



*More Tax Return Preparers Are Filing
Electronically, but Better Controls Are
Needed to Ensure All Are Complying With the
New Preparer Regulations*

December 20, 2011

Reference Number: 2012-40-010

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

Redaction Legend:

1 = Tax Return/Return Information

2(f) = Risk Circumvention of Agency Regulation or Statute

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HIGHLIGHTS

MORE TAX RETURN PREPARERS ARE FILING ELECTRONICALLY, BUT BETTER CONTROLS ARE NEEDED TO ENSURE ALL ARE COMPLYING WITH THE NEW PREPARER REGULATIONS

Highlights

Final Report issued on December 20, 2011

Highlights of Reference Number: 2012-40-010 to the Internal Revenue Service Deputy Commissioner for Services and Enforcement.

IMPACT ON TAXPAYERS

Every year, more than one-half of all taxpayers pay someone else to prepare their Federal income tax returns. During the 2011 Filing Season, the IRS processed approximately 66.9 million individual Federal income tax returns prepared by paid tax return preparers; 90 percent of these returns were electronically filed (e-filed).

WHY TIGTA DID THE AUDIT

This audit was initiated because in Fiscal Year 2011, new regulations changed the way many preparers do business with the IRS, including requirements for e-filing tax returns they prepare and implementing new IRS preparer regulations and oversight. The overall objective of this review was to monitor and evaluate the IRS's implementation of the e-file mandate for preparers.

WHAT TIGTA FOUND

The e-file mandate is helping the IRS with its goal to electronically receive 80 percent of individual tax returns by Calendar Year 2012. More than 79 percent of tax returns were e-filed in Calendar Year 2011 as of June 9, 2011. However, the continued use of multiple preparer identification numbers makes it difficult to match all tax returns to the preparers. The potential risk of Preparer Tax Identification Numbers (PTIN) *****2(f)***** *****2(f)*** also presents significant challenges. Additionally, the IRS is unable to

determine *****2(f)*****
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For the first few years, the IRS plans to use a "soft" approach to enforcement with emphasis on educating and collaborating with preparers in implementing e-file requirements. However, improvements are underway to ensure controls and system validations over the preparer registration process are effective.

WHAT TIGTA RECOMMENDED

TIGTA recommended that the IRS: 1) monitor preparers' compliance with the e-file mandate and, should it begin to decline, consider a) expanding the requirement for the submission of Form 8948, *Preparer Explanation for Not Filing Electronically*, to all tax returns prepared by a paid preparer and submitted on paper, and b) requiring that PTIN applicants provide the Employer Identification Numbers for any business entities in which the PTIN holder is preparing tax returns; 2) ensure suitability tests of PTIN applicants include matching PTIN applicants to IRS information to identify preparers who are not allowed to prepare tax returns; *****2(f)*****
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Management agreed with all four recommendations and stated that corrective actions to address the recommendations have been taken or are planned.



TREASURY INSPECTOR GENERAL
FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

December 20, 2011

**MEMORANDUM FOR DEPUTY COMMISSIONER FOR SERVICES AND
ENFORCEMENT**

Michael R. Phillips

FROM:

Michael R. Phillips
Deputy Inspector General for Audit

SUBJECT:

Final Audit Report – More Tax Return Preparers Are Filing
Electronically, but Better Controls Are Needed to Ensure All Are
Complying With the New Preparer Regulations (Audit # 201140003)

This report presents the results of our review to monitor and evaluate the Internal Revenue Service's implementation of the electronic filing mandate for tax return preparers. This audit was conducted as part of the Treasury Inspector General for Tax Administration Fiscal Year 2011 Audit Plan and addresses the major management challenge of Compliance Initiatives.

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

Copies of this report are also being sent to the Internal Revenue Service 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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but Better Controls Are Needed to Ensure All Are Complying
With the New Preparer Regulations*

Table of Contents

Background	Page 1
Results of Review	Page 5
More Preparers Submitted Tax Returns Electronically During the 2011 Filing Season, but Determining Noncompliance With the Electronic Filing Mandate Is Difficult.....	Page 5
<u>Recommendation 1:</u>	Page 12
Improvements Are Ongoing to Ensure the Preparer Registration Process Has Effective Controls and System Validations.....	Page 12
<u>Recommendations 2 and 3:</u>	Page 17
System Validations Are Insufficient to *****2(f)***** *****2(f)*****	Page 18
<u>Recommendation 4:</u>	Page 19
Appendices	
Appendix I – Detailed Objective, Scope, and Methodology	Page 20
Appendix II – Major Contributors to This Report	Page 23
Appendix III – Report Distribution List	Page 24
Appendix IV – Comparison of Preparer Identification Numbers Used on Tax Returns Filed in Calendar Years 2010 and 2011	Page 25
Appendix V – Management’s Response to the Draft Report	Page 26



*More Tax Return Preparers Are Filing Electronically,
but Better Controls Are Needed to Ensure All Are Complying
With the New Preparer Regulations*

Abbreviations

e-file(d); e-filing	Electronically file(d); electronic filing
EFIN	Electronic Filing Identification Number
IRS	Internal Revenue Service
PTIN	Preparer Tax Identification Number
TIGTA	Treasury Inspector General for Tax Administration
TPPS	Tax Professional PTIN System
U.S.	United States



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With the New Preparer Regulations*

Background

Every year, more than one-half of all taxpayers pay someone else to prepare their Federal income tax returns. During Calendar Year 2011,¹ the Internal Revenue Service (IRS) processed approximately 66.9 million individual Federal income tax returns prepared by preparers; 90 percent of these were electronically filed (e-filed). In Fiscal Year 2011, new regulations changed the way many tax return preparers do business with the IRS, including how they are required to submit the tax returns they prepare.

