

GAO

Report to the Subcommittee on
Financial Services and General
Government, Committee on
Appropriations, U.S. Senate

March 2011

TAX PREPARER REGULATION

IRS Needs a
Documented
Framework to
Achieve Goal of
Improving Taxpayer
Compliance



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Highlights of [GAO-11-336](#), a report to the Subcommittee on Financial Services and General Government, Committee on Appropriations, U.S. Senate

Why GAO Did This Study

Paid preparers prepare about 60 percent of all tax returns filed, and their actions significantly affect the Internal Revenue Service's (IRS) ability to administer tax laws. Previously, GAO found that some preparers made significant errors in preparing tax returns and proposed stricter regulation of preparers. IRS is implementing new requirements for paid preparers that it believes will increase tax compliance, which will reduce the gross tax gap between taxes owed and taxes paid, last estimated at \$345 billion for 2001.

GAO was asked to (1) describe IRS's plans for implementing and ensuring paid preparer compliance with the requirements; (2) assess IRS's resource estimates for the requirements; and (3) assess IRS's plans to use the requirements to improve taxpayer compliance and evaluate their effect. To meet these objectives, GAO reviewed IRS planning documents and interviewed IRS officials and representatives and members of paid preparer associations.

What GAO Recommends

GAO recommends that IRS document a framework for using the paid preparer requirements to improve taxpayer compliance and evaluate their effect on taxpayer compliance. In commenting on a draft of this report, IRS agreed with the recommendation.

To view the full product, including the scope and methodology, click on [GAO-11-336](#). For more information, contact James White at (202) 512-9110 or whitej@gao.gov.

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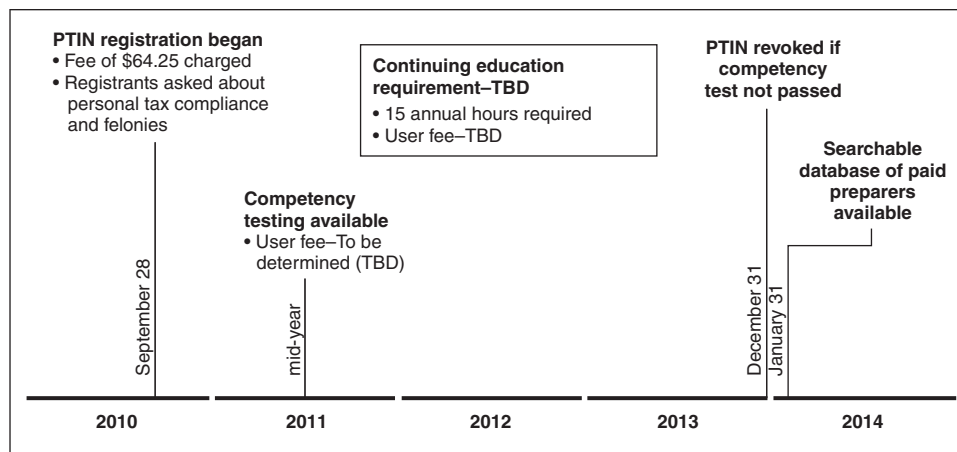
TAX PREPARER REGULATION

IRS Needs a Documented Framework to Achieve Goal of Improving Taxpayer Compliance

What GAO Found

IRS has implemented a registration requirement for paid preparers that includes obtaining a preparer tax identification number (PTIN) and plans to implement competency testing and continuing education requirements, as shown in the figure below. IRS also plans to require paid preparers to adhere to standards of practice and the revisions are currently being reviewed by the Office of Management and Budget. In addition, IRS has conducted an outreach campaign consistent with key practices to inform paid preparers of the new requirements. For example, IRS developed a standardized message that it distributed in different formats. IRS is developing strategies for how to ensure that paid preparers comply with the new requirements, according to the director of IRS's Return Preparer Office.

Proposed Timeline for IRS's Implementation of Paid Preparer Requirements



Source: IRS.

IRS is funding the paid preparer requirements through user fees, which it is setting consistent with established criteria for cost estimating. For example, in setting the PTIN user fee to ensure it covered program costs, IRS identified key costs associated with registration, estimated fixed costs, and based some variable costs on similar registration efforts.

IRS has discussed but not documented a framework for how it plans to use the requirements to improve taxpayer compliance. For example, IRS plans to develop a comprehensive database containing information on paid preparers and related tax returns. Also, IRS has yet to document how it will assess the requirements' effect, for example, by identifying what baseline data IRS needs. Without a documented framework, IRS may have difficulty (1) assessing whether it has adequately planned for what data it needs to collect and (2) deciding how to allocate resources given competing priorities. A framework could also help assure paid preparers, who bear the burden of complying with the requirements, that IRS will assess whether the requirements provide their intended benefit.

Contents

Letter		1
	Background	2
	IRS Has Implemented a Registration Requirement for Paid Preparers and Plans to Implement the Additional Requirements Gradually	5
	IRS Is Funding the New Paid Preparer Program through User Fees, Which IRS Is Setting Consistent with Established Criteria	12
	IRS Has Not Documented a Framework for Using the Requirements to Improve Taxpayer Compliance and Measuring Their Effect	15
	Conclusions	18
	Recommendation for Executive Action	18
	Agency Comments	18
Appendix I	Scope and Methodology	20
Appendix II	Comments from the Internal Revenue Service	23
Appendix III	GAO Contact and Staff Acknowledgments	26
Tables		
	Table 1: Applicability of New Requirements by Type of Paid Preparer	8
	Table 2: Setting the PTIN Registration User Fee	13
	Table 3: Collecting, Using, and Reviewing the PTIN Registration User Fee	14
Figure		
	Figure 1: Proposed Timeline for IRS's Implementation of Paid Preparer Requirements	5

Abbreviations

CPA	Certified Public Accountant
EA	Enrolled Agent
IRS	Internal Revenue Service
OMB	Office of Management and Budget
PTIN	preparer tax identification number
RPIPO	Return Preparer Implementation Project Office
RPO	Return Preparer Office
TIGTA	Treasury Inspector General for Tax Administration

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Accountability * Integrity * Reliability

United States Government Accountability Office
Washington, DC 20548

March 31, 2011

The Honorable Richard J. Durbin
Chairman
The Honorable Jerry Moran
Ranking Member
Subcommittee on Financial Services and General Government
Committee on Appropriations
United States Senate

Paid tax return preparers prepare approximately 60 percent of all tax returns filed. The Internal Revenue Service (IRS) has acknowledged that paid preparers' actions have an enormous impact on its ability to administer tax laws effectively. In previous work, described in our background section, we found that some paid preparers made significant errors in preparing tax returns, and we proposed stricter oversight of preparers as an option to address this issue. While paid preparers could be subject to penalties with respect to the preparation of tax returns, until recently IRS had not regulated the conduct and competency of all paid preparers. IRS is implementing new requirements, such as requiring certain types of paid preparers to pass a competency test. IRS has concluded that these requirements will increase tax compliance, which will reduce the gross tax gap between what is owed in taxes and what is paid voluntarily and on time. IRS's most recent estimate for the gross tax gap was \$345 billion for 2001.¹

You asked that we assess IRS's administration of the new requirements for paid preparers. In response, this report's objectives are to (1) describe IRS's plans for implementing and ensuring paid preparer compliance with the requirements; (2) assess IRS's resource estimates for developing and implementing the requirements; and (3) assess IRS's plans to use the requirements to improve taxpayer compliance and evaluate the effect of the requirements.

