

**Improvements Are Needed in the Screening  
and Monitoring of *E-File* Providers to  
Protect Against Filing Fraud**

**November 2003**

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DEPARTMENT OF THE TREASURY  
WASHINGTON, D.C. 20220

INSPECTOR GENERAL  
for TAX  
ADMINISTRATION

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MEMORANDUM FOR COMMISSIONER, WAGE AND INVESTMENT DIVISION  
COMMISSIONER, SMALL BUSINESS/SELF-EMPLOYED  
DIVISION

*Gordon C. Milbourn III*

FROM: Gordon C. Milbourn III  
Assistant Inspector General for Audit (Small Business and  
Corporate Programs)

SUBJECT: Final Audit Report - Improvements Are Needed in the Screening  
and Monitoring of *E-File* Providers to Protect Against Filing  
Fraud (Audit # 200340040)

This report presents the results of our review to assess the Internal Revenue Service's (IRS) regulation of Electronic Return Originators (ERO). Our assessment included the results from previously issued Treasury Inspector General for Tax Administration (TIGTA) audit reports<sup>1</sup> along with information provided in an interview with an ERO convicted of electronically filing (*e-filing*) fraudulent tax returns. Our review was performed to follow up on the current status of recommendations addressing the concerns identified in the previous reports.

The IRS' *e-file* Program offers taxpayers an alternative to filing a traditional paper tax return. The *e-file* Program enables taxpayers to send their tax returns to the IRS in an electronic format via an authorized IRS *e-file* Provider, known as an ERO. The ERO is the first point of contact for most taxpayers filing a tax return through the *e-file* Program. As of July 2003, 154,468<sup>2</sup> EROs were authorized to participate in the *e-file* Program, and they had *e-filed* over 36 million of the over 52 million *e-filed* tax returns.

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<sup>1</sup> *E-File Providers Are Not Adequately Screened* (Reference Number 2002-40-111, dated June 2002); and *Improvements to the Electronic Return Originator Monitoring Program Are Needed* (Reference Number 2003-30-039, dated January 2003).

<sup>2</sup> The IRS provided this figure, and we did not validate it. However, it is overstated, as *e-file* Providers can be authorized to transmit *e-filed* tax returns to more than one Electronic Individual Return Submission Processing Site.

The primary means by which the IRS regulates EROs are the ERO application screening process and the ERO monitoring program. The ERO application screening process is used by the IRS to ensure that the individuals applying for entry into the *e-file* Program have met required screening and verification checks before they are authorized to participate in the Program. The ERO monitoring program is designed to ensure EROs are in compliance with *e-file* regulations.

The IRS continues to authorize individuals to participate in the *e-file* Program without ensuring they have met all required screening checks. These checks include: (1) meeting age and/or citizenship requirements, (2) ensuring the validity of an individual's current standing when a professional certification is provided in lieu of a fingerprint card, and (3) passing a criminal background check. For the limited number of individuals that were subjected to a criminal background check,<sup>3</sup> procedures did not ensure that the results from the criminal background check were properly analyzed prior to making a decision regarding acceptance in the Program.

In 2003, the IRS took steps to strengthen its monitoring program by requesting computer programming that will continuously monitor the tax accounts of EROs for suspect transactions. However, improvements are needed in the process followed to monitor individuals once they have been authorized to participate in the *e-file* Program. Specifically, the monitoring program does not include requirements to perform periodic criminal background checks, or to analyze and use the results of the percentage of rejected returns<sup>4</sup> by an ERO as an indicator of noncompliance or possible educational outreach opportunities. Furthermore, goals and measurements to assess the effectiveness of the ERO monitoring program have not been established.

Both the TIGTA and an IRS Task Force have made numerous recommendations to address the above detailed weaknesses in the ERO screening process and monitoring program. However, the IRS has taken corrective actions in response to only some of these recommendations (see Appendix V for details on previous recommendations).

As a result of applicant screening and monitoring control weaknesses, individuals have been accepted into the Program and have used it to commit filing fraud. For example, 1 ERO filed approximately 9,000 fraudulent returns over a 3-year period and received approximately \$7 million in fraudulent refunds in 1 year alone. This ERO had a criminal history and an *e-file* reject rate of over 40 percent. The high reject rate occurred because the ERO used the IRS to verify whether illegally obtained Social Security Numbers the ERO used on the fraudulently prepared *e-filed* tax returns were valid per IRS records. This ERO has pled guilty to filing false, fictitious, and fraudulent claims against the United States (U.S.) (tax returns) for 5 years, among other crimes.

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<sup>3</sup> A fingerprint card is not required if the applicant has a professional certification. For applicants that do submit fingerprint cards, only one in four is sent for a Federal Bureau of Investigation criminal background check.

<sup>4</sup> When an *e-filed* return is transmitted to the IRS, it is run through a series of validity and error checks. These checks look for such things as names and Social Security Numbers that match IRS records, math errors, and other common errors. If errors are found, the return is rejected back to the ERO to fix the error and resubmit the return. The percentage of returns transmitted versus returns rejected is known as the "reject rate."

To protect the integrity of the *e-file* Program and protect taxpayers and the Federal Government against losses from filing fraud, we recommended that during the application screening process the Commissioner, Wage and Investment (W&I) Division, ensure that: (1) the age and citizenship requirements are met, (2) criminal background information is obtained electronically, (3) individuals who provide professional certifications are in current standing, and (4) the oversight responsibility for the screening process is transferred away from the current function to eliminate any potential conflict of interest. We also recommended that the Commissioner, W&I Division, subject authorized EROs to periodic updates of criminal investigations, and require *e-file* reject rates to be analyzed and used as an indicator when selecting EROs for visits/educational efforts. Finally, we recommended that the Commissioner, Small Business/Self-Employed Division, establish a system to measure the effectiveness of the ERO monitoring program.

Management's Response: The IRS agreed completely with five of our seven recommendations and partially agreed with one other. Management has already initiated a number of corrective actions. One change the IRS made recently was to shift the oversight of the screening/monitoring process for EROs to the Electronic Tax Administration organization that is responsible for oversight of the *e-file* Program.

While the IRS agreed that our outcome measure represents a reasonable estimate of potential cost savings, management did not agree that performing periodic criminal background checks for all individuals authorized to participate in the *e-file* Program is feasible. As a result, they did not agree with the outcome measure. IRS management believes that enhancements to the monitoring program will outweigh the cost associated with performing the additional checks.

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

Office of Audit Comment: We support the IRS' primary *e-file* goal of ensuring that individuals who apply to participate in the *e-file* Program have met required screening and verification checks. The recommendations management agreed to implement will assist the IRS in meeting this goal. However, management did not agree to completely implement Recommendation 1 and disagreed with Recommendation 5. Without fully implementing these two recommendations, the IRS' ability to protect the integrity of the *e-file* Program, and protect taxpayers and the Government against losses from filing fraud, may be hindered.

Specifically, IRS management indicated that concerning Recommendation 1, they do not believe researching existing information currently maintained to ensure applicants meet citizenship requirements is beneficial. We believe that this would be beneficial. Considering the Government's focus on citizenship issues, the IRS should ensure all EROs meet the requirements of citizenship. In addition, at the completion of our prior

review and based on our analysis of IRS data,<sup>5</sup> we referred to the TIGTA's Office of Investigations 350 authorized EROs identified as having questionable citizenship. To date, the Office of Investigations has confirmed that 93 of these individuals are not U.S. citizens or legal resident aliens and, therefore, should not have been authorized to participate in the *e-file* Program.

