Examination before being granted an EA license.

Management's Response: IRS management agreed with the recommendation. Because this will require a change to the regulations, the OPR will conduct a study to assess the pros and cons of implementation, including business unit feedback. In the interim, the IRS will review its current procedures and make appropriate adjustments.

The Internal Revenue Service Databases Do Not Record Data Consistently for Enrolled Agents Who Fail to Renew Their Licenses

EAs are required to renew their licenses every 3 years. If an EA fails to file the renewal form and pay the \$80 fee, the OPR does not automatically place the EA in terminated status on its database, the Enrolled Practitioner Program System (EPPS). If an EA fails to renew his or her license, the OPR will place the EA in inactive status, which means the EA is not eligible to represent taxpayers during this time. If an EA fails to renew his or her license after the next 3-year period, the EA will be placed in terminated status.

While the EPPS is used by the OPR to maintain information on EAs, the IRS also has a separate database for all powers of attorney, the CAF. IRS employees use the CAF (not the EPPS) to determine if a taxpayer has authorized a power of attorney to act on his or her behalf. The CAF also identifies powers of attorney who have been disbarred and who are not allowed to represent taxpayers. Due to disclosure rules, IRS employees must verify that a person has a valid



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Form 2848 on file before they discuss the taxpayer's account. However, as stated earlier, the Form 2848 does not indicate whether the EA is in good standing. As a result, as long as the taxpayer lists a person portraying himself or herself as an EA on the Form 2848, the CAF will indicate the person is representing the taxpayer and IRS employees will believe they are dealing with a licensed EA.

The CAF does not have an interface with the EPPS through which to exchange data on terminated EAs and does not have a field to show inactive or terminated EA status. Consequently, inactive or terminated status EAs could be listed on the CAF as being in good standing, although they should not be representing taxpayers because they have not renewed their licenses with the OPR. We identified this deficiency in a prior audit report in August 2004.¹¹

We selected a random sample of 130 EAs who were placed in terminated status during FYs 2002 through 2005 to determine if they were listed in good standing on the CAF. Of the 130 EAs sampled, 59 (45.38 percent) were listed on the CAF in good standing, although they had failed to comply with the OPR's renewal requirements and did not have valid EA licenses. We estimate 3,595 EAs who have lost their licenses since FY 2002 are not shown as censured on the CAF.

Because the IRS has separate computer systems that do not share all pertinent information, inactive or terminated status EAs could represent taxpayers without IRS employees or the taxpayers knowing the true status of the EAs.

Recommendations

Recommendation 5: The Director, OPR, should submit a Request for Information Services¹² so the CAF can interface with the EPPS to reflect EAs who failed to renew their licenses.

Management's Response: IRS management agreed with the recommendation. The OPR will work with the computer programmers for the EPPS and CAF, as well as the representative from the Wage and Investment Division Accounts Management function, to refine the data that are exchanged so they will include the EA's status.

¹¹ *Information on the Centralized Authorization File Is Often Not Accurate or Complete* (Reference Number 2004-10-148, dated August 2004).

¹² The IRS uses a Request for Information Services to request programming changes or updates to existing computer systems.



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Recommendation 6: The Director, OPR, should ensure the CAF is updated to show a terminated status for the 59 former EAs we identified in our sample.

Management's Response: IRS management agreed with the recommendation and will provide the CAF unit with a list of the EAs in terminated status and request that their CAF accounts be placed in "Ineligible Status."



