

GAO

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2007 TAX FILING SEASON

Interim Results and Updates of Previous Assessments of Paid Preparers and IRS's Modernization and Compliance Research Efforts

Statement of James R. White
Director
Strategic Issues

Statement of David A. Powner
Director
Information Technology Management Issues





Highlights of [GAO-07-720T](#), testimony before the Committee on Finance, U.S. Senate

Why GAO Did This Study

The Internal Revenue Service's (IRS) tax filing season performance is a key indicator of how well IRS serves taxpayers. This year's filing season was expected to be risky because of tax system changes, including the telephone excise tax refund (TETR) which can be requested by all individuals and entities that paid the excise tax. GAO was asked to describe IRS's service to taxpayers so far this filing season (including the impact of this year's tax systems changes). GAO was also asked to provide updates of previous assessments of the performance of paid tax preparers, IRS's efforts to modernize its information systems, and what IRS is doing to better measure taxpayer compliance. GAO compared IRS's filing season performance to prior years' and goals and based analyses of paid preparers, information systems, and compliance research efforts on recent reports.

What GAO Recommends

GAO is not making any new recommendations, but notes relevant past recommendations and their implementation status.

www.gao.gov/cgi-bin/getrpt?GAO-07-720T.

To view the full product, including the scope and methodology, click on the link above. For more information, contact James R. White at (202) 512-9110 or whitej@gao.gov.

2007 TAX FILING SEASON

Interim Results and Updates of Previous Assessments of Paid Preparers and IRS's Modernization and Compliance Research Efforts

What GAO Found

IRS's interim filing season performance is improved in some areas. The number of individual income tax returns processed to date is comparable to last year, and the number filed electronically is almost 6 percent greater. Taxpayers' ability to reach an IRS telephone assistor was somewhat less than last year, but the accuracy of answers to taxpayers' questions was about the same. Use of IRS's Web site increased, important because it is available 24 hours a day and is less costly than some other types of assistance. However, there have been challenges. Taxpayers' use of the Free File program, which provides free tax preparation and electronic filing through IRS's Web site—is 5.2 percent below last year at this time. Also, the Customer Account Data Engine (CADE), a modern tax return processing system, became operational 2 months behind schedule. IRS still expects to post 17 -19 million taxpayer accounts to CADE, which is about two and a half times more than last year. Tax systems changes have not had a significant effect on filing season performance. For example, IRS has received a fraction of the TETR-related telephone calls it expected to date.

Because paid preparers prepared over 62 percent of all individual income tax returns last year, they are a critical quality control for tax administration by helping to prevent noncompliance. Last year, GAO reported to this Committee about errors made by paid preparers. Some of the most serious errors involved not reporting business income and failing to itemize deductions. GAO's limited work last year did not permit observations about the quality of the work of paid tax preparers in general and undoubtedly, many preparers do their best to prepare tax returns that are compliant with tax laws. In response to GAO's report, IRS has scheduled compliance reviews of some preparers. In addition, recent Justice Department suits to stop fraudulent return preparation at more than 125 outlets of one preparation chain for allegedly taking part in tax preparation scams highlight the importance and obligations of paid preparers.

Despite progress made in implementing Business Systems Modernization projects, including CADE, and improving modernization management controls and capabilities, significant challenges and serious risks remain. Delays in the latest release of CADE resulted in continued contention for key resources and will likely impact future releases. Also, IRS has more to do to fully address GAO's prior recommendations such as developing a long-term strategy that would include timeframes for retiring legacy computer systems.

GAO has long supported IRS's research to better understand taxpayers' compliance. IRS's fiscal year 2008 budget request includes a proposal for annual research instead of larger but intermittent efforts. GAO considers this to be a good approach because it will allow compliance data to be continually refreshed and should reduce costs by eliminating the need to plan new studies every few years.

Mr. Chairman and Members of the Committee:

We appreciate this opportunity to support your oversight of the Internal Revenue Service (IRS) and the broader tax administration system.