The E-file Mandate

In November 2009, Congress approved a Federal e-file mandate² for tax return preparers. The IRS is implementing the e-file mandate over two years. As a result of the new rules, specified preparers will be required to start using IRS e-file beginning:

- **January 1, 2011**, for those preparers who anticipate filing 100 or more Federal individual, trust, or estate tax returns during the year.
- **January 1, 2012**, for those preparers who anticipate filing 11 or more Federal individual, trust, or estate tax returns during the year.

If a preparer is a member of a firm, the firm must compute the number of anticipated tax returns in the aggregate. If the firm meets the threshold, all preparers in the firm must e-file.

An individual income tax return is considered “filed” by a tax return preparer if the preparer:

... submits the individual income tax return to the IRS on the taxpayer’s behalf, either electronically (by e-file or other magnetic media) or in non-electronic (paper) form. Submission of an individual income tax return by a tax return preparer or a specified tax return preparer in non-electronic form includes the transmission, sending, mailing or otherwise delivering of the paper individual income tax return to the IRS by the preparer, any member, employee, or agent of the preparer, or any member, employee, or agent of the preparer’s firm.

An individual income tax return will not be considered filed by a tax return preparer (or required by the statute to be e-filed) if the preparer who prepared the tax return obtains, on or before the date the individual income tax return is filed, a hand-signed and dated statement from the taxpayer (by either spouse if a joint return) that states the taxpayer chooses to file the individual

¹ As of May 4, 2011.

² Worker, Homeownership, and Business Assistance Act of 2009, Pub. L. No. 111-92, 123 Stat. 2984, 2996 (Nov. 6, 2009).



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With the New Preparer Regulations*

income tax return in paper format, and that the taxpayer, and not the preparer, will submit the paper individual income tax return to the IRS.

IRS regulations provide exceptions to the mandate for specified preparers who cannot e-file for certain reasons.

1. Preparers may request waivers for undue hardship. To apply, preparers annually submit to the IRS Form 8944, *Preparer e-file Hardship Waiver Request* (also referred to as the hardship waiver).
2. The IRS provides administrative exemptions for preparers who belong to certain classes of preparers or are filing certain types of tax returns such as those that include forms that cannot be filed electronically.
3. Paid preparers are not required to e-file tax returns for taxpayers who choose to file on paper.

If specified preparers claim any of the above exceptions, they must attach to the paper tax return Form 8948, *Preparer Explanation for Not Filing Electronically* (also referred to as the administrative exception form).³

New Tax Return Preparer Program and Regulations

In January 2010, the IRS published its Return Preparer Review Final Report that recommended increased oversight of the tax return preparer industry through numerous actions, including requirements for registration, competency testing, continuing professional education, ethical standards, and enforcement. Before January 2010, the IRS did not provide oversight or have national standards that tax return preparers were required to satisfy before selling tax preparation services to the public. Anyone, regardless of training, experience, skill, or knowledge, was allowed to prepare Federal income tax returns for others for compensation.

Important! All paid preparers must register with the IRS and obtain a PTIN.

[SIGN UP NOW >>](#)

As of July 2011, more than 700,000 paid tax return preparers have registered with the IRS and obtained a PTIN.

Tax Return Preparer Population

Starting January 1, 2011, the IRS required all paid tax return preparers to register and obtain a unique Preparer Tax Identification Number (PTIN) and use it to sign all returns they prepare,

³ This includes Form 1040, *U.S. Individual Income Tax Return*, or Form 1041, *U.S. Income Tax Return for Estates and Trusts*, series.



*More Tax Return Preparers Are Filing Electronically,
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With the New Preparer Regulations*

both paper and electronic. Paid preparers can be self-employed or may work for accounting firms, tax preparation services, or law firms, and include the following:

- **Licensed professionals, such as attorneys and certified public accountants.** These licensed professionals are regulated by State licensing authorities, register with State agencies, and meet continuing professional education requirements.
- **Enrolled Agents.** These professionals pass an IRS examination or present evidence of qualifying experience as a former IRS employee and have been issued an enrollment card. Enrolled agents are the only taxpayer representatives who receive their right to practice from the Federal Government.
- **Registered Tax Return Preparers.** These professionals must do the following to become a registered tax return preparer: 1) pass a one-time competency examination, 2) pass a suitability check, and 3) obtain a PTIN (and pay the amount provided in the PTIN User Fee regulations).

To allow preparers a transition period to pass the competency examination, and because the competency examination was not available at the time the final regulations were published, individuals who obtain a provisional PTIN before the competency examination is offered may prepare for compensation any tax return or claim for refund until December 31, 2013, as long as the individuals renew their PTIN, pass a suitability check,⁴ and pay the applicable user fee.

Preparers can also be electronic return originators. Electronic return originators originate the electronic submission of income tax returns to the IRS. An electronic return originator electronically submits income tax returns that are either prepared by the electronic return originator firm or collected from taxpayers. Applicants to the Electronic Filing Program must pass certain IRS checks, including criminal background checks. Participants are also monitored.

On August 2, 2011, the new regulations governing practice before the IRS became effective. Section (§) 330 of Title 31 of the United States Code authorizes the Secretary of the Treasury to regulate the practice of representatives before the Department of the Treasury. These regulations are published as Regulations Governing Practice before the Internal Revenue Service (Treasury Department Circular No. 230, hereafter referred to as Circular 230).⁵

This review was performed at the Return Preparer Implementation Project Office in Washington, D.C., during the period February through August 2011. 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

⁴ Suitability checks are expected to be available in September 2011.

