

E-File Providers Are Not Adequately Screened

June 2002

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DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

INSPECTOR GENERAL
for TAX
ADMINISTRATION

June 27, 2002

MEMORANDUM FOR COMMISSIONER, WAGE AND INVESTMENT DIVISION

A handwritten signature in cursive script that reads "Pamela J. Gardiner".

FROM: Pamela J. Gardiner
Deputy Inspector General for Audit

SUBJECT: Final Audit Report – E-File Providers Are Not Adequately
Screened (Audit # 200140045)

This report presents the results of our review of the Internal Revenue Service's (IRS) screening procedures used to determine who should be allowed to participate in the Electronic Filing (*e-file*) Program as an *e-file* Provider.

The IRS' *e-file* Program enables taxpayers to send their tax returns to the IRS in an electronic format via an IRS-authorized *e-file* Provider. The IRS performs screening checks for those individuals applying to become an *e-file* Provider to ensure the integrity of the IRS' *e-file* Program. For Tax Year 2000, approximately 29 million electronic tax returns were transmitted by *e-file* Providers and accepted by the IRS.

Our review identified that the IRS does not have effective screening procedures to adequately determine who should be allowed to participate or to continue to participate in the *e-file* Program. Specifically, we found that the IRS does not independently validate age and citizenship requirements. Our analysis of IRS data identified *e-file* Providers who were not United States citizens, were under the age of 21, or were identified as deceased. In addition, screening checks publicized to the taxpaying public as being extensive were found to be limited primarily to whether an individual filed tax returns and paid taxes due. For those individuals that file electronic tax returns as part of IRS' volunteer income tax preparation program, no checks are performed. We also identified that for those limited number of individuals selected for a criminal background check, 60 percent of the individuals received authorization to participate in the *e-file* Program before results from the Federal Bureau of Investigation (FBI) were received and analyzed by the IRS. Finally, testing found that once individuals are authorized to participate in the *e-file* Program, no subsequent non-tax related screening checks are performed to ensure these individuals continue to maintain a high degree of integrity and adhere to the highest professional and ethical standards.

Management's Response: Management did not agree with the majority of our recommendations. Management indicated that the current screening process and its inherent rules strike a good balance. Management stated that the IRS does not generally refer to screening checks as being extensive and that "Neither an IRS executive stating "preparers have to undergo numerous background checks and security screenings before they link to the IRS site,"¹ nor the information in Publication 1345, Handbook for Authorized IRS *e-file* Providers, should be viewed in this light."

In addition, management stated that the results that would be obtained from two of our recommendations related to subjecting all applicants to criminal and credit history background checks would not warrant the additional expense to perform these checks. Furthermore, management indicated that subjecting volunteers to any suitability checks "might be devastating to the IRS' effort to expand electronic filing to low-income taxpayers." Management asserted that "...additional or different [screening] methods must be based on factual, cause, and effect data. Simply increasing the number of applicants we subject to an existing compliance check does not necessarily equal a more effective screening method."

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

Office of Audit Comment: We do not agree with management's assertion that the current suitability checks strike a good balance between meeting taxpayers' needs of increased electronic filing options and ensuring integrity of the *e-file* Program. Specifically, the majority of applicants are subjected to "minimal screening checks," often consisting of only a tax filing check. The IRS' minimal screening of applicants is contradictory to information publicized by the IRS in Publication 1345, Handbook for Authorized IRS *e-file* Providers. This publication indicates that each individual listed on the e-file application must be a U.S. citizen or a legal alien, be 21 years of age as of the date of application, and pass a suitability check.

We recognize our recommendations would result in an expenditure of resources; however, we do not agree that this expenditure would be significant. As indicated in our report, the IRS chose not to expend 26 percent of the money that was budgeted for criminal background checks for the last three fiscal years. The IRS should weigh the approximate \$20 cost per applicant for a criminal and credit history check against the benefit of providing assurance to the taxpaying public that the IRS is performing extensive screening checks to protect the integrity of the *e-file* Program.

While we still believe our recommendations are worthwhile, we do not intend to elevate our disagreement concerning this matter to the Department of Treasury for resolution.

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.

¹ USA Today article dated February 15, 2002.

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Background

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 taxpayers to send their tax returns to the IRS in an electronic format via an IRS-authorized *e-file* Provider. For Tax Year 2000, approximately 29 million electronic tax returns were transmitted by *e-file* Providers and accepted by the IRS.

In an attempt to meet the IRS' Restructuring and Reform Act of 1998¹ goal of 80 percent of all tax returns to be filed electronically by 2007, the IRS has aggressively marketed becoming an *e-file* Provider to private firms and individuals. It is the IRS' responsibility to ensure that applicants authorized to participate in the *e-file* Program maintain a high degree of integrity and adhere to the highest professional and ethical standards.

The IRS' *e-file* Program differs from the traditional paper tax return filing in that the IRS claims that it screens *e-file* Providers. There is no screening process for those tax return providers who prepare and submit paper tax returns to the IRS. Screening of *e-file* Providers is done because the providers transmit directly to the IRS computer systems and refunds on electronically filed tax returns are issued by the IRS much faster for *e-filed* tax returns than for paper filed tax returns.

To become an *e-file* Provider, 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 provides blank fingerprint cards with the *e-file* applications. It is the applicant's responsibility to fill out the fingerprint card; however, the IRS offers this service at its National Tax Forums.² The IRS allows individuals who have a professional certification³ to send a copy of the certification in lieu of a fingerprint card. The IRS' Handbook for Authorized IRS

¹ Pub. L. No. 105-206, 112 Stat. 685 (1998).

