



*The Screening and Monitoring of  
E-File Providers Has Improved,  
but More Work Is Needed to Ensure  
the Integrity of the E-File Program*

**March 31, 2010**

**Reference Number: 2010-40-042**

This report has cleared the Treasury Inspector General for Tax Administration disclosure review process and information determined to be restricted from public release has been redacted from this document.



TREASURY INSPECTOR GENERAL  
FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY  
WASHINGTON, D.C. 20220

March 31, 2010

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

*Michael R. Phillips*

**FROM:** Michael R. Phillips  
Deputy Inspector General for Audit

**SUBJECT:** Final Audit Report – The Screening and Monitoring of E-File Providers  
Has Improved, but More Work Is Needed to Ensure the Integrity of the  
E-File Program (Audit # 200940029)

This audit presents the results of our review to determine whether the Internal Revenue Service's (IRS) screening and monitoring of electronic filing (*e-file*) Providers is effective. This review was included in the Treasury Inspector General for Tax Administration's Fiscal Year 2009 Annual Audit Plan and is a followup to a prior report.<sup>1</sup> This audit addresses the major management challenges of Taxpayer Privacy and Protection, Leveraging Data to Improve Program Effectiveness and Reduce Costs, and Providing Quality Taxpayer Service Operations.

*Impact on the Taxpayer*

The primary means by which the IRS regulates *e-file* Providers are the application screening process and the monitoring program. The application screening process does not ensure the integrity of the individuals applying for participation in the *e-file* Program, and the monitoring program does not ensure *e-file* Providers are compliant with *e-file* Program requirements. Inadequate screening and monitoring increases the risk to both the taxpaying public and the Federal Government for potential losses associated with unscrupulous *e-file* Providers.

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<sup>1</sup> *Better Screening and Monitoring of E-File Providers Is Needed to Minimize the Risk of Unscrupulous Providers Participating in the E-File Program* (Reference Number 2007-40-176, dated September 19, 2007).



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Synopsis

There were 207,419 authorized Electronic Return Originators (a type of *e-file* Provider) as of June 21, 2009, who *e-filed* approximately 61 million (66 percent) of the 92 million *e-filed* tax returns accepted in Calendar Year 2009. The application screening process is used to ensure individuals applying for entry into the *e-file* Program have met required screening and verification checks before they are authorized to participate in the *e-file* Program. Monitoring visits are the primary means to verify the *e-file* Providers compliance with many of the *e-file* Program requirements.

The screening and monitoring of *e-file* Providers has improved, but more work is needed to ensure the integrity of the *e-file* Program. In response to our Fiscal Year 2007 report, the IRS began validating existing *e-file* Providers as Not-for-Profit organizations and verifying that existing *e-file* Providers and new applicants are either United States citizens or legal aliens with authorization to work. However, not all Not-for-Profit organizations were validated and not all citizenship statuses of *e-file* Providers have been verified. A statistical sample of 97 *e-file* Providers from a population of 13,797 that were active as of August 2009, and designated as Not-for-Profit organizations, showed that 18 (19 percent) were erroneously designated as Not-for-Profit organizations. Twelve (12 percent of the sample) of the 18 were not subjected to suitability checks.

For both existing and new applicants, if the citizenship status is blank or unknown on the Social Security Administration's Data Master-1 file, the IRS is not requesting that the *e-file* Provider verify citizenship status. The IRS found that about 109,000 (52 percent) of 210,000 *e-file* Providers do not have a citizenship code in the Data Master-1 file. Furthermore, the criteria being used to identify new applicants who are not United States citizens or legal aliens should include the citizenship category of "alien, student, restricted work authorization." A statistical sample of 89 of the 961 *e-file* Providers, active as of July 2009, showed that 73 (82 percent) of the *e-file* Providers proved their citizenship status; 16 (18 percent) did not.

For the 2009 Filing Season, the IRS planned to conduct more than 1,500 *e-file* Provider monitoring visits, which accounted for about 1 percent of the 143,000 *e-file* Providers who *e-filed* more than 50 tax returns in Fiscal Year 2008. The IRS reported that IRS employees conducted 1,651 visits during the 2009 Filing Season. As a result of these visits, 813 adverse actions were reported, including 102 (13 percent) proposed suspensions, 120 (15 percent) immediate suspensions, and 1 (0.1 percent) expulsion.

Although procedures have been developed to address recommendations from the Fiscal Year 2007 audit report regarding the monitoring of *e-file* Providers, they are not always being



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followed. Tests of three out of the seven Area Offices<sup>2</sup> showed that the changes have not been implemented. The Monitoring Coordinators are not contacting the IRS' Criminal Investigation Division to discuss any trends or problems it is finding with *e-file* Providers, suspension logs that track proposed suspensions are not always maintained, and followups are not always conducted with the IRS' Appeals Office to determine the outcome of appeals filed by the *e-file* Providers.

Furthermore, the IRS does not always target visits based on the criteria of 100 or more returns filed in the previous year and a 25 percent or higher reject rate, and the required followup visits are not always performed. Some referrals are tracked in the monitoring logs, but we were unable to verify if there were any additional referrals received by the Monitoring Coordinators, other than the referrals noted in the logs used to document all of the visits. Year-end reconciliations of the case files to the monitoring logs and the reports sent to the Small Business/Self-Employed (SB/SE) Division Headquarters are not conducted.

In addition, the SB/SE Division and the Electronic Tax Administration and Refundable Credits office are not using the results of the monitoring program to improve the *e-file* Program. The individual results of the monitoring visits do not go beyond the monitoring coordinators. The monitoring visit case files are maintained at the Area Offices, and the information elevated is only the total number of visits conducted and the number of warnings, reprimands, suspensions, and expulsions issued.

### *Recommendations*

The Commissioner, Wage and Investment Division, should ensure the citizenship and the Not-for-Profit statuses are verified for all *e-file* Program applicants and that both applicants and current *e-file* Providers who are identified with a blank or unknown citizenship status in the Data Master-1 file are verified as being a United States citizen or a legal alien. A process should also be established requiring the Stakeholder Partnerships, Education, and Communication function to notify the Electronic Tax Administration and Refundable Credits office when a volunteer site is closed or becomes inactive so that office can deactivate the Electronic Filing Identification Number.<sup>3</sup>

The Commissioner, SB/SE Division, should implement controls to ensure that the monitoring visit procedures are being followed, the information reported to SB/SE Division Headquarters is accurate, and the results of the monitoring visits are used to improve and measure the effectiveness of the *e-file* Program.

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<sup>2</sup> A geographic organizational level used by IRS business units and offices to help their specific types of taxpayers understand and comply with tax laws and issues.

<sup>3</sup> For those applicants accepted to participate in the *e-file* Program, the IRS assigns an Electronic Filing Identification Number. This number allows the IRS to identify a specific Authorized *e-file* Provider.



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*Response*

IRS management agreed with five of our six recommendations. The IRS will improve procedures to ensure compliance with internal guidelines; initiate programming changes to include the citizenship code for alien, student, restricted work authorization; and develop guidance to deactivate Volunteer Program Electronic Filing Identification Numbers. The IRS will also analyze its control system for monitoring visit procedures, assess effectiveness of changes, develop an action plan to assess the Monitoring Program, and update internal guidelines with relevant changes.

The IRS did not agree to verify the citizenship status of all *e-file* Providers, stating that recent legislation mandating *e-file* for most return preparers will require the IRS to modify the current citizenship rules. If this recommendation was implemented in concert with the *e-file* mandate, the IRS believes it would effectively bar all foreign preparers from completing United States tax returns, an outcome that would undermine effective tax administration. It is currently evaluating ways to address these challenges under the auspices of the Return Preparer Implementation team. Management's complete response to the draft report is included as Appendix VI.

*Office of Audit Comment*

In its response, the IRS stated that recent legislation mandating *e-file* for most return preparers will require it to modify the current *e-file* Provider citizenship rules. *E-file* Providers may no longer be required to be United States citizens.

However, as the IRS states, it shares our concern of the need to accurately verify information about *e-file* Providers. Therefore, although there may no longer be a requirement for *e-file* Providers to be United States citizens, the IRS should continue to ensure that all United States based *e-file* Providers have valid Social Security Numbers and pass a citizenship test. Any foreign-based preparers should be required to provide Individual Taxpayer Identification Numbers. These should also be verified. This will ensure all *e-file* Program requirements are being met and the IRS has reliable information to make decisions.