⁵ Title 31 Code of Federal Regulations, Subtitle A, Part 10.



*More Tax Return Preparers Are Filing Electronically,
but Better Controls Are Needed to Ensure All Are Complying
With the New Preparer Regulations*

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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Results of Review

More Preparers Submitted Tax Returns Electronically During the 2011 Filing Season,⁶ but Determining Noncompliance With the Electronic Filing Mandate Is Difficult

The e-file mandate is helping the IRS with its goal to receive 80 percent of individual tax returns electronically by Calendar Year 2012. More than 79 percent of tax returns were e-filed in Calendar Year 2011.⁷ Ninety percent of the tax returns prepared by preparers in Calendar Year 2011⁸ were e-filed, compared to 74 percent in Calendar Year 2010. Figure 1 shows the breakdown of tax returns prepared by preparers and submitted electronically and on paper for Calendar Years 2010 and 2011.

Figure 1: Tax Returns Prepared by Preparers in Calendar Years 2010 and 2011 (in millions)

Identification Numbers Used by Preparers	Calendar Year 2011*				Calendar Year 2010			
	Number and Percentage of Tax Returns Filed		Number and Percentage of Tax Returns Filed		Number and Percentage of Tax Returns Filed		Number and Percentage of Tax Returns Filed	
	E-Filed	%	Paper	%	E-Filed	%	Paper	%
Valid Identification Numbers	58.16	86.8%	6.27	9.4%	49.07	60.2%	17.52	21.5%
Invalid Identification Numbers	1.84	2.7%	0.48	0.7%	11.25	13.8%	3.20	3.9%
No Identification Number	0.10	0.1%	0.13	0.2%	0.16	0.2%	0.33	0.4%
Total Tax Returns E-filed and Submitted on Paper**	60.09	90%	6.88	10%	60.47	74%	21.05	26%
TOTAL TAX RETURNS	66.96				81.53			

Source: Our analysis of the IRS Return Transaction File.⁹ *Calendar Year 2011 as of May 4, 2011.

**Totals do not add up due to rounding.

⁶ The period from January through mid-April when most individual income tax returns are filed.

⁷ As of June 9, 2011.

⁸ As of May 4, 2011.

⁹ The Return Transaction File contains all edited, transcribed, and error-corrected data from the Form 1040 series and related forms for the current processing year and two prior years.



*More Tax Return Preparers Are Filing Electronically,
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With the New Preparer Regulations*

To implement the e-file mandate, the IRS established an e-file Mandate Team. This Team was part of the IRS’s Return Preparer Implementation Project Office. The Team developed a communication strategy with goals and a timeline to achieve those goals. The Project Office provided weekly status reports. These reports provided a list of e-file mandate accomplishments, “next steps,” and “key issues/questions.” Most importantly, the status reports included the key decisions made and any upcoming meetings. The Project Office also provided IRS executives with weekly updates, which included a list of key risks and next steps.

The IRS communicated extensively with paid preparers and industry groups about the e-file mandate, and published notices, forms, and frequently asked questions on IRS.gov. In addition, the IRS added staff to process new e-file applications for preparers who had not previously participated in the IRS e-file Program.

As of April 18, 2011, the IRS had processed 806 Forms 8944 and approved 630 (78 percent) of these hardship waivers

Processing of waiver requests during Calendar Year 2011 was limited to ensuring all the required documentation was included and sending an interim letter to waiver applicants acknowledging receipt of the application. The IRS expects an increase in the volume of hardship waivers in Calendar Year 2012 for preparers who file more than 10, but fewer than 100 tax returns. It also plans to be flexible in granting waivers to preparers in this category.

More preparers used valid identification numbers on the tax returns they prepared

Preparers are required to include their PTINs on the tax returns they prepare for taxpayers. The PTINs will allow the IRS to better identify tax return preparers, centralize information, and effectively administer the rules relating to tax return preparers. Figure 2 shows the section of Form 1040 where preparers provide required identifying information, including their PTIN, name, firm name, firm address, and Employer Identification Number, if applicable.

Figure 2: Extract From Form 1040

Paid Preparer Use Only	Print/Type preparer's name	Preparer's signature	Date	Check <input type="checkbox"/> if self-employed	PTIN
	Firm's name ▶			Firm's EIN ▶	
	Firm's address ▶			Phone no.	

Form **1040** (2010)

Source: IRS.gov. EIN=Employer Identification Number.

More preparers used valid identification numbers, including valid PTINs, when filing tax returns in Calendar Year 2011 than in Calendar Year 2010. However, many preparers are still using their Social Security Numbers or Employer Identification Numbers instead of the required PTIN.



*More Tax Return Preparers Are Filing Electronically,
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With the New Preparer Regulations*

Of the 751,493 preparer identification numbers used on tax returns processed in Calendar Year 2011:¹⁰

- 503,354 (67 percent) valid PTINs were used on 94 percent (62.7 million) of all tax returns prepared by preparers in Calendar Year 2011.
- 158,443 (21 percent) valid Social Security Numbers or Employer Identification Numbers were used on 3 percent (1.8 million) of all tax returns prepared by preparers in Calendar Year 2011.
- 89,696 (12 percent) invalid identification numbers were used on 3 percent (2.3 million) of all tax returns prepared by preparers in Calendar Year 2011.

Additionally, 223,059 returns were prepared in Calendar Year 2011 by preparers who did not provide an identification number. See Appendix IV for a breakdown of tax returns prepared by preparers and submitted to the IRS in Calendar Years 2010 and 2011.