² National Tax Forums are yearly seminars designed to provide the tax professional community with the latest and most complete information on IRS programs, practices, and policies and the most recent Electronic Tax Administration initiatives.

³ Per Form 8633, professional certifications include attorneys, banking officials, and Certified Public Accountants (CPA).

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e-file Providers of Individual Income Tax Returns (Publication 1345) outlines the requirements to be met, along with the screening checks that are performed. The requirements and screening checks outlined in Publication 1345 are meant to ensure the integrity of the individuals authorized to participate in the *e-file* Program and are as follows:

- The applicant must be a United States (U.S.) citizen or legal resident alien and must be over the age of 21.
- Screening checks include credit and criminal background checks and a determination as to whether individual and business tax returns were filed and taxes owed were paid.

Once the IRS receives a Form 8633, pertinent information is entered into a computer database referred to as the Applicants Database. This database is used to create and update *e-file* applicant information. As of September 2001,⁴ there were 108,164 Providers authorized to participate in the IRS' *e-file* Program.

In 1997, the IRS consolidated the process for screening individuals applying to be an *e-file* Provider to one location (the IRS' Andover Tax Processing Center). The consolidation of the screening process was done to ensure that consistent and stringent procedures are used to screen applicants. During the period October 1, 2000, to September 21, 2001, the IRS' consolidated screening site received 24,284 Forms 8633.

Audit work was conducted at the Andover Tax Processing site and the IRS' National Headquarters from August 2001 through March 2002. The audit was conducted in accordance with *Government Auditing Standards*. Detailed information on our audit objective, scope, and methodology is presented in Appendix I. Major contributors to the report are listed in Appendix II.

⁴ September 2001 is the date the IRS provided us the extract of the Applicants Database.

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Screening Procedures for *E-File* Providers Are Not Adequate

Our review identified that the IRS does not have effective screening procedures to adequately determine who should be allowed to participate or to continue to participate in the *e-file* Program. Specifically, our review of the *e-file* application process showed that:

- The IRS does not independently validate age and citizenship requirements.
- Screening checks publicized to the taxpaying public as being extensive were found to be limited primarily to whether an individual filed his or her tax return and paid taxes due.
- Applicants were authorized to participate in the *e-file* Program prior to the IRS' receipt and analysis of criminal background information from the Federal Bureau of Investigation (FBI).
- Subsequent screening checks were not performed to ensure individuals authorized to participate in the IRS' *e-file* Program continued to maintain a high degree of integrity and adhered to the highest professional and ethical standards.

The IRS does not independently validate age and citizenship requirements

To determine if individuals authorized to participate in the *e-file* Program were not U.S. citizens or were under 21 years of age, we performed two analyses. Our first analysis was of data input to the citizenship and birth date fields on the IRS' Applicants Database. It showed that individuals were accepted into the *e-file* Program who (if the information was accurately input by screening site employees) were not U.S. citizens or were under the age of 21. We found the following:

- 113 individuals were not U.S. citizens.
- 227 individuals were not over the age of 21.⁵

Our second analysis was a review of social security numbers (SSN) of authorized applicants per the IRS' Applicants

⁵ As of February 1, 2002 there were 187,058 authorized *e-file* Providers.

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Database to data provided in the IRS' National Account Profile (NAP).⁶ We found similar conditions, except that some individuals were identified as being deceased. Specifically, the data showed that:

- 350 individuals were not U.S. citizens.
- 63 individuals were not over the age of 21.⁷
- 30 individuals were deceased prior to January 1, 1986, (the inception of the IRS' *e-file* Program).

Example 1: An individual submitted a Form 8633 dated August 8, 2001. The application identified the Responsible Official's date of birth as January 11, 1975. However, our review of the Responsible Official's SSN to information provided to the IRS from the Social Security Administration (SSA) identified a date of birth of September 28, 1989. In addition, the last name of the applicant did not match the last name of the person per the SSA records for that SSN. This individual has *e-filed* 380 tax returns for this filing season.⁸ Further analysis revealed that there was no tax return filing history for this SSN in the IRS' records. This example was referred to the Treasury Inspector General for Tax Administration's (TIGTA) Office of Investigations for review.

Example 2: An individual submitted a Form 8633 dated November 6, 2001. The application identified the Responsible Official's date of birth as October 21, 1949. However, our review of the Responsible Official's SSN to information provided to the IRS from the SSA identified a date of birth of October 22, 1900, and also identified that the individual was deceased with a date of death of June 1, 1968. Furthermore, the last name of the applicant did not match the last name of the person per SSA records for this SSN. This individual has *e-filed* 241 tax returns for the 2002 Filing Season.⁸ Further analysis revealed that there was no tax return filing history for this SSN in the IRS'

⁶ The National Account Profile contains data provided to the IRS from the Social Security Administration.

⁷ As of February 1, 2002.

⁸ As of March 1, 2002.

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records. This example was referred to TIGTA's Office of Investigations for review.

Screening checks publicized to the taxpaying public as being extensive were found to be limited primarily to whether an individual filed a tax return and paid taxes due

IRS management indicated that once an individual is accepted into the *e-file* Program, evidence of disreputable conduct is based solely on referrals by the taxpaying public or information from the IRS' Criminal Investigation (CI) Division.