Copies of this report are also being sent to the IRS managers affected by the report recommendations. Please contact me at (202) 622-6510 if you have questions or Michael E. McKenney, Assistant Inspector General for Audit (Returns Processing and Account Services), at (202) 622-5916.



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## *Abbreviations*

DM-1	Data Master - 1
<i>e-file; e-filed</i>	Electronic filing; electronically filed
EFIN	Electronic Filing Identification Number
ERO	Electronic Return Originator
IRS	Internal Revenue Service
SB/SE	Small Business/Self-Employed
SPEC	Stakeholder Partnerships, Education, and Communication
U.S.	United States



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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 tax returns to be sent to the IRS in an electronic format via an authorized IRS *e-file* Provider. An *e-file* Provider is generally the first point of contact for most taxpayers filing a tax return through the IRS' *e-file* Program. Figure 1 lists the types of authorized *e-file* Providers.

**Figure 1: Types of Authorized IRS E-File Providers**

Electronic Return Originator (ERO)	EROs originate the electronic submission of income tax returns to the IRS. An ERO electronically submits income tax returns that are either prepared by the ERO firm or received from a taxpayer.
Intermediate Service Providers	Intermediate Service Providers receive tax return information from EROs or from taxpayers who file electronically using a personal computer, modem, and commercial tax preparation software on an Internet site; process the tax return information; and either forward the information to a transmitter or send the information back to the EROs or taxpayers.
Transmitters	Once the return is prepared, the income tax return data are sent to the IRS by a Transmitter. Transmitters must have software and modems that allow them to connect with IRS computers. EROs and Intermediate Service Providers may also apply to be Transmitters and transmit return data themselves or they may contract with accepted third-party Transmitters who will transmit the data for them.
Software Developers	Software Developers write the <i>e-file</i> programs according to IRS file specifications and record layouts making IRS <i>e-file</i> and Federal/State <i>e-file</i> possible. The IRS and participating States require that all software pass a series of tests each year. Once approved, this software may be sold and used by EROs.

Source: IRS training guidance provided to individuals interested in becoming *e-file* Providers.

As of June 21, 2009, there were 207,419 authorized EROs who electronically filed (*e-filed*) about 61 million (66 percent) of the approximately 92 million *e-filed* tax returns accepted in Calendar Year 2009. The primary means by which the IRS regulates *e-file* Providers are the application screening process and the monitoring program.



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The application screening process is used to ensure individuals applying for entry into the *e-file* Program meet required screening and verification checks before they are authorized to participate in the *e-file* Program. To become an *e-file* Provider, an applicant is required to complete an Application to Participate in the IRS *e-file* Program (Form 8633) and submit it and a fingerprint card to the IRS. The IRS allows an individual with a professional certification to send a copy of the certification in lieu of a fingerprint card. Certifications include Attorney, Certified Public Accountant, Enrolled Agent, and banking official. Each application is required to identify a Principal(s) and at least one Responsible Official.

- A Principal includes the sole proprietor, partners, or individuals authorized to act for the entity in legal and/or tax matters. At least one such individual must be listed on the application.
- A Responsible Official is the first point of contact with the IRS and has the authority to sign revised IRS *e-file* applications. A Responsible Official ensures the *e-file* Provider adheres to the provisions of the revenue procedure as well as all publications and notices governing IRS *e-file*.

The requirements and suitability checks outlined in the *IRS e-file Application and Participation* (Publication 3112) include:

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

Suitability checks may include:

- Criminal background check.
- Tax compliance check to ensure all required tax returns are filed and paid and to identify fraud and preparer penalties.

All authorized *e-file* Providers except those that function solely as Software Developers must meet requirements and pass suitability checks prior to acceptance into the *e-file* Program. If an individual does not meet the requirements or fails a suitability check, the application will be denied. An applicant denied participation in the IRS *e-file* Program will be notified in writing and may appeal the decision.

***E-file Program requirements are  
meant to protect the Program's  
image and integrity.***

Once approved, *e-file* Providers must maintain strict adherence to *e-file* Program requirements to ensure continued participation. An *e-file* Provider may continue to participate in the IRS *e-file* Program if the business and its Principal(s) and Responsible Official(s) meet and adhere to IRS *e-file* Program requirements. These requirements are included in Revenue Procedure 2007-40, *Handbook for Authorized IRS e-file Providers of Individual Income Tax*



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Returns (Publication 1345), and in Publication 3112. Requirements include the need to ensure tax returns are accurately filed, appropriate documentation is maintained, documentation is signed by the taxpayers, and security systems are in place to prevent unauthorized access to taxpayer accounts and personal information by third parties.

**The Wage and Investment Division is responsible for screening e-file Providers**

Two functions within the Wage and Investment Division are involved in the screening and certifying of *e-file* Providers. The Customer Account Services function's Electronic Products and Services Support (E-Help) office in the Andover Campus<sup>1</sup> accepts and processes *e-file* Program applications and performs the initial and periodic screening process to ensure applicants meet the requirements of the *e-file* Program. The Electronic Tax Administration and Refundable Credits office sets the policies for the *e-file* Program.

The IRS uses the Automated Suitability Analysis Program to analyze data included on applications to verify that all requirements are met. Each day, information is extracted from the new applications awaiting approval and matched against Master File<sup>2</sup> data to validate adherence with requirements. For those applicants that have "hits" (concerns identified regarding one or more of the factors validated), the information is added to a work list and assigned to an assistor for review. The system will also take those applicants with "no hits" and evaluate whether or not fingerprint cards are required and, for those that are required, send the fingerprint cards to the Federal Bureau of Investigation for a criminal background check. For those applicants with criminal records, reports are sent to the IRS Criminal Investigation Division's Fraud Detection Center for review.

For those applicants accepted to participate in the *e-file* Program, the IRS assigns an Electronic Filing Identification Number (EFIN). The EFIN allows the IRS to identify a specific Authorized *e-file* Provider.

**The Small Business/Self-Employed Division's Examination function is responsible for monitoring e-file Providers**

The Small Business/Self-Employed (SB/SE) Division's Examination Policy unit establishes the procedures for executing the IRS' monitoring visits of *e-file* Providers. The Exam Planning and Delivery unit coordinates and monitors the use of Examination function resources in executing the visitations. The visitations are conducted by field examiners located throughout all seven

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<sup>1</sup> The data processing arm of the IRS. The campuses process paper and electronic submissions, correct errors, and forward data to the Computing Centers for analysis and posting to taxpayer accounts.

<sup>2</sup> The IRS database that stores various types of taxpayer account information. This database includes individual, business, and employee plans and exempt organizations data.



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Area Offices.<sup>3</sup> The purpose of the monitoring program is to verify the *e-file* Providers' compliance with the *e-file* Program requirements.

Monitoring visits include:

- Referral visits that are mandatory when the referral suggests noncompliance.
- Targeted visits that are based on selection criteria that indicate compliance issues.
- Followup visits that are conducted if a violation was identified in the previous year.
- Random visits that are based on a sampling of *e-file* Providers.

Violation(s) identified during monitoring visits may result in a warning, written reprimand, suspension, or expulsion of an *e-file* Provider.

This review is a followup review to previous audits the Treasury Inspector General for Tax Administration performed assessing the effectiveness of the IRS' screening and monitoring of *e-file* Providers.<sup>4</sup> Appendix V provides a list of the recommendations and corrective actions associated with these reviews.

This review was performed at the Customer Account Services function's E-Help office at the Andover Campus and in the *E-File* Monitoring Coordinator offices in Phoenix, Arizona; San Jose, California; and Boston, Massachusetts, during the period May through December 2009. We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective. 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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<sup>3</sup> A geographic organizational level used by IRS business units and offices to help their specific types of taxpayers understand and comply with tax laws and issues.

<sup>4</sup> *Better Screening and Monitoring of E-File Providers Is Needed to Minimize the Risk of Unscrupulous Providers Participating in the E-File Program* (Reference Number 2007-40-176, dated September 19, 2007), *Improvements to the Electronic Return Originator Monitoring Program Are Needed* (Reference Number 2003-30-039, dated January 15, 2003), *Improvements Are Needed in the Screening and Monitoring of E-File Providers to Protect Against Filing Fraud* (Reference Number 2004-40-013, dated November 3, 2003), and *E-File Providers Are Not Adequately Screened* (Reference Number 2002-40-111, dated June 27, 2002).