Due to the interpretation of the word “filed,” fewer preparers are subject to the e-file mandate and determining noncompliance is difficult

Preparers who do not e-file can give prepared tax returns to the taxpayers for them to submit to the IRS and are considered compliant with the e-file mandate. The law states:

The Secretary shall require than [that] any individual income tax return prepared by a tax return preparer be filed on magnetic media if—

(i) such return is filed by such tax return preparer, and

(ii) such tax return preparer is a specified tax return preparer for the calendar year during which such return is filed.¹¹

Therefore, if taxpayers pay preparers to complete their tax returns but submit their paper tax returns to the IRS themselves, the preparers will be considered in compliance with the mandate because the tax returns were not “filed” by the preparer.

With the passing of the e-file mandate, the IRS originally projected that it would achieve an 82 percent e-file rate in Calendar Year 2011 and an 84 percent rate in Calendar Year 2012. However, the IRS adjusted its projections to 75 and 77 percent, respectively, because of the definition of “file.”

The Government Accountability Office has recommended that Congress consider revising the law by replacing the word “file” with “prepare or file.” It reported that 15 of 22 States with

¹⁰ As of May 4, 2011.

¹¹ Internal Revenue Code § 6011(e)(3)(A).



*More Tax Return Preparers Are Filing Electronically,
but Better Controls Are Needed to Ensure All Are Complying
With the New Preparer Regulations*

e-file requirements use either the word “prepare” alone or the term “prepare or file” in their requirements.¹²

More preparers e-filed tax returns in Calendar Year 2011 than in Calendar Year 2010; however, we were unable to determine how many preparers did not comply with the mandate. **2(f)**

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2(f). If a tax return is prepared by a paid preparer, but is submitted on paper by the taxpayer, the tax return is not required to be e-filed. In addition, **2(f)**

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Preparers that do not file the requisite number of tax returns do not qualify as “specified tax return preparers.”

The IRS faces difficulties when determining noncompliance with the e-file mandate

If a preparer is a member of a firm, the firm must compute the number of anticipated tax returns in the aggregate. If the firm meets the threshold, all preparers in the firm must e-file. The IRS plans to use the Employer Identification Number to identify the aggregate volume of returns filed at the firm level as part of its e-file enforcement.

However, not all tax return preparers included the firm’s Employer Identification Number on Tax Year 2010 returns. In addition, the IRS currently does not require the preparer’s Employer Identification Number to be entered or validated on the Tax Professional PTIN System (TPPS), the system for online registration and renewal. As of July 2011, 417,488 (59 percent) of the 711,560 preparers with an active or provisional PTIN were not associated with an Employer Identification Number.

When paper tax returns are processed and Form 8948 is attached to explain why the preparer did not e-file the tax return, the IRS codes the tax return to identify the reason the tax return was submitted on paper. Absence of a code indicates the preparer did not attach a Form 8948. We analyzed 6.9 million paper tax returns with 544,583 preparer identification numbers processed in Calendar Year 2011.¹⁴ Of these:

- 103,521 (19 percent) preparer identification numbers were used to prepare 881,594 paper tax returns with an attached administrative exception form. This is 13 percent of all

¹² Government Accountability Office, GAO-11-344, *ELECTRONIC TAX RETURN FILING: Improvements Can Be Made before Mandate Becomes Fully Implemented* (March 2011).

¹³ *******2(f)*******
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¹⁴ As of May 4, 2011.



*More Tax Return Preparers Are Filing Electronically,
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With the New Preparer Regulations*

paper tax returns, or 1 percent of all individual tax returns, prepared by preparers in Calendar Year 2011.

- 6,285 (1.2 percent) preparer identification numbers that were each used to prepare 100 or more paper tax returns covered by the e-file mandate, did not have an approved e-file hardship waiver, and an administrative exception form was not attached to the tax return. The tax returns totaled 1,477,979, or 21 percent of the paper tax returns filed by preparers and 2 percent of all individual tax returns filed by preparers in Calendar Year 2011.
- 595 (0.1 percent) preparer identification numbers were used to prepare 2,647 paper tax returns with an administrative exception form attached designating that an approved hardship waiver was obtained, but the preparers did not have an IRS-approved hardship waiver. This is 0.04 percent of all preparer paper tax returns filed or 0.004 percent of all individual tax returns prepared by a preparer in Calendar Year 2011.

Preparers who attached Form 8948 to 881,594 paper tax returns¹⁵ stated they did so for the following reasons:

- 729,045 (83 percent)—Taxpayer elected to file on paper.
- 100,179 (11 percent)—Other.
- 26,924 (3 percent)—Tax return was rejected by the IRS and unable to resolve the reject condition.
- 15,916 (2 percent)—Preparer received an approved hardship waiver.
- 7,477 (1 percent)—E-file software package does not support the form or schedule.
- 2,053 (0.2 percent)—Member of a religious group exempted from e-filing.

The IRS is proceeding carefully with e-file mandate enforcement plans

The IRS recognizes that the new return preparer and e-file mandate requirements represent significant changes in the way preparers do business. In addition, as of August 29, 2011, guidance regarding e-file administrative exceptions had not been finalized. Therefore, for the first few years, the IRS plans to use a “soft” approach to enforcement with emphasis on educating and collaborating with preparers in implementing e-file requirements.

For the first few years, the IRS plans to use a “soft” approach to enforcement with emphasis on educating and collaborating with preparers in implementing e-file requirements.

For preparers who are not complying with requirements, the IRS initially plans to send notices to advise them of concerns and encourage

¹⁵ As of May 4, 2011.