Our review of 50 cases randomly selected from the Applicants Database found that the applicant-screening site properly ensured that all 50 applicants were in compliance with filing their tax returns and paying any taxes owed. However, additional screening checks were either not performed or were performed on a limited basis. The checks that were not performed or were limited are those detailed in Publication 1345 as being performed prior to an individual being accepted into the *e-file* Program. They include the following:

- ***Credit checks not being performed.*** Specifically, the IRS did not perform a credit history check for any of the 50 cases in our sample. Discussions with screening site management identified that the screening site does not perform *any* credit history checks.⁹

However, we identified that the IRS has a blanket contract with a credit company that could be used by the screening site. The credit checks cost the IRS between \$1.25 and \$2.25 based on the number of credit checks requested in any given month and the option year of the contract. Using these amounts, the credit checks for the 24,284 individuals who applied during the period October 1, 2000, to September 21, 2001, would have cost the IRS approximately \$30,000 to \$55,000.

⁹ We did not test for instances of bad credit among *e-file* Providers.

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- ***Professional certifications were accepted in lieu of fingerprint cards with no IRS verification as to whether the individual was in good standing with the organization issuing the certification at the time of the application.*** Specifically, the IRS does not require all applicants to provide a fingerprint card when applying to become an *e-file* Provider. In 18 of the 50 cases we reviewed, the IRS accepted a professional certification in lieu of the fingerprint card. The IRS did not perform any independent verification that the applicant was in good standing with the professional organization from which the certification was issued. No verification was performed despite the fact that two individuals who applied in Calendar Year 2000 provided CPA professional certifications that were dated 1976 and 1977. Additionally, in another case, the applicant wrote in his own certification on the application, did not submit any documentation, and was accepted into the Program.
- ***Screening checks are not performed for those individuals who participate as e-file Providers in the IRS' volunteer income tax preparation program.*** For 6 of the 50 cases we reviewed, no professional certification or fingerprint card was provided. Per Form 8633, if the applicant will be providing electronic filing or tax preparation as a service not for profit, (such as Volunteer Income Tax Assistance (VITA) sites and American Association of Retired Persons sites) the applicant does not need to disclose his or her name and social security number on the form.

Because these individuals do not provide their names and SSNs, they are accepted into the *e-file* Program without any screening checks being performed. Of the 108,164 *e-file* Providers authorized to participate in the IRS' *e-file* Program, 6,059 were in the VITA program. For the 2002 Filing Season (as of March 12, 2002), these individuals have filed 558,399 electronic returns.

- ***Criminal background checks are limited to one in four of those individuals who are required to provide a fingerprint card.*** For the period October 1998 to September 2001, the IRS received (per its Applicants

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Database) 55,282 Forms 8633. However, only 6,555¹⁰ applicants were selected for a criminal background check.¹¹

For 22 of the 50 cases we reviewed where a fingerprint card was provided to the IRS, only 3 were selected and sent to the FBI for a criminal background check. For one of the three, the FBI returned the card as “unprocessable.”¹² A new fingerprint card was subsequently obtained and re-sent to the FBI to properly complete the criminal background check. For the other two individuals, the IRS authorized the individuals to participate in the *e-file* Program prior to the receipt of the criminal background information from the FBI.

- ***Fingerprint cards were not provided.*** For 3 of the 50 cases we reviewed, the applicant did not submit a fingerprint card or a professional certification. IRS management at the applicant-screening site indicated that these individuals were not required to provide a fingerprint card because they were authorized to participate in the Program prior to when a fingerprint card was required.

Applicants were authorized to participate in the *e-file* Program prior to the IRS’ receipt and analysis of criminal background information from the FBI

Our review of the 6,555 individuals for whom a criminal background check was performed during the period October 1998 to September 2001 to the date the individual was authorized to participate in the IRS’ *e-file* Program (authorization date included in the Applicants Database) identified that 3,905 (60 percent) of the 6,555 individuals were authorized to participate in the IRS’ *e-file* Program prior to the IRS’ receipt and analysis of criminal

¹⁰ Figure compiled from analysis of a database the IRS maintains to control the status of individuals selected for a criminal background check. The fingerprint database was created in October 1997, and as of September 2001, contained 8,266 applicants.

¹¹ Criminal background check exclusions (professional certifications and individuals participating in the IRS’ VITA program) cause the number of criminal background checks performed to be less than one in four.

¹² Per the FBI, unprocessable cards are those cards for which the fingerprints are unreadable.

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background information from the FBI. Of these 3,905 individuals, 438 had a criminal background history that would require the CI Division to review the results and provide the applicant-screening site with a recommendation as to whether or not to permit the individual to participate in the *e-file* Program. The average number of days the FBI takes to return the results of a fingerprint card is 11 days.¹³

For example, an individual filed a Form 8633. The Responsible Official notated that he or she had been convicted of a crime on the application. The Responsible Official's fingerprint card was then sent for a criminal background check. The fingerprint card provided with the application was sent to the FBI for a criminal background check.

Prior to the receipt of information from the FBI, the IRS issued an acceptance letter to the applicant authorizing him or her as an *e-file* Provider. When the IRS received the results from the FBI criminal background check, it included various convictions. As a result of the convictions, the information was sent to the Chief, Andover Fraud Detection Center (CI Division), who reviewed the FBI record and recommended that the individual not be allowed into the *e-file* Program.

Based on the recommendation from the CI Division review, the *e-file* Provider was issued a letter that denied his or her participation in the *e-file* Program. The *e-file* Provider called the IRS expressing concern that he or she had already purchased the necessary computer software to participate in the *e-file* Program and now the IRS had denied their participation. This individual *e-filed* over 40 tax returns before he or she was placed in rejected status.