To describe IRS's plans for implementing and ensuring paid preparer compliance with the requirements, we analyzed IRS documents and

¹IRS estimated that it would eventually collect about \$55 billion of the gross tax gap through late payments and IRS enforcement actions, leaving a net tax gap of around \$290 billion.

interviewed officials from IRS's Return Preparer Office (RPO) and Return Preparer Implementation Project Office (RPIPO) based on IRS's plans for the requirements, internal control standards, and our prior work on communicating with the public about a new initiative. To assess IRS's resource estimates, we reviewed IRS documents on the user fee that IRS is charging paid preparers for obtaining a preparer tax identification number (PTIN) and interviewed officials from IRS's RPO, RPIPO, and Chief Financial Officer's office based on prior GAO work on cost estimating and user fees. To assess IRS's plans to use the requirements to improve taxpayer compliance and evaluate the effect of the requirements, we reviewed IRS documents and interviewed RPO and RPIPO officials utilizing IRS's plans for the requirements and prior GAO work on evaluating performance. In addition, for all three objectives, we interviewed representatives from paid preparer associations and a representative from a retail tax return preparation chain. For further details on our scope and methodology, see appendix I.

We conducted this performance audit from July 2010 to March 2011 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 objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Background

A paid preparer is any person who prepares for compensation, or who employs one or more persons to prepare for compensation, all or a substantial portion of a tax return or claim for refund of tax.² Paid preparers prepared almost 60 percent of all federal tax returns filed in 2008 and 2009. IRS does not know how many paid preparers there are but estimates there are between 900,000 and 1.2 million. Prior to the new requirements for paid preparers there were no national standards that a paid preparer was required to satisfy before being compensated for preparing a federal tax return. Currently, attorneys, certified public

²26 U.S.C. § 7701(a)(36).

accountants (CPA), enrolled agents³ (EA), enrolled actuaries,⁴ enrolled retirement plan agents,⁵ and other individuals authorized to practice before IRS are subject to standards of practice under Department of the Treasury *Circular No. 230*.⁶ Most EAs are required to pass an examination and complete annual continuing education, while attorneys and CPAs are licensed by states but are still subject to *Circular 230* standards of practice if they practice before IRS. Previously, other paid preparers were not regulated, required to pass a competency examination, complete continuing education, or adhere to the standards of practice in *Circular 230*. The states of Oregon, California, New York, and Maryland all regulate paid preparers, but oversight in each state varies. IRS has noted that the lack of uniform federal regulation of all paid preparers has resulted in greatly varying oversight of paid preparers depending on the paid preparer's professional affiliations, or lack thereof, and the geographical area in which they practice.

In previous work, we and the Treasury Inspector General for Tax Administration (TIGTA) found that some paid preparers made significant errors preparing tax returns and we recommended that IRS conduct research to determine the extent to which paid preparers file accurate and complete tax returns.⁷ We also recommended that IRS develop a plan to require stricter regulation of paid preparers and suggested Congress adopt a nationwide paid preparer regulatory regime similar to Oregon's paid

³An enrolled agent is an individual who has, either through past service and technical experience at IRS or by demonstrating special competence through a written examination, earned the ability to represent taxpayers before IRS.

⁴An enrolled actuary is an individual who has been enrolled as an actuary by the Joint Board for the Enrollment of Actuaries by fulfilling certain knowledge and experience requirements and may represent taxpayers before IRS with respect to issues involving retirement plans.

⁵An enrolled retirement plan agent is an individual who has, either through past service and technical experience at IRS or by demonstrating special competence through a written examination, earned the ability to represent taxpayers before IRS with respect to issues involving retirement plans.

⁶*Circular No. 230* contains regulations governing the practice of practitioners before IRS. 31 C.F.R. part 10.

⁷GAO, *Paid Tax Return Preparers: In a Limited Study, Chain Preparers Made Serious Errors*, GAO-06-563T (Washington, D.C.: Apr. 4, 2006) and TIGTA, *Most Tax Returns Prepared by a Limited Sample of Unenrolled Preparers Contained Significant Errors*, TIGTA 2008-40-171 (Washington, D.C.: Sep. 3, 2008).

preparer regulatory regime⁸ if it judged that Oregon's regulatory regime accounted for at least a modest portion of the higher federal tax return accuracy in the state.⁹

In June 2009, the Commissioner of Internal Revenue initiated a review of paid preparers to help IRS strengthen its partnerships with paid preparers and ensure that paid preparers adhere to applicable professional standards and follow tax laws. IRS recommended changes to the oversight of paid preparers in its December 2009 *Return Preparer Review* report.¹⁰ These recommended changes included mandatory registration for paid preparers who are required to sign a federal tax return; competency testing and continuing education for paid preparers who are required to register with IRS and who are not attorneys, CPAs, or EAs; and holding all paid preparers to *Circular 230* standards of practice, regardless of whether or not the preparers are required to sign a federal tax return. IRS intends these new requirements to improve service to taxpayers, increase confidence in the tax system, and increase taxpayer compliance.¹¹

⁸Oregon requires paid preparers to complete qualifying education, pass a state-administered examination, and register to be certified as a Licensed Tax Preparer. Paid preparers must complete 30 hours of continuing education and reregister in each subsequent year. Oregon also requires that all preparers work under the supervision of a Licensed Tax Consultant, CPA, public accountant, or attorney.

⁹GAO, *Internal Revenue Service: Fiscal Year 2009 Budget Request and Interim Performance Results of IRS's 2008 Tax Filing Season*, [GAO-08-567](#) (Washington, D.C.: Mar. 13, 2008) and *Tax Preparers: Oregon's Regulatory Regime May Lead to Improved Federal Tax Return Accuracy and Provides a Possible Model for National Regulation*, [GAO-08-781](#) (Washington, D.C.: Aug. 15, 2008).