The annual tax return filing season is when IRS provides much of its service to taxpayers. From January through April, IRS will process well over 100 million individual tax returns and issue refunds, handle tens of millions of phone queries from taxpayers, and provide forms and answers to questions for tens of millions of taxpayers on its Web site. Smaller numbers of taxpayers will be assisted at IRS's walk-in sites or at sites operated by other organizations and staffed by volunteers.

While it is always a massive undertaking, the IRS Commissioner stated that this year's filing season is high risk for several reasons, including challenges in implementing the new telephone excise tax refund (TETR), split refund option (refunds can now be directly deposited to up to three separate accounts), and several tax law extensions that were enacted in December of 2006.¹

We have reported that IRS has made significant progress improving taxpayer service since the passage of the IRS Restructuring and Reform Act of 1998 (RRA 98),² including increased electronic filing, better access to IRS's telephone assistors, and more accurate answers to taxpayers' questions. The progress has been due, in part, to IRS bringing modern information systems on line. However, we have also described taxpayer service challenges including the quality of assistance at walk-in and volunteer sites, delays in some new information systems, and fully implementing our prior recommendations on the management of systems acquisition and development.

¹ The Tax Relief and Health Care Act of 2006 signed into law in December 2006 extended some provisions that expired at the end of calendar year 2005. These changes include extensions of three tax deductions: (1) state and local sales tax, (2) higher education tuition and fees, and (3) educator expenses. Pub. L. No. 109-432, Dec. 20, 2006.

² See, for example, GAO, Tax Administration: *IRS Improved Some Filing Season Services, but Long-term Goals Would Help Manage Strategic Trade-offs*, [GAO-06-51](#) (Washington, D.C.: Nov. 14, 2005), *Internal Revenue Service: Assessment of the Interim Results of the 2006 Filing Season and Fiscal Year 2007 Budget Request*, [GAO-06-615T](#) (Washington, D.C.: Apr. 6, 2006), and *Tax Administration: Most Filing Season Services Continue to Improve, but Opportunities Exist for Additional Savings*, [GAO-07-27](#) (Washington, D.C.: Nov. 15, 2006).

In addition to the IRS, tax administration in the U.S. relies heavily on the private sector including the paid preparer industry, the tax preparation software industry, and third parties who withhold taxes or submit information returns. Last filing season, over 60 percent of returns were prepared by paid preparers, and another one-fourth use commercial tax preparation software.

IRS's Business Systems Modernization (BSM) program, a multibillion-dollar, high-risk, highly complex effort for delivering modern information systems, is critical to supporting IRS's taxpayer service and enforcement goals and reducing the tax gap.³

The ultimate goal of taxpayer service is to help taxpayers understand and comply with their tax obligations. However, we have reported that IRS lacks quantitative estimates of the impact of taxpayer service on voluntary compliance by taxpayers as well as on the impact of enforcement on compliance. As a necessary first step to gaining more understanding of the impact of service on compliance, we have strongly supported IRS's ongoing National Research Program (NRP) to measure compliance and estimate the tax gap.

As agreed, our statement will describe IRS's service to taxpayers so far this filing season (including the impact of this year's tax system changes) and provide updates of previous assessments of the performance of paid tax preparers in our tax administration system, IRS's ongoing efforts to modernize its information systems, and what IRS is doing to better measure taxpayer compliance with the tax laws including the impact of service on compliance.

To assess IRS's filing season performance for processing, telephones, face-to-face assistance and its Internet Web site, we obtained and analyzed IRS's performance and production data and compared it to annual goals and prior years' performance. Our work also included direct observations of key filing season operations, and interviews with IRS officials and external stakeholders.

³ The tax gap is an estimate of the difference between what taxpayers pay in taxes voluntarily and on time and what they should pay under the law. IRS estimated the gross tax gap to be \$345 billion for tax year 2001. After late payments by taxpayers and revenue brought in by IRS's enforcement efforts, the resulting net tax gap is estimated to be \$290 billion.