A prior TIGTA report issued in September 1999¹⁴ brought to the IRS' attention that applicants were being admitted into the *e-file* Program prior to fingerprint results being

¹³ This figure is based on 2,119 fingerprint cards submitted to the IRS from October 1, 2000, to September 21, 2001.

¹⁴ *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).

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received and analyzed. To date, the same condition still exists.

Criminal background checks are further limited by the manner in which the IRS handles those fingerprint cards returned as unprocessable from the FBI. During the period October 1997 to September 2001, 8,266 fingerprint cards were sent to the FBI for a criminal background check. Of the 8,266 cards sent to the FBI, 957 (12 percent) were returned as unprocessable. For 541 (57 percent) of the 957 fingerprint cards returned as unprocessable, the IRS never requested a new fingerprint card from the applicant to properly enable the FBI to complete the criminal background check.

Subsequent screening checks were not performed to ensure individuals authorized to participate in the IRS' e-file Program continue to maintain a high degree of integrity and adhere to the highest professional and ethical standards

Despite Publication 1345 detailing that, "annual checks performed by the IRS include a check for evidence of disreputable conduct or other facts that would reflect adversely on the IRS' e-file Program," no checks are performed outside of the normal tax compliance analysis subsequent to an individual being accepted into the IRS' e-file Program unless the taxpaying public notifies the IRS of a problem with one of the e-file Providers.

For example, an informant sent a letter to their local IRS office dated January 3, 2002. The letter was forwarded to the CI Office in Andover. The letter alerted the IRS to the fact that an approved e-file Provider was operating a tax practice (location was provided) and that this person had been sentenced to 2 years for embezzling union funds and falsifying records to cover the theft (this occurred after acceptance into the e-file Program). The informant included a copy of a news article that stated that this individual had been sentenced to 2 years in prison and was ordered to repay embezzled funds. The IRS is currently reviewing this case to determine what action should be taken.

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Contributing Factors

- Internal IRS guidelines specifically state that the applicant-screening site is not responsible for verifying the age, citizenship, or validity of professional certifications of applicants.
- Internal IRS guidelines direct the applicant-screening site to perform credit checks on an “as needed basis.” Management noted that the screening site does not have a system in place to perform these checks.
- IRS management indicated that it relies on voluntary compliance (applicant provides correct information) and the fact that the IRS asks for information such as a fingerprint card, professional certification, etc., is a deterrent to individuals with criminal backgrounds who would attempt to apply to the *e-file* Program.
- Internal IRS guidelines do not require IRS volunteers to provide identifying information on the *e-file* application.
- Internal IRS guidelines limit criminal background checks to a random sample of one in every four applicants who provide a fingerprint card as the result of a study performed in June 2000. The results of this study identified that only 10 percent of the fingerprint cards sent to the FBI for criminal background analysis were returned to the IRS with criminal histories.

A criminal background check costs the IRS approximately \$18 per fingerprint card. For the last 3 years, the IRS has not expended all of the money allocated to perform criminal background checks. As per the chart below, if the money allocated was used, 2,304 more criminal background checks could have been performed.

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Fingerprint Card Costs Fiscal Years (FY) 1999--2001

	<i>FY 99</i>	<i>FY 00</i>	<i>FY 01</i>
Budgeted	\$53,045	\$54,636	\$55,000
Expended	\$43,440	\$37,980	\$39,762
Not expended	\$ 9,605	\$16, 656	\$15,238
Additional cards that could have been processed	533	925	846

Source: *The IRS' Electronic Tax Administration.*

- Internal IRS guidelines direct the applicant-screening site to issue a letter providing conditional acceptance to applicants who have passed all other checks until a response from the FBI is received and analyzed by the IRS.
- Internal IRS guidelines regarding the handling of unprocessable fingerprint cards were not always followed. Specifically, new fingerprint cards were not always requested from applicants when the FBI deemed the original fingerprint card as being unprocessable. Until recently, the consolidated application-screening site did not have a system in place to track which applicants resubmitted fingerprint cards that were originally deemed as unprocessable by the FBI. Since the process was established,¹⁵ it has not been followed.
- IRS management indicated that once an individual is accepted in the *e-file* Program, evidence of disreputable conduct is based solely on referrals by the taxpaying public

When the IRS does not ensure that minimum requirements are met and that publicized screening checks are performed, the taxpaying public who use the IRS' *e-file* Providers are provided a false assurance of the requirements that are needed prior to an individual being accepted into the IRS' *e-file* Program. In a recent USA Today article, an IRS executive stated, "The IRS won't guarantee an error-free filing, but preparers have to undergo numerous background

¹⁵ This process was established around the end of 2001.

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checks and security screenings before they can link to the IRS site.”¹⁶

Furthermore, this same false assurance is being given to State Department of Revenue Offices who have *e-file* Programs. For example, we contacted the Massachusetts and the Pennsylvania Department of Revenue offices. These two state offices are performing minimal, if any, compliance checks on potential state *e-file* Providers because they are relying on the “lengthy process” the IRS performs on Federal *e-file* Providers.

As stated in the IRS’ *e-file* Handbook, “...While all Authorized IRS *e-file* Providers must be on the lookout for fraud and abuse in the IRS *e-file* Program, EROs [Electronic Return Originators, an IRS term for *e-file* Providers] 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.”¹⁷

The screening checks and requirements listed in the IRS *e-file* Handbook were meant to ensure the integrity of the *e-file* Program. If the IRS does not perform the screening checks and does not review applications for adherence to the requirements for application, fraudulent *e-file* Providers could be admitted into the *e-file* Program. Each year, the IRS’ Questionable Refund Program identifies a number of electronically filed returns with questionable refunds. The following are the number of electronically filed tax returns and the amount of the questionable refunds that were identified and deleted by the IRS for the last three tax processing years.

