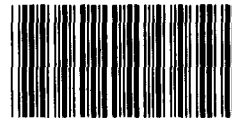


Report to the Chairman, Subcommittee on
Oversight, Committee on Ways and Means,
House of Representatives

February 1992

TAX
ADMINISTRATION

Federal Agency Tax
Compliance Problems
Remain; Improvements
Are Planned



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General Government Division**B-246833**

February 18, 1992

The Honorable J. J. Pickle
Chairman, Subcommittee on Oversight
Committee on Ways and Means
House of Representatives

Dear Mr. Chairman:

In your May 7, 1991, request you asked us to update the detailed analysis we provided you last year regarding the status of federal agency accounts in the Internal Revenue Service's (IRS) accounts receivable inventory.¹ This report contains (1) the updated information on federal agency receivables and (2) information on the status of the Secretary of the Treasury's efforts to implement our recommendations addressing federal agency tax compliance problems.²

Results in Brief

Our analysis of federal agency accounts in IRS' accounts receivable inventory on June 22, 1991, indicated that the tax payment and processing problems we had identified in our earlier review were still occurring. Although IRS' June 1991 accounts receivable inventory contained \$268.5 million in federal agency accounts receivable, this amount did not truly reflect how much money was actually owed by federal agencies.³ Instead, it largely reflected overstatements in IRS' accounts receivable inventory caused by tax payment and processing errors. On the basis of our analysis of the 12 largest agency receivables, we concluded that at least \$245.1 million, or 91 percent of the \$268.5 million in federal agency receivables, was attributable to tax payment and processing errors and did not reflect money owed. In fact, one agency's mistake caused a single erroneous assessment of \$212.4 million, or 79 percent of the total agency receivables. Preliminary data showed that 1 of the 12 agencies may ultimately have to pay about \$200,000 in late tax payments to resolve its account balance.

Late filing of employment tax returns was still prevalent. Of the 525 agency accounts in IRS' accounts receivable inventory on June 22, 1991, 270

¹IRS' Accounts Receivable Inventory (GAO/T-GGD-91-2, Oct. 18, 1990).

²Tax Administration: Changes Are Needed to Improve Federal Agency Tax Compliance (GAO/GGD-91-45, Apr. 16, 1991).

³This amount consisted of \$266.2 million in employment taxes, \$2.2 million in withholding on foreign persons' U.S. source income, and \$.1 million in excise taxes. Employment taxes include social security and unemployment taxes owed by employers and employees' social security and income taxes withheld for the government by employers.

accounts, or 52 percent, had 1 or more late filed employment tax returns. In our earlier work, we reported that two-thirds of the agencies' accounts we sampled had a late filed employment tax return. Not only is late filing of tax returns a measure of noncompliance by the agencies, but late filing of tax returns also impairs IRS' ability to detect late and insufficient payments and errors because IRS does not complete processing and reconciling tax information until a tax return has been filed for the quarterly period.

Our current analysis also showed that other problems we had previously identified continued to occur at the agencies and caused their accounts to show up in IRS' accounts receivable inventory. For example, checks issued by the Department of the Treasury for the payment of agencies' taxes continued to get lost as they moved through the Federal Tax Deposit (FTD) system. Agencies continued to make mistakes in paying their taxes and filing their quarterly tax returns, and the mistakes eventually showed up in their accounts at IRS. Likewise, IRS' mistakes in processing agency payments continued to result in erroneous receivables. (See table 1.)

Resolving erroneous receivables can take long periods of time. In fact, 17 of the 63 agency accounts with balances of \$100,000 or more in IRS' accounts receivable inventory from our previous study still had unresolved amounts due a year later. The majority of the unresolved accounts had been part of IRS' accounts receivable inventory for even longer periods. Many of them related to tax periods more than 5 years old. (See table 2.)

IRS, in conjunction with Treasury's Financial Management Service (FMS), has plans under way to change the way agencies make federal tax payments and file their quarterly employment tax returns. These plans, targeted to become effective in mid-1992, would implement our recommendation to allow agencies to make their tax payments electronically. The proposed procedures would also allow for electronic filing of the quarterly employment tax returns.