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Appendix I

Detailed Objective, Scope, and Methodology

The overall objective of this review was to evaluate the effectiveness of the OPR's administration of the EA Practitioner Program. To accomplish this objective, we:

- I. Determined if the OPR adequately and timely processed applications from persons who took and passed the EA Special Enrollment Examination.
 - A. Obtained from the IRS EPPS¹ database a computer extract showing the number of persons who took the Special Enrollment Examination and the number of persons who applied to become EAs in FY 2005. We conducted audit tests by reviewing the data on a Microsoft Access database and determined the data provided by the IRS were reliable.
 - B. Evaluated the OPR's enrollment process for new applicants who had passed the Special Enrollment Examination by reviewing a random sample of 50 of the 1,586 persons who applied to become EAs in FY 2005. We used a 90 percent confidence interval, a ± 7 percent precision rate, and an expected error rate of 10 percent to determine the sample size.
 1. Reviewed the case files to determine if the OPR properly recorded its determination and if there was supporting documentation when EA status was not granted.
 2. Determined if the OPR conducted tax checks and criminal background checks on persons who applied to become EAs.
 3. Determined the length of time it took the OPR to process the applications of the persons in our random sample and compared the results to the OPR's performance goal.
- II. Determined if the OPR adequately and timely processed applications from former IRS employees who applied to become EAs during FYs 2002 through 2005.
 - A. Obtained from the EPPS database a computer extract showing the number of former IRS employees who had applied for enrollment since FY 2002. We conducted audit tests using a Microsoft Access database and determined the data provided by the IRS were reliable.

¹ The EPPS is the IRS database that stores information on EAs.



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1. Reviewed 2 separate samples of 50 former IRS employees who were offered full and limited enrollment and all 47 former IRS employees denied enrollment during FYs 2002 through 2005 (for a total of 147 of 1,378 former IRS employees). We used a 90 percent confidence interval, a ± 7 percent precision rate, and an expected error rate of 10 percent to determine the sample sizes.
 2. Determined the length of time it took the OPR to process applications from former IRS employees and if it met the OPR's 90-day performance goal.
 3. Determined if there was justification for the OPR's determination for granting full enrollment, granting limited enrollment, or denying the application from the former IRS employees.
- B. Evaluated the regulations, procedures, and resources to process applications from former IRS employees.
- III. Determined if the OPR was adequately conducting the renewal process for EAs that had renewed their licenses.
- A. Obtained from the EPPS database a computer extract of EAs in active, inactive, and terminated status. We conducted audit tests using a Microsoft Access database and determined the data provided by the IRS were reliable.
 - B. Reviewed a random sample of 130 of the 7,920 EAs who had failed to renew their licenses and had been placed in terminated status during FYs 2002 through 2005 to determine if they had valid powers of attorney on the CAF.² We used a 90 percent confidence interval, a ± 7 percent precision rate, and an expected error rate of 10 percent to determine the sample size.
 - C. Evaluated the OPR's renewal process by reviewing a random sample of 51 of the 10,935 EAs who had renewed their licenses in 2005 to determine if they were compliant with their tax obligations. We used a 90 percent confidence interval, a ± 7 percent precision rate, and an expected error rate of 10 percent to determine the sample size.
- IV. Reviewed the outsourcing of the Special Enrollment Examination to a commercial contractor to determine the level of service provided to the public and the cost to the Federal Government.

² The CAF is an IRS database that stores information on persons that are allowed to represent taxpayers as powers of attorney.



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- A. Reviewed the Federal Government's current process of administering the Special Enrollment Examination and the costs incurred by the Federal Government.
- B. Reviewed the proposal to outsource the test including user fees, the type and length of contract, and the statement of work. We determined if the Federal Government would be responsible for any actions or costs after outsourcing the Examination.
- C. Reviewed the winning contractor's proposal to determine the level of service and costs passed on to the Federal Government.



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Appendix II

Major Contributors to This Report

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Appendix III

Report Distribution List

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Audit Liaison: Director, Office of Professional Responsibility SE: OPR



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Appendix IV

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 Congress.

Type and Value of Outcome Measure:

- Reliability of Information – Potential; 644 EA accounts (see page 3).