¹⁶ USA Today article dated February 15, 2002.

¹⁷ Publication 1345 (Rev. 1-2001).

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Questionable Refunds From E-File Returns

Processing Year	Returns	Questionable Refunds Claimed	Refunds Deleted	Percentage Deleted
1999	3,907	\$12,142,461	\$ 7,260,953	60%
2000	8,949	\$33,401,230	\$21,552,804	65%
2001	14,787	\$69,036,394	\$48,732,669	71%

Source: CI Division, Refund Crimes.

Recommendations

The Commissioner, Wage and Investment Division, should ensure that:

1. Screening procedures for new applicants include an independent validation of age and citizenship.

Management's Response: As a long-standing business decision, the IRS does not screen applicants for verification of age or citizenship. IRS management stated that corrective action is not needed for this recommendation because the number of ineligibles is extremely small (less than 1 percent of active individuals as of February 1, 2002) and a very insignificant number would be identified through additional screening. Management also believes the numbers may be significantly smaller than we reported due to input errors and inaccurate data in the IRS database used for our analyses (the NAP). As a result, additional screening processes are not needed. Management has requested a copy of our data.

Office of Audit Comment: We do not agree with management's assertion that the number of non-citizens and individuals under 21 is insignificant. The IRS has the ability to easily validate whether applicants are meeting age or citizenship requirements by researching data it receives from the SSA and has in its computer files. We agree with management and notate in the audit report that some of the individuals TIGTA identified as not meeting age and citizenship requirements may be the result of IRS employee input errors. However, the IRS does not have management information that shows the level of these input errors.

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Management indicates that our analysis may include individuals who are resident aliens and who have met age requirements, thereby allowing these individuals to participate in the *e-file* Program. Our analysis was limited to only those individuals who were aliens not allowed to work or alien students with restricted work authorization per IRS data, which was obtained from the SSA.

Furthermore, our identification of individuals under 21 was conservative, and the total number of individuals identified is probably understated. Specifically, our analysis was based on the applicant being 21 by February 2002, which was when the analysis was performed. The information provided to us by the IRS for this analysis was dated September 2001. Our identification was of individuals not reaching the age of 21 by February 2002, and did not include those individuals who may have turned 21 between September 2001 to February 2002.

2. All applicants be subjected to a credit and criminal background check, and individuals not be authorized to participate in the *e-file* Program until all verifications and checks are completed.

Management's Response: Management stated that corrective action is not needed for this recommendation. They assert that they do not generally refer to screening checks as being extensive and that "Neither an IRS executive stating "preparers have to undergo numerous background checks and security screenings before they link to the IRS site,"¹⁸ nor the information in Publication 1345, Handbook for Authorized IRS *e-file* Providers, should be viewed in this light."

Management further explains that they previously performed the credit checks and deemed them ineffective after several years. They state that since our report does not show that applicants with poor credit negatively affect the *e-file* Program or any other reason for performing credit checks, the checks are not warranted.

Management also believes additional FBI checks and background investigations are not necessary and cites an

¹⁸ USA Today article dated February 15, 2002.

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IRS business case study which showed that, while 10 percent of the investigations revealed information, it was usually not significant enough to deny participation in the *e-file* Program. They also assert that they allow individuals to participate in the Program prior to receiving the FBI results because they are unlikely to deny participation based solely on those results. Lastly, management stated that they have no indications of fraud or other criminal activity at volunteer sites and that performing suitability checks on volunteers would be detrimental to the volunteers who *e-file* returns for low-income taxpayers and the IRS' efforts to expand electronic filing to these taxpayers.

Office of Audit Comment: We disagree with management's assertion that the IRS does not refer to screening checks as being extensive. The presentation of the screening checks that the IRS performs on *e-file* Provider applicants is misleading to the taxpaying public who use them as well as state Department of Revenues that rely on the IRS performing these checks. Management's assertion that screening checks are not extensive is contradictory to the information publicized by the IRS in written documents (Publication 1345, Handbook for Authorized IRS *e-file* Providers) and portrayed to the media.¹⁹ Furthermore, for those individuals who file electronic tax returns as part of the IRS' volunteer program, no screening checks are performed.

In addition, management indicates that individuals are allowed to participate in the *e-file* Program before results of fingerprint cards are received back from the FBI because the IRS is unlikely to deny acceptance based solely on the results of criminal background checks. We continue to disagree with management on approving individuals prior to receipt and analysis of the results from the FBI. Significant burden is placed both on the applicant as well as taxpayers who may have been conducting business with the applicant if criminal background results are returned that cause the IRS to remove the already accepted applicant from the *e-file* Program. This again seems to be a compromise in the integrity of the *e-file* Program in the IRS' effort to increase

¹⁹ USA Today article dated February 15, 2002.

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participation in the *e-file* program. The average number of days to receive the results of criminal background checks from the FBI is 11 days.

Finally, we continue to disagree with management's assertion that fingerprint cards are not obtained from individuals with professional certifications because their professional status rightfully provides additional privilege and trust. We agree that an individual's professional status should provide additional privilege and trust; however, as we detail in our audit report, the IRS performs no verification to ensure the applicant is in good professional standing or that the certification is legitimate.

3. Subsequent credit and criminal background checks are performed at regular intervals.

Management's Response: Management again stated that corrective action is not needed. As with their response to recommendation number 2, they believe our report does not indicate that additional credit and background checks at regular intervals are needed. Management also states that they do perform regular monitoring of the operations of *e-file* Providers to ensure compliance with Program rules and that we have not shown that their current screening and monitoring processes produce negative results, thus justifying additional checks.

