GAO

United States General Accounting Office

Report to the Committee on the Budget
U.S. Senate

July 1992

TAX ADMINISTRATION

Congress Needs More Information on Compliance Initiative Results

147313

GAO/GGD-92-118

GAO

United States
General Accounting Office
Washington, D.C. 20548

General Government Division

B-249396

July 31, 1992

The Honorable Jim Sasser
Chairman
The Honorable Pete Domenici
Ranking Minority Member
Committee on the Budget
United States Senate

You asked us to monitor the Internal Revenue Service's (IRS) tracking of three compliance initiatives that were funded as part of IRS' fiscal year 1991 appropriation. The three initiatives were designed to (1) increase collection staff so that IRS could collect additional delinquent accounts (the collection initiative), (2) increase examination staff so that IRS could audit more returns (the examination initiative), and (3) revise IRS' training program for revenue agents so that experienced staff could spend less time training new staff and, as a result, more time doing audits (the training initiative).

On January 30, 1992, we issued a fact sheet that discussed the interim results of our work so that the Committee could use them in deliberating IRS' fiscal year 1993 budget request.[1] As agreed with your offices in April 1992, we continued our work so that we could (1) assess the reasonableness of IRS' latest revenue projections for the initiatives that IRS prepared between January and March 1992 and (2) identify any limitations in IRS' tracking of the results of the three initiatives.

Background

IRS' fiscal year 1991 appropriation included $191 million for 3,476 additional staff to implement 9 compliance initiatives that were expected to produce an additional $5.7 billion in enforcement revenue during the 5-year period ending with fiscal year 1995. The 3 initiatives that are the subject of this report accounted for $140 million of the appropriation, 2,226 of the additional staff, and $3.2 billion of the estimated revenue.

In developing its initial 5-year revenue target for the collection and examination initiatives, IRS used various productivity assumptions and applied those assumptions to the initiative staffing increases. IRS derived the 5-year target for the training initiative by subtracting the opportunity costs of training 1,500 agents annually using IRS' previous training program from the opportunity costs of training those agents using a revised training

[1]Tax Administration: IRS' Implementation of Certain Compliance Initiatives (GAO/GGD-92-45FS, Jan. 30, 1992).

program.[2] This revised training program was intended to reduce opportunity costs by (1) replacing some IRS revenue agent instructors with contract trainers and (2) restructuring the program to reduce the amount of time new revenue agents and revenue agent instructors spend in training.

To track the results of the collection and examination initiatives, IRS first projected baseline staffing that should have been available in each of the 5 years and the amount of revenue such a level of staffing should generate. IRS then compared that estimate with actual staffing and the revenue actually achieved, attributing the difference to the initiatives.[3] This amount is then compared to the revenue targets for the initiatives.

In a September 1990 report, we discussed IRS' plans for tracking the results of these initiatives and cautioned that the reliability of IRS' tracking system depended on the validity of the baseline staffing levels.[4] We also discussed the importance of disclosing to Congress the extent of and reasons for any erosion to baseline staffing. We said it did little good for Congress to approve additional staffing with the intent of generating additional revenue if that benefit is eroded by reductions to baseline staffing. Therefore, for Congress to assess the effects of staffing increases, it needs to know how and why the baseline has changed.

The Assistant Commissioner (Finance)/Controller is responsible for tracking the results of the fiscal year 1991 compliance initiatives. During fiscal year 1991, his office issued monthly reports showing IRS' progress in meeting its initiative targets. These reports were distributed to the Senate and House Appropriations Committees and the Senate Committee on the Budget. For fiscal year 1992, the reports have been prepared quarterly and, according to IRS officials, will be distributed to these same congressional committees beginning with the June 30, 1992, quarterly report.

Results in Brief

IRS' latest revenue projection for the three initiatives that we reviewed is $2.4 billion—25 percent less than the original revenue target that was

[2]Opportunity costs are the potential revenue that is unrealized when experienced revenue agents, who would otherwise be auditing returns, are used to train new staff.

[3]For the examination initiative, IRS' "actual revenue" is an estimate of how much revenue will be collected as a result of the additional tax dollars it recommends from its audits. For the collection initiative, actual revenue is the total dollars that are collected from taxpayer delinquent accounts.