Methodology Used to Measure the Reported Benefit:

We obtained from the EPPS¹ an extract of EAs who had renewed their licenses during 2005 to determine if they were compliant with their Federal tax obligations. We selected a random sample of 51 of the 10,935 EAs to review their tax compliance. In our sampling methodology, we used a 90 percent confidence interval, a 10 percent expected error rate, and a ± 7 percent precision rate. Three (5.88 percent) of the EAs in our sample were potentially not compliant with their Federal tax obligations, but the OPR had not addressed the noncompliance issues. We estimate 644 EAs who renewed their licenses in 2005 may not have complied with their Federal tax obligations. The OPR did not identify potential tax noncompliance when it renewed the licenses of the EAs.

Type and Value of Outcome Measure:

- Reliability of Information – Potential; 3,595 taxpayer accounts affected (see page 10).

Methodology Used to Measure the Reported Benefit:

We obtained from the EPPS an extract of EAs who had lost their licenses during FYs 2002 through 2005 because they had not complied with the OPR's renewal requirements. We selected a random sample of 130 of the 7,920 unlicensed EAs (in terminated status) to determine if they were shown as eligible to represent taxpayers before the IRS. We found 59 (45.38 percent) of 130 unlicensed EAs were listed on the CAF (the IRS database for powers of attorney) in good standing. We estimate 3,595 unlicensed EAs have valid powers of attorney and are eligible to represent taxpayers without the taxpayers or the IRS being aware of this situation. In our sampling methodology, we used a 90 percent confidence interval, a 10 percent expected error rate, and a ± 7 percent precision rate.

¹ The EPPS is the IRS database that stores information on EAs.



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Appendix V

Management's Response to the Draft Report



Office of Professional Responsibility

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
Washington, D.C. 20224
September 25, 2006

RECEIVED
SEP 26 2006

MEMORANDUM FOR DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: Stephen Whitlock 
Acting Director, Office of Professional Responsibility

SUBJECT: Draft Audit Report – The Office of Professional Responsibility Does Not Ensure Enrolled Agents are Qualified and System Limitations Prevented Identification of Ineligible Representatives (Audit # 200510039)

Thank you for the opportunity to comment on the draft audit report. The Office of Professional Responsibility (OPR) administers a comprehensive program to ensure that those who wish to become enrolled agents, and those who wish to remain enrolled agents, are competent and qualified to do so. Over the past several years, OPR has been engaged in a number of projects to improve our ability to administer this important program. These have included a multi-year effort to shift administration of the Special Enrollment Examination (SEE) to the private sector professional testing industry, which has resulted in a new computer based examination that conforms to industry best practices for test development and delivery. We shifted our enrollment renewal cycle from once every three years to a "rolling renewal" of approximately one third of the enrolled agents each year. We improved the timeliness of a number of our processes, and conducted studies to provide a basis for informed decisions regarding program and policy changes. Notable among these was a comprehensive study of tax compliance among attorneys, certified public accountants and enrolled agents, which revealed that enrolled agents have a substantially lower tax non-compliance rate than the other professions.

The draft audit report identifies areas for improvement in screening applications for enrollment and renewal for potentially disqualifying behaviors, including tax non-compliance, and recommends that OPR discontinue the policy of permitting former IRS employees to demonstrate technical qualifications based on qualifying experience, rather than through the SEE.

The OPR recognizes the need to effectively identify and act against practitioners who do not timely file returns and pay their Federal tax obligations. Although we rely on an enrolled agent's self-disclosure statements when processing applications for renewal, that is not the only avenue we utilize to verify tax compliance. We conducted a random sample review of tax noncompliance among enrolled agents and, as is noted above, commissioned a broader Office of Program Evaluation and Risk Assessment (OPERA)



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review of non-compliance among attorneys, CPAs and enrolled agents. We are also seeking approval to require a unique identifier on Form 2848 to aid in the verification of eligibility to represent taxpayers. This change will also facilitate automated tax non-compliance matching for attorneys, CPAs and enrolled agents. If approved, this effort will detect both individual and business non-compliance matters, and permit these cases to be considered for discipline. This enforcement effort reinforces the message included in all of OPR's speaking engagements over the past several years that we consider tax compliance to be an important matter and expect tax professionals to remain compliant. The broader focus also recognizes that enrolled agents have a substantially lower rate of tax non-compliance than the other professions, making a program that would only address enrolled agent compliance a poor strategic choice.