Office of Audit Comment: We agree with management that our report does not establish that additional credit and background checks conducted at regular intervals are necessary to ensure the integrity of the *e-file* Program. This recommendation was made to alert the IRS that information provided to the taxpaying public details that "annual checks performed by the IRS include a check for evidence of disreputable conduct or other facts that would reflect adversely on the IRS' *e-file* Program." This again is another area where the IRS is misleading the taxpaying public as no annual checks other than tax compliance are performed.

Furthermore, management cites the performance of monitoring visits in their response. However, monitoring visits do not check the integrity of the *e-file* Provider; the visits only focus on compliance with IRS *e-file* rules. In addition, IRS program information shows that only

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approximately 4 percent of the individuals in the *e-file* Program were subjected to a monitoring visit during the previous 3 fiscal years (1999 through 2001).

4. Internal guidelines be adhered to regarding the handling of those 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.

Management's Response: IRS management agreed with our recommendation in part. They asserted that they will obtain new cards and submit them in future instances where fingerprint cards are returned as unprocessable. However, they do not believe they need to contact those who were already identified to date since those individuals are already participants in the Program.

Office of Audit Comment: Management is taking a risk by not obtaining fingerprint cards for individuals who have been accepted into the e-file Program and had unprocessable fingerprint cards. Also, as stated earlier, field monitoring visits do not involve a check of the integrity of the *e-file* Provider; the visits only focus on compliance with IRS *e-file* rules.

Detailed Objective, Scope, and Methodology

The overall objective of this review was to determine if the Internal Revenue Service (IRS) has effective screening procedures to determine who should be allowed to participate in the electronic filing (*e-file*) Program. To accomplish our objective, we:

- I. Reviewed IRS and Treasury Inspector General for Tax Administration documentation regarding the IRS' *e-file* Program.
 - A. Reviewed prior audit findings and corrective actions regarding the *e-file* Program.
 - B. Reviewed any documentation the IRS had related to the *e-file* Program; specifically, the suitability checks performed.
- II. Determined what guidance the IRS uses to review applications for the *e-file* Program.
 - A. Reviewed the IRS Handbook for Authorized IRS *e-file* Providers of Individual Income Tax Returns (Publication 1345).
 - B. Reviewed the pertinent Internal Revenue Manual sections regarding the processing of the Application to Participate in the IRS *e-file* Program (Form 8633).
- III. Determined if the IRS prior to authorizing individuals to participate in the program validated age and citizenship requirements.
 - A. Analyzed data input to the citizenship and birth date fields on the IRS' Applicants Database to determine if individuals were accepted into the *e-file* Program who were not United States (U.S.) citizens or were under the age of 21.
 - B. Reviewed social security numbers (SSN) of authorized applicants per the IRS' Applicants Database to the IRS' National Account Profile. The National Account Profile contains data provided to the IRS from the SSA. Determined if individuals were not U.S. citizens, were under the age of 21, or were deceased.
- IV. Determined if all required suitability checks are being performed on *e-file* applicants prior to authorizing individuals to participate in the Program.
 - A. Selected a judgmental interval sample of 50 (every 667th record) out of 33,357 (active *e-file* Providers after October 1, 1997) *e-file* applications and reviewed them to determine if suitability checks were performed.
 1. Determined if the IRS' suitability determinations were correct.
 - a) Determined if professional certifications or fingerprint cards were obtained.

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- b) Determined if the applicant timely filed individual and any business tax returns.
 - c) Determined if the applicant was under criminal investigation.
 - B. If suitability checks were not performed or were not correct, interviewed management and IRS' National Headquarters employees to determine why and attempted to quantify the number of taxpayers that may be impacted.
 - C. Selected a judgmental interval sample of 20 (every 437th record) out of 8,266 *e-file* applications where the IRS sent a fingerprint card to the Federal Bureau of Investigations (FBI) for criminal analysis. Also, selected a judgmental interval sample of 20 (every 8th record) out of 165 *e-file* applications where the IRS sent the fingerprint cards to the FBI for criminal analysis and the FBI showed that there was criminal activity.
 - 1. Determined if suitability determinations were correct based on the FBI results.
 - 2. Analyzed all of the *e-file* applications on the fingerprint database where the FBI reported that the applicant had a criminal record and the application was accepted before the IRS received the FBI results.
 - a) Determined the number of *e-file* applications on the fingerprint database where the FBI reported that the applicant had a criminal record and the application was accepted before the IRS received the FBI results.
 - b) Determined if the suitability determinations were changed or should have been changed based on the fingerprint results from the FBI.
 - 3. If suitability checks relating to the use of the FBI data were not performed or were not correct, interviewed management to determine why and attempted to quantify the number of taxpayers that may be impacted.
- V. Determined if the FBI provided the IRS with a report for every fingerprint card sent by the IRS for criminal analysis.
 - A. Identified any procedures regarding the control of fingerprint cards that were sent to the FBI.
 - B. Queried the fingerprint database to identify any instances where the IRS sent a fingerprint card to the FBI for a criminal analysis, but the results were never received by the IRS.
 - C. Provided a list to management of any fingerprint cards that were sent to the FBI, but the results of the criminal check were not provided to the IRS.
 - D. Determined whether the IRS obtained a new fingerprint card from the applicant and whether the new fingerprint card was sent to the FBI for analysis for instances where the FBI returns the fingerprint card as unprocessable or unreadable.