Our work was done primarily at IRS's National Office operating divisions, the Joint Operations Center in Atlanta, Ga. and processing centers and call sites in Atlanta, Ga. and Andover, Ma. We reviewed relevant external documentation, our reports, and reports of the Treasury Inspector General for Tax Administration (TIGTA). Our analyses of Internet return preparation and electronic filing options, TETR compliance, BSM, and NRP is based upon the results of our recent reports.⁴ We reviewed IRS's efforts to address our prior year recommendations related to our annual filing season, paid preparer, and BSM work.

In past work, we assessed IRS's filing season performance data. We considered filing season performance measures and data to be objective and reliable based on our prior work. Since sources and procedures for producing this year's data have not significantly changed from prior years, we determined that the data were sufficiently reliable for the purposes of this report. Data limitations are discussed where appropriate. We performed our work from December 2006 through March 2007 in accordance with generally accepted government auditing standards.

In summary, we make the following major points:

- IRS's interim filing season performance is improved in some areas, although there have been challenges. As of March 30, 2007, IRS had processed 76.8 million individual income tax returns and issued over 68 million refunds, about the same number as last year. The number of returns filed electronically was almost 6 percent greater than this time last year. However, taxpayers' use of the Free File program, accessible through IRS's Web site and which allows for free on line tax preparation and electronic filing, is 5.2 percent below last year at this time. IRS's latest release of the Customer Account Data Engine (CADE), a modern tax return processing system that issues faster refunds, was delayed—it became operational 2 months behind schedule. IRS expects to post approximately 17 – 19 million taxpayer returns to CADE in 2007. Although this is less than the 33 million

⁴ See, for example, GAO, *Taxpayer Service: State Experiences Indicate IRS Would Face Challenges Developing an Internet Filing System with Net Benefits*, [GAO-07-570](#) (Washington, D.C.: Apr. 5, 2007), GAO, *Tax Administration: Telephone Excise Tax Refund Requests Are Fewer Than Projected and Have Had Minimal Impact on IRS Services*, [GAO-07-695](#) (Washington, D.C.: Apr. 11, 2007), GAO, *Business Systems Modernization: Internal Revenue Service's Fiscal Year 2007 Expenditure Plan*, [GAO-07-247](#) (Washington, D.C.: Feb. 15, 2007) and GAO, *Tax Compliance: Multiple Approaches Are Needed to Reduce the Tax Gap*, [GAO-07-488T](#) (Washington, D.C.: Feb. 16, 2007).

planned, it is almost two and a half times the approximately 7.4 million taxpayer accounts posted last year on CADE. With respect to taxpayer service, call volume continued to decline, taxpayers' ability to reach an IRS assistor was somewhat less than last year, but the accuracy of answers to taxpayers' questions was about the same as last year. Use of IRS's Web site continues to increase, important because it is available around the clock and is lower cost than most other types of assistance. About 69 percent of individual income tax returns filed to date included TETR requests. The impact of TETR on taxpayer services has been much less than IRS anticipated. For example, IRS has received a fraction of the TETR-related telephone calls it expected to date.

- Because they help the majority of taxpayers prepare their returns, paid preparers are a critical quality control checkpoint for the tax system. Last year, over 62 percent of all individual income tax returns were prepared by paid preparers. However, we reported to this Committee last year about errors made by paid preparers.⁵ In visits to 19 outlets of several commercial chain preparers, we found that paid preparers made mistakes in every one of our visits, with tax consequences that were sometimes significant. Some of the most serious problems involved preparers not reporting business income and failing to itemize deductions at all or failing to claim all available deductions. The limited data did not permit observations about the quality of the work of paid tax preparers in general. Undoubtedly, many paid preparers do their best to provide their clients with tax returns that are compliant with the tax law. IRS has initiated some enforcement actions in response to our findings with audits of some preparers' returns scheduled to begin in April 2007. Recent Justice Department suits to stop fraudulent return preparation at more than 125 outlets of one preparation chain for allegedly taking part in preparation scams highlight the obligations of paid preparers. Their due diligence has the potential to prevent noncompliance and reduce IRS's cost and intrusiveness.
- IRS continues to make progress in implementing BSM projects and meeting cost and schedule commitments, but two key projects—CADE (discussed above) and Modernized e-File (a new electronic filing system)—experienced significant cost overruns during 2006. Future BSM project releases face serious risks, which IRS is working to mitigate. For example, delays in deploying the latest release of CADE have resulted in contention for key resources and will likely impact the