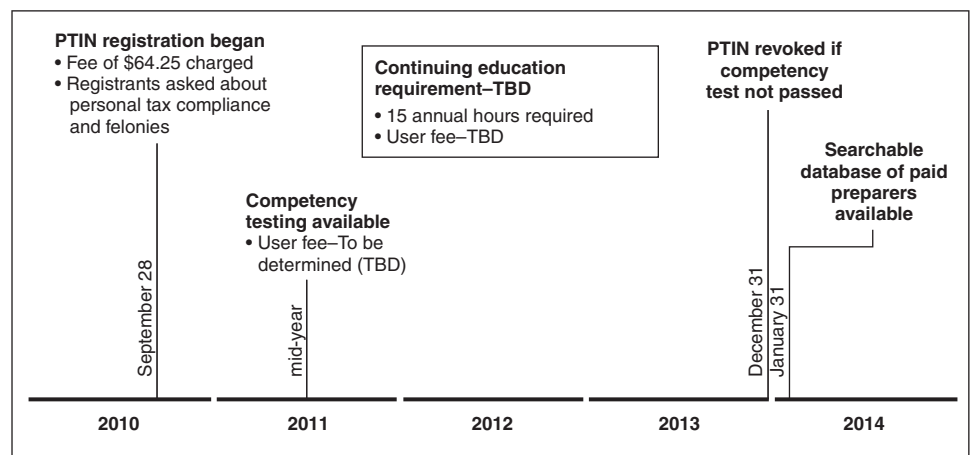
¹⁰IRS, *Return Preparer Review*, IRS Publication 4832 (December 2009).

¹¹In addition to new requirements for paid preparers, IRS is in the process of implementing a mandate contained in the Worker, Homeownership, and Business Assistance Act of 2009 (Pub. L. No.111-92) for some paid preparers to file tax returns electronically. We evaluated IRS's implementation of the mandate in GAO, *Electronic Tax Return Filing: Improvements Can Be Made before Mandate Becomes Fully Implemented*, [GAO-11-344](#) (Washington, D.C.: Mar. 7, 2011).

IRS Has Implemented a Registration Requirement for Paid Preparers and Plans to Implement the Additional Requirements Gradually

IRS has implemented a requirement that paid preparers obtain a PTIN if they prepare all or substantially all of a tax return filed after December 31, 2010.¹² Figure 1 shows IRS's tentative schedule for implementing the other new requirements. In addition to the requirements shown in figure 1, IRS will require all paid preparers to adhere to *Circular 230* standards of practice. Revisions to the *Circular 230* regulations are currently being reviewed by the Office of Management and Budget (OMB), according to an official involved in the implementation of the new requirements. When the revisions to the *Circular 230* regulations have been finalized, paid preparers will be required to adhere to its standards of practice.

Figure 1: Proposed Timeline for IRS's Implementation of Paid Preparer Requirements



Source: IRS.

The dates for implementing the competency testing and continuing education requirements are tentative because OMB is currently reviewing the proposed revisions to the *Circular 230* regulations. Because these proposed regulations are not final, IRS has not decided how it will implement some details of the competency testing and continuing education requirements. Nevertheless, the RPO Director discussed with us his thoughts on approaches IRS might take.

¹²*Furnishing Identifying Number of Tax Return Preparer (Final Rule)*, 75 Fed. Reg. 60,309 (Sept. 30, 2010). In *IRS Notice 2011-6*, IRS has provided a list of forms for which a paid preparer will not be required to obtain a PTIN in order to prepare.

Paid preparers may register for a PTIN online or on paper via Form W-12, *IRS Paid Preparer Tax Identification Number (PTIN) Application*.¹³ Paid preparers who currently have a PTIN¹⁴ must register in the new PTIN registration system but in most cases can retain their old PTIN as long as IRS can verify identifying information for the existing PTIN. Online registrants are supposed to receive a provisional PTIN immediately while paper registrants are supposed to receive a provisional PTIN in 4-6 weeks.¹⁵ As of March 20, 2011, according to an IRS official involved in implementing the new requirements, IRS had issued 692,297 PTINs, approximately 60 percent of which were issued to paid preparers with existing PTINs and approximately 40 percent of which were issued to paid preparers without existing PTINs.

Most, but not all, paid preparers were able to obtain a PTIN online. According to an official involved in the implementation of the new requirements, approximately 92 percent of paid preparers who attempted to obtain PTINs by the start of the filing season got them online. The rest either attempted to obtain a PTIN by paper or were directed to obtain a PTIN by paper, likely as a result of an online authentication issue. Officials and members of multiple paid preparer organizations stated that some preparers have encountered technical problems when using the PTIN registration system but also noted that IRS's administration of the PTIN registration system has improved. The RPO Director said that IRS has worked to address problems with the registration system since it was initiated. For example, married paid preparers with different last names from their spouses who filed tax returns under the married filing jointly status were experiencing difficulty obtaining a new PTIN. The RPO director said that IRS solved this problem. For the 2011 tax filing season, IRS will allow paid preparers who are able to demonstrate a good faith effort to obtain a PTIN, but were unsuccessful, to use their old PTINs or Social Security numbers on tax returns.

¹³Foreign paid preparers and paid preparers who are conscientious objectors to Social Security numbers can register for a PTIN by submitting a supplemental form with their application.

¹⁴IRS created the PTIN several years ago as a number that paid preparers could obtain and use as a substitute for their Social Security number on tax returns.

¹⁵Attorneys' and CPAs' PTINs will not be provisional. Other paid preparers' PTINs will be provisional until IRS can verify the information on their application or until paid preparers pass a competency test.

When applying for a PTIN, paid preparers are asked to self-disclose if they are compliant with their personal and business taxes, under penalty of perjury. The RPO Director said that IRS plans to initiate automated tax compliance checks on all paid preparers. IRS plans to limit the checks to whether the preparers have filed all federal tax returns and paid or entered into an agreement to pay federal tax debts. Paid preparers are also asked if they have been convicted of a felony in the past 10 years, under penalty of perjury. The PTIN application includes space to write an explanation for both tax compliance and felony information. The RPO Director said that IRS plans to check the accuracy of registrants' tax compliance and background information by late 2011 and that registrants who provide false information on their PTIN applications will have severely limited appeal rights if IRS proposes to deny them PTINs. Paid preparers who are attorneys, CPAs, or EAs are asked to self-identify their professional credentials. The RPO Director said that IRS does not have a single-source database through which it can verify these professional credentials (it only has information on EAs).¹⁶ IRS plans to sample randomly attorneys and CPAs for verification of their self identification, and the RPO Director said that IRS is working toward developing a database that contains information about attorneys and CPAs that will allow for automated verification.