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With the New Preparer Regulations*

future compliance. The preparer may also be selected for an IRS compliance visit to determine if the preparer is in compliance with all rules and regulations. Later actions may include imposing penalties and suspension/removal from the Return Preparer Program. Ultimately, preparers could have their PTIN revoked and be prohibited from preparing tax returns if they do not comply with the mandate.

All registered preparers will be governed by the revised Circular 230. There are no penalties imposed against preparers who file Forms 8948 under false pretenses, who falsely indicate they have a hardship waiver, or who fail to file the Form 8948. However, Circular 230 states that if a preparer willfully fails to e-file a tax return that he or she prepared and is required to e-file by Federal tax law, it is considered incompetence and disreputable conduct, unless the failure is due to reasonable cause and not due to willful neglect.

Enforcing the e-file mandate is dependent on preparers complying with the new PTIN requirements

Although 94 percent of the tax returns filed as of May 4, 2011, and prepared by preparers, had

e-News for Tax Professionals	July 15, 2011
Issue Number: 2011-27	
EIN not acceptable as PTIN entry	
Effective January 1, 2011, a Preparer Tax Identification Number (PTIN) is the required number that should be entered in the preparer identification number field on tax returns. An Employer Identification Number (EIN) is not an appropriate entry.	

valid PTINs, 89,696 tax returns contained invalid identification numbers and 158,443 tax returns contained Social Security Numbers and Employer Identification Numbers. *****2(f)*****
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The IRS continues to ensure more preparers obtain PTINs. For example, the IRS has used its e-subscriptions (a free IRS e-mail service) to remind preparers they cannot use an

Employer Identification Number in place of a PTIN. Starting July 7, 2011, the IRS began sending letters to about 100,000 tax return preparers who either used outdated PTINs or used Social Security Numbers as identification numbers on tax returns they prepared for the 2011 Filing Season. The letters explain the new oversight program, inform preparers of how to register for a new PTIN or renew an old PTIN, and inform preparers of where to get assistance.



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The IRS plans to complete its e-file mandate analysis by November 2011

In September 2010, we reported that it will take years to implement the Return Preparer Program.¹⁶ This was due in part to the IRS not having established all program requirements at the time the registration of tax return preparers started in September 2010. As of August 2011, the organizational structure for the Return Preparer Program was still not in place. The IRS is in the process of hiring the management team and plans to have the first group of support personnel in place by October 2011.

The IRS has defined a methodology for identifying preparers who potentially did not comply with the e-file mandate and plans to complete its analysis by November 2011. The methodology includes identifying:

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The IRS also plans to link PTINs to their associated Employer Identification Numbers to ensure firms in the aggregate are not filing 100 or more tax returns on paper. However, this will require the IRS to ensure that it has all the Employer Identification Numbers of the PTIN holders.

The Return Preparer Office has asked the IRS’s Office of Program Evaluation and Risk Analysis to complete an analysis by September 2011 to determine: 1) how many and which preparers are not e-filing any tax returns, 2) the characteristics of the paper tax returns not e-filed, 3) the geographical patterns in paper filing, and 4) the number of taxpayers who decided not to e-file their Tax Year¹⁷ 2010 return but e-filed in the past. Until the IRS analyzes the results of its research efforts, adding more controls to mitigate noncompliance with the e-file mandate may be burdensome to taxpayers and preparers.

¹⁶ Treasury Inspector General for Tax Administration, Ref. No. 2010-40-127, *It Will Take Years to Implement the Return Preparer Program and to Realize Its Impact* (September 2010).

¹⁷ A 12-month accounting period for keeping records on income and expenses used as the basis for calculating the annual taxes due. For most individual taxpayers, the tax year is synonymous with the calendar year.



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Recommendation

The Deputy Commissioner for Services and Enforcement should:

Recommendation 1: Monitor preparers' compliance with the e-file mandate and, should it begin to decline, consider: a) expanding the requirement for the submission of Form 8948 to all tax returns prepared by a paid preparer and submitted on paper, regardless of whether they are submitted by the taxpayer or the preparer, and b) requiring that PTIN applicants provide the Employer Identification Numbers for any business entities for which the PTIN holder is preparing tax returns.

Management's Response: IRS management agreed with the recommendation to monitor the level of preparers' compliance with the e-file mandate. The IRS's objective is to have more tax returns filed electronically and increase preparers' compliance with the e-file mandate. The IRS will establish a process for reviewing the population of tax returns submitted by paid preparers to determine their compliance with the e-file mandate. If there is a decline in compliance with the e-file mandate, the IRS will establish a strategy to promote and generate an increase in compliance through education and enforcement action as appropriate.

Improvements Are Ongoing to Ensure the Preparer Registration Process Has Effective Controls and System Validations

In September 2010, we reported that there were drawbacks to registering preparers before establishing all guidelines and regulations, and before developing a management information system to effectively administer the Return Preparer Program. Without an organizational structure with dedicated resources, the IRS was unable to initially conduct suitability and verification tests¹⁸ to ensure all preparers met Program requirements.

Although the IRS is working to obtain access to the TPPS for itself and the Treasury Inspector General for Tax Administration (TIGTA), currently, neither has direct access. The contract with the vendor that developed and maintains the TPPS was finalized in May 2010 and registration began in September 2010. Initial data extracts from the vendor were inaccurate and unreliable.

Although the number of records with inconsistencies is not significant, three separate tests of the TPPS showed that it contained questionable records and inaccurate data. It also appeared that some applicants were granted PTINs when they did not meet Return Preparer Program Requirements. Figure 4 provides a list of these findings as of July 2011.