⁵ GAO, *Paid Tax Return Preparers: In a Limited Study, Chain Preparers Made Serious Errors*, GAO-06-563T (Washington, D.C.: Apr. 4, 2006).

design and development of the next two important releases, which are scheduled to be deployed later this year. IRS has made significant progress in implementing our prior recommendations and improving its modernization management controls and capabilities. However, critical controls and capabilities related to requirements development and management and post-implementation reviews of deployed BSM projects have not yet been fully implemented. In addition, more work remains to be done by the agency to fully develop a long-term vision and strategy for completing the BSM program, including establishing time frames for consolidating and retiring legacy systems.

- Continued compliance research is essential to IRS's ability to effectively focus its service and compliance efforts, and we have long been a supporter of such research. Well-designed compliance research gives IRS and Congress an important measure of taxpayer compliance and it allows IRS to better target enforcement resources towards noncompliant taxpayers. IRS's fiscal year 2008 budget request includes a proposal for a rolling sample of individual returns (small annual samples that would replace larger but intermittent efforts) and a dedicated cadre of examiners to review the returns. We consider this to be a good approach to refreshing research compliance data because doing compliance studies once every few years does not provide information in the intervening years. A rolling sample should also reduce costs by eliminating the need to plan new studies every few years.

IRS's Filing Season Performance Is Improved in Some Areas with Challenges in Others, and the Effect of Tax System Changes Has Been Minimal

IRS's key filing season efforts are processing electronic and paper individual income tax returns and issuing refunds, as well as providing assistance or services to taxpayers. As already noted, processing and assistance were complicated this year by three tax system changes: TETR, the split refund option, and enactment in December 2006 of tax law changes.

Returns Processing Is Comparable to Last Year, Despite Delays with CADE and Implementation of Tax System Changes

From January 1 through March 30, 2007, IRS processed 76.8 million returns, about the same number as last year, and issued 68.3 million refunds for \$163.4 billion compared to 66.7 million refunds for \$154.4 billion at the same time last year. Over 69.3 percent of all refunds were directly deposited into taxpayers' accounts, up 6.2 percent over the same time last year. Direct deposits are faster and more convenient for taxpayers than mailing paper checks.

According to IRS data and officials, performance is comparable to last year. IRS is meeting most of its performance goals, including deposit error rate, which is the percentage of deposits applied in error, such as being posted to the wrong tax year. Groups and organizations we spoke with, including the National Association of Enrolled Agents, the American Institute of Certified Public Accountants, and a large tax preparation company, corroborated IRS's view that filing season performance is comparable to last year.

CADE Will Expedite Refunds for Millions of Taxpayers, but Delays in Implementation Caused Millions More Not to Benefit

IRS uses two systems for storing taxpayer account information—the antiquated Master File legacy system and CADE. The latest release of CADE became operational in early March, 2 months behind schedule because of problems identified during testing. IRS had originally planned to post 33 million taxpayer returns to CADE and the remaining 100 million individual returns on the legacy system. However, as a result of the delay, officials expect to post approximately 17 -19 million taxpayer returns to CADE. Although this is significantly less than planned, it is almost two and a half times the approximate 7.4 million taxpayer accounts posted last year on CADE. Taxpayers eligible for a refund this year whose returns are posted to CADE will benefit from CADE's faster processing, receiving their refunds 1-5 days faster for direct deposit and 4-8 days faster for paper checks than if their return had been processed on the legacy system. The remaining 14 – 16 million returns that were to have been processed on CADE were instead processed by the legacy system and thus did not receive the benefit of faster refunds. The CADE setback may impact IRS's ability to deliver the expanded functionality of future versions of CADE, thus delaying the transition to the new processing system (discussed further in the BSM section of this testimony).