Management also disagreed with Recommendation 5 to perform periodic criminal background checks. Management indicated that this would apply to only *e-file* Providers in good standing with initial checks being done to determine if an individual can be trusted to process electronic tax returns. We agree that the initial checks, if performed, assist in identifying individuals who should not be authorized to participate. In addition, we agree that periodic checks alone will not correct the problem of *e-file* filing fraud. However, we continue to believe that these periodic checks may complement other monitoring process improvements the IRS is making. Periodic checks and other planned monitoring improvements may assist the IRS in ensuring that authorized *e-file* Providers continue to comply with *e-file* rules and are not involved in unethical practices regarding tax return preparation and/or disreputable conduct, which are both conditions for non-acceptance in the Program. While we still believe our recommendations are worthwhile, we do not intend to elevate our disagreement concerning them to the Department of Treasury for resolution.

Finally, management noted that although the outcome measure presented in our audit report was a reasonable estimate, they could not agree to the outcome because they disagreed with Recommendation 5. We continue to support our revenue protection outcome measurement and believe that if the recommendations made in prior reports had been implemented, the ERO we cited in our audit report as having filed approximately 9,000 fraudulent tax returns over a 3-year period, and who received approximately \$7 million in fraudulent tax refunds in 1 year, could have been identified earlier, thus preventing a loss of Government funds.

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.

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<sup>5</sup> *E-File Providers Are Not Adequately Screened* (Reference Number 2002-40-111, dated June 2002); and *Improvements to the Electronic Return Originator Monitoring Program Are Needed* (Reference Number 2003-30-039, dated January 2003).

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## Improvements Are Needed in the Screening and Monitoring of E-File Providers to Protect Against Filing Fraud

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### Background

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The Internal Revenue Service's (IRS) electronic filing (*e-file*) Program offers taxpayers an alternative to filing a traditional paper tax return. The *e-file* Program enables tax returns to be sent to the IRS in an electronic format via an authorized IRS *e-file* Provider known as an Electronic Return Originator (ERO).

An ERO is the first point of contact for most taxpayers filing a tax return through the IRS' *e-file* Program. An ERO originates the electronic submission of a return to the IRS. As of July 2003, 154,468<sup>1</sup> EROs were authorized by the IRS to participate in the *e-file* Program, and they had electronically filed (*e-filed*) over 36 million of the over 52 million *e-filed* tax returns.

The IRS is responsible for reviewing applications from individuals applying to participate in the *e-file* Program, as well as ensuring that the individuals who have been authorized to participate maintain a high degree of integrity and adhere to the highest professional and ethical standards.

To become an ERO, an applicant is required to prepare and submit to the IRS an Application to Participate in the IRS *e-file* Program (Form 8633), along with a fingerprint card. The IRS allows individuals who have a professional certification to send a copy of the certification in lieu of a fingerprint card.<sup>2</sup> The requirements and screening checks outlined in the IRS' *Handbook For Authorized IRS e-file Providers of Individual Income Tax Returns* (Publication 1345) are meant to ensure the integrity of the individuals authorized to participate in the *e-file* Program and include:

- Applicant must be a United States (U.S.) citizen or legal resident alien.
- Applicant must be 21 years of age as of the date of the application.

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<sup>1</sup> The IRS provided this figure, and we did not validate it. However, it is overstated, as *e-file* Providers can be authorized to transmit electronically filed tax returns to more than one Electronic Individual Return Submission Processing Site.

<sup>2</sup> Per Form 8633, professional certifications include attorneys, banking officials, and Certified Public Accountants.

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- Applicant must pass a criminal background check.
- A determination must be made as to whether individual and business tax returns were filed and taxes owed were paid.

The primary means by which the IRS regulates EROs are the ERO application screening process and the ERO monitoring program. The ERO application screening process is used to ensure that the individuals applying for entry into the *e-file* Program have met required screening and verification checks before they are authorized to participate in the Program. The ERO monitoring program is designed to ensure EROs are in compliance with *e-file* regulations.

This audit was performed in the Wage and Investment (W&I) Division Headquarters in Atlanta, Georgia. Our assessment included reviewing the results from previously issued Treasury Inspector General for Tax Administration (TIGTA) audit reports,<sup>3</sup> along with information provided in an interview with an ERO convicted of filing fraudulent tax returns. Our review was performed to follow up on the current status of recommendations addressing the concerns published in our two previous audit reports.

Audit work was conducted between February and May 2003 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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### Improvements Are Needed in the Applicant Screening Process

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The W&I Division has initiated actions to improve its applicant screening process. Specifically, management consolidated the screening site of all applicants to one location to ensure consistent and stringent procedures are used to screen the applicants. In addition, the IRS encourages individuals who attend its National Tax Forums

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<sup>3</sup> *E-File Providers Are Not Adequately Screened* (Reference Number 2002-40-111, dated June 2002); and *Improvements to the Electronic Return Originator Monitoring Program Are Needed* (Reference Number 2003-30-039, dated January 2003).



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to apply onsite to be EROs, including providing fingerprinting.

In an attempt to meet the IRS Restructuring and Reform Act of 1998 (RRA 98)<sup>4</sup> goal of having 80 percent of all tax returns filed electronically by 2007, the IRS aggressively marketed becoming an *e-file* Provider to private firms and individuals. However, the IRS function responsible for oversight of the screening and acceptance process for new EROs is also responsible for marketing the *e-file* Program to potential EROs. This could result in a separation-of-duties conflict, as the function is both responsible for creating standards and controls to ensure integrity of the system, and involved in trying to encourage practitioners to become EROs.

There continue to be several areas where the ERO applicant screening process can be improved.

### **Prior audit report identified that applicant screening checks were not always being completed**

A previous TIGTA report<sup>5</sup> assessing the IRS' process of screening ERO applicants found that the IRS did not have effective screening procedures to adequately determine who should be allowed to participate in the *e-file* Program. Specifically, we reported that:

- The IRS does not independently validate age and citizenship requirements.
- Screening checks publicized to the taxpaying public as extensive were found to be limited primarily to whether an individual filed tax returns and paid taxes due.
- Screening checks were not performed for individuals who participate as EROs as a service not for profit (such as at Volunteer Income Tax Assistance (VITA) and American Association of Retired Persons (AARP) sites).

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<sup>4</sup> Pub. L. No. 105-206, 112 Stat. 685 (codified as amended in scattered sections of 2 U.S.C., 5 U.S.C. app., 16 U.S.C., 19 U.S.C., 22 U.S.C., 23 U.S.C., 26 U.S.C., 31 U.S.C., 38 U.S.C., and 49 U.S.C.).

<sup>5</sup> *E-File Providers Are Not Adequately Screened* (Reference Number 2002-40-111, dated June 2002).

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- For the limited number of individuals selected for a criminal background check, 60 percent received authorization to participate in the *e-file* Program before the results from the Federal Bureau of Investigation (FBI) were received and analyzed.<sup>6</sup>

Weaknesses in the applicant screening process resulted from internal IRS guidelines that state the applicant screening site is not responsible for verifying the age, citizenship, or validity of professional certification programs. Also, the Form 8633 does not require IRS volunteers to provide identifying information on the *e-file* application. IRS management indicated that it relies on voluntary compliance and the fact that the IRS asks for information such as a fingerprint card or professional certification as deterrents to individuals with criminal backgrounds who would attempt to apply to the *e-file* Program.

In response to the previous recommendations, IRS management acknowledged the risks involved and chose to partially accept one of the four recommendations. The IRS' response to those recommendations not accepted was that "simply increasing the number of applicants we subject to an existing compliance check does not necessarily equal a more effective screening method."

### **Follow-up audit work identified that EROs continue to be inadequately screened**

Our follow-up audit work has identified that the IRS continues to authorize individuals to participate in the *e-file* Program without adequately screening these individuals. Specifically, individuals continue to be accepted into the *e-file* Program without assurance that they:

- Met age and citizenship requirements.
- Are in current standing with the organization to which a professional certification relates.
- Successfully passed a criminal background check.

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<sup>6</sup> A fingerprint card is not required if the applicant has a professional certification. For applicants that do submit fingerprint cards, only one in four is sent for an FBI criminal background check.