IRS plans to hold paid preparers to *Circular 230* standards of practice and will establish a new category of practitioner—registered tax return preparer.¹⁷ These paid preparers will be limited in their practice before IRS to preparing tax returns, claims for refund, and other documents for submission to IRS but will be required to adhere to professional ethical standards when doing so or face a penalty. Additionally, paid preparers who are supervised by an attorney, CPA, EA, enrolled actuary, or enrolled retirement plan agent at a law firm, CPA firm, or other recognized firm and do not sign tax returns but obtain a PTIN, while not being granted rights to practice before IRS, will be required to meet the same standards. The RPO Director said that if paid preparers are denied a PTIN or have their PTIN revoked, paid preparers will have the right to appeal this denial or revocation in the same manner as other *Circular 230* sanctions.

¹⁶Attorneys and CPAs are professionally certified at the state level. EAs are professionally certified by IRS.

¹⁷*Regulations Governing Practice Before the Internal Revenue Service (Proposed Rule)*, 75 Fed. Reg. 51,713 (Aug. 23, 2010) (to be codified at 31 C.F.R. part 10).

Applicability of the new paid preparer requirements will vary by type of paid preparer, as shown in table 1:

Table 1: Applicability of New Requirements by Type of Paid Preparer

Preparer type	PTIN registration	Competency testing	Continuing education	Circular 230 standards
Registered tax return preparers	X	X	X	X ^a
Attorneys/CPAs/EAs	X			X ^b
Enrolled actuaries, enrolled retirement plan agents, and preparers of forms not covered by competency test	X			X ^c
Supervised tax return preparers	X			X ^d

Source: GAO analysis of IRS documents.

^aRegistered tax return preparers are granted limited rights to represent taxpayers before IRS and subject to *Circular 230* standards of practice by the proposed amendments.

^bAttorneys', CPAs', and EAs' rights to represent taxpayers under *Circular 230* are unchanged by the proposed amendments.

^cEnrolled actuaries' and enrolled retirement plan agents' rights to represent taxpayers before IRS under *Circular 230* are unchanged by the proposed amendments. Preparers of forms not covered by the competency examination are granted limited rights to represent taxpayers before IRS and subject to *Circular 230* standards of practice.

^dSupervised tax return preparers who obtain PTINs are exempt from the competency testing and continuing education requirements but are not permitted to sign tax returns as paid preparers and are not granted rights to represent taxpayers before IRS. They will be subject to certain duties and restrictions relating to the preparation of returns under *Circular 230*.

According to the RPO Director, some types of paid preparers will be exempt from the new competency testing and continuing education requirements because they are subject to competency testing and continuing education requirements set by their professional licensing bodies.¹⁸

IRS proposed regulations amending *Circular 230* will require individuals (see table 1 above) to pass a competency test to become an officially registered tax return preparer.¹⁹ Paid preparers who have a valid PTIN before competency testing is available will have until 2013 to pass a competency test. Paid preparers who register for a PTIN after testing is

¹⁸Enrolled actuaries and enrolled retirement plan agents will be exempt from the paid preparer competency testing requirement if they only prepare tax returns within their limited practice areas, and will be exempt from the continuing education requirement.

¹⁹75 Fed. Reg. 51,713.

available must pass a competency test before obtaining a PTIN. The RPO Director said that IRS is allowing this delay in testing for preparers who register for a PTIN before testing is available to encourage paid preparers to register for a PTIN as soon as possible while giving them time to prepare for the competency test. The RPO Director also said that IRS plans to develop and implement one competency test for individuals who prepare returns from the individual tax return (Form 1040) series and will assess whether IRS needs to add additional tests in the future. The RPO Director also said that IRS plans to have the test available at national and international locations, which will allow individuals to consult forms and instructions during the test, and that individuals will pay a fee each time they take the test. After completing the competency test, registered tax return preparers will be subject to suitability checks, which IRS plans to conduct to determine whether the individual has engaged in disreputable conduct.²⁰ According to the RPO Director, IRS plans to link suitability checks for registered tax return preparers to the competency test so that when paid preparers take the competency test they will be fingerprinted, thereby submitting to a suitability check.

IRS plans to implement a continuing education requirement, whereby registered tax return preparers (see table 1 above) will be required to take 15 hours of training annually—3 hours of federal tax law updates, 2 hours of ethics, and 10 hours of additional federal tax topics. The RPO Director said that IRS plans to approve continuing education providers and audit a random sample of continuing education courses.

²⁰75 Fed. Reg. 51,713. Attorneys and CPAs may practice before IRS by submitting a declaration that they are in good standing with their licensing authority and that the taxpayer has authorized them to represent the taxpayer. 5 U.S.C. § 500(b), (c). IRS is authorized to require others wanting to practice before IRS to demonstrate good character, good reputation, necessary qualifications, and competency to advise persons in presenting their cases. 31 U.S.C. § 330(a). Section 10.51 of *Circular 230* (31 C.F.R. § 10.51) provides a list of conduct considered disreputable, including criminal convictions, and therefore punishable by sanction or disbarment.

IRS Is Conducting an Outreach Campaign Consistent with Key Practices to Inform Paid Preparers of the New Requirements

In support of the new requirements for paid preparers, IRS established a communications team and vested in it responsibility for educating paid preparers and taxpayers about the new requirements. In prior reports, we have discussed the importance of focusing on external communications as a key internal control standard and identified key practices for communicating with the public about a new initiative.²¹ In line with key practices for communicating with the public about a new initiative, IRS's communications team, for example, prepared an action plan, identified stakeholders to engage, and developed a standardized message that it distributed in different formats—by presentations at IRS Nationwide Tax Forums, executive talks to industry groups, and written correspondence with tax professionals. Consistent with established criteria for improving the usefulness of communication, the RPO Director said that IRS plans to develop secure online mailboxes for paid preparers that will be used for IRS-paid preparer communication.

The official leading IRS's communications team said that IRS has not yet developed a plan for how it will monitor and evaluate the success of its outreach efforts, a key practice for communicating with the public. Since the requirements are just beginning to be implemented, the effectiveness of the outreach campaign will not be known until after the requirements are implemented. Officials and members of paid preparer associations we interviewed said that IRS has conducted an effective outreach campaign. However, officials and members of one paid preparer association we interviewed worry that some paid preparers remain unclear about the applicability of the new requirements to certain types of paid preparers, and officials and members of two paid preparer organizations we interviewed said that some paid preparers have likely not heard of the new requirements.