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## *Results of Review*

### ***Although the Application Screening Process Has Improved, More Work Is Needed to Help Ensure the Integrity of the Individuals Applying for Participation in the E-File Program***

As we reported in Fiscal Year 2007, the IRS has an effective process for ensuring applicants (Principals and Responsible Officials) meet age requirements and *e-file* Providers meet certain suitability checks, such as tax compliance. The IRS verifies that all new applicants are at least 21 years of age and not using the identity of a deceased person. It has also developed an automated process to check and monitor tax compliance of both applicants and existing approved *e-file* Providers.

***In response to TIGTA's 2007 report, the IRS has implemented citizenship tests and checks to ensure organizations claiming Not-for-Profit status are, in fact, Not-for-Profit organizations.***

Additionally, as of June 2009, the IRS stated that it is submitting 100 percent of the fingerprint cards, if one is required of the applicant, to the Federal Bureau of Investigation so that criminal background checks can be conducted. Prior to June 2009, the IRS was conducting limited background checks.

In response to our Fiscal Year 2007 report, the IRS began validating the Not-for-Profit status of existing *e-file* Providers and verifying that all existing *e-file* Providers and applicants are either U.S. citizens or legal aliens with authorization to work in the U.S. However, not all Not-for-Profit organizations were validated, and the verification of citizenship status has not been completed for all existing *e-file* Providers.

In addition, we conducted a separate review to determine whether the IRS has established effective access and audit trail controls for the Registered User Portal<sup>5</sup> to protect taxpayer data from unauthorized disclosure.<sup>6</sup> That review found that the IRS does not perform suitability checks on all users with the ability to *e-file* tax returns. The IRS allows Principals and Responsible Officials to delegate their access rights to employees, partners, members of the firm, or any person with a business relationship with the firm. These “delegated users” are not required to undergo a suitability check. In addition, a Principal or Responsible Official can assign a special “Principal Consent” privilege to a delegated user that allows the delegated user

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<sup>5</sup> The Registered User Portal allows access to the IRS’ *e-Services* suite of applications.

<sup>6</sup> *Additional Security Is Needed for Access to the Registered User Portal* (Reference Number 2010-20-027, dated March 31, 2010).



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to propagate his or her privileges to other individuals. IRS records show that there are 9,988 delegated users with the ability to *e-file* tax returns, and approximately 6,500 of these users also had access to the *e-Services* incentive products.

The IRS made a decision to allow Principals and Responsible Officials to assume the risks of delegating their access rights to other individuals, and it believes the risks are mitigated by requiring Principals and Responsible Officials to file a Power of Attorney<sup>7</sup> with the IRS. However, the Treasury Inspector General for Tax Administration believes that taxpayers expect the IRS to protect their personal data, and the Power of Attorney document does not provide the same assurance as the suitability check. The Treasury Inspector General for Tax Administration recommended that the Director of the Electronic Tax Administration and Refundable Credits office require suitability checks on delegated users who *e-file* tax returns.

The review also found that the automated program used to systemically check the tax compliance of an *e-file* applicant does not provide a systemic check of the spouse's tax compliance. Therefore, the spouse's tax compliance check is performed manually, which is inefficient and increases the risk of human error. We recommended that the Chief Technology Officer enhance the Automated Suitability Analysis Program to enable systemic analysis of a spouse's tax compliance.

More improvements are needed to ensure applicants meet certain suitability checks, such as Not-for-Profit status and citizenship status. It is important that the IRS adequately screens all *e-file* Provider applicants to protect both the taxpaying public and the Federal Government from the actions of unscrupulous *e-file* Providers.

**Some Not-for-Profit organizations were not validated**

Not-for-Profit applicants are excluded from all *e-file* Program requirements and suitability checks. Therefore, it is essential that the IRS verify the applicant is in fact a Not-for-Profit organization.

**The IRS conducted a one-time match of 85 percent of the *e-file* Providers that claimed to be Not-for-Profit organizations to validate their Not-for-Profit status**

In response to our Fiscal Year 2007 report, in November 2008, the IRS conducted a one-time match to ensure that the current *e-file* Providers claiming to be Not-for-Profit organizations were correctly claiming Not-for-Profit status. The IRS stated that 85 percent of the *e-file* Providers that claimed to be Not-for-Profit were designated as "Stakeholder Partnerships, Education, and

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<sup>7</sup> A Power of Attorney is a written authorization to act on someone else's behalf in a legal or business matter.



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Communication (SPEC)-related,” indicating they were partners in the IRS’ Volunteer Program.<sup>8</sup> The IRS matched its list of SPEC-related Not-for-Profit *e-file* Providers to the SPEC function’s database of organizations that participate in its Volunteer Program. The IRS determined that 1,217 Not-for-Profit organizations could not be validated to the SPEC function’s database. As a result, 1,185 EFINs were deactivated. Thirty-two *e-file* Providers submitted a successful appeal and were reinstated. The IRS did not validate the approximately 15 percent of the Not-for-Profit *e-file* Providers that were designated as Not-for-Profit organizations but were not SPEC-related.

As of November 2008, new applicants that indicate they are Not-for-Profit organizations and claim to be part of the SPEC function are required to enter a Site Identification Number<sup>9</sup> when they apply to the *e-file* Program. The Site Identification Numbers are systemically validated to the SPEC function database of volunteer organizations. Also included in the verification process are the IRS’ local walk-in offices, called Taxpayer Assistance Centers. IRS employees verify the Office Designation Number reflected on the *e-file* Program application to the IRS Taxpayer Assistance Center list. The Not-for-Profit status of large entities,<sup>10</sup> Employee Benefit Programs,<sup>11</sup> and State Government agencies are verified manually by IRS employees by researching the related tax information on the Integrated Data Retrieval System.<sup>12</sup>

**Tests show some Not-for-Profit organizations have not been validated**

A statistical sample of 97 *e-file* Providers from a population of 13,797 that were active as of August 2009 and designated as Not-for-Profit organizations showed that 18 (19 percent) were erroneously designated as Not-for-Profit organizations. Twelve (12 percent of the total sample) of the 18 were not subjected to suitability checks. Of these:

- 10 *e-file* Providers were designated as SPEC-related Not-for-Profit organizations, but were either not on the SPEC function’s database or were in an inactive status on the SPEC function list. Six are currently active *e-file* Providers and appear to be for-profit organizations. Four were placed in an inactive status after our sample was selected. The IRS does not have a process to notify the *e-file* Program to deactivate EFINs when a SPEC function volunteer site closes or the SPEC function designates an EFIN as inactive.

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<sup>8</sup> The SPEC function is responsible for the IRS’ Volunteer Program, which provides no-cost Federal tax return preparation and electronic filing directed toward underserved segments of individual taxpayers, including low-income to moderate-income, elderly, disabled, and limited-English-proficient taxpayers. The Volunteer Program includes the Volunteer Income Tax Assistance Program, the Tax Counseling for the Elderly Program, and the Volunteer Income Tax Assistance Grant Program.

<sup>9</sup> The identification number of the Volunteer Program tax preparation assistance site.

<sup>10</sup> Companies that file their own tax returns electronically.

<sup>11</sup> Employers who choose to offer electronic filing as an employee benefit.

<sup>12</sup> IRS computer system capable of retrieving or updating stored information; it works in conjunction with a taxpayer’s account records.



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- 2 *e-file* Providers were erroneously input into the database as Not-for-Profit organizations when they are actually for-profit organizations. They are still active *e-file* Providers.

Based on the population of 13,797 *e-file* Providers who are designated as Not-for-Profit organizations, there is a potential that 2,560 of these *e-file* Providers were improperly designated as Not-for-Profit organizations and that 1,707 of these Providers did not go through the suitability process, which is required for all for-profit organizations.

**The IRS is working toward validating the citizenship of all e-file Providers, but not all e-file Providers have had their citizenship status validated**

In March 2009, the IRS began checking the citizenship and immigration status of new applicants. It is also checking the status of existing *e-file* Providers. This is completed by systemically matching applicant data to the Social Security Administration's Data Master-1 (DM-1) file. The DM-1 file should contain date of birth, date of death, gender, citizenship, and name control information for all issued Social Security Numbers.

If an applicant indicates on the *e-file* Provider application that he or she is a U.S. citizen or a legal alien with authorization to work in the U.S. and this does not match the data on the DM-1 file, the application is denied. A letter is sent to the applicant to explain that the IRS' records did not match the citizenship information he or she supplied on the application. However, for both existing and new applicants, if the citizenship status is blank or unknown on the DM-1 file, the IRS is not requesting that the *e-file* Provider verify citizenship status.