¹⁸ Verifications and suitability checks include verifying information the preparers provide on their applications, verifying applicants meet minimum standards, and conducting tax compliance and background checks.



*More Tax Return Preparers Are Filing Electronically,
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More Tax Return Preparers Are Filing Electronically, but Better Controls Are Needed to Ensure All Are Complying With the New Preparer Regulations

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There are no systemic controls to prevent records from being altered, and there is no audit trail to show why a record was altered or deleted

Customer service assistors inadvertently changed records when a number of applicants or preparers called with a question. The assistors accidentally changed at least 10 preparers' Social Security Numbers. In addition, eight Social Security Numbers were deleted in the TPPS by customer service assistors.

The IRS is working on improving the audit trail for the TPPS so changes to records in the system can be identified and tracked. The IRS is also in the process of correcting the data inaccuracies we identified. *****2(f)*****
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*More Tax Return Preparers Are Filing Electronically,
but Better Controls Are Needed to Ensure All Are Complying
With the New Preparer Regulations*

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*****2(f)*****. The competency test and background checks are expected to be available in October 2011. PTIN applicants may have their fingerprints taken at the time of the test, but it will not be required. The IRS expects the tax compliance checks to be in place in September 2011.

Prisoners registered and obtained PTINs

Current regulations do not prohibit prisoners from registering and obtaining PTINs.

- 962 PTIN applicants on the IRS's Prisoner File with an incarceration date within the last 10 years received active or provisional PTINs – 745 (77 percent) of the 962 applicants did not disclose the felony conviction.
- 331 active or provisional PTIN holders were in prison when they received their PTINs.
- 43 PTIN applicants are serving life sentences and received active/provisional PTINs. None of the 43 disclosed the felony conviction on the PTIN applications. Eleven (26 percent) of the 43 indicated they had a qualifying professional certification and they received active PTINs; 32 (74 percent) received provisional PTINs.

The IRS has decided that prisoners will not be issued PTINs and those who were issued PTINs will have them suspended. The IRS stated that it is actively working on solutions for suspending PTINs of prisoners and preventing future PTIN applicants who are prisoners from receiving a PTIN. *****2(f)*****
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The IRS has been taking steps to bring preparers into compliance with the PTIN requirements

Through Calendar Year 2013, the IRS plans to focus its efforts on educating preparers on the new preparer registration requirements and implementing the competency test. The IRS stated that during the 2011 Filing Season preparer visits, it ensured preparers had PTINs or advised them of the new PTIN requirements. It also sent more than 100,000 reminder letters about the PTIN requirements to preparers who did not use PTINs on tax returns they prepared during the 2011 Filing Season.

The IRS stated that it is developing a comprehensive database to house all preparer information, with the goal of early detection and intervention of unscrupulous tax return preparers. This central database will enable the IRS to track preparers who try to avoid detection by changing



*More Tax Return Preparers Are Filing Electronically,
but Better Controls Are Needed to Ensure All Are Complying
With the New Preparer Regulations*

locations and customers. The IRS plans to design a referral system to investigate and timely address taxpayer and stakeholder complaints surrounding tax return preparers.

The IRS is also developing an identification system for preparers who are compensated to prepare returns, but who are not properly identifying themselves. These “ghost preparers” do not enter any identifying information on the tax returns they prepare. The IRS anticipates the database and outreach campaign will launch at the end of Calendar Year 2013, which is the deadline for testing and background checks.

The Return Preparer Program is still evolving

The Return Preparer Office has yet to stand up and be fully staffed. In addition, the IRS is still studying how the Return Preparer Program will affect its other preparer programs – the e-file Provider, Enrolled Agent, and Acceptance Agents Programs. Some preparers can and will be all four types of preparers. The IRS is working on making the suitability requirements and the criteria used to review the background check results consistent among the different Programs.

The IRS is working on a Return Preparer Strategic Plan. As of August 2011, the Office mission and goals have been defined. IRS executives stated that measuring performance is a key component for any program, and the IRS must monitor how the new return preparer initiative is adding value to tax administration. The IRS is developing long-term strategic measures that will enable it to assess the effect of the Return Preparer Program. The IRS stated that it is working to establish a baseline for measures in Calendar Year 2012 and to develop a more customized means to measure the impact that the Return Preparer Program has on tax administration over the next two to three years.

Recommendations

The Deputy Commissioner for Services and Enforcement should ensure:

Recommendation 2: The suitability tests of PTIN applicants include matching PTIN applicants to the list of individuals who have IRS Criminal Investigation convictions and individuals permanently enjoined from preparing tax returns.

Management’s Response: IRS management agreed with the recommendation to implement suitability checks that include matching PTIN applicants to the list of individuals who have IRS Criminal Investigation convictions and individuals permanently enjoined from preparing tax returns.

Recommendation 3: *****2(f)*****
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More Tax Return Preparers Are Filing Electronically, but Better Controls Are Needed to Ensure All Are Complying With the New Preparer Regulations

Management's Response: *****2(f)*****
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System Validations Are Insufficient to *****2(f)*****
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In March 2011, we reported that *****2(f)*****
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The Government Accountability Office has recommended²⁴ the IRS determine whether it would be practical and cost effective to use preparers' PTINs as the authorizing numbers to e-file taxpayers' returns.

During discussions at a software developer's conference about whether a PTIN could be used to e-file instead of having to use an EFIN, the suggestion was made that a security code be required with a PTIN to help prevent the same issues that exist for the misuse of an EFIN. *****2(f)*****
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The IRS needs to implement a process to identify a tax return (e-file or paper) submitted with**
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24 Government Accountability Office, GAO-11-344, ELECTRONIC TAX RETURN FILING: Improvements Can Be Made before Mandate Becomes Fully Implemented (March 2011).