The consulting study referenced in your report included a wide array of recommendations, many of which affected the enrollment process. These included contracting out the development and administration of the SEE, consolidation of applications to take the exam with applications to become an enrolled agent, and relocation of the EPPS functions in Detroit to the Andover Campus. The last aspect of the recommendation, if adopted, would have consolidated enrolled agent program functions with the electronic return originator program. There was some expectation that program synergies and economies of scale would permit additional steps to be taken in the enrolled agent application and renewal process, including criminal background checks and tax compliance checks. However, the recommendation to move operations to Andover was not adopted. This meant that OPR had to work within available resources to develop and implement program improvements while maintaining or improving service levels in the ongoing program. OPR put the criminal background check recommendation on a lower priority than implementation of "rolling renewal," cutting cycle times for examination grading and other application processes, a study of tax compliance rates, continuing professional education audits, and outsourcing the SEE. As these efforts progressed, we also had to devote significant attention to an EPPS information system replacement. We are now in a position to add criminal background checks to our enrollment process.

Our response to your specific recommendations is below:

Recommendation 1: The Director, OPR, should implement a process to conduct criminal background checks on persons who apply to become EAs before approving their EA licenses.

Response: We agree with this recommendation, assuming criminal background checks can be added to the tasks that TIGTA's Office of Investigations performs for OPR. If this is not possible, we will consider alternative processes, taking into account resource constraints.

Completion Date: February 15, 2007



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Recommendation 2: The Director, OPR, should revise the renewal form (Form 8554) to require that EAs provide their Employer Identification Numbers so the IRS can verify compliance with their business and employment tax obligations.

Response: We agree with this recommendation. We will include the requirement for an Employer Identification Number on the next revision of the Form 8554.

Completion Date March 15, 2007

Recommendation 3: The Director, OPR, should develop a process and guidelines for identifying EAs who are not compliant with their Federal tax obligations (both individual and any business obligations) when they submit their renewal forms and address the noncompliance issues.

Response: We agree with this recommendation. As mentioned above, the next revision of the Form 8554 will include an Employer Identification Number and we will continue to pursue the use of a PTIN, which we believe will provide a comprehensive approach to tax non-compliance among tax professionals. In the interim, we will continue to conduct a random sampling of all practitioners to review their tax compliance. Enrolled Agents will be randomly sampled after each renewal cycle.

Completion Date: April 15, 2007

Recommendation 4: The Director, OPR, should cease allowing former IRS employees to become EAs based on experience and require all persons to take and pass the Special Enrollment Examination before being granted an EA license.

Response: Circular 230, 10.4(b) authorizes the Director of OPR to grant enrollment to former employees by virtue of his or her past service and technical experience in the IRS. This recommendation requires a change to the regulations. To accomplish this, we will conduct a study of the pros and cons of implementation including feedback from the affected Business Units. In the interim, we will review our current procedures and make appropriate adjustments.

Completion Date: June 30, 2007

Recommendation 5: The Director, OPR, should submit a Request for Information Services so the CAF can interface with the EPPS to reflect EAs who failed to renew their licenses.

Response: We agree with this recommendation. As the result of a Request for Information Services, data is currently beginning exchanged between the CAF and EPPS. For the past several months we have been reviewing the exchange of data and working closely with the programmers for the EPPS and the CAF, as well as a



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representative from W&I Accounts Management, to refine the data that is exchanged to include the enrolled agent's status.

Completion Date: October 1, 2007

Recommendation 6: The Director, OPR, should ensure the CAF is updated to show a terminated status for the 59 former EAs we identified in our sample.

Response: We agree with this recommendation. We will provide the CAF Unit a listing of the enrolled agents in terminated status with the request that their CAF account be placed in 'Ineligible Status'.

Completion Date: December 1, 2006.

If you need additional information, please contact me at (202) 927-5794.