²¹See GAO, *Internal Control Management and Evaluation Tool*, [GAO-01-1008G](#) (Washington, D.C.: Aug. 2001) and *Digital Television Transition: Increased Federal Planning and Risk Management Could Further Facilitate the DTV Transition*, [GAO-08-43](#) (Washington, D.C.: Nov. 19, 2007).

IRS Is Developing Strategies for How to Ensure Paid Preparer Compliance with the New Requirements

In its strategic plan for 2009-2013, IRS established strategies designed to help it meet its objective of ensuring that paid preparers adhere to *Circular 230* standards of practice and follow the law, including penalizing paid preparers who do not follow tax laws and leveraging research to identify fraudulent and noncompliant paid preparers.²² According to the RPO Director, IRS plans to implement initiatives intended to ensure paid preparers' compliance with the new requirements but has yet to make many decisions because it is waiting for information from the PTIN registration system that will allow it to implement effective initiatives.

During the first year after the PTIN requirement has been implemented, IRS plans to focus on bringing paid preparers into compliance and improving its communications and outreach, and not on penalizing paid preparers for noncompliance, according to the RPO Director. For example, the RPO Director said that IRS plans to contact paid preparers who file returns signed with an old PTIN, a SSN, or other identification number after the filing season is over. The RPO Director said that IRS will direct them to obtain a PTIN that will retroactively cover their practice during the recently completed filing season. The RPO Director also said that in cases of egregious noncompliance, such as paid preparers ignoring an IRS contact directing them to use a PTIN, IRS plans to contact paid preparers directly. IRS has the authority to penalize paid preparers who are required to but fail to include a PTIN on a tax return.²³

IRS has undertaken one initiative for ensuring paid preparer compliance with the new requirements and is evaluating other future compliance initiatives. IRS sent letters in November 2010 to 10,000 paid preparers to remind them of their responsibility to comply with requirements for paid preparers, including registering for a PTIN. According to officials involved in the implementation of the new requirements, IRS is visiting some of the paid preparers who received letters to confirm their compliance based on an analysis of IRS visits to paid preparers in 2010. An official involved with the implementation of the new requirements also said that IRS plans to evaluate the results of the visits. The RPO Director also said that IRS plans to identify individuals who prepare tax returns for others but do not sign the tax return as paid preparers, and is currently evaluating methods by which it might do so. Additionally, the RPO Director said that IRS seeks to

²²See IRS, *IRS Strategic Plan 2009-2013*, IRS Publication 3744.

²³26 U.S.C. § 6695(c).

develop a risk-based scoring model to maximize the efficacy of its compliance efforts.

IRS plans to launch a publicly accessible database of all registered paid preparers by January 31, 2014, so that taxpayers can check whether a paid preparer has registered. The RPO Director said that the database will likely include preparers' contact information, whether or not preparers have passed the competency test, professional credentials, and tax preparation legal problems, if applicable. The RPO Director also said that IRS will not launch the database until it is sure it has the capability to rapidly respond to any associated problems with the data because paid preparers mistakenly identified as noncompliant could be negatively affected financially.

IRS Is Funding the New Paid Preparer Program through User Fees, Which IRS Is Setting Consistent with Established Criteria

IRS is funding the administration of the paid preparer requirements through user fees for PTIN registration, competency testing, and continuing education.²⁴ IRS has only determined the user fee for PTIN registration so far, which is \$50 per PTIN.²⁵ IRS contracted with a vendor to establish and maintain the PTIN registration system, and the vendor will charge a \$14.25 fee, bringing the total fee for PTIN registration to \$64.25. In determining the level of the PTIN registration user fee, IRS has taken actions or made plans consistent with established criteria for setting user fees and using the resulting revenue. These criteria, which we identified in prior reports, include a set of key questions that should be considered when designing and implementing user fees and best practices for developing cost estimates.²⁶ Key questions to consider when designing and implementing a user fee are contained within four primary components: setting, collecting, using, and reviewing. Table 2 below shows key questions to consider when setting a user fee, key criteria for establishing a credible estimate of a program's costs, and IRS's actions in setting the PTIN registration user fee.

²⁴IRS is authorized to prescribe regulations establishing user fees for government services or things of value. 31 U.S.C. § 9701. User fees must be fair and be based on the cost to the government, the value of the service to the recipient, public policy or interest served, and other relevant facts. OMB *Circular No. A-25* establishes federal policy regarding user fees and provides guidance for agency implementation of these fees.

²⁵26 C.F.R. § 300.9.

²⁶See GAO, *Federal User Fees: A Design Guide*, [GAO-08-386SP](#) (Washington, D.C.: May 29, 2008) and *GAO Cost Estimating and Assessment Guide*, [GAO-09-3SP](#) (Washington, D.C.: Mar. 2009).

Table 2: Setting the PTIN Registration User Fee

Key questions and criteria	IRS action
How do users benefit from the program?	IRS determined that paid preparers benefit by being able to prepare returns, and thus IRS can charge a user fee for PTIN registration.
How will the fee be linked to costs?	
Develop estimating plan and define program characteristics	IRS documented key pieces of the PTIN registration program that will need to be funded, such as customer support and marketing, IT, compliance, operations support, and foreign paid preparer registration.
Determine estimating structure	IRS estimated PTIN registration program administration costs, including start-up, personnel, IT investment, and other related program costs.
Identify ground rules & assumptions	IRS estimated that there are between 900,000 and 1.2 million paid preparers, and that program costs are uncertain and could be higher or lower than estimated.
Obtain data and develop and document an estimate	IRS developed detailed spreadsheets of PTIN estimates based on cost data and documented a user fee to cover its total PTIN costs.
Present estimate to management	Treasury and OMB reviewed IRS's PTIN user fee cost-estimate.

Source: GAO and GAO analysis of IRS documents and interviews with IRS officials.

Note: Key questions and criteria are from *Federal User Fees: A Design Guide*, [GAO-08-386SP](#) and *GAO Cost Estimating and Assessment Guide*, [GAO-09-3SP](#).

IRS identified key costs associated with PTIN registration and grouped them into five categories: (1) foreign paid preparer registration processing, (2) paid preparer program compliance, (3) communications and customer support, (4) IT, and (5) operations support.