Background

In our October 18, 1990, testimony before your Subcommittee, we stated that the problems experienced by federal agencies and IRS in properly accounting for federal taxes were caused by agencies (1) making mistakes on their tax returns or filing them late and (2) using ill-designed and outdated processes to make tax payments. We stated that simpler procedures were needed for federal agencies to comply with their payment requirements, which are intragovernmental transfers of funds. From a broader perspective, we recommended that changes be made to the FTD rules for all

employers because private employers also have difficulty complying with them⁴.

In our previous work, we reviewed in detail the 63 federal agency accounts in IRS' accounts receivable inventory as of February 1990 with individual balances of \$100,000 or more. We did this review in order to gain an understanding of federal agencies' tax compliance problems. The 63 accounts had an aggregate balance of \$178 million, or 96 percent of the \$185 million in federal agency receivables in February 1990. Using masterfile transcripts—the official record of the agencies' accounts—we analyzed bookkeeping entries made in these accounts from late February 1990, the starting point for our analysis, through late August 1990, when we completed our work. We also obtained information on each account from IRS revenue officers and other IRS officials knowledgeable about the accounts. We found that IRS' records were inaccurate because the vast majority of the \$178 million in accounts receivable had already been paid. Most of the receivables were the result of processing errors associated with paying taxes and filing tax returns. We did, however, find that agencies owed \$4.3 million for six of the accounts.

Under current procedures, government finance centers and disbursing offices are to issue checks on behalf of the agencies for their taxes. The checks are to be sent to a Federal Reserve Bank accompanied by FTD coupons that show the type of tax and the period for which the payment applies. The Federal Reserve Bank is to submit agency payment information and the FTD coupons to IRS so that the agencies' accounts can be updated. This type of payment system has a great potential for error because of the number of paper documents that must remain intact as they move through the payment process. A lost check, for instance, can cause an agency's account to be underpaid at IRS. Tracing lost checks can be an arduous process involving the agency, IRS, the Federal Reserve Bank, and the government finance center or disbursing office that issued the check. Some misplaced checks have not been found, and the agency ultimately has to submit a replacement check to clear its account at IRS.

On the basis of the work we did for the October 18, 1990, congressional testimony, we recommended in April 1991 that the Secretary of the Treasury coordinate governmentwide efforts to improve federal agency tax processing. Our recommendations stated that these efforts should include procedures to (1) allow electronic interagency tax payments, (2) tailor notices to federal agency tax situations and inform agencies of account

⁴Simplifying Payroll Tax Deposit Rules (GAO/T-GGD-91-59, July 24, 1991).

adjustments, (3) provide training programs for agencies' staff involved in making tax payments and filing tax returns, and (4) develop methods to promote accountability by top agency management for compliance with tax laws and regulations.

Objectives, Scope, and Methodology

As the Subcommittee requested, our objectives were to (1) analyze that portion of IRS' accounts receivable inventory pertaining to federal agencies, (2) determine which federal agency accounts remained unresolved from our previous study, and (3) comment on the status of actions to implement the recommendations in our April 1991 report to the Secretary of the Treasury and determine if additional measures were needed.

To analyze IRS' federal agency accounts receivable, we obtained from IRS masterfile extracts of all agencies that had balance due accounts in its receivables inventory as of June 1991 and August 1991. The masterfile extracts summarized tax return information for each agency account, including tax periods and corresponding dollar amounts. We used these masterfile extracts to monitor the disposition of all balance due accounts over \$100,000—51 accounts—from June 1991 to August 1991. The 51 accounts totalled \$263.9 million, or 98 percent of the \$268.5 million in federal agency accounts receivable. From these 51 accounts, we selected the 12 largest accounts with balances exceeding \$1 million each for detailed analysis. For the 12 accounts, we obtained IRS fact sheets describing the nature of the receivable and the proposed disposition. The fact sheets were prepared by IRS officials knowledgeable about the receivables. To obtain additional information about the causes of the receivables and their statuses, we obtained IRS masterfile transcripts and discussed the accounts with IRS officials. IRS officials also provided us with information on agencies with late filed tax returns as of June 22, 1991.

We also determined which of the 63 federal agency accounts we reviewed last year remained in the accounts receivable inventory a year later. We used information from last year's study as of August 21, 1990, the ending date for that study, to ascertain the agencies' names and account information. We used IRS masterfile extracts for August 24, 1991, to update information from the accounts in last year's study. August 24, 1991, was the last date we received tax return information from IRS for this update.