[4]Tax Administration: IRS' Improved Estimates of Tax Examination Yield Need to Be Refined (GAO/GGD-90-119, Sept. 5, 1990).

included in the President's fiscal year 1991 budget submission.[5] More than half of this reduction is attributable to the collection initiative. IRS could not provide complete documentation on how the original 5-year revenue target for this initiative was calculated. However, according to IRS, this reduction resulted from a combination of staffing reductions, changes in productivity assumptions, and failure to account for the costs associated with using experienced staff to train new hires.

Even with the changes made to account for changing circumstances, IRS' quarterly tracking reports do not provide Congress and other interested parties with enough meaningful information on the impact of providing the additional staff that was authorized in the fiscal year 1991 initiatives. Rather than reporting the difference between an estimated, changing baseline and actual results (which in some cases are estimated), IRS needs to report total staffing levels achieved and total revenue generated. In this way, Congress can assess what is actually being achieved over a period of time. In addition, IRS needs to report and explain the reasons for any differences in what Congress expected and what IRS actually achieved.

Objectives, Scope, and Methodology

Our objectives were to assess the reasonableness of IRS' latest revenue projections for the three initiatives and identify limitations, if any, in IRS' tracking of initiative results. To assess the reasonableness of IRS' latest revenue projections for the three initiatives, we interviewed IRS officials and reviewed, to the extent they were available, documents explaining IRS' revenue estimation methodology for fiscal years 1991 and 1992 to determine whether any changes were made and if so, the reasons for those changes.

To determine whether tracking limitations existed, we (1) analyzed IRS' methodology for developing its baseline staffing and revenue targets and projections for fiscal years 1991 and 1992 and (2) reviewed fiscal year 1991 and 1992 tracking reports that showed data on staffing and revenue results.

We did our work at IRS' National Office within the Examination and Collection functions, which are responsible for implementing the three initiatives, and the Finance Division, which has day-to-day responsibility for tracking initiative results for the Assistant Commissioner

[5]IRS' quarterly tracking reports show IRS' latest projections, which are adjusted revenue estimates, based on its current experience with implementing the initiatives.

(Finance)/Controller. We also did work on the implementation of the training initiative at IRS' Midwest Region.

In a July 22, 1992, letter (see app. II), IRS' Assistant Commissioner (Finance)/Controller provided written comments on a draft of our report. He generally agreed with our recommendations and provided technical comments. These comments are incorporated where appropriate in the report.

We did our work between May 1991 and May 1992 in accordance with generally accepted government auditing standards.

IRS' March 1992 5-Year Revenue Projection Is $809 Million Less Than Original Target

IRS' March 1992 5-year revenue projection for the training, examination, and collection initiatives is $809 million (25 percent) less than the original target. When IRS submitted its fiscal year 1991 budget request, it said that the three initiatives would result in an additional $3.21 billion in revenue.

In commenting on a draft of our report, IRS said initiative results are being tracked against the February 1991 target of $2.425 billion, which is shown in table 1, because these targets more accurately reflect the funding level that was ultimately provided for initiatives. Initiative funding was reduced in fiscal year 1991 to cover unbudgeted costs and account for delays in receiving the fiscal year 1991 appropriation. IRS' quarterly tracking reports show IRS' current revenue projections. These projections, which are also shown in table 1, indicate that IRS may fall short of its revised target for these three initiatives by $26 million.

Table 1: Original and Revised Revenue Targets and Latest Revenue Projection for Fiscal Years 1991 Through 1995

Dollars in millions

Initiative	President's 1991 budget submission	February 1991	March 1992
Training	$518	$492	$409
Examination	1,082	819	854
Collection	1,608	1,114	1,136
Total	**$3,208**	**$2,425**	**$2,399**

Source: IRS data.

Appendix I provides additional information on reasons the targets changed, the assumptions used in determining the latest revenue projections, and reasons IRS may not meet its most recent revenue projections.

Congress Needs More Information to Adequately Assess Initiative Results

IRS' current tracking reports do not provide Congress with the information it needs to assess the net effect of the staffing increases it authorized in fiscal year 1991. Specifically, the reports focus on revenue gained from initiative staff without accounting for the revenue lost when baseline staffing levels are reduced.

Fiscal Year 1992 Baselines for Collection and Examination Initiatives Are Lower Than in 1991

As shown in table 2, to track fiscal year 1992 results, IRS has reduced its staffing and revenue baselines for the collection and examination initiatives.