Approximately 75 percent of the costs IRS plans to cover with the PTIN registration user fee are variable and are contained within the two categories of foreign paid preparer registration processing and paid preparer program compliance, which includes tax compliance and criminal background screenings for paid preparers. To calculate the cost of foreign paid preparer registration processing, IRS estimated the number of PTIN registrants who will be foreign paid preparers and the cost to process each registration. To calculate the cost of screening paid preparers for tax compliance and a criminal background, IRS extrapolated to the paid preparer requirements the costs of screening individuals applying to become IRS e-File providers²⁷ for tax compliance and a

²⁷ IRS e-file providers are businesses or organizations authorized by IRS to participate in IRS's program to file taxpayers' returns electronically. Select individuals from these businesses or organizations must be listed on their applications, and IRS screens these individuals' tax compliance histories and criminal backgrounds.

criminal background. The RPO Director acknowledged that these estimates are uncertain and therefore the actual costs could be higher or lower.

Approximately 25 percent of the costs IRS is planning to cover with the PTIN registration user fee are fixed and are contained within the remaining three categories: communications and customer support, IT, and operations support. For these three categories, IRS estimated various component costs, including staff salary and benefits. IRS developed these cost figures assuming that as many as 1.2 million individuals will register for a PTIN, an estimate based on the number of individuals who signed tax returns as paid preparers in 2006 with a PTIN, SSN, or other identification number. IRS has acknowledged that this estimate is uncertain. Because these costs are fixed, their average will depend on the number of paid preparers who register for a PTIN.

In addition to setting the user fee, there are key questions that should be addressed when implementing a new user fee that cover collecting, using, and reviewing the fee. Table 3 shows IRS's actions to date, as well as planned actions, to address these key questions.

Table 3: Collecting, Using, and Reviewing the PTIN Registration User Fee

Key questions	IRS action
Collecting a user fee When should the user fee be collected, and can the collection system be structured to decrease administrative costs?	Paid preparers pay the user fee when they register for their PTIN online or by paper. IRS contracted with a vendor to manage the PTIN registration system.
Using a user fee How can the fee be used?	IRS has authority to use funds from the PTIN user fee to cover program costs. ^a
Reviewing a user fee How often is the fee reviewed, and what information is included in the review?	As required by OMB, IRS plans to review the user fee every two years.

Source: GAO and GAO analysis of IRS documents and interviews with IRS officials.

Note: Key questions and criteria are from *Federal User Fees: A Design Guide*, [GAO-08-386SP](#).

^aIRS has legislative authority to retain and spend user fees collected, provided the fees are based on the cost to IRS of providing a service. Treasury, Postal Service, and General Government Appropriations Act, 1995, Pub. L. No. 103-329 (Sept. 30, 1994), as amended by Pub. L. No. 109-115 § 209 (Nov. 30, 2005).

An official who helped to estimate the PTIN registration user fee acknowledged that the PTIN registration cost estimates are uncertain and subject to change. The official stated that IRS plans to conduct a first

review of the PTIN registration user fee in the summer of 2011. Additionally, the RPO Director said that IRS will be able to change the user fee following the review if actual costs are higher or lower than predicted.

IRS Has Not Documented a Framework for Using the Requirements to Improve Taxpayer Compliance and Measuring Their Effect

IRS has discussed but not documented a framework for how it plans to develop service and enforcement efforts that leverage the new paid preparer requirements to improve taxpayer compliance. Likewise it has not developed a framework for evaluating the effect of any planned service and enforcement efforts or the effect of the requirements themselves on improving taxpayer compliance. One of IRS's goals for the paid preparer requirements is to better leverage the tax preparer community to improve taxpayer compliance. The RPO Director shared with us ideas on how to achieve that goal. For example, according to the RPO Director, IRS plans to develop a comprehensive database containing information on paid preparers and the tax returns they prepare. IRS plans to use information from this database to test which strategies are most effective for improving the quality of tax returns prepared by different types of paid preparers.²⁸ Likewise, IRS has discussed how to measure the effect of the requirements, for example, the effects that requiring continuing education and testing have on tax return accuracy. In planning, the RPO has included other IRS divisions, such as the Small Business/Self-Employed division, which is responsible for examining tax returns, and the Research, Analysis, and Statistics unit, which will help monitor and evaluate whether the new requirements improve taxpayer compliance. Although IRS discussed with us its planned approaches for using the requirements to improve taxpayer compliance, it has not yet produced a document that lays out this approach. Likewise, as discussed previously, IRS has yet to decide how it will enforce paid preparers' compliance with the requirements.

Documenting a framework for using the requirements and measuring their effect is consistent with three steps we found leading public sector organizations take to increase the accountability of their initiatives: (1) define clear missions and desired outcomes; (2) measure performance to gauge progress; and (3) use performance information as a basis for

²⁸For more information on the management information system IRS will need to have in order to develop an enforcement strategy based on paid preparer data, see TIGTA, *It Will Take Years to Implement the Return Preparer Program and to Realize Its Impact*, 2010-40-127 (Washington D.C.: Sept. 30, 2010).

decision-making.²⁹ IRS has defined an overarching desired outcome of increasing taxpayer compliance and could increase its accountability by including the next two steps in a documented framework. Likewise, we have reported that it is important to develop assessment plans prior to full project implementation in order to ensure that the data necessary for evaluation are collected.³⁰ We also previously reported that we were unable to assess whether California's and Oregon's paid preparer requirements led to improved return accuracy because data were not available on return accuracy prior to the enactment of the requirements.³¹ Both IRS and we have acknowledged the importance of measuring performance, including using baseline data and having intermediate and end outcomes.³² Since the PTIN registration requirement has been implemented and IRS plans to implement the other requirements gradually, it is important for IRS to identify and collect baseline data to have a basis by which to measure the effect of the requirements, IRS's strategies to leverage the requirements to increase taxpayer compliance, and the strategies' relative costs. In addition, we have also reported that establishing a timeline that includes critical phases and essential activities that need to be completed by particular dates to achieve results is important for accountability. The timeline can help pinpoint performance shortfalls and gaps, suggest midcourse corrections, and demonstrate progress toward goals.³³

The RPO Director stated that IRS decided to begin implementing the requirements before determining how to use them to improve taxpayer compliance and measure their impact because it would take less time than waiting to implement all of the requirements until it documented its plans.

²⁹GAO, *Executive Guide: Effectively Implementing the Government Performance and Results Act*, [GAO/GGD-96-118](#) (Washington D.C.: June 1996).

³⁰GAO, *Tax Administration: Planning for IRS's Enforcement Process Changes Included Many Key Steps but Can Be Improved*, [GAO-04-287](#) (Washington D.C.: Jan. 20, 2004).