To determine the status of actions to implement the recommendations in our April 1991 report to the Secretary of the Treasury, we interviewed IRS officials. A Treasury official told us IRS was taking the lead in implementing

the recommendations. While interviewing IRS officials, we obtained relevant documentation to support actions currently cited as being implemented or planned.

Internal Revenue Code section 6103 precludes the public disclosure of tax return information, including the identity of the taxpayer, without the taxpayer's authorization. During the course of our previous work, the Subcommittee staff obtained authorizations from the federal agencies to allow public disclosure of their tax return information. The authorizations covered the disclosure of return information pertaining to tax returns through tax year 1990 in connection with the October 18, 1990, hearing and related matters, which include this report on agency tax compliance issues. The names of agencies that signed waivers authorizing disclosure of return information are shown in this report. The Subcommittee staff did not request waivers from agencies that were not covered in our previous work; therefore, we have not shown the names of these agencies.

We discussed the contents of this report with IRS. IRS' comments dealt primarily with the status of their efforts to implement the recommendations we made in our earlier report. We have incorporated IRS' comments in this report.

We did our work from June 1991 through October 1991 in accordance with generally accepted government auditing standards.

Federal Agency Tax Compliance Problems Are Still Occurring

IRS' accounts receivable inventory for June 22, 1991, included \$268.5 million in accounts receivable from federal agencies compared to \$185 million in February 1990 from our previous study. The results of our current work were similar to the results we reported previously. Both studies showed that IRS' records on the agencies' accounts contained many errors that caused the accounts to become part of the accounts receivable inventory, thereby giving the appearance that agencies had not paid their taxes. The errors occurred for a variety of reasons. However, they were mainly attributable to the cumbersome paper-based processes used to make payments and to meet filing requirements.

In this study, we monitored the disposition of the 51 federal agency accounts in IRS' accounts receivable inventory on June 22, 1991, with individual balances exceeding \$100,000. For these accounts, the aggregate receivable balance of \$263 million in June 1991 had fallen to \$27.1 million by August 1991. We selected the 12 largest accounts for in-depth analysis

to gain insights about the nature and causes of the receivables and to determine how they might possibly be resolved. Each of the 12 accounts had a balance exceeding \$1 million. The 12 accounts totalled \$252.9 million, or 94 percent of IRS' receivables from federal agencies on June 22, 1991. The receivables were caused by tax compliance problems similar to those we identified in our earlier work. For example, agencies continued to file their quarterly tax returns late; checks were lost; agencies made mistakes in completing required paperwork; and IRS' processing errors caused accounts to be in error. Table 1 summarizes information on the 12 accounts we reviewed. The table also shows the dollar value of the receivables on October 11, 1991, the date we last obtained return information from IRS pertaining to these accounts.

Table 1: Federal Agency Receivables Over \$1 Million on June 22, 1991

Dollars in thousands

Agency	Account balance		Causes of receivable	Disposition	Number of tax periods involved	Number of tax returns filed late
	6/22/91	10/11/91				
1	\$212,386	\$0	Agency error	Tax abated	1	0
2	12,231	0	Agency error	Tax abated	3	2
3	9,311	1,091	^a	^a	3	2
4	3,850	0	Agency error	Tax abated	2	2
5	2,543	1,036	^b	^b	5	3
6	2,358	0	Agency error	Tax abated	1	1
7	2,223	0	Lost check	Check reissued	2	1
8	2,115	2,111	^c	Unresolved	3	0
9	2,011	2,011	Agency error	^d	2	0
10	1,564	0	Federal Reserve Bank error	Tax abated	1	0
11	1,202	651	IRS & agency errors	^e	4	4
12	1,061	1,022	Lost check	Unresolved	2	2
Total	\$252,855	\$7,922			29	17

^aThis receivable was the result of IRS and agency errors and a missing check. The balance on 10/11/91 was the unresolved amount after IRS made various adjustments to the account to correct previous posting errors. IRS officials stated that the agency would reissue a check to clear the remaining balance.

^bThis receivable was due to errors made by IRS and the agency in applying tax payments and a lost check. IRS made adjustments for errors, which partially resolved this receivable.

^cThis receivable arose because withholdings by the agency on foreign persons' U.S. source income was less than the persons' actual liability when the agency's tax return was processed.