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- Are subjected to screening checks if they participate as volunteer EROs.

***Individuals continue to be accepted into the e-file Program without assurance that age and citizenship requirements have been met.***

Despite having the data to enable independent verification of age and citizenship requirements, the IRS still relies on applicants' voluntary compliance when providing this information. The IRS receives data from the Social Security Administration that contains an individual's date of birth and a citizenship code. These data are readily available through the IRS' computer system.

***Individuals continue to be accepted into the e-file Program without assurance that they are in current standing with the organization to which a professional certification relates.***

The IRS still permits individuals to provide a professional certification in lieu of a fingerprint card. This means these individuals will not be subjected to a criminal background check. However, during our previous review, we found that individuals submitted certifications that were over 20 years old. In addition, one individual simply stated he or she had a certification but did not submit the documentation. In both examples, the individuals were accepted into the *e-file* Program.

***Individuals continue to be accepted into the e-file Program without assurance that they successfully passed a criminal background check.***

- *Criminal background checks are not completed on some individuals who apply to become an ERO.* The IRS still subjects only one out of every four applicants, excluding those who provide a professional certification, to a criminal background check. The process used by the IRS to perform these criminal background checks is a time-consuming, manual, paper-based fingerprint process. However, significant technological advances have created an electronic means to perform criminal background checks, enabling fingerprints to be electronically scanned and transmitted to the FBI over

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a Wide Area Network. This would reduce the IRS' current time period to obtain criminal background checks from up to 14 days to a 24-hour turnaround. Currently, other Federal Government agencies such as the Office of Personnel Management and the Census Bureau use this method. Depending upon the volume and other technical issues, the cost of the system would be approximately \$10,000 to \$20,000.

- *Criminal background investigations, when performed, were not properly conducted.* When criminal background checks were performed and results (criminal activity) were returned, these results were not properly analyzed prior to making the decision to accept the applicant into the *e-file* Program.

Specifically, we reviewed the data returned from criminal background checks on 90 applicants during December 2002. We found that only 10 of the 90 reports were sent to the Criminal Investigation (CI) function for review despite IRS procedures specifying that when the criminal background information is returned from the FBI showing criminal activity, the information must be forwarded to the Fraud Detection Center<sup>7</sup> in the CI function. The CI function recommended a “fail” on 9 of the 10 reports sent for review.

Our review of the 80 criminal background reports not sent to the CI function for review identified that 5 of the individuals had criminal histories that would warrant review. Specifically:

- One applicant had been convicted of three counts of theft and served time for the crime. On documentation sent in with his or her application, the prospective applicant stated, “The charge was brought about because I had taken funds from an account over which I had power of attorney and used these funds for personal use.”

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<sup>7</sup> The Fraud Detection Centers detect refund fraud and identify prevention measures.

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- One applicant was convicted of Breach of Trust and stated in an attachment to the application that he or she had been “Convicted Breach of Trust, Nov. 1994. Misappropriation of Funds.”
- One applicant was convicted in 1982 of Forgery and served 3 years.
- One applicant was convicted of theft of personal property and battery of a spouse and had other criminal charges.
- One applicant was charged with Fraud Activities. According to documentation sent in with the application, the applicant stated he or she was convicted of “Larceny in a building over \$100.00.”

Procedures detailing the process to be followed when criminal background information is returned by the FBI, including the need to refer for review those individuals who have criminal histories, were not always followed. Subsequent to our review, the IRS issued specific procedures to clarify that when the FBI returns a fingerprint card with criminal data, it is to be forwarded to the CI function.

***Individuals continue to be accepted into the e-file Program without assurance that they are subjected to screening checks if they participate as volunteer EROs.***

Individuals who participate as EROs as a service not for profit (such as at VITA and AARP sites) are not screened. During 2002, there were 6,059 EROs in the VITA Program who provided *e-filing* or tax preparation as a service not for profit and *e-filed* in excess of 500,000 tax returns. IRS management stated that screening of these volunteers is extremely difficult because:

- *Training of volunteers continues up to February 1.* Since the training of the volunteers occurs until the volunteer sites open, it would take until after the normal tax filing deadline (April 15) to complete all the screening checks on the volunteers.

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- *Many trained volunteers do not show up.* Approximately one-half of the volunteers who are trained will not appear to help taxpayers at the volunteer sites.
- *Perceived burden on the volunteers.* Subjecting volunteers to the same screening process required of a paid tax preparer would seem intrusive and a burden to volunteers. As a result, individuals would not volunteer to help low-income taxpayers prepare their returns.

Although there is a risk in not screening these volunteers, the IRS must weigh the risk against the benefits they have to low-income taxpayers. The IRS should continue to monitor the volunteer programs, especially as they grow in the future.

### **Control weaknesses in the applicant screening process enable EROs to commit filing fraud**

Both the TIGTA and an IRS Task Force have made numerous recommendations to IRS management to address the above concerns with the ERO screening process; however, IRS management has adopted only a few of the recommendations (see Appendix V for a list of the recommendations). As a result, these concerns still exist, and some EROs have used the *e-file* Program to commit filing fraud and obtain fraudulent refunds. For example:

- One ERO filed approximately 9,000 fraudulent tax returns over a 3-year period and received approximately \$7 million in fraudulent tax refunds in 1 year alone. This ERO had a criminal history before being accepted as an ERO. The ERO recently pled guilty to filing false, fictitious, and fraudulent claims against the U.S. (tax returns) for 5 years, conspiracy to file false claims against the U.S., and conspiracy to negotiate forged U.S. Treasury checks of approximately \$33,000. In an interview with the ERO, we learned that the person had been arrested for alien smuggling and deported, but then re-entered the U.S. using the passport of another person and became an ERO.

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- One ERO was allowed to participate in the *e-file* Program despite being a convicted felon. The ERO never disclosed having been convicted of a crime on the application to participate in the *e-file* Program, and the person's fingerprints were sent for FBI analysis. This ERO has since pled guilty to mortgage fraud, bank fraud, and identity theft and is serving an 8-year sentence.

### **Applicant screening control weaknesses could impact taxpayers and the Federal Government**

As stated in Publication 1345:

*...While all authorized IRS e-file Providers must be on the lookout for fraud and abuse in the IRS e-file Program, EROs must be particularly diligent while acting in their capacity as the first contact with taxpayers filing a return. Neither EROs nor the IRS benefit when the integrity and reputation of the IRS e-file Program is tarnished by fraud or allegations of abuse. EROs with problems involving fraud and abuse may be suspended from the IRS e-file Program, be assessed civil and preparer penalties, or be subject to legal action.*

There are currently no national standards that an individual is required to satisfy before presenting himself or herself as a Federal tax preparer and selling tax preparation services to the public. Therefore, it is of the utmost importance that the IRS adequately screen individuals to protect both the taxpaying public and the Federal Government from losses resulting from actions by unscrupulous EROs.

### **Recommendations**

The Commissioner, W&I Division, should enhance the screening procedures for EROs by:

1. Requiring verification of age and citizenship of applicants before acceptance into the *e-file* Program.

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Management's Response: The deployment of *e-Services* Release 1.2 will allow the IRS to validate both the Social Security Number (SSN) and date of birth during the *e-file* application process. Unfortunately, *e-Services* does not offer a separate systemic citizenship check. The IRS will continue to use current procedures that require principals and responsible officials to possess valid SSNs. If the applicant does not provide a valid SSN, then the applicant is ineligible and the application is rejected.