³¹GAO, *Tax Preparers: Oregon's Regulatory Regime May Lead to Improved Federal Tax Return Accuracy and Provides a Possible Model for National Regulation*, [GAO-08-781](#) (Washington D.C.: Aug. 15, 2008).

³²GAO, *Agency Performance Plans: Examples of Practices That Can Improve Usefulness to Decisionmakers*, [GAO/GGD/AIMD-99-69](#) (Washington D.C.: Feb. 26, 1999) and IRS, Internal Revenue Manual 1.5.1-5, *Process to Create a Performance Model for New (or Revised) Programs*.

³³GAO, *Results-Oriented Cultures: Implementation Steps to Assist Mergers and Organizational Transformations*, [GAO-03-669](#) (Washington D.C.: July 2, 2003).

As noted above, IRS's approach to implementing the requirements is sequential, so the details of its compliance strategy will not be known for some time. However, not documenting the basic framework being followed may create problems.

The lack of a documented framework may have negative repercussions for several reasons. First, without a documented framework, the various IRS divisions and offices involved in implementing the new requirements may have difficulty assessing whether there is a sound analysis plan and whether adequate plans are in place to collect the data needed to carry out the analysis. Without such assessments IRS is at risk of incurring additional evaluation costs by, for example, conducting unplanned data analyses, collecting irrelevant data, or failing to collect needed data in a timely manner.³⁴ Second, the RPO Director stated that IRS does not know when the comprehensive database on paid preparers will be completed because there are many competing priorities for IRS resources. A documented framework with proposed steps and a timeline could help IRS make more informed resource allocation decisions. Third, members and officials from paid preparer associations whom we interviewed stressed that it is essential for IRS to evaluate whether the requirements are improving taxpayer compliance, and some stated that the requirements will be worthwhile only if they result in an improvement. The impact of these requirements depends on the compliance of paid preparers and paid preparers bear the burden of complying with the requirements. Demonstrating to paid preparers that IRS will evaluate whether the requirements provide the benefit of improved taxpayer compliance could improve preparers' voluntary compliance with the requirements.

The framework will likely evolve over time and become more detailed. Initially, the framework may be a high level road map for achieving taxpayer compliance results sooner and perhaps at a lower cost and could include information on IRS's strategies and tactics for improving taxpayer compliance and what data need to be collected now. The framework may change as IRS assesses the effectiveness of the paid preparer requirements and future strategies for using the requirements to improve taxpayer compliance.

³⁴GAO, *Designing Evaluations*, [GAO/PEMD-10.1.4](#) (Washington D.C.: Mar. 1991).

Conclusions

IRS has made much progress in starting to implement the new paid preparer requirements, including educating paid preparers about the requirements, implementing the PTIN requirement, and developing a PTIN user fee. In order to launch this important initiative, IRS began implementing the requirements before laying out strategies for how to leverage them and measure their impact in an effort to realize benefits sooner. Implementation is under way, but IRS has not documented a framework for how to achieve the goal of improving taxpayer compliance. Without such a documented framework to guide its overall effort, IRS may not adequately or effectively identify and collect key baseline data now, modify its strategies to improve outcomes, allocate its resources most effectively given competing priorities, or maximize paid preparers' compliance with the requirements. Initially, the framework may not be detailed. Instead it may evolve as IRS develops and assesses additional strategies.

Recommendation for Executive Action

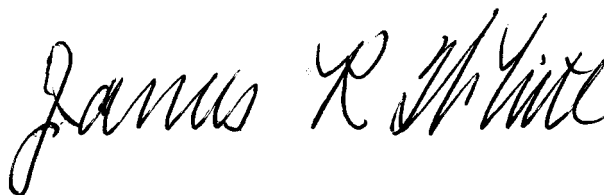
We recommend that the Commissioner of Internal Revenue document a strategic framework showing how IRS intends to use the paid preparer requirements to improve taxpayer compliance and assess their effectiveness.

Agency Comments

In a letter commenting on a draft of this report, IRS agreed with the recommendation. IRS stated that it has begun working on a strategic framework and plans for the final product to detail the overall mission, vision, and overall goals to ensure return preparer oversight will ultimately achieve improved taxpayer compliance and tax administration. IRS also provided technical comments, which we incorporated as appropriate. IRS's comments are reprinted in appendix II.

We are sending copies of this report to the Commissioner of Internal Revenue and other interested parties. The report is also available at no charge on the GAO Web site at <http://www.gao.gov>. If you or your staff have any questions about this report, please contact me at (202) 512-9110 or whitej@gao.gov. Contact points for our Offices of Congressional

Relations and Public Affairs may be found on the last page of this report.
Key contributors to this report are listed in appendix III.

A handwritten signature in black ink that reads "James R. White". The signature is written in a cursive style with a large, looped initial "J".

James White
Director, Tax Issues
Strategic Issues Team

Appendix I: Scope and Methodology

To describe IRS's plans for implementing and ensuring compliance with the new paid preparer requirements, we reviewed documents, including Treasury's proposed and final regulations containing the new requirements. Additionally, we interviewed officials from IRS's Return Preparer Implementation Project Office and Return Preparer Office (RPO) responsible for implementing the paid preparer requirements. To describe IRS's outreach campaign to inform paid preparers of the new requirements, we reviewed IRS documents on communication with external stakeholders and the public about the new requirements. Additionally, we interviewed the official responsible for leading IRS's communication with external stakeholders and the public. We analyzed this information against key communications internal control standards we identified in GAO's *Internal Control Management and Evaluation Tool* and key practices for communicating with the public about a new initiative that we identified in GAO's *Digital Television Transition: Increased Federal Planning and Risk Management Could Further Facilitate the DTV Transition*.¹

To assess IRS's resource estimates to develop and implement the new requirements, we reviewed IRS documents on the preparer tax identification number (PTIN) user fee that IRS is charging paid preparers for obtaining a PTIN and interviewed officials from the Return Preparer Implementation Project Office, RPO, and IRS's Chief Financial Officer's office. We examined this information using key questions that agencies should consider when developing and implementing user fees that we identified in GAO's *Federal User Fees: A Design Guide* and best practices that agencies should follow when developing cost estimates that we identified in GAO's *Cost Estimating and Assessment Guide*.² In table 2, we examined key questions to consider when setting a user fee and key criteria for establishing a credible estimate of a program's cost, and IRS's actions in setting the PTIN registration user fee. In table 3, we examined key questions to consider when collecting, using, and reviewing a user fee, and IRS's actions and planned actions in collecting, using, and reviewing the PTIN registration user fee. We determined whether IRS had considered

¹GAO, *Internal Control Management and Evaluation Tool*, [GAO-01-1008G](#) (Washington, D.C.: Aug. 2001) and *Digital Television Transition: Increased Federal Planning and Risk Management Could Further Facilitate the DTV Transition*, [GAO-08-43](#) (Washington, D.C.: Nov. 19, 2007).