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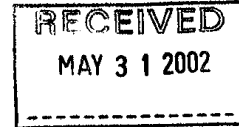
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Management's Response to the Draft Report



DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
ATLANTA, GA 30308

May 31, 2002



MEMORANDUM FOR TREASURY INSPECTOR GENERAL FOR TAX
ADMINISTRATION

FROM:


John M. Dalrymple
Commissioner, Wage and Investment Division

SUBJECT:

Draft Audit Report – E-File Providers Are Not Adequately
Screened (Audit # 200140045)

We have reviewed the above-mentioned report. While we do not agree with the majority of your recommendations, we do appreciate the need for your review of this sensitive and critical area of tax administration.

Since 1994, when the IRS developed and implemented its first major efforts to prevent and detect fraud in electronic filing, we have been working with your organization to improve our screening of applicants to the IRS e-file Program. In fact, we have adopted many of your recommendations, and they are currently part of our operations.

We have initiated other program changes over time as we have analyzed e-file results and relationship management issues to find the optimum balance between these sometimes competing priorities. For example, our initial procedures required 100 percent review of fingerprint cards and analysis of credit history of all e-file Providers – two of the recommendations contained in your most recent report. We moved away from these procedures because the results did not warrant the significant expenditure of resources. We feel the current suitability process and its inherent rules strike a good balance, although we always look for ways to maximize our effectiveness while minimizing the unwarranted expenditure of taxpayer dollars.

An issue we are still struggling with is one not referenced specifically in your report but implied in your statement related to our "ineffective method of screening." Suitability is designed to "protect the integrity of the electronic filing system," and we feel strongly we are obligated to look for ways to improve the effectiveness of our screening. However, additional or different methods must be based on factual, cause, and effect data. Simply increasing the number of applicants we subject to an existing compliance check does not necessarily equal a more effective screening method. We would be happy to have recommendations from your office, and data from the Office of Refund Crimes, that would justify changes to our current screening process.

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Our comments on your recommendations follow:

RECOMMENDATION # 1

The Commissioner, Wage and Investment Division, should ensure screening procedures for new applicants include independent validation of age and citizenship.

ASSESSMENT OF CAUSE

You completed two analyses to determine if we authorized individuals to participate in the IRS *e-file* Program who were not U.S. citizens or were under 21 years of age, and therefore, did not meet eligibility requirements for participation in the program. One analysis was of the citizenship and birth date field data in the IRS' Applicants Database. The analysis revealed 113 individuals were not U.S. citizens and 227 individuals were not over the age of 21, if our screening site employees accurately input the information.

Your other analysis was a review of data from the IRS' National Account Profile using social security numbers of applicants. That analysis indicated similar results: 350 individuals were not U.S. citizens, 63 individuals were not over the age of 21, and 30 individuals were identified as deceased before the start of the IRS *e-file* Program.

Your report also references 187,058 Authorized *e-file* Providers as of February 1, 2002, as the number of applicants checked in the two analyses.

CORRECTIVE ACTION

A corrective action is not needed. We believe some of the ineligibles you identified may have been caused by input error and inaccurate data in the National Account Profile. We asked for this data to validate our suspicion. Without additional research, we cannot determine if the number of individuals not meeting the citizenship and age eligibility requirements is accurate or significantly less than you reported, as we believe. Also, some individuals who are not citizens may be resident aliens and thus eligible for participation in the program. One additional note that may affect the accuracy of your data, the age requirement for eligibility to participate is age 21, not over the age of 21, as identified in your analyses.

Although we have not verified the accuracy of your analyses, the number of ineligibles using the TIGTA results is extremely small – less than 1 percent of active individuals as of February 1, 2002, and probably less if we validated the data. As a long-standing business decision, we do not screen applicants for verification of age or citizenship. At this time, it appears a very insignificant number of individuals would be identified as ineligible through additional screening. Therefore, additional screening processes are

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not warranted. We would like to receive the actual data to validate the numbers in these analyses. We would also be interested in data that shows this additional review of age and citizenship would directly contribute to fraud prevention.

IMPLEMENTATION DATE

Not Applicable

RESPONSIBLE OFFICIAL

Director, Stakeholder, Partnership, Education and Communication (SPEC)

CORRECTIVE ACTION MONITORING PLAN

Not Applicable

RECOMMENDATION # 2

The Commissioner, Wage and Investment Division, should ensure that all applicants be subjected to a credit and criminal background check, and individuals not be authorized to participate in the *e-file* Program until all verifications and checks are completed.

ASSESSMENT CAUSE

Our screening checks were found to be limited primarily to whether an individual filed a tax return and paid taxes due. We were not performing credit checks. We accepted professional certifications instead of fingerprint cards, and we did not verify whether the individual was in good standing with the organization issuing the certification. We do not screen individuals who participate as *e-file* Providers in the Volunteer Income Tax Assistance (VITA) program. Our criminal background checks are limited to one in four of those individuals who had to provide a fingerprint card. We allowed applicants to participate in the *e-file* Program before we received criminal background information from the FBI.

CORRECTIVE ACTION

Corrective action is not needed. We do not generally refer to screening checks as being extensive. Neither an IRS executive stating "preparers have to undergo numerous background checks and security screenings before they link to the IRS site," nor the information in Publication 1345, *Handbook for Authorized IRS e-file Providers*, should be viewed in this light. We distribute Publication 1345 to third parties, and it contains guidelines on participating in the *e-file* Providers program. The publishing of these guidelines is sometimes a deterrent in itself.