Table 2: Baselines for Tracking Collection and Examination Initiatives

Dollars in billions

Initiative	1991 baseline for staffing	1992 baseline for staffing	1991 baseline for revenue	1992 baseline for revenue
Collection	14,257	14,151	$7.618	$6.324
Examination	15,190	15,045	2.770	2.682

Source: IRS data.

The baseline staffing estimates for the collection and examination initiatives have been reduced by 106 and 145 staff, respectively, as measured by full-time equivalents (FTE). According to IRS officials, these reductions were part of larger staffing reductions that were made to examination and collection programs in fiscal years 1991 and 1992 to, among other reasons, accommodate changing program priorities and the need to fund unbudgeted costs.

In addition to reducing the fiscal year 1992 baseline staffing estimates for these two initiatives, IRS also reduced the baseline revenue estimates. We had some concerns about the procedure IRS used to calculate the fiscal year 1992 baseline revenue estimate of $6.324 billion for the collection initiative. IRS' finance officials said that the 1992 baseline revenue estimate for the collection initiative was developed by first projecting baseline revenue of $7.601 billion and discounting it by about 17 percent. Collection officials could not provide the specific data used to determine the initial estimate of $7.601 billion. The officials' inability to provide support for this estimate stemmed in part from staff turnover in the office that developed the estimate and from a lack of documentation on how the baselines were derived.

This lack of documentation existed despite IRS' recognition of the importance of a clear and accurate description of its revenue estimation methodology. In an October 1990 report, IRS discussed planned improvements to its system for estimating enforcement revenue.[6] The report said that each enforcement function would prepare and regularly update a comprehensive description of the methods and models used to estimate enforcement revenue. This description was to include an explanation of the various assumptions that were made and the nature of the data used. On the basis of the difficulties we encountered, it appears that IRS has not met the documentation standard it set for itself in the 1990 report.

Once the baseline estimate was developed, it was discounted by about 17 percent—something that was not done for purposes of tracking initiative results in fiscal year 1991. According to IRS officials, this discount was to account for collections that resulted from other IRS enforcement efforts, such as audits done by IRS' examination function. Using this rationale, however, it would seem that most baseline delinquent tax collections would be discounted since delinquent tax liabilities are usually identified by other IRS enforcement programs. For that reason, we do not believe baseline revenue should be discounted. We discussed our concern with IRS officials and they agreed. They told us that the baseline revenue estimate will be revised in the tracking report for the quarter that ended June 30, 1992.

Irs' Tracking Methodology Does Not Reflect Revenue Impact of Baseline Staffing Reductions

Logically, if reductions occur in baseline staffing, some loss of baseline revenue may also occur. To the extent that the fiscal year 1992 baselines were reduced to account for actual staffing reductions from fiscal year 1991, IRS' tracking methodology does not provide for offsetting the revenue loss that may result. For example, we estimate (using IRS' productivity assumptions for dollars collected per FTE) that a 106 FTE baseline reduction in collection staff could produce a reduction of $56 million in baseline revenue—thereby offsetting some of the revenue that may be gained from the initiative in fiscal year 1992.

[6]Evaluation of the IRS System of Projecting Enforcement Revenue (1990 Update), Department of the Treasury, IRS report (Washington, D.C.: October 1990).

Conclusion

The revenue impact of providing IRS with additional enforcement staff is the focus of much congressional debate, particularly as Congress seeks to reduce the federal deficit. Thus, it is important for Congress to understand the net impact of the additional staff it authorizes. As we have said in the past, it does little good for Congress to approve additional staffing with the intent of generating additional revenue if that benefit is eroded by reductions to baseline staffing.

IRS' current tracking system focuses on the revenue gained from the initiative staffing increase but does not account for reductions in revenue that occur as a result of reductions to baseline staffing. IRS needs to track the total picture so that Congress can assess the net effect of its initiative staffing increases.

Furthermore, in the past, IRS has recognized the importance of documenting its methodology, assumptions, and the data it uses to develop its revenue estimates. Yet, IRS did not follow this standard for its collection initiative.