Electronic Filing is Higher than Last Year, Despite a Decline in the Free File Program

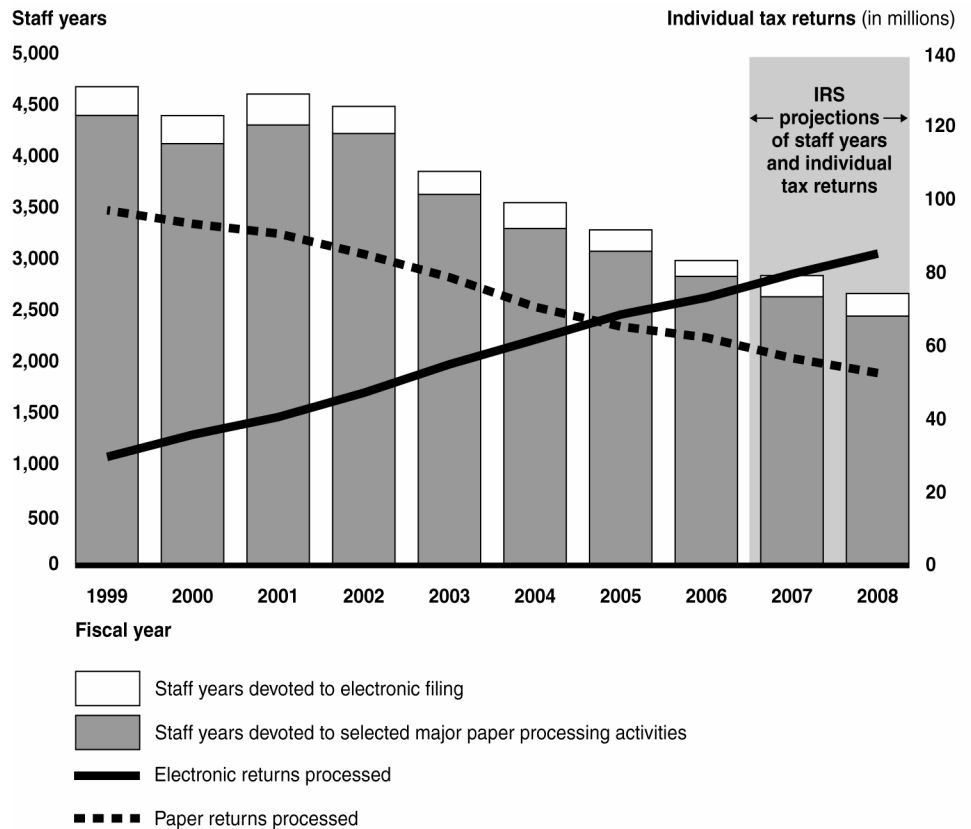
The growth rate for electronic filing is up from the same period last year. As of March 30, over 56.9 million (74.1 percent) of all individual income tax returns were filed electronically. This is up 5.8 percent over the same time last year, and an increase over the previous years' growth of 3.3 percent.

We previously reported that state mandates for electronic filing of state tax returns also encourage electronic filing of both state and federal tax returns and last year, we suggested that Congress consider mandating electronic filing by paid tax preparers meeting criteria such as a threshold for number of returns filed.⁶ Last year, electronic filing of federal returns increased 27 percent for the three states (New York, Connecticut, and Utah) with new 2006 mandates. This year, state mandates are likely to continue to show a positive effect on federal electronic filing because, with the addition of West Virginia, 13 states now have state mandates.

Compared to processing paper returns, electronic filing reduces IRS's costs by reducing staff devoted to processing. In 2006, IRS used almost 1,700 (36 percent) fewer staff years for processing paper tax returns than in 1999, shown in figure 1. IRS estimates this saved the agency \$78 million in salary, benefits, and overtime in 2006. Electronic filing also improves service to taxpayers. Returns are more accurate because of built-in computer checks and reduced transcription errors (paper returns must be transcribed in IRS's computers—a process that inevitably introduces errors). Electronic filing also provides faster refunds.