*More Tax Return Preparers Are Filing Electronically,
but Better Controls Are Needed to Ensure All Are Complying
With the New Preparer Regulations*

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*****2(f)***** can cause burden for compliant preparers once the IRS
begins enforcement of the e-file mandate and starts to analyze returns prepared by preparers. In
addition, taxpayers*****2(f)*****
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Recommendation

Recommendation 4: The Deputy Commissioner for Services and Enforcement should
develop and implement a process to *****2(f)*****
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Management's Response: IRS management agreed with the recommendation to
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*More Tax Return Preparers Are Filing Electronically,
but Better Controls Are Needed to Ensure All Are Complying
With the New Preparer Regulations*

Appendix I

Detailed Objective, Scope, and Methodology

Our overall objective was to monitor and evaluate the IRS's implementation of the e-file mandate for return preparers. To accomplish this objective, we:

- I. Determined how the IRS is monitoring and enforcing the e-file mandate.
 - A. Reviewed the final IRS regulations for the e-file mandate.
 - B. Reviewed the IRS's manual for guidance on processing the e-file hardship waivers and the administrative exception forms.
 - C. Interviewed IRS employees to determine how the IRS is monitoring and enforcing the e-file mandate.
 - D. Reviewed the e-file hardship waiver process and determined if controls were in place to allow for future monitoring and enforcement.
 - E. Reviewed the e-file mandate administrative exception process and determined if controls were in place to allow for future monitoring and enforcement.
 - F. Obtained an extract of the database for the e-file hardship waiver, Form 8944, *Preparer e-file Hardship Waiver Request*, and compared it to the paper returns prepared by preparers in Calendar Year 2011.¹ We relied on the IRS's list of the e-file hardship waivers.
 - G. Obtained a list/extract for the e-file administrative exceptions, Form 8948, *Preparer Explanation for Not Filing Electronically*, and compared it to the paper tax returns filed during the 2011 Filing Season.²
- II. Performed data analysis to determine if individual return preparers followed the e-file mandate guidelines during Calendar Year 2011.³
 - A. Obtained an extract of the TPPS, the preparer registration system, to identify all PTINs assigned to preparers.

¹ As of May 4, 2011.

² The period from January through mid-April when most individual income tax returns are filed.

³ As of May 4, 2011.



*More Tax Return Preparers Are Filing Electronically,
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With the New Preparer Regulations*

- B. Obtained the Return Transaction Files⁴ from the TIGTA’s Data Center Warehouse for individual tax returns processed in Calendar Years 2010 and 2011.
 - 1. Determined the volume of tax returns submitted during Calendar Year 2011⁵ and Calendar Year 2010 by PTIN, Social Security Number, or Employer Identification Number for the tax returns covered by the e-file mandate. We relied on the validations performed by the TIGTA’s Information Technology staff on the Return Transaction File.
 - 2. Identified preparers with 100 or more tax returns filed who used any identification number and did not e-file all tax returns, and determined if a waiver or individual administrative exceptions were received by the IRS.
- III. Conducted limited testing of the TPPS to identify anomalies. To validate the data, we matched five records from the system to the records in the database.
 - A. Compared tax return preparers in the TPPS to the Social Security Administration’s records and the IRS’s Prisoner File to determine whether PTINs were issued to applicants who were:
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 - 2. *****2(f)*****.
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 - 4. On the IRS’s Prisoner File at the time of application. We relied on the IRS’s Prisoner File.
 - B. Compared tax return preparers in the TPPS to the Office of Professional Responsibility database of preparers, who are enjoined from preparing tax returns or who have felony convictions. We relied on the IRS’s listing for these preparers. We identified invalid PTINs used on tax returns filed during Calendar Year 2011⁶ by comparing the PTINs on the tax returns to the TPPS.

⁴ The Return Transaction File contains all edited, transcribed, and error-corrected data from the Form 1040 series and related forms for the current processing year and two prior years.

⁵ As of May 4, 2011.

⁶ As of May 4, 2011.



*More Tax Return Preparers Are Filing Electronically,
but Better Controls Are Needed to Ensure All Are Complying
With the New Preparer Regulations*

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 internal controls were relevant to our audit objective: the IRS's policies, procedures, and practices for processing e-filed tax returns and issuing PTINs. We evaluated these controls by interviewing management, reviewing the Internal Revenue Manual, analyzing tax returns prepared by preparers, and analyzing information on the TPPS.



*More Tax Return Preparers Are Filing Electronically,
but Better Controls Are Needed to Ensure All Are Complying
With the New Preparer Regulations*

Appendix II

Major Contributors to This Report

Michael E. McKenney, Assistant Inspector General for Audit (Returns Processing and Account Services)

Augusta R. Cook, Director

Wilma Figueroa, Audit Manager

Pamela DeSimone, Lead Auditor

Bonnie Shanks, Auditor

James Allen, Information Technology Specialist



*More Tax Return Preparers Are Filing Electronically,
but Better Controls Are Needed to Ensure All Are Complying
With the New Preparer Regulations*

Appendix III

Report Distribution List

Commissioner C
Office of the Commissioner Attn: Chief of Staff C
Commissioner, Wage and Investment Division SE:W
Director, Office of Professional Responsibility SE:OPR
Director, Return Preparer Office SE:RPO
Director, Strategy and Finance, Wage and Investment Division SE:W:S
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:PEI