Recommendations

We recommend that the Commissioner of Internal Revenue report the net revenue effect of the staffing increases that Congress authorized in fiscal year 1991 to congressional oversight, budget, and appropriation committees. In doing so, IRS needs to revise its tracking approach so that it (1) compares the total examination and collection staffing levels that Congress authorized in fiscal year 1991 and the total revenue Congress expected from that authorization to the total examination and collection staffing levels and revenue that IRS actually achieved and (2) explains the reasons for the differences in what Congress expected and what IRS actually achieved.

Furthermore, the Commissioner should direct the Assistant Commissioner for Collection to review the revenue estimation methodology for the collection function to ensure that its assumptions and the data that are used for computing revenue estimates are valid and adequately documented.

Agency Comments

In commenting on a draft of our report, IRS pointed out that its quarterly tracking reports were prepared in accordance with guidance jointly developed by IRS and the Department of Treasury's Office of Tax Analysis and that these reports were intended to show the revenue collected from the initiative and not total revenue yield. However, IRS agreed that the needs of Congress and other interested parties would be fully met with a tracking approach that focuses on the net effect of staffing increases and their impact on total revenue.

Copies of this report are being sent to the Secretary of the Treasury, the Commissioner of Internal Revenue, and the Director of the Office of Management and Budget. We will also make copies available to others upon request.

Major contributors to this report are listed in appendix III. Please contact me on (202) 275-6407 if you or your staffs have any questions.

Jennie S. Stathis

Jennie S. Stathis
Director, Tax Policy and
Administration Issues

Reasons for Changes to the Original 5-Year Revenue Target and Assumptions for the Latest Revenue Projections

IRS First Reduced the 5-Year Revenue Target in February 1991

IRS revised its 5-year revenue target for the three initiatives in February 1991—from the $3.21 billion in the President's fiscal year 1991 budget submission to $2.42 billion. Of that $790 million decrease, almost $500 million, or 63 percent, was for the collection initiative.

About $112 million of the $500 million reduction resulted from changes in the collection initiative's first-year revenue target. On the basis of our review of the information that IRS could provide on its original target for fiscal year 1991, it appears that the first-year target was reduced to account for the following factors. First, IRS did not factor in opportunity costs associated with using experienced collection staff to train new hires. Second, a reduction was made to the amount of revenue collected by new staff on the assumption they were working on cases with lower dollar values. Third, IRS reduced the number of staff it hired for this initiative. As we reported in January 1992, IRS made reductions to its original initiative staffing levels to cover unbudgeted fiscal year 1991 costs.

The remaining reductions applied to that part of IRS' target relating to fiscal years 1993-95. We were unable to identify the reasons for these reductions. This inability stemmed from the fact that IRS could not provide data to show how it calculated the original target for fiscal years 1992-95. In commenting on a draft of our report, IRS said that the targets for the outyears (1993-95) were reduced for the same reasons as the first-year target.

Assumptions Used for Latest 5-Year Revenue Projection

IRS' current 5-year revenue projection is $2.40 billion. This projection, at least in part, reflects IRS' experience with the initiatives in fiscal year 1991. That reduction was actually the net result of a decrease in the training initiative and increases in the examination and collection initiatives.

IRS currently estimates that the training initiative will realize $409 million through fiscal year 1995, or $83 million less than the February 1991 target of $492 million. That reduction resulted from changes in certain assumptions. As a result of its experiences in fiscal year 1991, for example, IRS now assumes that the proportion of contract instructors used to train new hires will be one in three instead of the two in three that IRS originally assumed. Also, no additional revenue agents will be trained in fiscal year 1992 because of a hiring freeze. IRS' February 1991 revenue target was based on the hiring of 1,500 revenue agents per year to fill attrition vacancies.

IRS may not meet its current 5-year revenue projection for the training initiative because it is falling short of its fiscal year 1992 revenue projection of $21 million. IRS may have difficulty reaching that projection because (1) through the first half of the fiscal year 1992, IRS reported that it had saved only a little more than a third ($8 million) of the projection and (2) IRS had not hired as many contract instructors as planned. Specifically, as of March 31, 1992, of the 109 instructors used in classroom training during the first half of fiscal year 1992, only 24 (or 22 percent) were contractors rather than the 36 (or 33 percent) that IRS had assumed it would hire. When IRS uses more revenue agents as instructors, the opportunity costs associated with training new staff are higher.