^dAccording to IRS, after account adjustments are made to correct errors, this agency may make a \$200,000 late tax payment to clear its account balance.

^eThis receivable was reduced by IRS adjustments for errors. Because the agency has not filed all of the quarterly employment tax returns that have been due, there were available payments recorded in the account that may offset current receivables.

As table 1 shows, most of the federal agency receivables were being resolved by IRS adjustments to correct errors and erroneous assessments and not by the agencies paying money for late taxes. In fact, one single adjustment of \$212.4 million to correct an agency's error was 79 percent of the \$268.5 million in agency receivables. Of the six agencies in the table with unresolved accounts as of October 11, 1991, only one may ultimately have to pay late taxes to clear its account. When we ended our work, IRS officials were still reviewing this account to determine the exact amount due, which was estimated to be about \$200,000. These results are similar to the conclusions from our previous work in which the majority of the

receivables were resolved through adjustments and abatements and not by late tax payments.

Late filing of employment tax returns was still widespread among federal agencies for periods covered by this review. Overall, 270 accounts, or 52 percent of the federal agency accounts in IRS' accounts receivable inventory on June 22, 1991, had 1 or more late filed tax returns. Table 1 also shows that 8 of the 12 agencies with the largest account balances did not comply with the requirements for timely filing of their quarterly tax returns. The 12 agencies filed returns late for 17 of 29 quarterly tax periods. Late filing is a measure of noncompliance that hinders IRS' ability to detect late and insufficient payments and errors because IRS does not complete the processing of tax information until a return has been filed for the quarterly period.

Most Agency Receivables From Last Year's Inventory Have Been Resolved

In our previous work, we analyzed information pertaining to the 63 largest federal agency accounts in IRS' accounts receivable inventory in February 1990. On the basis of IRS' records, each account owed \$100,000 or more in employment taxes. The aggregate balance due for all 63 accounts was \$178 million. As we reported at the October 18, 1990, congressional hearing, \$145.6 million of these receivables had been resolved by late August 1990. The majority of this amount—\$141.3 million—was resolved by IRS abatements and adjustments. In addition, six agencies made additional tax payments of \$4.3 million to clear their account balances.

As part of our current work, we obtained updated information on the agencies' accounts comprising the \$34.5 million in receivables that remained from last year's study. The updated information is shown in table 2. As the table shows, the receivables declined from the \$34.5 million in August 1990 to about \$2.4 million a year later. The table also shows that many of the unresolved amounts as of August 1991 related to tax periods over 5 years old. One of the accounts had unresolved taxes relating to 1982. Several accounts had unresolved taxes associated with tax year 1983. We did not do further analysis of these quarterly tax periods to determine why they were not resolved. However, as our previous work showed, IRS revenue officers had difficulty understanding account activity because of the volume and complexity of bookkeeping entries.

Table 2: Account Balances of Federal Agencies in IRS' Accounts Receivable Inventory on August 21, 1990, as of August 24, 1991

Agency and location	Tax period	Balance	
		8/21/90	8/24/91
U.S. Army			
Fort Drum, N.Y.	12/87	\$224	\$0
	9/89	453,511	0
Fort Dix, N.J.	9/83	144,502	153,835
	3/84	11	0
	12/85	1,029	0
	12/89	516,383	0
Dover, N.J.	3/85	180,265	182,822
	12/85	12	12
	9/87	581	0
	9/88	1,459	730
	9/89	921	0
	12/89	3,840	14
Aberdeen, Md.	6/87	44	44
Havre de Grace, Md.	9/87	1,520	0
APO New York, N.Y.	3/84	29,966	0
Washington, D.C.	6/88	262,639	0
	12/87	18,601	6,002
	12/88	16,520	0
	12/85	4,065	0
Fort Benning, Ga.	9/89	261	0
	12/86	2,551	0
San Francisco, Calif.	3/89	760,008	477
APO New York, N.Y.	12/85	779	0
APO New York, N.Y.	3/86	134,859	148,814
	12/83	1,354	962
	9/84	88	0
	6/85	9,945	0
	12/85	3,918	9,307
	9/82	46,946	0
	6/86	560,650	0
	9/86	620,750	0
U.S. Air Force			
Washington, D.C.	12/88	4,265,374	0
	3/88	33	0
	3/89	2,816	0
Vandenberg, Calif.	9/83	502,097	0
	6/84	382	0
	9/85	462	0
	3/86	1,269	0