Office of Audit Comment: Management indicated that they do not believe researching existing information they currently maintain to ensure applicants meet citizenship requirements is beneficial. We do not agree with management's assertion that this would not be beneficial. Considering the Government's focus on citizenship issues, the IRS should be participating by ensuring all EROs are legal citizens, as required. In addition, at the completion of our prior review,<sup>8</sup> we referred 350 authorized EROs to TIGTA's Office of Investigations identified as having questionable citizenship based on our analysis of IRS data. To date, the Office of Investigations has confirmed that 93 of these individuals are, in fact, not U.S. citizens or legal resident aliens and, therefore, should not have been authorized to participate in the *e-file* Program. Without implementing this recommendation, the IRS' ability to protect the integrity of the *e-file* Program, as well as taxpayers and the Government against losses from filing fraud, may be hindered.

2. Sending scanned fingerprints to the FBI electronically. For those fingerprint cards that are unprocessable, a name check should be used as the basis for the criminal background check.

Management's Response: Based on IRS discussions with the FBI, the IRS would qualify to obtain electronic access to the FBI's fingerprint system. This process requires that the

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<sup>8</sup> *E-File Providers Are Not Adequately Screened* (Reference Number 2002-40-111, dated June 2002); and *Improvements to the Electronic Return Originator Monitoring Program Are Needed* (Reference Number 2003-30-039, dated January 2003).



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IRS purchase scanning hardware and software. Fingerprint results will be returned within a 24-hour period. However, completion of this acquisition process will not occur before the 2004 Filing Season.<sup>9</sup>

For those fingerprint cards that are unprocessable, interim procedures were instituted that provide an applicant two opportunities to submit processable fingerprint cards. If the second attempt is unprocessable, the IRS will request the FBI perform a background check using name and other available information.

3. Verifying that individuals who provide professional certifications in lieu of a fingerprint card are in current standing with the organization to which the professional certification relates.

Management's Response: The deployment of *e-Services* Release 1.2 will systemically validate that an enrolled agent is in current standing during the application process. While there is no central repository of information that can currently be systemically checked for other categories of professionals, the IRS will pursue the feasibility of developing a method to perform this check for the other categories.

4. Addressing the separation-of-duties conflict by shifting the oversight responsibility for the screening/verification process for EROs to the organization responsible for oversight of the *e-file* Program and away from the marketing function.

Management's Response: On August 10, 2003, the IRS transferred the oversight responsibility for the screening process for EROs to the Electronic Tax Administration Division, which also has oversight of the *e-file* Program.

Improvements are needed in the process followed to monitor individuals once they have been authorized to participate in the *e-file* Program to ensure these individuals continue to maintain a high degree of integrity and adhere to the highest professional and ethical standards. The purpose

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### **Improvements Are Needed in the Electronic Return Originator Monitoring Program**

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<sup>9</sup> The filing season is the period between January and mid-April when most individual income tax returns are filed.

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of monitoring is to verify EROs' compliance with requirements for participating in the IRS' *e-file* Program. The IRS uses two methods to monitor EROs: Program monitoring and Field monitoring.

Program monitoring consists of a computerized analysis of an ERO's tax filing and tax payment compliance. This analysis is performed on a yearly basis for all EROs participating in the Program, as well as when an individual applies to become an ERO.

Field monitoring involves IRS employees visiting an ERO's establishment. These visits are designed to ensure the ERO is in compliance with *e-file* regulations. Depending on the seriousness of the infraction, violations of the IRS' ERO requirements may result in a verbal or written warning, written reprimand, suspension, or expulsion of the ERO from the IRS *e-file* Program. The goal to visit 1 percent of all EROs was achieved in both Calendar Years 2001 and 2002.

### **ERO monitoring does not include subsequent criminal background checks and/or the analysis and use of the percentage of e-file reject rates**

In response to a recommendation made by the TIGTA in 1999,<sup>10</sup> IRS management submitted a request in 2003 for a computer program that will continuously monitor the tax accounts of EROs for suspect transactions.

However, the current ERO monitoring consists only of monitoring for tax compliance and submission of required *e-file* forms. We found that there are no subsequent, nontax-related screening checks performed. For example:

- *Periodic criminal background checks are not performed once an ERO is accepted into the e-file Program. As we reported in June 2002,<sup>11</sup> once individuals are authorized to participate in the e-file Program, there are no*

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<sup>10</sup> *Further Improvements Are Needed to the Internal Revenue Service's Process for Admitting Preparers and Transmitters Into Its Electronic Filing Program* (Reference Number 092104, dated September 1999).

<sup>11</sup> *E-File Providers Are Not Adequately Screened* (Reference Number 2002-40-111, dated June 2002).

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subsequent monitoring checks to ensure they continue to maintain a high degree of integrity and adhere to the highest professional and ethical standards.

In response to our previous report, IRS management indicated that once an individual is accepted in the *e-file* Program, evidence of disreputable conduct is based solely on referrals from the taxpaying public. The IRS could periodically update criminal background checks on EROs with electronically scanned fingerprint cards.

- *Reject rate<sup>12</sup> information is not analyzed and used to identify noncompliance or EROs that may require educational assistance.* Currently there is no requirement to use an ERO's reject rate as a possible indicator of ERO noncompliance or education needs. Using reject rates would focus Program as well as Field monitoring to specific EROs.

An IRS *e-file* task force report, "*Electronic Filing System: Suitability/Security/QRDT*,"<sup>13</sup> issued May 1991, recommended that a reject rate of 15 percent be the maximum for continued participation in the Program. A TIGTA report<sup>14</sup> issued in 1999 found that although the national average reject rate for all EROs is 14 percent, EROs with fraud penalties had an overall reject rate of 23 percent.

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<sup>12</sup> When an *e-filed* return is transmitted to the IRS, it is run through a series of validity and error checks. These checks look for such things as names and SSNs that match IRS records, math errors, and other common errors. If errors are found, the return is rejected back to the ERO to fix the error and resubmit the return. The percentage of returns transmitted versus returns rejected is known as the "reject rate."

<sup>13</sup> QRDT stands for the Questionable Refund Detection Team.

<sup>14</sup> *Further Improvements Are Needed to the Internal Revenue Service's Process for Admitting Preparers and Transmitters Into Its Electronic Filing Program* (Reference Number 092104, dated September 1999).

## Improvements Are Needed in the Screening and Monitoring of E-File Providers to Protect Against Filing Fraud

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During 2002, there were 47,804 authorized EROs that transmitted at least 100 *e-filed* tax returns each. Table 1 shows that 11,921 (25 percent) of the 47,804 authorized EROs had an *e-file* reject rate over 15 percent.

**Table 1: 2002 Reject Rates for EROs With 100 or More *e-filed* Returns**

Reject Rate Percentage	Number of EROs	Percentage
Equal to or less than 15 percent	35,883	75%
Over 15 percent	11,921	25%

Source: TIGTA Analysis of IRS 2002 data.

### **Program goals and measurements should be results-oriented and used in ERO monitoring**

ERO monitoring involves IRS employees visiting an ERO's establishment. These visits are designed to ensure the ERO is in compliance with *e-file* regulations. Depending upon the seriousness of the infraction, violations of the IRS' ERO requirements may result in a verbal or written warning, written reprimand, suspension, or expulsion of the ERO from the IRS *e-file* Program.

However, in a TIGTA report issued in January 2003,<sup>15</sup> we reported that there are no meaningful goals or methods to measure program results. A recommendation to establish a measurement system to assess the effectiveness of field monitoring was included in the report. IRS management disagreed, stating it would be impossible to measure the effect on voluntary compliance. IRS management believed that although they could establish a goal and measures to track the results of follow-up visits, the results would not be of significant value in determining the affect on voluntary compliance. Therefore, goals and measurements to assess the effectiveness of the ERO monitoring program have not been established.