**The automated program for verifying the citizenship status of new applicants needs to be adjusted**

The criteria being used to identify new applicants who are not U.S. citizens or legal aliens does not include the citizenship category of "alien, student, restricted work authorization." The automated program is currently identifying only applicants with a citizenship status of "legal alien, not eligible to work" and "other" when determining ineligibility for the *e-file* Program. *E-file* Provider applicants with a citizenship status of "alien, student, restricted work authorization" who have applied to the *e-file* Program since March 2009, have been allowed into the Program and should not have been accepted.

**The IRS is currently determining the citizenship status of existing e-file Providers**

In Fiscal Year 2007, we reported that the IRS was not ensuring that all applicants were either U.S. citizens or legal aliens. In response, the IRS performed two matches of all active *e-file* Providers' Social Security Numbers to the Social Security Administration's DM-1 file to determine the citizenship status of the *e-file* Providers.

As a result, the IRS stated that it mailed 1,167 letters to *e-file* Providers who did not have a citizenship code A (U.S. citizen) or B (legal alien). As of December 2009, the IRS had closed 981 cases.



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- 828 applicants (71 percent) proved that they were either a U.S. citizen or legal alien.
- 133 applicants (11 percent) could not prove they were either a U.S. citizen or legal alien.
- 20 applicants (2 percent) proved that they were either a U.S. citizen or legal alien, but received reprimands because the citizenship status indicated on the application was not accurate at the time the application was filed.

Sixteen percent (186 of 1,167) are unresolved—16 letters resulted in no responses and 170 cases are still being worked.

A statistical sample of 89 *e-file* Providers from a population of 961 *e-file* Providers active as of July 2009 showed that 73 (82 percent) *e-file* Providers proved of their citizenship status. Of the 16 (18 percent) who did not:

- 1 (1 percent) *e-file* Provider was not appropriately identified by the new applicant citizenship check. According to the IRS, this problem was fixed by April 2009.
- 2 (2 percent) *e-file* Providers were deactivated after we notified the IRS that the Providers did not meet the criteria of the *e-file* Program regarding citizenship status.
- 2 (2 percent) *e-file* Providers did not meet the IRS' criteria to be included in the citizenship verification check.
- 5 (6 percent) *e-file* Providers were not U.S. citizens or legal aliens per the DM-1 file. These individuals applied to the *e-file* Program from September 2008 to February 2009, which is after the IRS ran the last check of citizenship status for existing *e-file* Providers and before the IRS implemented the citizenship check for new applicants. As a result, these applicants have not received a citizenship verification letter. They are still active *e-file* Providers.
- 6 (7 percent) *e-file* Provider files did not contain any supporting citizenship documentation or the documentation was not sufficient, even though the IRS had indicated that they received adequate documentation to support citizenship status. When we notified IRS management of the missing and/or incomplete documentation, they reissued five citizenship letters to these *e-file* Providers asking them to provide supporting citizenship documentation. They issued a letter to the sixth *e-file* Provider notifying the Provider that his or her EFIN would be deactivated.

As of October 2009, the IRS stated that it will perform another mail-out of citizenship status verification letters to existing *e-file* Providers to include any applicants who were not identified in the first two mailings. A date has not been established.

There are 961 active *e-file* Providers listed who are not U.S. citizens or legal aliens but have a citizenship status on the DM-1 file. Of these, there is a potential that 173 of them have not been properly validated to ensure they meet the citizenship requirements of the *e-file* Program.



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**If the citizenship status is blank or unknown on the DM-1 file, the IRS is not requesting that the e-file Provider verify citizenship status**

There are instances for which the Social Security Administration does not know the citizenship or immigration status of an individual. Consequently, the IRS made the decision to not expend its resources to ask the *e-file* Provider or applicant to verify citizenship status. The IRS found that about 109,000 (52 percent) of 210,000 *e-file* Providers do not have a citizenship code in the DM-1 file. As a result, the IRS cannot ensure the eligibility of these individuals for the *e-file* Program and does not have reliable information from which to make decisions.

***Recommendations***

The Commissioner, Wage and Investment Division, should:

**Recommendation 1:** Ensure the Not-for-Profit status is verified for all *e-file* Program applicants.

**Management's Response:** The IRS agreed with this recommendation. In 2008 and 2009, the Electronic Tax Administration and Refundable Credits office partnered with Not-for-Profit business owners to establish and implement formal procedures for validating existing Authorized IRS *e-file* Providers as Not-for-Profit services. The Electronic Tax Administration and Refundable Credits office will implement the following steps to ensure continuing compliance: 1) produce regular Not-for-Profit *e-file* applicant reports categorized by program types, including Volunteer Income Tax Assistance, Military, Tax Counseling for the Elderly, Tax Assistance Center, State Government Agency, Large Taxpayer, and Employee Benefit Program; 2) validate with Not-for-Profit business owners that procedures are followed; and 3) perform regular quality reviews to identify any manual deviations.

**Recommendation 2:** Ensure the citizenship status is verified for all new and existing *e-file* Program applicants, including updating the automated suitability program for new applicants to include “alien, student, restricted work authorization” as criteria for not meeting the citizenship check.

**Management's Response:** The IRS agreed with this recommendation and has already initiated programming to include the additional Citizenship Code E (alien, student, restricted work authorization) to the existing Citizenship Analysis of the Automated Suitability Analysis Program. However, recent legislation mandating *e-filing* for most return preparers will eventually require the IRS to change the current *e-file* Provider rules with respect to citizenship status.

**Recommendation 3:** Ensure the citizenship status is verified for all *e-file* Providers who show a blank or unknown citizenship status in the DM-1 file.



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**Management's Response:** The IRS did not agree with this recommendation. Recent legislation mandating *e-file* for most return preparers will require the IRS to modify the current citizenship rules. If this recommendation was implemented in concert with the *e-file* mandate, it would effectively bar all foreign preparers from completing U.S. tax returns, an outcome that would undermine effective tax administration.

The IRS stated that it shares our concern of the need to accurately verify information about *e-file* Providers, but the new law will require it to change the current *e-file* Provider rules with respect to citizenship status. The IRS is currently evaluating ways to address this challenge under the auspices of the Return Preparer Implementation team, which has a similar issue with respect to foreign-based preparers. The IRS' goal is to develop a comprehensive and complimentary set of requirements for both *e-file* Providers and return preparers. The team's current objective is to finish the policy development in this area by May 2010 and to then develop an implementation timeline.

**Office of Audit Comment:** In its response, the IRS stated that recent legislation mandating *e-file* for most return preparers will require it to modify the current *e-file* Provider citizenship rules. However, as the IRS states, it shares our concern of the need to accurately verify information about *e-file* Providers. Therefore, although there may no longer be a requirement for *e-file* Providers to be U.S. citizens, the IRS should continue to ensure that all U.S. based *e-file* Providers have valid Social Security Numbers and pass a citizenship test. Any foreign-based preparers should be required to provide Individual Taxpayer Identification Numbers.<sup>13</sup> These should also be verified. This will ensure all *e-file* Program requirements are being met and the IRS has reliable information to make decisions.

**Recommendation 4:** Establish a process requiring the SPEC function to notify the Electronic Tax Administration and Refundable Credits office when a SPEC-related volunteer site is closed or becomes inactive so that office can deactivate the EFIN.

**Management's Response:** The IRS agreed with this recommendation. The SPEC function e-team coordinated with the Electronic Tax Administration and Refundable Credits office and Submission Processing function to develop guidance on deactivating a Volunteer Income Tax Assistance/Tax Counseling for the Elderly EFIN. On January 28, 2010, the SPEC function issued Policy Directive 22.30.1-09.1, which stated effective immediately, a Volunteer Income Tax Assistance and/or Tax Counseling for the Elderly EFIN will be deactivated when a partner refuses to comply with the SPEC function's Quality Site Requirements and/or when sites are closed as a result of partner choice or termination of SPEC function support.

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<sup>13</sup> The Individual Taxpayer Identification Number was created to provide individuals who are not eligible to obtain a Social Security Number with an identification number for tax purposes. It does not change the recipient's immigration status or confer the right of employment in the U.S.



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## **The Monitoring Program Is Still Not Ensuring E-File Providers Are Compliant With Program Requirements**

In response to our Fiscal Year 2007 audit report, the IRS has:

- Added procedures requiring that the Monitoring Coordinator check with the Criminal Investigation Division to ensure results of *e-file* Provider criminal cases are used to identify potential risk factors or indicators that can be built into the screening and monitoring process.
- Developed a process to ensure established risk-based selection criteria are used to identify *e-file* Providers for targeted monitoring visits.
- Clarified procedures regarding when followup visits should be performed and implemented a process to ensure followup visits are conducted in accordance with the clarified guidelines.
- Developed a process to record the receipt and disposition of referrals from internal and external sources.
- Developed a process for the Monitoring Coordinators to track results and forward them to the SB/SE Division Headquarters analyst.
- Developed a process for the Monitoring Coordinators to track *e-file* Provider suspension cases using a new control log. The Monitoring Coordinator is to perform followups to ensure the *e-file* Providers are suspended and documentation is placed in the case file.
- Developed procedures requiring the maintenance of adequate documentation supporting an *e-file* Provider's request for an appeal, as well as documentation supporting the review and outcome of an appeal.