IRS' latest projection for the examination initiative is $35 million higher than the February 1991 revenue target, increasing the amount from $819 million to $854 million. According to IRS officials, the projection is higher than the target because revenue agent productivity has increased.

IRS' latest projection for the collection initiative of $234 million is about $23 million higher than the revised target. However, that projection is based on 943 FTEs instead of the 905 FTEs that were originally allocated for this initiative. We asked IRS officials why this initiative was allocated more staff than originally planned. Upon further review of the staffing allocation, IRS officials agreed that the number of staff should be reduced. IRS said the correct staffing level is 909 FTEs and the revenue projection will be revised in the tracking report for the quarter that ended June 30, 1992.

Comments From the Internal Revenue Service

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

ASSISTANT COMMISSIONER
(FINANCE)/CONTROLLER

JUL 22 1992

Hazel E. Edwards
Associate Director
Tax Policy and Administrative Issues
United States General Accounting Office

Dear Ms. Edwards:

Thank you for the opportunity to comment on the draft report to Chairman Sasser, Senate Budget Committee, on IRS' tracking of three FY 1991 Compliance Initiatives.

One of GAO's primary findings is that the FY 1991 Compliance Initiatives Tracking Report does not include the effects of changes to baseline staffing on revenue receipts. While we see the value to Congress of such data, this was not one of the Service's objectives when designing the report. Requirements for this system were developed jointly by Treasury's Office of Tax Analysis and the IRS in order to track the initiative increments only. We believe the system and related reports achieve that objective. Consequently, the draft report's findings in this area of baseline results might more properly be considered recommendations for the future. We see the value in focusing on the net effect in total rather than just the initiative, and support altering tracking systems along those lines.

We agree that there is still room for improvement in our documentation procedures. IRS has progressed significantly in the last two years in providing more comprehensive methodology descriptions on estimating revenue but recognize the need for further improvement.

Our detailed technical comments regarding the report are attached. If your staff has questions regarding these comments, they may contact Jerry Jones or Gary Peyser.

Sincerely,

Carl Lee Moravitz

for C. Morgan Kinghorn

Attachment

Revenue Reporting:

Throughout their report, GAO expressed serious concern that the IRS revenue tracking report does not provide sufficiently meaningful information that Congress can use to assess the net impact of additional staffing it authorizes. GAO recommends that the Commissioner should reconsider the approach we take in tracking reports.

We support GAO's concern and see value in preparing a report that addresses the revenue impacts of the overall IRS, rather than just reporting revenue at the margin.

Before proceeding on possible future reporting requirements, GAO should not lose sight of the fact that our quarterly tracking reports have been prepared in accordance with guidance jointly developed by Treasury's Office of Tax Analysis (OTA) and IRS. The information contained in this report attempts to describe the impact of the initiatives on additional revenue collected. For resource initiatives, it is basically looking at the revenue collected at the margin. This method satisfies OTA's primary objective of providing the details necessary for them to score the compliance initiatives. It was not the intent of Treasury to track and report on the overall revenue yield.

We agree the needs of Congress, OMB, or GAO would be fully met with an approach that focuses on the net effect in total rather than just the initiative. The IRS would still prepare revenue estimates for any new initiative in order for OTA to score them. However, for tracking purposes the initiative staffing and resulting revenue will be reported at a total level (i.e., the baseline plus initiative together). We envision three reports. The first report would be produced at the beginning of the fiscal year and display total staffing levels as appropriated by Congress along with the underlying assumptions associated with the estimated revenue amounts projected for that particular fiscal year. A second report would be produced at the end of the first quarter after completion of the financial plan, including new estimates based on the staffing levels included in the financial plan, reasons for changes in staffing, revenue impact, and actuals to-date. An end-of-the-year report would show actual results for the entire fiscal year and provide analysis on the differences between the various measures reported in the first report and the final report.

Besides providing Congress, OMB, and GAO with the type of information they need to assess how overall staffing changes impact on revenue, this approach would allow the IRS to make better decisions. By requiring revenue impact estimates for any potential shift in enforcement staffing, the managers would have more information from which to base their decisions.