²GAO, *Federal User Fees: A Design Guide*, [GAO-08-386SP](#) (Washington, D.C.: May 29, 2008) and *Cost Estimating and Assessment Guide*, [GAO-09-3SP](#) (Washington, D.C.: Mar. 2009).

the key questions and criteria and did not examine the appropriateness of the specific program costs that IRS plans to fund with the PTIN user fee.

To assess IRS's plans to use the requirements to improve taxpayer compliance and evaluate the effect of the paid preparer requirements, we reviewed IRS documents and interviewed Return Preparer Implementation Project Office and RPO officials. We examined this information using IRS's plans in the December 2009 *Return Preparer Review* and its guidance on measuring performance in the *Internal Revenue Manual Exhibit 1.5.1-5, Process to Create a Performance Model for New (or Revised) Programs*. We also examined this information using our past work on evaluating a program in *Agency Performance Plans: Examples of Practices That Can Improve Usefulness to Decisionmakers*; *Executive Guide: Effectively Implementing the Government Performance and Results Act*; *Tax Administration: Planning for IRS's Enforcement Process Changes Included Many Key Steps but Can Be Improved*; *Designing Evaluations*; *Results-Oriented Cultures: Implementation Steps to Assist Mergers and Organizational Transformations*; and *Tax Preparers: Oregon's Regulatory Regime May Lead to Improved Federal Tax Return Accuracy and Provides a Possible Model for National Regulation*.³

In addition, for all three objectives we interviewed members and officials of paid preparer associations that IRS had convened as industry stakeholders, which included the major types of paid preparers that IRS intended the requirements to cover. These associations were the American Bar Association, American Institute of Certified Public Accountants, National Association of Enrolled Agents, National Society of Accountants, and National Association of Tax Professionals. We also interviewed a representative from H&R Block, a retail tax return preparation chain that IRS consulted as part of an independent preparer panel and representatives of two additional return preparer associations, the

³GAO, *Agency Performance Plans: Examples of Practices That Can Improve Usefulness to Decisionmakers*, [GAO/GGD/AIMD-99-69](#) (Washington D.C.: Feb. 26, 1999); *Executive Guide: Effectively Implementing the Government Performance and Results Act*, [GAO/GGD-96-118](#) (Washington, D.C.: Jun. 1996); *Tax Administration: Planning for IRS's Enforcement Process Changes Included Many Key Steps but Can Be Improved*, [GAO-04-287](#) (Washington D.C.: Jan. 20, 2004); *Designing Evaluations*, [GAO/PEMD-10.1.4](#) (Washington D.C.: Mar. 1991); *Results-Oriented Cultures: Implementation Steps to Assist Mergers and Organizational Transformations*, [GAO-03-669](#) (Washington D.C.: Jul. 2, 2003); and *Tax Preparers: Oregon's Regulatory Regime May Lead to Improved Federal Tax Return Accuracy and Provides a Possible Model for National Regulation*, [GAO-08-781](#) (Washington D.C.: Aug. 15, 2008).

American Payroll Association and American Society of Pension Professionals and Actuaries, that included types of paid preparers that IRS, at the time, intended the requirements to cover. IRS has since decided that individuals who prepare only employee benefit plan returns are not covered by the requirements. We summarized the members' and officials' responses to a variety of questions about the paid preparer requirements.

We shared the criteria on which we based our descriptions and assessments in our three objectives with IRS during the course of our audit work.

We conducted this performance audit from July 2010 to March 2011 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 objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Appendix II: Comments from the Internal Revenue Service



DEPUTY COMMISSIONER

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

March 25, 2011

Mr. James R. White
Director, Tax Issues
U.S. Government Accountability Office
441 G Street, N.W.
Washington, DC 20548

Dear Mr. White:

I have reviewed your draft report entitled "Tax Preparer Regulations: IRS Needs a Documented Framework for Achieving Goal of Improving Taxpayer Compliance" (GAO-11336). I appreciate your recognition of our accomplishments to date in registering over 690,000 paid preparers, conducting an outreach program informing paid preparers of the new requirements and developing user fees using a methodology consistent with established criteria for cost estimating.

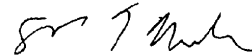
Paid tax return preparers prepare approximately 60 percent of all tax returns filed. In calendar year 2009, the IRS processed approximately 83,000,000 individual income tax returns prepared by paid tax return preparers. The IRS acknowledges the role that tax return preparers play in tax administration. As such, the IRS included the following objectives in its strategic plan: 1) strengthen partnerships with tax practitioners, tax return preparers, and other third parties in order to ensure effective tax administration; and, 2) ensure that all tax practitioners, tax return preparers, and other third parties in the tax system adhere to professional standards and follow the law. In June 2009, the Commissioner launched the Return Preparer Review to help accomplish these objectives. The IRS recommendations were shared in December 2009 in Publication 4832, Return Preparer Review. The new preparer requirements that GAO studied in this report were the result. We are committed to moving forward with implementation of all of the new return preparer requirements, including testing and continuing education, as effectively and expeditiously as possible.

We will take appropriate actions to address or further review issues as they are identified. We agree with your recommendation, and look forward to continued engagement by the Government Accountability Office. Our specific comments regarding your recommendation are enclosed.

2

If you have any questions, please contact me, or members of your staff can contact David R. Williams, Return Preparer Program, at (202)927-6428.

Sincerely,



Steven T. Miller
Deputy Commissioner for
Services and Enforcement

Enclosure

ENCLOSURE

Recommendation

The Internal Revenue Service should document a strategic framework showing how the IRS intends to use the paid preparer requirements to improve taxpayer compliance and assess their effectiveness.

Corrective Action

The IRS agrees with this recommendation and in fact began work on the strategic framework for return preparer oversight in September of 2010. The final product will detail the overall mission, vision, and overall goals to ensure return preparer oversight will ultimately achieve improved taxpayer compliance and tax administration.

Appendix III: GAO Contact and Staff Acknowledgments

GAO Contact

James White, (202) 512-9110

Acknowledgments

In addition to the contact person named above, Jeff Arkin, Assistant Director; Amy Bowser; Maya Chakko; Ellen Grady; Donna Miller; Cindy Saunders; and Dan Webb made key contributions to this report.

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