Although procedures have been developed, they are not always being followed. Improvements are needed to ensure the *e-file* Monitoring Program will have the most impact in detecting and stopping unscrupulous Providers. Taxpayers and the Federal Government's risk from fraudulent tax return filings increases when noncompliant *e-file* Providers are not identified.

### **Although procedures have been developed, they are not always being followed**

For the 2009 Filing Season, the IRS planned to conduct more than 1,500 *e-file* Provider monitoring visits, which is about 1 percent of the 143,000 *e-file* Providers who *e-filed* more than 50 tax returns in Calendar Year 2008. The IRS reported that it conducted 1,651 visits during the 2009 Filing Season.

The IRS also conducted a pilot program during the 2009 Filing Season. The pilot focused on *e-file* Providers that may be using pay stubs or Earning and Leave Statements to prepare tax



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**Monitoring visits are a combination of referrals, followups, targeted visits, and random visits.**

For targeted visits, only active *e-file* Providers who have *e-filed* at least 100 tax returns and have a reject rate of 25 percent or more are selected.

Referrals can be from internal or external sources. The referral is reviewed by the monitor and, if warranted, a monitoring visit is conducted within 5 business days.

If a followup visit is designated, it should be conducted in the subsequent year.

After all of the referral, followup, and targeted visits are scheduled, if there are still more visits that need to be conducted, based on a predetermined number of visits for the year for each office, random visits are selected.

returns instead of the taxpayers' Wage and Tax Statement (Form W-2). The IRS requires that a tax return be submitted using income reported on a Form W-2. Twenty percent of the more than 1,500 planned visits for the 2009 Filing Season were to focus on *e-file* Providers with the highest *e-file* reject rates of "Employer Identification Number is incorrect or invalid," which is an indication that the tax return might have been filed using a pay stub.

As a result of the 1,651 visits to *e-file* Providers by IRS employees during the 2009 Filing Season, 813 adverse actions were reported to SB/SE Division Headquarters, including 102 (13 percent) proposed suspensions, 120 (15 percent) immediate suspensions, and 1 (0.1 percent) expulsion. As of April 24, 2009, 390 Forms W-2 monitoring visits were completed. Based on these visits, 22 suspensions were proposed, 58 *e-file* Providers were suspended, 66 were provided written reprimands, and 66 were provided warnings.

Seven recommendations in our Fiscal Year 2007 audit report related to the monitoring of *e-file* Providers. As a result of those recommendations, the IRS' manual was updated. However, tests in three of the seven Area Offices showed that not all changes have been implemented.

- The Monitoring Coordinators are not contacting the IRS' Criminal Investigation Division to discuss any trends or problems it is finding with *e-file* Providers that might help the Monitoring Coordinators select high-risk Providers to visit. None of the three Monitoring Coordinators interviewed had discussed selection criteria for targeted cases with the Criminal Investigation Division.
- The IRS does not always target visits based on the criteria of 100 or more returns filed in the previous year and a 25 percent or higher reject rate. Two of the three Monitoring Coordinators did not target visits for the 2009 Filing Season. For 1 office, 66 (46 percent) of the 145 targeted visits did not meet the established criteria.
- The Form W-2 visits were also not always correctly selected by the Monitoring Coordinators based on the criteria provided by SB/SE Division Headquarters. One office conducted only 17 (55 percent) of the required 31 Form W-2 visits and none of these visits were correctly selected based on the criteria established by SB/SE Division Headquarters.
- The IRS does not always perform the required followup visits. One office visited did not perform any of the 44 followup visits required during the 2009 Filing Season. For the



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other 2 offices visited, 6 (11 percent) of 57 and 7 (32 percent) of 22 followup visits from the 2008 Filing Season were not conducted during the 2009 Filing Season.

- The IRS does track some referrals it receives. The referral visits that were conducted by the Monitoring Coordinators are noted on the monitoring log by each office; however, we were unable to verify if any additional referrals were received by the Monitoring Coordinators other than what was noted on the log used to document all of the visits. For example, one office stated that it received a few telephone referrals. The Monitoring Coordinator stated that the information was passed on to another area to be reviewed, but there was no documentation that the telephone referrals were received or that they were sent elsewhere to be worked.
- The IRS does not conduct year-end reconciliations of the case files to the monitoring logs and the reports that are sent to the SB/SE Division Headquarters. Without this reconciliation, inaccurate statistics are being recorded for the *e-file* Program and there is a potential that *e-file* Providers that should have followup visits in the next year or be suspended in the current year will be overlooked.

Additionally, for two of the three offices visited, statistics reported to SB/SE Division Headquarters included visits that were not actually conducted. One office reported that 168 visits were conducted during the 2009 Filing Season. However, 35 (21 percent) of these visits were not conducted. The reasons the visits were not conducted included inclement weather or the inability of the Monitoring Coordinator to locate the *e-file* Provider. For 6 (60 percent) of the 10 visits that were not conducted because the Coordinator was unable to locate the *e-file* Provider, the EFINs were still active as of July 2009 and the Providers had *e-filed* tax returns during the 2009 Filing Season.

- The Monitoring Coordinators are not always maintaining accurate suspension logs to track proposed suspensions and the date by which the *e-file* Provider has to respond to appeal the proposed suspension. If the Coordinators do not review the deadline dates to appeal the proposed suspension, the *e-file* Provider may remain in the Program instead of being suspended. The 3 Area Offices visited showed that 15 (23 percent) of the 65 *e-file* Providers that were recommended for suspension in Fiscal Years 2008 or 2009 were not removed from the Program as required.
- The Monitoring Coordinators are not always following up with the IRS' Appeals Office to determine the outcome of appeals filed by the *e-file* Providers. The required quarterly followups are not being done to determine the status of the appeals cases, so the case files are not being updated and the Coordinators are not able to ensure that the *e-file* Providers who should be suspended from the Program are suspended.

In addition, the SB/SE Division and the Electronic Tax Administration and Refundable Credits office are not using the results of the monitoring program to improve the *e-file* Program. The individual results of the monitoring visits do not go beyond the Monitoring Coordinators. The



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monitoring visit case files are maintained at the Area Offices, and the only information elevated to the SB/SE Division Headquarters and then to the Electronic Tax Administration and Refundable Credits office is the total number of visits conducted and the number of warnings, reprimands, suspensions, and expulsions issued.

## **Recommendations**

The Commissioner, SB/SE Division, should:

**Recommendation 5:** Implement controls to ensure that the monitoring visit procedures are being followed.

**Management's Response:** The IRS agreed with this recommendation. A conference call was held during the current filing season on February 3, 2010, with its Area Coordinators and managers. Topics included re-emphasis of current procedures for monitoring the program and changes to final report requirements to include the type of violation and method of disposition for all visitations. In addition, final reports will require managerial approval before submission to Headquarters.

The IRS will take additional corrective actions:

1. It will further analyze its control system for monitoring visit procedures, review and formulate appropriate changes, create an action plan, and make changes to its control system.
2. It will assess the effectiveness of the changes at the end of the Fiscal Year 2011 filing season and update the Internal Revenue Manual 4.21.1, Electronic Filing Program - Monitoring the IRS *e-file* Program, to reflect changes to the program.

**Recommendation 6:** Ensure information reported to SB/SE Division Headquarters is accurate and the results of the monitoring visits are used to improve and measure the effectiveness of the *e-file* Program.

**Management's Response:** The IRS agreed with this recommendation and will take the following corrective actions:

1. Develop an action plan to assess the Monitoring Program and formulate appropriate recommendations to improve its effectiveness on an annual basis.
2. Update internal guidelines to reflect changes to the program, if any.