Unless IRS management determines the indicators of potential ERO noncompliance and uses them for monitoring

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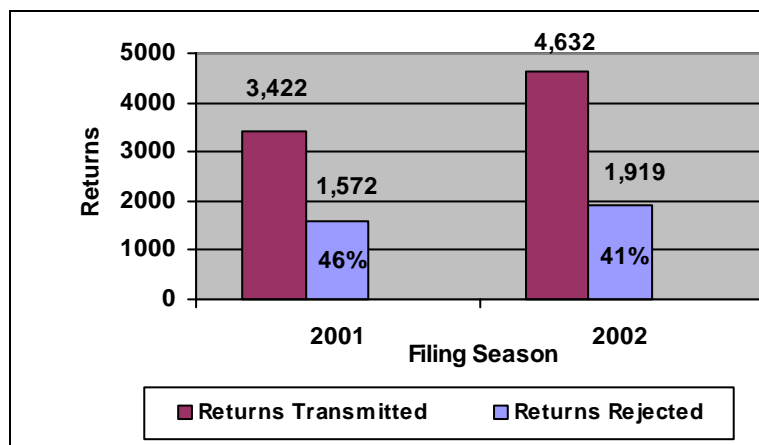
<sup>15</sup> *Improvements to the Electronic Return Originator Monitoring Program Are Needed* (Reference 2003-30-039, dated January 2003).

## Improvements Are Needed in the Screening and Monitoring of E-File Providers to Protect Against Filing Fraud

visit selection and educational efforts, they will not be able to effectively focus their resources.

Discussions TIGTA auditors had with an ERO who pled guilty to filing false tax returns identified that this particular ERO had a high reject rate. Analysis of the ERO's *e-file* data showed a reject rate in excess of 40 percent for tax returns submitted during 2001 and 2002.

**Table 2: Reject Rates for ERO Who Committed Filing Fraud**



Source: IRS e-file records.

The ERO explained that the high reject rate was the result of a process known as “washing.” This process involved the ERO submitting tax returns containing fraudulently obtained SSNs. These SSNs were included as primary or secondary filers, dependents, or children to be claimed for the Earned Income Tax Credit. As part of the IRS’ validity checks, SSNs are verified against computer files to determine issues such as if the SSN is an issued SSN and/or was previously used on another tax return. If any of these checks identify problems with the SSN, the tax return is rejected and the ERO is provided with an explanation as to the problem with one or more of the SSNs contained on the tax return. The ERO would then keep track of those SSNs that were rejected to ensure they were not used on subsequently submitted fraudulent tax returns. The IRS had no documentation of a monitoring visit for this ERO.

Without a method to measure the effectiveness of the monitoring program, the IRS will not be able to determine where resources will have the most impact in identifying

## Improvements Are Needed in the Screening and Monitoring of *E-File* Providers to Protect Against Filing Fraud

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and stopping unscrupulous EROs. If noncompliant EROs are not identified, the taxpaying public and the Federal Government are at risk of losses due to fraudulent filings of tax returns.

### Recommendations

5. The Commissioner, W&I Division, should perform periodic criminal background checks for all individuals authorized to participate in the *e-file* Program.

Management's Response: The IRS did not agree with this recommendation. Changing the periodic suitability rules to include criminal background checks would apply only to *e-file* Providers in good standing with the IRS. Checks are done initially to attempt to determine if a Provider can be trusted to process electronic returns according to *e-file* rules.

Expanding the program to Providers who demonstrate compliance with *e-file* rules will not correct the problem. *E-file* is an alternative way of sending return data to the IRS, not a method of preparing returns. Revenue Procedure 2000-31, section 6.02(4) states that if data on an electronic return are altered by an *e-file* Provider, *e-file* rules no longer have jurisdiction because income tax return preparation rules apply. Only after a determination of penalties and fraud can the screening/verification process take action against an applicant or sanction an accepted *e-file* Provider.

In addition, IRS management believes that their enhancements to the monitoring program will reduce the need for this recommendation.

Office of Audit Comment: IRS management indicated that changing the periodic suitability rules to include criminal background checks would apply only to *e-file* Providers in good standing, with initial checks being done to determine if an individual can be trusted to process electronic tax returns. We agree that the initial checks, if performed, assist in identifying individuals who should not be authorized to participate. In addition, we agree that periodic checks alone will not correct the problem of *e-file* fraud.

## Improvements Are Needed in the Screening and Monitoring of E-File Providers to Protect Against Filing Fraud

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However, we continue to believe that periodic checks may complement other monitoring process improvements the IRS is making. Periodic checks may assist the IRS in ensuring that *e-file* Providers continue to comply with *e-file* rules and are not involved in unethical practices regarding tax return preparation and/or disreputable conduct, which are both conditions for non-acceptance in the Program.

Finally, IRS management noted that although our outcome measure was a reasonable estimate, they could not agree with it because they disagree with this recommendation. We continue to support our revenue protection outcome measurement and believe that if the recommendations made in prior reports had been implemented, the ERO we cited in our audit report as having filed approximately 9,000 fraudulent tax returns over a 3-year period, and who received approximately \$7 million in fraudulent tax refunds in 1 year, could have been identified earlier, thus preventing a loss of Government funds.

Without implementing this recommendation, the IRS' ability to protect the integrity of the *e-file* Program, as well as taxpayers and the Government against losses from filing fraud, may be hindered.

6. The Commissioner, W&I Division, should include reject rates as selection criteria for ERO visits and/or educational efforts.

Management's Response: The IRS will establish a baseline on the top three reject rates and develop educational material for subsequent outreach efforts. Additionally, the IRS is preparing guidance for the ERO Coordinators. This guidance will instruct them on the use of the Online Applicants database to determine the proper mix of random visits based on a random sample to provide broad geographic coverage, and targeted visits based on selection criteria indicating that *e-file* compliance issues may be present in a particular ERO's *e-file* practice.

7. The Commissioner, Small Business/Self-Employed Division, should develop a system to measure the effectiveness of the ERO monitoring program.

**Improvements Are Needed in the Screening and Monitoring  
of *E-File* Providers to Protect Against Filing Fraud**

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Management's Response: The IRS will revise its monitoring reports to reflect the results broken down by referral type. This change in reporting will provide it with more detail and it could measure the results of follow-up and targeted versus random visits.



## Improvements Are Needed in the Screening and Monitoring of *E-File* Providers to Protect Against Filing Fraud

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### Appendix I

#### Detailed Objective, Scope, and Methodology

The overall objective of this review was to assess the Internal Revenue Service's (IRS) regulation of Electronic Return Originators (ERO). To accomplish this objective, we conducted the following tests:

- I. Identified prior audit reports issued by the Treasury Inspector General for Tax Administration (TIGTA) and other organizations regarding the regulation of EROs.
  - A. Analyzed the reports to determine the control weaknesses and whether IRS management's actions corrected the weaknesses.
  - B. Discussed the IRS' responses to previous recommendations and determined the current position of IRS management.
- II. Determined if there were any cases of convicted EROs who had evaded detection in screening and monitoring.
  - A. Interviewed an ERO who pled guilty to preparing and filing false, fraudulent tax returns. Determined the control weaknesses that enabled this ERO to participate in the IRS' electronic filing Program.
  - B. Coordinated and communicated with the TIGTA's Office of Investigations to determine if there were any other investigations/prosecutions of EROs who committed filing fraud.
- III. Determined if there was any information available to aid in the detection of EROs who may commit filing fraud.
  - A. Analyzed any information obtained to determine patterns, thresholds, costs, etc.
  - B. Reviewed all available ERO folders that had had fingerprint cards sent to the Federal Bureau of Investigation in December 2002 for analysis (687) and returned with information of a criminal history (90).