*More Tax Return Preparers Are Filing Electronically,
but Better Controls Are Needed to Ensure All Are Complying
With the New Preparer Regulations*

Appendix IV

*Comparison of Preparer Identification Numbers
Used on Tax Returns
Filed in Calendar Years 2010 and 2011*

Type of Identification Numbers Used by Preparers	Calendar Year 2011*				Calendar Year 2010			
	Identification Numbers Used and Percentage of Total		Tax Returns Prepared (in millions) and Percentage of Total		Identification Numbers Used and Percentage of Total		Tax Returns Prepared (in millions) and Percentage of Total	
Valid PTINs	503,354	67%	62.65	94%	300,609	29%	48.49	60%
Valid Social Security Numbers	112,968	15%	1.27	2%	426,813	41%	15.78	19%
Valid Employer Identification Numbers**	45,475	6%	0.50	1%	83,916	8%	2.32	3%
Total Valid Numbers	661,797	88%	64.42	96%	811,338	78%	66.59	82%
Invalid PTINs	50,806	7%	2.13	3%	158,899	15%	13.71	17%
Invalid Social Security Numbers	18,660	2%	0.08	0.1%	51,464	5%	0.41	1%
Invalid Employer Identification Numbers	20,230	3%	0.11	0.2%	24,672	2%	0.33	0.4%
Total Invalid Numbers	89,696	12%	2.32	3%	235,035	22%	14.45	18%
No Identification Number			0.22	0.3%			0.49	0.3%
Total	751,493	100%	66.96	100%	1,046,373	100%	81.53	100%

Source: Our analysis of the IRS Return Transaction File.¹ *Calendar Year 2011 as of May 4, 2011. **PTIN field is blank. Percentages may not add up due to rounding.

¹ The Return Transaction File contains all edited, transcribed, and error-corrected data from the Form 1040, U.S. Individual Income Tax Return, series and related forms for the current processing year and two prior years.



*More Tax Return Preparers Are Filing Electronically,
but Better Controls Are Needed to Ensure All Are Complying
With the New Preparer Regulations*

Appendix V

Management's Response to the Draft Report

**DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, DC 20224**

November 23, 2011

MEMORANDUM FOR MICHAEL R. PHILLIPS
DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: *for* David R. Williams /s/ Preston B. Benoit
Director, Return Preparer Office

SUBJECT: Draft Audit Report - More Tax Return Preparers Are Filing Electronically, but Better
Controls Are Needed to Ensure All Are Complying With the New Preparer Regulations
(Audit # 201140003)

Thank you for the opportunity to comment on your draft report titled "More Tax Return Preparers Are Filing Electronically, but Better Controls Are Needed to Ensure All Are Complying with the New Preparer Regulations." Your report accurately describes the background of the Federal e-file mandate and how the mandate will help us with our goal to have 80 percent of individual tax returns filed electronically by the end of 2012. Your report also addresses the new return preparer regulations and how they relate to compliance with the e-file mandate.

We agree with your four recommendations. We concur that it is vital to monitor compliance with the e-file requirements and return preparer regulations, and to ensure that only those individuals who have been authorized by the IRS are preparing returns for compensation. To date, IRS efforts have focused on educating and registering tax return preparers and on the integral components of competency testing and continuing education. In 2012, we anticipate that the e-filing mandate will result in an increase in the number of returns filed electronically. After completion of the 2012 filing season, we will begin to monitor preparers' adherence to the e-file mandate.

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***** . We are committed to making the PTIN a symbol of integrity.

Our specific comments to your recommendations are attached. If you have any questions, please contact me, or a member of your staff may contact Preston B. Benoit, Deputy Director, Return Preparer Office, at (202) 622-4935.

Attachment



*More Tax Return Preparers Are Filing Electronically,
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With the New Preparer Regulations*

Attachment

The Deputy Commissioner for Services and Enforcement should:

RECOMMENDATION #1

Monitor preparers' compliance with the e-file mandate and should it begin to decline, consider a) expanding the requirement for the submission of Form 8948 to all tax returns prepared by a paid preparer and submitted on paper, regardless of whether they are submitted by the taxpayer or the preparer, and b) requiring that PTIN applicants provide the Employer Identification Numbers for any business entities in which the PTIN holder is preparing tax returns.

CORRECTIVE ACTION

We agree with the recommendation to monitor the level of preparers' compliance with the e-file mandate. Our objective is to have more returns filed electronically and increase preparers' compliance with the e-file mandate. The IRS will establish a process for reviewing the population of returns submitted by paid preparers to determine their compliance with the e-file mandate. If there is a decline in compliance with the e-file mandate, we will establish a strategy to promote and generate an increase in compliance through education and enforcement action as appropriate.

IMPLEMENTATION DATE

June 30, 2013

RESPONSIBLE OFFICIAL(S)

Director, Return Preparer Office

CORRECTIVE ACTION MONITORING PLAN

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

RECOMMENDATION #2

Ensure that the suitability tests of PTIN applicants include matching PTIN applicants to the list of individuals who have IRS Criminal Investigation convictions and individuals permanently enjoined from preparing tax returns.

CORRECTIVE ACTION

We agree with the recommendation to implement suitability checks that include matching PTIN applicants to the list of individuals who have IRS Criminal Investigation convictions and individuals permanently enjoined from preparing tax returns.

IMPLEMENTATION DATE

This recommendation has already been implemented.

RESPONSIBLE OFFICIAL(S)

Director, Return Preparer Office

CORRECTIVE ACTION MONITORING PLAN

N/A

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*More Tax Return Preparers Are Filing Electronically,
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