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## Appendix I

### *Detailed Objective, Scope, and Methodology*

Our overall objective was to determine whether the IRS' screening and monitoring of its *e-file* Providers is effective. To accomplish this objective, we:

- I. Assessed the effectiveness of the IRS corrective actions to confirm Not-for-Profit organizations' claims and ensure applicants are U.S. citizens or legal aliens authorized to work in the U.S.
  - A. Determined if the IRS' corrective actions to confirm the Not-for-Profit status of existing *e-file* Providers were adequate. We selected a statistically valid sample of 97 of the 13,797 Not-for-Profit organizations that were active as of August 2009 from an extract of the Third Party Data Store.<sup>1</sup> The sample was selected based on a 10 percent error rate, 5 percent precision rate, and 90 percent confidence level. To validate the Third Party Data Store information, we selected six EFINs<sup>2</sup> from the extract and validated the extract information to printouts from the Third Party Data Store.
  - B. Determined if the IRS has an effective process to ensure new *e-file* Provider applicants selecting Not-for-Profit status are, in fact, Not-for-Profit organizations.
  - C. Determined if the corrective actions taken by the IRS to confirm that existing *e-file* Providers are U.S. citizens or legal aliens were adequate. There were 961 active *e-file* Providers on the Third Party Data Store as of July 2009 who did not have a citizenship code of A (U.S. citizen), B (legal alien), or blank per the Social Security Administration's DM-1 file. We selected a statistically valid sample of 89 of the 961 active *e-file* Providers based on a 10 percent error rate, 5 percent precision rate, and 90 percent confidence level. To validate the information on the Third Party Data Store extract, we selected 5 of the 89 *e-file* Providers and validated their citizenship status to the IRS' Integrated Data Retrieval System.<sup>3</sup>

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<sup>1</sup> A database that is used to store and update all IRS *e-file* application information and generate electronic filing and transmitting identification numbers, letters, and reports. The database is also used to store information for other e-Services products as well.

<sup>2</sup> For those applicants accepted to participate in the *e-file* Program, the IRS assigns an EFIN. This number allows the IRS to identify a specific Authorized *e-file* Provider.

<sup>3</sup> IRS computer system capable of retrieving or updating stored information; it works in conjunction with a taxpayer's account records.



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- D. Determined if the IRS has an adequate process to ensure new *e-file* Provider applicants are U.S. citizens or legal aliens.
- II. Assessed the effectiveness of the IRS' corrective actions to ensure the *e-file* Program monitoring process is effectively identifying those *e-file* Providers that are not in compliance with Program requirements.
- A. Judgmentally selected and performed field visits at three of seven *e-file* Monitoring Coordinator offices (Phoenix, Arizona; San Jose, California; and Boston, Massachusetts) to assess adherence to Program guidelines to conduct field visits.
    - 1. Assessed the effectiveness of the process followed for selecting *e-file* Providers for monitoring visits by interviewing appropriate IRS personnel and obtaining a list of the visits conducted during the 2009 Filing Season to determine if the selection process included referrals, targeted visits, and random visits based on the *e-file* Program requirements.
    - 2. Determined if the *e-file* Monitoring Coordinators correctly reported the results of the monitoring visits.
    - 3. Determined if mandatory followup visits were conducted.
    - 4. Determined if referral visits were conducted.
    - 5. Determined if recommended disciplinary actions were correctly taken.
    - 6. Determined if the IRS maintains adequate documentation supporting an *e-file* Provider's request for an appeal, as well as documentation supporting the review and outcome of an appeal.
    - 7. Determined if the Monitoring Coordinators are using information from the Criminal Investigation Division to improve the screening checks and monitoring selection criteria of *e-file* Providers.
  - B. Determined what the IRS does with the information gathered during the monitoring visits to improve the *e-file* Program.
  - C. Reviewed the effectiveness of the IRS' *e-file* Provider monitoring process and identified any control breakdowns, assessed the risk for fraud, and attempted to assess the impact on taxpayers and the IRS.

**Internal controls methodology**

Internal controls relate to management's plans, methods, and procedures used to meet their mission, goals, and objectives. Internal controls include the processes and procedures for planning, organizing, directing, and controlling program operations. They include the systems for measuring, reporting, and monitoring program performance. We determined the following



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internal controls were relevant to our audit objective: the IRS' policies, procedures, and practices for verifying the citizenship status and Not-for-Profit status of *e-file* Program applicants and the monitoring of *e-file* Providers. We evaluated these controls by interviewing management, performing queries on related data, and reviewing case files.



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## **Appendix II**

### *Major Contributors to This Report*

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## **Appendix III**

### *Report Distribution List*

Commissioner C  
Office of the Commissioner – Attn: Chief of Staff C  
Chief Technology Officer OS:CTO  
Deputy Commissioner for Services and Enforcement SE  
Deputy Commissioner, Small Business/Self-Employed Division SE:S  
Deputy Commissioner, Wage and Investment Division SE:W  
Director, Compliance, Small Business/Self-Employed Division SE:W:CP  
Director, Customer Account Services, Wage and Investment Division SE:W:CAS  
Director, Customer Assistance, Relationships, and Education, Wage and Investment Division  
SE:W:CAR  
Director, Electronic Tax Administration and Refundable Credits, Wage and Investment  
Division SE:W:ETARC  
Director, Strategy and Finance, Wage and Investment Division SE:W:S  
Senior Operations Advisor, Wage and Investment Division SE:W:ETARC  
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 Internal Control OS:CFO:CPIC:IC  
Audit Liaison: Chief, Program Evaluation and Improvement, Wage and Investment Division  
SE:W:S:RPA:PEI



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## Appendix IV

### *Outcome Measure*

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 Congress.

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

- Reliability of Information – Potential; 111,733 *e-file* Providers; 2,560 *e-file* Providers are improperly designated as Not-for-Profit organizations, 173 active *e-file* Providers did not have their citizenship status properly validated and may not meet the citizenship requirements of the *e-file* Program, and the IRS is unable to determine whether approximately 109,000 active *e-file* Providers meet the citizenship requirements of the *e-file* Program (see page 5).

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

As of August 2009, there were 13,797 *e-file* Providers designated as Not-for-Profit organizations. We selected a statistically valid sample of 97 of the 13,797 *e-file* Provider organizations designated as Not-for-Profit. The sample size was based on a 10 percent error rate, 5 percent precision rate, and 90 percent confidence level. We found that 18 (18.5567 percent) of the 97 Providers were improperly designated as Not-for-Profit organizations. Twelve (12.3711 percent) of the 97 Providers did not go through the suitability process required for all for-profit organizations. Based on the population of 13,797 *e-file* Providers designated as Not-for-Profit organizations, there is a potential that 2,560<sup>1</sup> of these *e-file* Providers were improperly designated as Not-for-Profit organizations and that 1,707<sup>2</sup> of these Providers did not go through the suitability process that is required for all for-profit organizations.

There were 961 active *e-file* Providers as of July 2009 who did not have a citizenship code of A (U.S. citizen), B (legal alien), or blank per our match of the *e-file* Provider database to the Social Security Administration's DM-1 file. We selected a statistically valid sample of 89 of the 961 active *e-file* Providers based on a 10 percent error rate, 5 percent precision rate, and 90 percent confidence level. We found that the citizenship status of 16 (18 percent) of the 89 Providers was not properly validated. Based on the population of 961 active *e-file* Providers who are not U.S. citizens or legal aliens and who have a citizenship status on the DM-1 file,

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<sup>1</sup> 13,797 x 18.5567 percent = 2,560.

<sup>2</sup> 13,797 x 12.3711 percent = 1,707.



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there is a potential that the citizenship status of 173<sup>3</sup> of the *e-file* Providers has not been properly validated to ensure they meet the citizenship requirements of the *e-file* Program.

The IRS performed a match of the 210,000 Social Security Numbers of active *e-file* Providers as of June 2008 to the Social Security Administration's DM-1 file. The results showed that 109,000 (52 percent) Social Security Numbers had a blank or unknown citizenship status on the DM-1 file. For the 1,167 Social Security Numbers that had a citizenship status other than a U.S. citizen or legal alien, letters were sent to the *e-file* Providers to request that the Providers submit supporting documentation to verify their citizenship status. For the 109,000 Social Security Numbers that had an unknown or blank citizenship status, a business decision was made to not send out letters to determine the citizenship status of these individuals. For these 109,000 *e-file* Providers, the IRS does not have any information to determine whether the Providers meet the citizenship requirements of the *e-file* Program and, therefore, it does not know if these Providers qualify to remain in the *e-file* Program.

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<sup>3</sup> 961 x 18 percent = 173.