Tracking Targets:

For the FY 1991 President's Budget, former Commissioner Goldberg committed the IRS to a five year goal of collecting an additional $9.4 billion between FY 1991 and FY 1995 through implementation of the FY 1991 Compliance Initiatives. After some restructuring, the final goal for five management initiatives and seven resource initiatives became $9.8 billion of collected dollars. This figure included the impact of the late start in FY 1991 caused by delayed action on our FY 1991 budget. We were requested by then Assistant Secretary for Tax Policy, Ken Gideon, to track and report on the results of these initiatives.

After eighteen months, through March 1992, nearly $6.5 billion has been collected toward the $9.8 billion five-year goal shared with Congressional committees in February 1991, and toward our current estimate of $11.8 billion for the management and resource initiatives combined.

The GAO report concentrates its efforts on only three of these resource initiatives. Throughout the report it is not clear as to what the revenue targets are. The targets to which the IRS is tracking actual results against are as follows:

	FY 1992	FY 1991-95
Collection	$211.2M	$1113.6M
Field Audit	6.0M	818.8M
Training	41.9M	492.0M

The IRS prepares updated current estimates on a quarterly basis. Based on current conditions, we will not meet the contractor training initiative targets displayed above. The major reason for the shortfall is that a reduced budget did not enable us to hire the expected number of attrition replacements. As for the Collection's Accounts Receivable initiative, based on only six months of actual results in FY 1992, it is still too early to tell if we will meet the target of $211.2 million.

Documentation:

GAO expressed concern over the lack of sufficient documentation despite IRS' recognition of the importance of a clear and accurate description. GAO references our October 1990 report which discusses our planned improvements for documenting the methodology used for estimating enforcement revenue.

For the most part, we have prepared comprehensive descriptions of the methods and models used and identified the assumptions and data sources. Only in the case of Collection's initiative did GAO identify any limitations on the documentation, with most of the problems arising out of lack of documentation of the original estimate prepared in the spring of 1990.

IRS recognizes that our standard for documentation, although refined over the past two years, still needs improvement.

Technical Issues:

Now on p. 6.

(1) **17% Discount Factor** (pages 7-8): We apply a 17% discount factor to Collection's revenue to eliminate any double counting of revenue that is also counted by Examination, the Information Returns Program, and Collection's Delinquent Returns Program. The five-year initiative targets were based on application of this factor. In reporting during FY 1991, we applied the 17% factor against the initiative only. During FY 1992, we have applied it against both the baseline and the initiative. After recent review, we concluded that further research needs to be conducted prior to deciding on how elimination of double counting should be resolved. Therefore, until that determination, we will apply the factor only against revenue from the initiative.

Section was deleted. There is no new page number.

(2) **FY 1991 Collection Results** (page 9): The approach taken by GAO in reporting how our Collection initiative faired in meeting the FY 1991 target of $38 million fails to explain our thought process. Our overall target for the accounts receivable program in FY 1991 was to collect $7,656 million (baseline plus initiative). Actual overall results were $7,613 million, about one-half of one percent below the target. Taking the approach that the initiative will share in the actuals in the same proportion as it did in the target, the initiative's share of the actuals, after rounding, is $38 million. Thus, following this reasoning, the FY 1991 target was met. It should be noted that this particular issue would not surface if we were tracking total revenue rather than the initiative only.

Now on p. 11.

(3) **Collection's staffing level** (pages 12-13): The FY 1992 target of $211.2 million for the collection initiative was based on a staffing level of 905. Our current estimate of $234.0 million is based on a 943 staffing level. After recent investigations, IRS determined that calculation errors contributed to the derivation of an incorrect staffing figure of 943; the correct staffing level is 909. Revised estimates for FY 1992 and the outyears will be prepared and reported in the next tracking report, as of June 30, 1992. Again, this issue would not surface if we were tracking total staffing rather than the initiative only.

Now on p. 10.

(4) **Reduction in Collection's Revenue Estimates** (Appendix I, pages 16-17): GAO cited three major reasons for the $112 million reduction (in FY 1991) from the original estimate of $1,608.4 million to the target of $1,113.6 million: (1) including opportunity costs associated with training new hires; (2)

assuming new hires would work lower dollar cases; and (3) reducing the number of staff hired. Due to lack of detailed documentation for the outyears, GAO was unable to identify the reasons for the remaining reductions of about $383 million. The same reasons listed for the FY 1991 reduction also apply for the outyears. Applying these same conditions to the outyears, it can be concluded that our five-year target is reasonable.

Major Contributors to This Report

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