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We do not complete credit checks on applicants at this time. When we first began the suitability check process, we completed credit checks on 100 percent of the applicants. After several years, we analyzed the results and deemed the checks ineffective. The additional expense to reinstate the use of credit checks would be warranted only if we determined that applicants with poor credit negatively affect the integrity of the *e-file* Program. Your report does not establish any such correlation or any other reason for researching applicants' credit.

Likewise, it is not warranted to have the FBI to complete additional background investigations for 100 percent of applicants' fingerprints. An IRS business case study conducted October 1999 through January 2000 showed 10 percent of criminal background investigations revealed information. However, this information was not significant enough to deny an applicant's participation in the *e-file* Program. Also, no evidence exists to support any additional expenditure for researching more than the current sampling of one of four fingerprint cards for criminal background information. We allow applicants to participate in the *e-file* Program before we receive criminal background information from the FBI because we are unlikely to deny acceptance based solely on the results of the background check.

We do not require fingerprint cards from individuals with professional certifications or who provide free electronic filing or tax preparation as a service, because their status rightfully provides additional privilege and trust. Also, it has not been proven that securing fingerprint cards from these individuals would positively affect the overall quality of applicants we accept into the *e-file* Program. You do not explain why you believe we should complete a suitability check for individuals administering volunteer programs. We have no indications of fraud or other criminal activity occurring at volunteer sites. Completing suitability checks on volunteers might be devastating to the IRS' effort to expand electronic filing to low-income taxpayers. The IRS report titled "Electronic Filing System: Suitability/Security/QRDT," May 1999, recommended we exclude VITA sites, military sites, and employer programs from suitability screening. We often do not know who will volunteer and/or actually show up for VITA duty until the filing season actually starts, often around the first of February. At this late date, it is impossible for us to perform a suitability check, including screening checks, in time for the volunteer to *e-file* returns. Therefore, if we implemented this recommendation, it would be detrimental to volunteers who *e-file* returns for low-income taxpayers, the primary recipients of services at VITA sites.

IMPLEMENTATION

Not Applicable

RESPONSIBLE OFFICIAL

Director, SPEC

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CORRECTIVE ACTION MONITORING PLAN

Not Applicable

RECOMMENDATION # 3

The Commissioner, Wage and Investment Division, should ensure that subsequent credit and criminal background checks are performed at regular intervals.

ASSESSMENT OF CAUSE

We do not perform checks outside the normal tax compliance analysis before we accept an individual into the *e-file* Program unless the taxpaying public notifies us of a problem with one of the *e-file* Providers.

CORRECTIVE ACTION

Corrective action is not needed. As explained in the corrective action for recommendation # 2, your report does not establish that additional credit and background checks conducted at regular intervals are necessary to ensure the integrity of the *e-file* Program. We have no evidence that additional research at regular intervals would help us identify individuals who are negatively affecting the integrity of the *e-file* Program. We receive information from internal and external sources about possible criminal activity of Authorized IRS *e-file* Providers. We evaluate and refer it to the appropriate IRS organization for further investigation.

We also conduct Tax Compliance Checks and monitor Providers' *e-file* operations. Tax Compliance Checks include identification of assessment of penalties, including fraud, preparer, negligence, and other penalties. Monitoring of Providers' *e-file* operations ensure compliance with *e-file* rules. SB/SE Compliance conducts field monitoring usually by visiting the Providers' places of business. Field monitoring is conducted both randomly and as the result of complaints or information received. We provided statistics on our visits during the audit, however, your report does not reference this monitoring activity. Monitoring visits for the last 3 years are as follow:

Year	Number of Visits
1999	1,748
2000	1,136
2001	1,237

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Your report does not show our current screening and monitoring processes produce negative results, thus justifying additional checks to further ensure the integrity of the *e-file* Program. Nor does your report provide any data to show that implementing this recommendation would have more positive results than our current processes.

IMPLEMENTATION DATE

Not Applicable

RESPONSIBLE OFFICIAL

Director, SPEC

CORRECTIVE ACTION MONITORING PLAN

Not Applicable

RECOMMENDATION # 4

The Commissioner, Wage and Investment Division, should ensure that internal guidelines be adhered to regarding the handling of those 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.

ASSESSMENT OF CAUSE

From October 1997 to September 2001, we sent 8,266 fingerprint cards to the FBI for background checks. Twelve percent (957) were returned as unprocessable. For 541 of the 957 unprocessable cards, we did not request a new fingerprint card from the applicant.

CORRECTIVE ACTION

In the future, when this happens, we will request new fingerprint cards from applicants and resubmit them to the FBI. We do not believe we need to contact those individuals who have been identified to date as having unprocessable fingerprint cards to obtain a new card. We have accepted those Providers to participate in the program, and they are subject to our ongoing Tax Compliance Checks and field monitoring. Those processes, and Criminal Investigation's fraud detection efforts, are intended to identify Providers who are negatively affecting the *e-file* Program. We believe the accepted Providers should be allowed to continue participating in the *e-file* Program, if we have not identified them as noncompliant with tax obligations after their acceptance to the

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e-file Program. We will issue interim guidance on obtaining new fingerprint cards when the FBI returns them as unprocessable to Andover Submission Processing Center by August 1, 2002. We will include procedures in the Internal Revenue Manual by October 15, 2002.

IMPLEMENTATION DATE

October 15, 2002

RESPONSIBLE OFFICIAL

Director, SPEC

CORRECTIVE ACTION MONITORING PLAN

We will secure monthly reports from Andover to ensure adherence to procedure.

If you have any questions, please call me at (202) 622-6860, or Mark Pursley, Director, SPEC, at (404) 338-7104.