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**Appendix V**

*Prior Treasury Inspector General for Tax  
Administration Report Recommendations*

<b>Report Reference</b>	<b>Recommendation</b>	<b>Corrective Action per the IRS</b>
2007-40-176 September 2007 <sup>1</sup>	Verify Not-for-Profit applicants are a Not-for-Profit organization.	Agreed – Procedures developed.
	Validate an applicant’s citizenship status.	Agreed – Reviewed the citizenship verification process and developed a solution.
	Develop a process that ensures established risk-based selection criteria is used to identify <i>e-file</i> Providers for monitoring visits.	Agreed – A “risk-based” selection criterion has been developed.
	Clarify procedures regarding when followup visits should be performed and implement a process that ensures followup visits are conducted in accordance with the clarified guidelines.	Agreed – Clarified procedures regarding followup visits.
	Develop a process to record the receipt and disposition of referrals from internal and external sources.	Agreed – Developed a process.
	Develop a process to ensure <i>e-file</i> Provider privileges are suspended, as appropriate, and removed from the <i>e-file</i> Program when they do not adhere to the <i>e-file</i> Program requirements.	Agreed – Developed a process.

<sup>1</sup> *Better Screening and Monitoring of E-File Providers Is Needed to Minimize the Risk of Unscrupulous Providers Participating in the E-File Program* (Reference Number 2007-40-176, dated September 19, 2007).



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the Integrity of the E-File Program*

<b>Report Reference</b>	<b>Recommendation</b>	<b>Corrective Action per the IRS</b>
2007-40-176 September 2007 (continued)	Develop procedures requiring the maintenance of adequate documentation supporting an <i>e-file</i> Provider's request for an appeal and the review and outcome of an appeal.	Agreed – Clarified procedures.
	Develop a process to ensure management information accurately reflects the results of the <i>e-file</i> monitoring program.	Agreed – Process developed.
	Ensure results of criminal cases involving <i>e-file</i> Providers are used to identify potential risk factors or indicators that can be built into the screening and monitoring process to improve on the identification of unscrupulous <i>e-file</i> Providers.	Partially Agreed – Will study the feasibility of using results of criminal cases involving <i>e-file</i> Providers to identify risk factors or indicators for the suitability process.
2004-40-013 November 2003 <sup>2</sup>	Ensure citizenship and age requirements are met.	Agreed – Will ensure responsible officials possess valid Social Security Numbers.
	Ensure criminal background checks are obtained electronically.	Agreed – Process requires the purchase of scanning hardware and software. Completion of this acquisition will not occur before the 2004 Filing Season.
	For unprocessable fingerprint cards, a name check should be used as the basis for the criminal background check.	Agreed – Guidelines revised.
	Ensure individuals who provide professional certifications are in current standing.	Agreed – Revised <i>IRS e-file Application and Participation</i> (Publication 3112) as well as guidelines and procedures.

<sup>2</sup> *Improvements Are Needed in the Screening and Monitoring of E-File Providers to Protect Against Filing Fraud* (Reference Number 2004-40-013, dated November 3, 2003).



*The Screening and Monitoring of E-File Providers  
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<b>Report Reference</b>	<b>Recommendation</b>	<b>Corrective Action per the IRS</b>
2004-40-013 November 2003 (continued)	Periodic updates of criminal investigations.	Disagreed – No action.
	Use <i>e-file</i> reject rates for selecting monitoring visits.	Agreed – Will develop related guidance.
	Establish a system to measure the effectiveness of the <i>e-file</i> Provider monitoring program.	Agreed – Will revise monitoring reports to reflect the results broken down by referral type.
2003-30-039 January 2003 <sup>3</sup>	Establish a goal and method for measuring monitoring program effectiveness for improving ERO compliance, such as results of followup visits.	Disagreed – Cannot accurately measure results of visits.
	Maintain case documentation – re-enforce that followup visits are a measure of monitoring the impact on compliance.	Agreed – Issued memo guidance.
	Allow time for case building.	Agreed – Training provided.
	Ensure ease of identifying referral sites.	Agreed – Guidance issued.
	Develop a process for proper mix of random/mandatory visits and a broad geographic coverage.	Agreed – Guidance issued.
	Develop uniform risk-based criteria for selecting <i>e-file</i> Providers to include in monitoring visit plans.	Agreed – Guidance issued on use of indicators in selecting <i>e-file</i> Providers for monitoring visits.
	Provide clear and unambiguous infraction and sanction guidelines.	Agreed – Guidelines revised.

<sup>3</sup> *Improvements to the Electronic Return Originator Monitoring Program Are Needed* (Reference Number 2003-30-039, dated January 15, 2003).



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<b>Report Reference</b>	<b>Recommendation</b>	<b>Corrective Action per the IRS</b>
2003-30-039 January 2003 (continued)	Revise <i>e-file</i> Program monitoring guidelines to consider Earned Income Tax Credit due diligence when determining <i>e-file</i> Provider compliance with <i>e-file</i> Program requirements.	Agreed – Instructed Monitoring Coordinators to pursue due diligence penalties when appropriate.
	Ensure complete case documentation is maintained.	Agreed – Guidance issue.
2002-40-111 June 2002 <sup>4</sup>	Screening procedures should include an independent validation of citizenship and age.	Disagreed – Due to view that number of ineligible applicants based on age and citizenship is small.
	All applicants should be subjected to credit and criminal background checks before acceptance in the <i>e-file</i> Program.	Disagreed – Experience shows credit checks are ineffective. <i>E-file</i> Program growth and return preparation for low-income taxpayers would be adversely affected with checks at volunteer sites.
	Perform subsequent credit/criminal checks at regular intervals.	Disagreed – Report does not justify need. Regular monitoring of <i>e-file</i> Providers occurs, which ensures compliance with rules. The audit report does not show screening and monitoring processes produce negative results, which would justify additional checks.
	Guidelines for handling fingerprint cards returned as unprocessable should be followed and individuals with unprocessable fingerprint cards should be contacted and a new card provided for completion of criminal check.	Agreed – Will request new fingerprint cards from applicants and resubmit them to the Federal Bureau of Investigation.

*Source: Prior Treasury Inspector General for Tax Administration audit reports as cited.*

<sup>4</sup> *E-File Providers Are Not Adequately Screened* (Reference Number 2002-40-111, dated June 27, 2002).



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**Appendix VI**

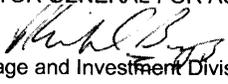
*Management's Response to the Draft Report*



DEPARTMENT OF THE TREASURY  
INTERNAL REVENUE SERVICE  
ATLANTA, GA 30308  
MAR 10 2010

RECEIVED  
MAR 19 2010  
BY: LAS

MEMORANDUM FOR MICHAEL R. PHILLIPS  
DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: Richard Byrd, Jr.   
Commissioner, Wage and Investment Division

SUBJECT: Draft Audit Report – The Screening and Monitoring of  
E-File Providers Has Improved, but More Work Is Needed  
to Ensure the Integrity of the E-File Program  
(Audit # 200940029)

Thank you for the opportunity to comment on the draft audit report concerning screening and monitoring of IRS electronic filing (*e-file*) Providers. Your report methodically details the many improvements in IRS' *e-file* screening and monitoring program since the Fiscal Year (FY) 2007 report<sup>1</sup> and identifies several process refinements which build upon these *e-file* Program advances. In brief, we agree with five of the six recommendations and, where appropriate, have delineated specific actions to further improve IRS' *e-file* screening and monitoring practices. Our concerns with Recommendation 3 on citizenship status are discussed in more detail below.

The integrity of the IRS *e-file* Program depends, in large part, on the caliber of authorized IRS *e-file* Providers. Ensuring applicants and authorized Providers fully satisfy IRS *e-file* requirements are vital to U.S. taxpayers and to IRS operations. Since the *e-file* Program's inception, and in response to your FY 2007 report, the IRS has implemented *e-file* Program screening and monitoring process improvements in areas such as suitability screening, Not-for-Profit validation, citizenship verification, risk-based selection criteria for monitoring visits, and Provider suspension case tracking. The IRS remains committed to rigorous screening and monitoring of *e-file* Providers and will continue to strengthen screening and monitoring practices.

<sup>1</sup> *Better Screening and Monitoring of E-File Providers Is Needed to Minimize the Risk of Unscrupulous Providers Participating in the E-File Program* (Reference Number 2007-40-176, dated September 19, 2007).



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Specifically, to strengthen IRS *e-file* Program screening processes, IRS will improve verification procedures for Not-for-Profit entities and implement automated suitability program criteria to include "alien, student, restricted work authorization". To improve IRS *e-file* Program monitoring practices, IRS has already implemented enhanced Electronic Filing Identification Number deactivation practices for Volunteer Income Tax Assistance and Tax Counseling for the Elderly sites. Also, IRS will continue to improve *e-file* Provider monitoring visit management controls and reporting.