(continued)

Agency and location	Tax period	Balance	
		8/21/90	8/24/91
	12/87	1,386	0
	12/88	52	0
APO Miami, Fla.	6/86	196,671	196,671
	6/87	190,114	190,114
APO San Francisco, Calif.	12/87	303,137	0
	12/83	24	0
	12/84	5,660	0
	3/86	1,137	0
	12/86	5,220	0
	12/89	3,809	0
APO New York, N.Y.	12/83	68,103	67,353
	12/85	4,909	0
APO San Francisco, Calif.	9/85	156,357	0
APO San Francisco, Calif.	12/86	1,024,040	0
	6/83	39,844	0
APO New York, N.Y.	12/86	523,147	7,396
	12/84	2,535	2,535
	12/87	5,393	5,393
	12/88	2,634	1,196
	3/89	1,027	1,027
U.S. Navy			
Cleveland, Ohio	9/89	13,077	0
Dahlgren, Va.	12/89	1,486,914	0
San Diego, Calif.	12/86	354,108	0
FPO New York, N.Y.	6/84	40,757	0
	12/87	53,950	0
	9/89	177,177	163,523
FPO San Francisco, Calif.	12/84	4,832,695	0
	12/86	122	0
Lakehurst, N.J.	3/88	778,802	0
	6/88	808,004	0
Charleston, S.C.	9/89	2,501	0
	12/86	6,549	0
U.S. Marine Corps			
Camp LeJeune, N.C.	3/83	126,125	126,080
Albany, Ga.	6/89	118,379	0
Department of Defense			
Columbus, Ohio	12/86	7,818	5,096
APO New York, N.Y.	6/88	608,002	0
	12/88	284,946	0
	6/89	354,920	354,920

(continued)

Agency and location	Tax period	Balance	
		8/21/90	8/24/91
Agana, Guam, M.I.	3/89	188,391	165,446
	12/88	78,218	7,873
Columbus, Ohio	12/89	191,273	0
	3/89	62,635	0
	6/89	97,711	0
Department of State			
Arlington, Va.	12/86	2,396,331	0
APO San Francisco, Calif.	9/84	398,728	397,378
	6/88	291	0
	6/84	4,497	0
U.S. Department of Education			
Washington, D.C.	3/85	1,408,005	0
Department of Commerce			
Germantown, Md.	12/83	4,580,583	0
	9/84	323,844	0
Federal Bureau of Investigation			
Washington, D.C.	9/89	2,829,768	0
	12/89	648,003	0
USAID El Salvador, APO			
Miami, Fla.	3/89	10,970	10,718
	12/89	130	130
No waiver ^a	3/87	153,087	141,331
	6/87	1,823	1,823
	3/89	933	933
	6/89	1,010	1,010
	2/89	270	0
Total		\$34,517,181^b	\$2,350,965

Note: Each listing represents a separate employment tax account for the agency shown.

^aFor this account, the agency involved did not provide a waiver to disclose tax return information.

^bSome of these agencies have overpayments and credit balances for tax periods not shown totalling \$2 million.

Source: IRS masterfile records.

Status of Efforts to Implement GAO Recommendations to Improve Federal Agency Tax Compliance

In recognizing that the problems experienced by federal agencies and IRS in properly accounting for federal taxes require a governmentwide solution, we recommended that the Secretary of the Treasury take the lead to coordinate such efforts with FMS, IRS, and the agencies. Listed below are the recommendations we made to the Secretary of the Treasury and a

summary of actions under way or planned to address these recommendations.

Streamlining Federal Agency Tax Payment Processing Through Electronic Interagency Funds Transfer

Plans are under way to allow federal agencies to submit all their federal tax payments currently made through the FTD system via the Government On-Line Accounting Link System (GOALS) using a specially tailored version for on-line payments. Tax payments entered on the system will be immediately transferred from the agency's Treasury account to IRS for posting. The proposed system, which is expected to be operational in mid-1992, would also allow agencies to electronically file their quarterly employment tax returns. Potential benefits of the proposed system include reduction in paper flow, elimination of the need for agency FTD coupons, elimination of the need for paper Treasury checks, and the ability of IRS to better track and report delinquent and missing agency payments by status messages on computer screens and hard copy reports. In addition, the proposed system will have built-in controls to prevent or eliminate some of the errors that are so prevalent under the payment and filing methods currently being used.