**Improvements Are Needed in the Screening and Monitoring  
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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, Acting Director

Pamela DeSimone, Senior Auditor

Kristi Larson, Senior Auditor

Edie Lemire, Senior Auditor

**Improvements Are Needed in the Screening and Monitoring  
of E-File Providers to Protect Against Filing Fraud**

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**Appendix III**

**Report Distribution List**

Commissioner C  
Office of the Commissioner – Attn: Chief of Staff C  
Deputy Commissioner for Services and Enforcement SE  
Acting Deputy Commissioner, Small Business/Self-Employed Division SE:S  
Deputy Commissioner, Wage and Investment Division SE:W  
Director, Communications and Liaison SE:S:M:CL  
Director, Compliance SE:S:C  
Director, Customer Assistance, Relationships, and Education SE:W:CAR  
Director, Electronic Tax Administration OS:CIO:I:ET  
Director, Field Operations SE:W:CAR:SPEC:FO  
Director, Reporting Compliance SE:S:C:CP:RC  
Director, Stakeholder Partnerships, Education, and Communications SE:W:CAR:SPEC  
Director, Strategy and Finance SE:W:S  
Deputy Director, Compliance Policy SE:S:C:CP  
Chief Counsel CC  
National Taxpayer Advocate TA  
Director, Office of Legislative Affairs CL:LA  
Director, Office of Program Evaluation and Risk Analysis RAS:O  
Office of Management Controls OS:CFO:AR:M  
Audit Liaisons:  
    Chief, Customer Liaison, Small Business/Self-Employed Division S:COM  
    GAO/TIGTA Liaison, Wage and Investment Division W:S:PA

## Improvements Are Needed in the Screening and Monitoring of *E-File* Providers to Protect Against Filing Fraud

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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. This benefit will be incorporated into our Semiannual Report to the Congress.

##### Type and Value of Outcome Measure:

- Revenue Protection – Actual; over \$7 million in fraudulent tax refunds (see page 2).

##### Methodology Used to Measure the Reported Benefit:

One Electronic Return Originator (ERO) filed approximately 9,000 fraudulent tax returns over a 3-year period and received approximately \$7 million in fraudulent tax refunds in 1 year. The ERO had a criminal history before being accepted as an ERO, and recently pled guilty to filing false, fictitious, and fraudulent claims against the United States (U.S.) (tax returns) for 5 years, conspiracy to file false claims against the U.S., and conspiracy to negotiate forged U. S. Treasury checks of approximately \$33,000. In an interview with the ERO, we learned that the person was arrested for alien smuggling and was deported, but then re-entered the U.S. by using the passport of another person and became an ERO.

If the recommendations made in prior reports had been implemented, this ERO could have been identified earlier, preventing a loss of Federal Government funds.

**Improvements Are Needed in the Screening and Monitoring  
of E-File Providers to Protect Against Filing Fraud**

**Appendix V**

**Recommendations Related to the Screening and Monitoring  
of Electronic Return Originators**

During Fiscal Years 2002 and 2003, the Treasury Inspector General for Tax Administration (TIGTA) issued two audit reports that addressed the Internal Revenue Service's (IRS) screening and monitoring of Electronic Return Originators (ERO). In 1991, an internal IRS Task Force also made recommendations regarding the screening of EROs. The table below provides details of the 13 audit recommendations and the 1 Task Force recommendation and shows the agreement/disagreement by the IRS. Copies of the TIGTA audit reports can be obtained at [www.treas.gov/tigta](http://www.treas.gov/tigta).

Reference Number	Title	Recommendation and Corrective Actions	Agree/ Disagree
2002-40-111	<i>E-File Providers Are Not Adequately Screened</i>	<b>Recommendation:</b> The Commissioner, Wage and Investment (W&I) Division, should ensure that screening procedures for new applicants should include an independent validation of age and citizenship	Disagreed
		<b>Recommendation:</b> The Commissioner, W&I Division, should ensure that all applicants should be subjected to a credit and criminal background check, and individuals should not be authorized to participate in the <i>e-file</i> Program until all verifications and checks are completed.	Disagreed
		<b>Recommendation:</b> The Commissioner, W&I Division, should ensure that subsequent credit and criminal background checks are performed at regular intervals.	Disagreed
		<b>Recommendation:</b> The Commissioner, W&I Division, should ensure that internal guidelines be adhered to regarding the handling of fingerprint cards returned as unprocessable from the FBI. Also, those individuals who have been identified to date as having unprocessable fingerprint cards should be contacted, and a new card should be provided so the criminal background check can be completed.  <b>Management's Response:</b> IRS management asserted that they will obtain new cards and submit them in future instances where fingerprint cards are returned as unprocessable. However, they did not believe they needed to contact those who were already identified to date since those individuals are already participants in the Program.	Agreed in part

**Improvements Are Needed in the Screening and Monitoring  
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<b>Reference Number</b>	<b>Title</b>	<b>Recommendation and Corrective Actions</b>	<b>Agree/Disagree</b>
2003-30-039	<i>Improvements to the ERO Monitoring Program Are Needed</i>	<b>Recommendation:</b> Establish a goal and method for measuring program effectiveness for improving ERO compliance, such as results of follow-up visits.	Disagreed
		<b>Recommendation:</b> Ensure that historical case documentation is associated with current year cases and reinforce that the purpose of follow-up visits is to measure the impact of the ERO Monitoring Program on compliance.  <b>Management's Response:</b> The Director, Reporting Compliance Policy, Small Business/Self-Employed (SB/SE) Division will issue a memorandum providing additional direction and guidance on documentation.	Agreed
		<b>Recommendation:</b> Establish a planning process that allows sufficient time for training and case building.  <b>Management's Response:</b> The IRS plans to conduct training prior to the new fiscal year [2004]. Also, the analyst responsible for the program will be responsible for the planning, training, and case building.	Agreed
		<b>Recommendation:</b> Ensure that the functionality of the OLA [On-Line Applicants] Database's replacement meets user requirements and that EMCs [ <i>e-file</i> Monitoring Coordinators] and monitors are sufficiently trained on all pertinent <i>e-file</i> systems.  <b>Management's Response:</b> All new EMCs were trained on all pertinent <i>e-file</i> systems in the 2002 train-the-trainer classes. Guidance will be provided to EMCs who did not attend training.	Agreed in part
		<b>Recommendation:</b> Develop a process to determine the proper mix of random and mandatory ERO monitoring visits that also provides for broad geographic coverage.  <b>Management's Response:</b> Management will provide written guidance to Coordinators advising them to consider balance of geographic coverage when selecting random visits.	Agreed
		<b>Recommendation:</b> Develop uniform risk-based selection criteria that take advantage of available information and data for selecting EROs for random monitoring visits.  <b>Management's Response:</b> The Director, Reporting Compliance Policy, SB/SE Division, will provide guidance to Coordinators on using available information to select EROs whose filing statistics show potential problems.	Agreed

**Improvements Are Needed in the Screening and Monitoring  
of E-File Providers to Protect Against Filing Fraud**

Reference Number	Title	Recommendation and Corrective Actions	Agree/ Disagree
		<p><b>Recommendation:</b> Provide clear and unambiguous ERO Monitoring Program infraction and sanction guidelines for EMCs and monitors.</p> <p><b>Management's Response:</b> Management revised training materials to include additional examples of infraction and sanction guidelines.</p>	Agreed
		<p><b>Recommendation:</b> Revise <i>e-file</i> Monitoring Guidelines to consider the Earned Income Tax Credit due diligence when determining ERO compliance with IRS <i>e-file</i> Program requirements.</p> <p><b>Management's Response:</b> The IRS instructed monitors to pursue due diligence penalties when appropriate.</p>	Agreed
		<p><b>Recommendation:</b> The Director, Compliance, SB/SE Division, should issue a memorandum reinforcing the importance of complete case documentation of ERO monitoring visits.</p> <p><b>Management's Response:</b> Management will issue written guidance to reinforce the importance of complete case documentation of ERO Monitoring visits.</p>	Agreed
	<p><i>Electronic Filing System Suitability/Security /QRDT [Questionable Refund Detection Team] Final Report 5/91</i></p>	<p><b>Recommendation:</b> Establish error rate standards. An error rate of 5 percent and a reject rate of 15 percent are the suggested maximums for continued participation in the EFS [Electronic Filing System]. Remedial action should be left to the discretion of the Service Center Directors, giving consideration to receipt volumes, corrective actions, performance history, etc.</p>	No action taken