We do not agree with your recommendation to verify the citizenship status of all e-file Providers because it would create untenable *e-file* Program eligibility conflicts with impending IRS Return Preparer Review<sup>2</sup> and IRS *e-file* Mandate<sup>3</sup> provisions – especially with respect to foreign preparer *e-file* Program participation. The IRS is currently evaluating ways to address these challenges under the auspices of the Return Preparer Implementation team. By May 2010, the Return Preparer team will recommend comprehensive Preparer eligibility standards that fully integrate Return Preparer Review and IRS *e-file* Program requirements.

In summary, we are committed to continually improving IRS *e-file* Provider screening and monitoring to ensure all Providers fully satisfy IRS *e-file* Program requirements. Attached are our specific comments to your recommendations. If you have any questions, please contact me, or a member of your staff may contact David Williams, Director, Electronic Tax Administration and Refundable Credits, Wage and Investment Division, at (202) 622-7990.

Attachment

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<sup>2</sup> IRS Return Preparer Review (December 2009), <http://www.irs.gov/pub/irs-utl/54419109.pdf>

<sup>3</sup> HR 3548 SEC. 17. Certain Tax Return Preparers Required to File Returns Electronically (January 2009)



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Attachment

The Commissioner, Wage and Investment Division, should;

**RECOMMENDATION 1**

Ensure the Not-for-Profit status is verified for all *e-file Program* applicants.

**CORRECTIVE ACTION**

We agree with this recommendation. In 2008 and 2009, the Electronic Tax Administration (ETA) partnered with Not-for-Profit business owners to establish and implement formal procedures for validating existing Authorized IRS *e-file* Providers as Not-for-Profit services, including the establishment of Internal Revenue Manual (IRM) 3.42.10.12, Validating Not-for-Profit Business Activities. Going forward, ETA will implement the following steps to ensure continuing IRM 3.42.10.12 compliance: 1) Produce regular Not-for-Profit *e-file* applicant reports categorized by program types, including Volunteer Income Tax Assistance, Military, Tax Counseling for the Elderly, Tax Assistance Center, State Government Agency, Large Taxpayer, and Employee Benefit Program, 2) Validate with Not-for-Profit business owners that IRM 3.42.10.12 procedures are followed, 3) Perform regular quality reviews to identify IRM 3.42.10.12 deviations.

**IMPLEMENTATION DATE**

November 15, 2010

**RESPONSIBLE OFFICIAL**

Director, Electronic Tax Administration and Refundable Credits, Wage and Investment Division

**CORRECTIVE ACTION MONITORING PLAN**

We will monitor this corrective action as part of our internal management control system.

**RECOMMENDATION 2**

Ensure the citizenship status is verified for all new and existing *e-file Program* applicants, including updating the automated suitability program for new applicants to include "alien, student, restricted work authorization" as criteria for not meeting the citizenship check.

**CORRECTIVE ACTION**

We have already initiated programming changes to include the additional Citizenship Code E (alien, student, restricted work authority) to the existing Citizenship Analysis of the Automated Suitability Analysis Program. However, recent legislation mandating electronic filing for most return preparers will eventually require the IRS to change the current provider rules with respect to citizenship status.



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**IMPLEMENTATION DATE**

May 15, 2010

**RESPONSIBLE OFFICIAL**

Director, Electronic Tax Administration and Refundable Credits, Wage and Investment Division

**CORRECTIVE ACTION MONITORING PLAN**

We will monitor this corrective action as part of our internal management control system.

**RECOMMENDATION 3**

Ensure the citizenship status is verified for all *e-file* Providers who show a blank or unknown citizenship status in the DM-1 file.

**CORRECTIVE ACTION**

We cannot agree to this recommendation. In fact, recent legislation mandating electronic filing for most return preparers will require the IRS to modify the current citizenship rules. If this recommendation were implemented in concert with the *e-file* mandate, it would effectively bar all foreign preparers from completing U.S. tax returns – an outcome that would undermine effective tax administration.

While we share the Treasury Inspector General for Tax Administration's concern with the need to accurately verify information about *e-file* providers, the new law will require the IRS to change the current provider rules with respect to citizenship status. The IRS is currently evaluating ways to address this challenge under the auspices of the Return Preparer Implementation team which has a similar issue with respect to foreign-based preparers. Our goal is to develop a comprehensive and complimentary set of requirements for both *e-file* providers and return preparers. The team's current objective is to finish the policy development in this area by May 2010 and to then develop an implementation timeline.

**IMPLEMENTATION DATE**

N/A

**RESPONSIBLE OFFICIAL**

N/A

**CORRECTIVE ACTION MONITORING PLAN**

N/A



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**RECOMMENDATION 4**

Establish a process requiring the SPEC function to notify the Electronic Tax Administration and Refundable Credits office when a SPEC-related volunteer site is closed or becomes inactive so that office can deactivate the EFIN.

**CORRECTIVE ACTION**

We agree with this recommendation. The Stakeholder Partnerships, Education and Communication (SPEC) e-team coordinated with ETA and Submission Processing to develop guidance on deactivating a Volunteer Income Tax Assistance/Tax Counseling for the Elderly (VITA/TCE) Electronic Filing Identification Number (EFIN). During Fiscal Year (FY) 2009, SPEC began deactivating EFINs when a site was closed for non-compliance with its Quality Site Requirements. This action was expanded to include sites that are closed by partner choice or due to termination of SPEC's support (such as SPEC no longer providing computers or software). In addition, on January 28, 2010, SPEC issued Policy Directive 22.30.1-09.1, which stated effective immediately, a VITA and/or TCE EFIN will be deactivated when a partner refuses to comply with SPEC's Quality Site Requirements and when sites are closed as a result of partner choice or termination of SPEC support. The request for deactivation is made through the Andover Campus. This process serves as notification to ETA regarding EFIN deactivation.

**IMPLEMENTATION DATE**

Completed January 28, 2010

**RESPONSIBLE OFFICIAL**

Director, Stakeholder Partnerships, Education, and Communication, Wage and Investment Division

**CORRECTIVE ACTION MONITORING PLAN**

N/A

The Commissioner, SB/SE Division, should:

**RECOMMENDATION 5**

Implement controls to ensure that the monitoring visit procedures are being followed.

**CORRECTIVE ACTION**

We agree with this recommendation. A conference call was held during the current filing season on February 3, 2010, with our Area Coordinators and their managers. Topics included re-emphasis of current procedures for monitoring the program and changes to final report requiring the results of all visitations including the type of violation and method of disposition. In addition, final reports will require managerial approval before submission to Headquarters.



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4

We will take the additional following corrective actions:

1. We will further analyze our control system for monitoring visit procedures, review and formulate appropriate changes, create an action plan, and make changes to our control system.
2. We will assess the effectiveness of the changes at the end of the FY 2011 filing season and update IRM 4.21.1, Electronic Filing Program – Monitoring the IRS e-file Program, to reflect changes to the program.

**IMPLEMENTATION DATE**

1. October 15, 2010
2. September 15, 2011

**RESPONSIBLE OFFICIAL**

Director, Examination Policy, Small Business/Self-Employed Division

**CORRECTIVE ACTION MONITORING PLAN**

The Director, Examination Policy, Small Business/Self-Employed Division (SB/SE) will advise the Director, Examination SB/SE of any delays in implementing this corrective action.

**RECOMMENDATION 6**

Ensure information reported to SB/SE Division Headquarters is accurate and the results of the monitoring visits are used to improve and measure the effectiveness of the *e-file* Program.

**CORRECTIVE ACTION**

We agree with this recommendation. A conference call was held during the current filing season on February 3, 2010, with our Area Coordinators and their managers. Topics included re-emphasis of current procedures for monitoring the program and changes to final report requiring the results of all visitations including the type of violation and method of disposition. In addition, final reports will require managerial approval before submission to Headquarters.

We will take the additional following corrective actions:

1. We will develop an action plan to assess our Monitoring Program and formulate appropriate recommendations to improve its effectiveness on an annual basis.
2. IRM 4.21.1 will be updated to reflect changes to the program, if any.



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**IMPLEMENTATION DATE**

1. October 15, 2010
2. September 15, 2011

**RESPONSIBLE OFFICIAL**

Director, Examination Policy, Small Business/Self-Employed Division

**CORRECTIVE ACTION MONITORING PLAN**

The Director, Examination Policy, SB/SE will advise the Director, Examination SB/SE of any delays in implementing this corrective action.