This proposed electronic payment system is limited to agencies currently linked to GOALS. Agencies not currently linked to GOALS may not use the proposed new procedures because extensive system and program changes could be required by them. The Department of Defense (DOD), for example, may not adopt the proposed new procedures for this reason. DOD agencies make about one-half of all federal agency tax payments. If DOD and other agencies not linked to GOALS continue to use the current paper-based system, tax compliance problems of the nature we describe in this report will likely continue for them. Our work did not include an analysis of system and program changes necessary for all agencies to use the proposed electronic payment and filing procedures.

Enhancing the Clarity of IRS Notices to Agencies and Informing Agencies of Account Adjustments

IRS has taken some actions that are indirectly related to this recommendation. For example, the assignment of a federal agency coordinator in each service center to specifically deal with the agencies' tax concerns is a step that should result in better communications between agencies and IRS about matters pertaining to notices and account adjustments. IRS has also developed new procedures to identify and resolve large dollar errors on returns before assessment of tax. In addition, under the proposed electronic payment and filing procedures, delinquent status

messages will be shown on the delinquent agency's computer screen as a way of informing agencies that they need to deal with discrepancies.

IRS plans to continue sending agencies hard copy notices as is currently being done. Although we believe that IRS actions thus far will assist in addressing federal agencies' tax concerns, further action is needed to specifically address issues relating to notice clarity and informing agencies of account adjustments.

Providing an IRS Training Program for Agency Staffs Involved in Making Tax Payments and Filing Returns

IRS has not fully implemented this recommendation. However, National Office officials have been discussing options for governmentwide training programs and are planning for the training to begin in October 1992. In absence of a National Office program, one IRS regional office has initiated its own program for training agencies. In addition, IRS' Taxpayer Service and Collection Divisions have given training to federal agency employees responsible for the tax matters of agencies located overseas.

Developing Methods to Promote Greater Accountability by Agency Management for Compliance With Tax Laws and Regulations

This recommendation has not been implemented by IRS' National Office. IRS, in coordination with Treasury and the Office of Management and Budget, is considering using the Fiscal Year 1992 Federal Managers' Financial Integrity Act (FMFIA) reviews as the vehicle for implementing methods for promoting greater accountability by top agency managers for compliance with tax laws and regulations. FMFIA reviews annually assess the adequacy of agency internal controls and focus on areas deemed to be vulnerable to abuse. Payroll processing, including compliance with tax laws, could be covered by these reviews.

Conclusions

In our April 1991 report on federal agencies' tax compliance problems, we said that governmentwide efforts are needed to resolve them. Since that time, IRS has developed an action plan specifically tailored to address the tax problems of federal agencies. IRS' action plan includes steps to deal with our earlier recommendations. Because the action plan is not yet fully implemented, IRS' accounts receivable inventory still contains millions of dollars in erroneous receivables from federal agencies, which require that IRS and the agencies spend their valuable resources correcting them. The errors are primarily attributable to the cumbersome paper-based processes used to make tax payments and to meet filing requirements.

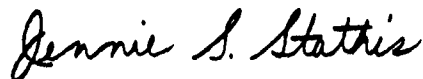
We recognize that IRS and FMS have plans under way that, when implemented, will help alleviate erroneous agency receivables. We believe that the proposed electronic payment and filing procedures offer promise in stemming the occurrence of erroneous receivables from the agencies who will use it. Because all agencies may not use the proposed new procedures, tax compliance problems are likely to continue for IRS and those agencies using the current procedures.

IRS needs to follow through on plans to fully implement our earlier recommendations. We believe that as IRS continues to adopt measures to implement our recommendations, the tax compliance problems of federal agencies should diminish greatly.

As arranged with the Subcommittee, unless you publicly announce its contents earlier, we plan no further distribution of this report until 30 days from the date of this letter. At that time, we will send copies to the Secretary of the Treasury, the Commissioner of Internal Revenue, and other interested parties. We will make copies available to others upon request.

Major contributors to this report are listed in appendix I. If you or your staff have any questions, please call me on (202) 275-6407.

Sincerely yours,



Jennie S. Stathis
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