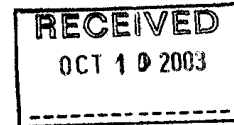
Improvements Are Needed in the Screening and Monitoring  
of E-File Providers to Protect Against Filing Fraud

Appendix VI

Management's Response to the Draft Report



DEPARTMENT OF THE TREASURY  
INTERNAL REVENUE SERVICE  
ATLANTA, GA 30308



OCT 09 2003

MEMORANDUM FOR TREASURY INSPECTOR GENERAL FOR TAX  
ADMINISTRATION

FROM: Henry O. Lamar, Jr. *Henry O. Lamar, Jr.*  
Commissioner, Wage and Investment Division

SUBJECT: Draft Audit Report – Improvements Are Needed in the Screening  
and Monitoring of E-File Providers to Protect Against Filing  
Fraud (Audit # 200340040)

As noted in your report, we have made tremendous strides in strengthening our monitoring program by requesting computer programming that will continuously monitor the tax accounts of Electronic Return Originators (EROs) for suspect transactions. While this was a major step to increase compliance, we are also pursuing other program changes. One change we made recently was to shift the oversight responsibility for the screening/monitoring process for EROs to the Electronic Tax Administration (ETA) organization that is responsible for oversight of the e-file program. This change occurred on August 10, 2003.

One of our primary goals for electronic filing is to ensure that individuals that apply to participate in the e-file program have met the required screening and verification checks before they are authorized to participate in the program. As reflected in Attachment 1, we are pursuing several of your recommendations. In addition, we have taken this opportunity to advise you of the status of previous recommendations made on the ERO process (Attachment 2).

We have reviewed the outcome measures and believe they represent a reasonable estimate of potential cost savings. However, we do not agree that performing periodic criminal background checks for all individuals that are authorized to participate in the e-file program is feasible. Since we disagree with this recommendation, we cannot agree with the outcome measure. We believe that our enhancements to the monitoring programs will outweigh the cost associated with performing these additional checks.

If you have any questions, please contact Terence H. Lutes, Director, Electronic Tax Administration, at (202) 622-7990.

Attachments (2)



## **Improvements Are Needed in the Screening and Monitoring of E-File Providers to Protect Against Filing Fraud**

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Attachment 1

### **RECOMMENDATION 1**

The Commissioner, W&I Division should enhance the screening procedures for EROs by:

1. Requiring verification of age and citizenship of applicants before acceptance into the e-file program.

### **CORRECTIVE ACTION**

We agree with this recommendation. The deployment of e-services release 1.2 will allow us to validate both the social security number (SSN) and date of birth during the e-file application process. If the application is being submitted through the Registered User Portal (RUP), as part of e-services, the system will reject the application.

Unfortunately, e-services does not offer a separate systemic citizenship check. We will continue to use current procedures that require principals and responsible officials to possess valid SSNs. If the applicant does not provide a valid SSN, then the applicant is ineligible and the application is rejected. We do not believe that researching this information on the National Account Profile (NAP) would be beneficial because the majority of the records contain a blank in the citizenship code field.

### **IMPLEMENTATION DATE**

January 1, 2004

### **RESPONSIBLE OFFICIAL**

Director, Electronic Tax Administration, Modernization & Information Technology Services (MITS)

### **CORRECTIVE ACTION MONITORING PLAN**

Monitoring will be incorporated during annual review visits.

### **RECOMMENDATION 2**

The Commissioner, W&I Division should enhance the screening procedures for EROs by:

2. Sending scanned fingerprints to the FBI electronically. For those fingerprint cards that are unprocessable, a name check should be used as the basis for the criminal background check.

## **Improvements Are Needed in the Screening and Monitoring of E-File Providers to Protect Against Filing Fraud**

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### **CORRECTIVE ACTION**

We agree with this recommendation. We have initiated preliminary research and discussions with the Federal Bureau of Investigation (FBI). Based on these discussions, the Service would qualify to obtain electronic access to their fingerprint system. This process requires that the Service purchase scanning hardware and software. Fingerprint results will be returned within a 24-hour period. However, completion of this acquisition process will not occur before the 2004 filing season.

For those fingerprint cards that are unprocessable, interim procedures were instituted that provide an applicant two opportunities to submit processable fingerprint cards. If the second attempt is unprocessable, the Service will request the FBI to perform a background check using name and other available information. These procedures were included in the October 1, 2003, revision of Internal Revenue Manual (IRM) 3.42.10.2.14.1(9).

### **IMPLEMENTATION DATES**

January 1, 2005 – (fingerprint system)  
Completed -- October 1, 2003 – (revision to IRM 3.42.10)

### **RESPONSIBLE OFFICIAL**

Director, Electronic Tax Administration, MITS

### **CORRECTIVE ACTION MONITORING PLAN**

Monitoring will be incorporated during annual review visits.

### **RECOMMENDATION 3**

The Commissioner, W&I Division should enhance the screening procedures for EROs by:

3. Verifying that individuals who provide professional certifications in lieu of a fingerprint card are in current standing with the organization to which the professional certification relates.

### **CORRECTIVE ACTION**

We agree with this recommendation. The deployment of e-services release 1.2 will systemically validate that an enrolled agent is in current standing during the application process. There is no central repository of information that can be systemically checked for the other categories of professionals. However, we will pursue the feasibility of developing a method to perform this check for the other categories.

## **Improvements Are Needed in the Screening and Monitoring of *E-File* Providers to Protect Against Filing Fraud**

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### **IMPLEMENTATION DATE**

January 1, 2004 – (validation of enrolled agents)  
January 1, 2006 – (validation in the other categories)

### **RESPONSIBLE OFFICIAL**

Director, Electronic Tax Administration, MITS

### **CORRECTIVE ACTION MONITORING PLAN**

Monitoring will be incorporated during annual review visits.

### **RECOMMENDATION 4**

The Commissioner, W&I Division should enhance the screening procedures for EROs by:

4. Addressing the separation of duties conflict by shifting the oversight responsibility for the screening/verification process for EROs to the organization responsible for oversight of the e-file Program and away from the marketing function.

### **CORRECTIVE ACTION**

We agree with this recommendation. On August 10, 2003, we transferred the oversight responsibility for the screening/verification process for EROs to the Electronic Tax Administration Division. This division also has oversight of the e-file program.

### **IMPLEMENTATION DATE**

Completed August 10, 2003

### **RESPONSIBLE OFFICIAL**

Not Applicable

### **CORRECTIVE ACTION MONITORING PLAN**

Not Applicable

### **RECOMMENDATION 5**

The Commissioner, W&I Division should perform periodic criminal background checks for all individuals authorized to participate in the e-file program.

## **Improvements Are Needed in the Screening and Monitoring of E-File Providers to Protect Against Filing Fraud**

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4

### **CORRECTIVE ACTION**

We do not agree with this recommendation. Changing the periodic suitability rules to include criminal background checks would apply only to e-file providers in good standing with the Service. Checks are done initially to attempt to determine if a provider can be trusted to process electronic returns according to e-file rules.

Expanding the program to providers who demonstrate compliance with e-file rules will not correct the problem. E-file is an alternative way of sending return data to the IRS, not a method of preparing returns. Revenue Procedure 2000-31, section 6.02(4) states that if data on an electronic return is altered by an e-file provider, e-file rules no longer have jurisdiction because income tax return preparer rules apply. Only after a determination of penalties and fraud can the screening/verification process take action against an applicant or sanction an accepted e-file provider.

In addition, we believe that our enhancements to the monitoring program will reduce the need for this recommendation.

### **IMPLEMENTATION DATE**

Not Applicable

### **RESPONSIBLE OFFICIAL**

Not Applicable

### **CORRECTIVE ACTION MONITORING PLAN**

Not Applicable

### **RECOMMENDATION 6**

The Commissioner, W&I Division should include reject rates as selection criteria for ERO visits and/or educational efforts.

### **CORRECTIVE ACTION**

We agreed with this recommendation. Our Stakeholder Partnerships, Education and Communication (SPEC) Office will analyze the Distribution Channel Management (DCM) activity reporting system for the source of reject rate data. The DCM system compiles data two times each year – in May and November. The November snapshot will be used to establish a baseline of the top three reject rates and to develop educational material for subsequent outreach efforts.

Additionally, Compliance Policy, of the Small Business/Self-Employed Division, is preparing guidance for the ERO Coordinators. This guidance will instruct them on the use of the Online Applicants (OLA) database to determine the proper mix of random visits based on random sample to provide broad geographic coverage, and targeted visits based on selection criteria indicating that e-file compliance issues may be present in a particular ERO's e-file practice.

## Improvements Are Needed in the Screening and Monitoring of *E-File* Providers to Protect Against Filing Fraud

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### **IMPLEMENTATION DATE**

November 15, 2003 – Compliance Policy (SB/SE)  
December 15, 2003 – SPEC (W&I)

### **RESPONSIBLE OFFICIALS**

Director, Compliance Policy, Small Business/Self-Employed Division (SB/SE)

Director, Stakeholder Partnerships, Education and Communications

### **CORRECTIVE ACTION MONITORING PLAN**

We will review the reject rates on a quarterly basis.

### **RECOMMENDATION 7**

The Commissioner, SB/SE Division should develop a system to measure the effectiveness of the ERO monitoring program.

### **CORRECTIVE ACTION**

We agreed with this recommendation. We will revise our monitoring reports to reflect the results broken down by referral type. This change in reporting will provide us with more detail and we could measure the results of follow-up and targeted vs. random visits.

### **IMPLEMENTATION DATE**

January 15, 2004

### **RESPONSIBLE OFFICIAL**

Director, Reporting Compliance, SB/SE

### **CORRECTIVE ACTION MONITORING PLAN**

Monitoring will be incorporated during annual review visits.

## Improvements Are Needed in the Screening and Monitoring of E-File Providers to Protect Against Filing Fraud

### Status of Recommendations Related to the Screening and Monitoring of Electronic Returns Originator (Audit #2003-40040)

Attachment 2

Audit Title	Corrective Action Number	Recommended Corrective Action	Planned Actions	Status
E-File Providers Are Not Adequately Screened	2002-40-111/1-4-1	<p>Management will request new fingerprint cards from applicants whose fingerprint cards are returned as unprocessable from the FBI and those individuals who have been identified to date as having unprocessable fingerprint cards should be contacted and a new card provided so the criminal background check can be completed and resubmitted to the FBI.</p> <p>Management will include new procedures in the Internal Revenue Manual (IRM) by October 15, 2002. Interim guidance will be distributed to Andover Submission Processing Center by August 1, 2002.</p>	<ul style="list-style-type: none"> <li>New procedures for handling FBI unprocessable fingerprints were established. A draft letter will be mailed to request a new fingerprint card from the applicant(s). Starting with the report due September 2003, two new columns will be added to the Month End Nationwide Fingerprint Card Report               <ol style="list-style-type: none"> <li>"Unprocessable by FBI (2<sup>nd</sup> request)";</li> <li>"Dropped Status".</li> </ol> </li> <li>This report will be sent monthly with the Fingerprint Card Report to the program analyst in N.O., that handles Form 8633. Filers not providing a new fingerprint card within 30 days from the date of the letter will be classified as "dropped."</li> <li>Official IRS manuals were updated to reflect new procedures. The IRM has been updated for the October 2002 edition, for Processing Year 2003, to incorporate the following procedures: 3.42.4.14.1 (7) c&amp;d.</li> </ul>	Implemented September 25, 2003

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## Improvements Are Needed in the Screening and Monitoring of E-File Providers to Protect Against Filing Fraud

### Status of Recommendations Related to the Screening and Monitoring of Electronic Returns Originator (Audit #200340040)

Audit Title	Corrective Action Number	Recommended Corrective Action	Planned Action	Status
Improvements to the ERO Monitoring Program Are Needed	2003-30-039/1-2-1	Ensure that historical case documentation is maintained and re-enforce that the purpose of follow-up visits is to measure the impact of the ERO Monitoring Program on compliance.	We will issue a memorandum providing additional direction and guidance on documentation.	Delayed until October 15, 2003*
	2003-30-039/2-1-1	Establish a planning cycle to allow sufficient time for training and case building.	<ul style="list-style-type: none"> <li>The analyst responsible for the program is now responsible for planning, training, and case building.</li> <li>Training was conducted the week of 8/12 – 8/14/03.</li> </ul>	Implemented August 14, 2003
	2003-30-039/3-1-1	Enhance OLA's (On-Line Applicants) functionality to better meet user requirements and ensure that EMCs (e-file Monitoring Coordinators) and monitors are sufficiently trained on all pertinent e-file systems.	<ul style="list-style-type: none"> <li>In our 2002 train-the-trainer classes, held Nov. 19-21, 2002, we ensured training for all newly selected EMCs on all pertinent e-file systems.</li> <li>We also provided guidance to coordinators who did not attend the training.</li> </ul>	Implemented November 21, 2002
	2003-30-039/4-1-1	Develop a process to determine the proper mix of random and mandatory ERO monitoring visits that also provide broad geographic coverage.	We will provide guidance to all coordinators to consider the best balance of geographic coverage as possible when choosing the location of random visits.	Delayed until October 15, 2003*
	2003-30-039/4-2-1	Develop uniform risk-based selection criteria that take advantage of available information and data for selecting EROs for random monitoring visits.	We will provide guidance to Area Coordinators on using available information to pinpoint EROs whose filing statistics show potential problems (high reject rates, history of missing Forms 8453 over several years, multiple missing Forms 8453 in one given year) and other criteria to consider in determining when to conduct random or targeted visitations.	Delayed until October 15, 2003*

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Audit Title	Corrective Action Number	Recommended/Corrective Action	Planned Action	Status
	2003-30-039/5-1-1	The Director, Compliance, Small Business/Self-Employed Division should provide clear and unambiguous infraction and sanction guidelines for EMCs and monitors.	Training materials were revised to include additional examples of infraction and sanction guidelines; however, it is impossible for examples to be all-inclusive. Every case must stand on its own merits, and monitors must exercise their judgment based on the history, facts, and circumstances of each case.	Implemented November 21, 2002
	2003-30-039/6-1-1	Revise e-file Monitoring Guidelines to consider EITC due diligence when determining ERO compliance with IRS e-file Program requirements.	In the train-the-trainer session, held Nov. 19-21, 2002, we instructed monitors to pursue due diligence penalties when appropriate. Publication 1345 clearly states that penalties assessed against e-file Providers will cause them to fail suitability requirements.	Implemented November 21, 2002
	2003-30-039/7-1-1	The Director, Compliance, Small Business/Self-Employed Division should issue a memorandum reinforcing the importance of complete case documentation of ERO monitoring visits.	<ul style="list-style-type: none"> <li>• We will emphasize complete case documentation of ERO monitoring visits in the train-the-trainer class.</li> <li>• We will provide written guidance to reinforce the importance of complete case documentation of ERO monitoring visits.</li> </ul>	Delayed until October 15, 2003
Audit Title	Corrective Action Number	Recommended/Corrective Action	Planned Action	Status
Electronic Filing System Suitability/Security/QRD T (Questionable Refund Detection Team) Final Report 5/91		Establish error rate standards. An error rate of 5% and a reject rate of 15% are the suggested maximums for continued participation in EFS [Electronic Filing System]. Remedial action should be left to the discretion of the Service Center Directors, giving consideration to receipt volumes, corrective actions, performance history, etc.		No action taken

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