⁶ GAO-07-27.

Figure 1: Number of Individual Returns and IRS Staff Years for Individual Paper and Electronic Processing, Fiscal Years 1999 – 2008



Source: GAO analysis of IRS data.

Notes: Staff years and full-time equivalents are units of measurement that are often used interchangeably. According to IRS, a full-time equivalent is the equivalent of one person working full-time for one year with no overtime. A staff year includes overtime. Therefore, the cost of one staff year is equal to the cost of one full-time equivalent plus overtime. Projections for 2007 do not include Form 1040 EZ-Ts.

Although electronic filing continues to grow, taxpayers' use of the Free File program continues to decline.⁷ The Free File program, accessible through IRS's Web site, is an alliance of companies that have an agreement with IRS to provide free on-line tax preparation and electronic filing on

⁷ IRS does not have the capability to receive electronic returns directly from taxpayers. Taxpayers can electronically file their returns by using a paid tax preparer, commercial tax preparation software, or the Free File program. Paid preparers and tax preparation software companies may charge for the service.

States' Internet Return
Preparation and Electronic
Filing Benefits and Costs Were
Modest

their Web sites for taxpayers below an adjusted gross income ceiling of \$52,000 in 2007. About 95 million (70 percent) of all taxpayers are eligible for free file. Under the agreement, companies are not allowed to offer refund anticipation loans and checks, or other ancillary products, to free file participants. Although IRS has increased its marketing efforts, the agency has not been successful in increasing free file use. As of March 17, 2007, IRS processed about 2.6 million free file returns, which is a decrease of 5.2 percent from the same period last year. While all 19 companies participating in the Free File program allow for TETR requests, only 3 of the 19 companies offer Form 1040 EZ-T requests.⁸

We recently reported to this Committee on states' experience with return preparation and electronic filing on their Web sites.⁹ These systems, called I-file, provide taxpayers with another option for preparing and electronically filing their tax returns. To the extent that the I-file systems convert taxpayers from paper to electronic filing, the costs of processing returns are reduced.

For the eight states we profiled, I-file benefits and costs were relatively modest. While state I-file systems generated benefits, such as increased electronic filing, the overall benefits were limited by low usage, which ranged from about 1 percent to just over 5 percent of eligible taxpayers. Restrictions on taxpayer eligibility and system features helped keep costs modest. States varied in whether they used contractors to develop and operate the I-file system. For the states we profiled, it is unclear whether benefits were greater than costs, in part, because of the low number of taxpayers who converted from paper to electronic filing.

IRS's potential to realize net cost savings from an I-file system depends on the costs of developing the system and the number of taxpayers converted from paper. IRS's costs to provide a new I-file service could be higher than states' for several reasons: (1) the federal tax system is more complex, (2) unlike some states that already had transactional Web sites, IRS would need to develop the capability to receive tax returns on its Web site, and (3) developing an I-file system could further stretch IRS's capability to manage systems development, an area we have designated high risk since 1995. The key to IRS achieving a net cost savings depends on the number

⁸ Individuals who do not normally file tax returns but paid the tax can request the refund on Form 1040EZ-T (Request for Refund of Federal Telephone Excise Tax).

⁹ [GAO-07-570](#).

Tax System Changes Have Had Less Impact on Returns Processing Than Projected

of individuals converted from paper to electronic filing and the savings per return estimated to be \$2.36 by IRS.¹⁰ It is uncertain how many of the 58 million taxpayers who filed on paper would convert. The over 13 million taxpayers who self-prepare their returns on a computer but print them out and mail them to IRS are an attractive target for I-file because they already have access to a computer and may be more willing to try I-file. However, IRS's Free File program, designed to attract similar taxpayers, had low use in 2006, with only 4 million users (about 3 percent of total taxpayers and 4 percent of eligible taxpayers).

TETR and split refund volume have been less than IRS projected. Almost 69 percent of individuals who filed individual income tax returns by the end of March have requested TETR, although all who paid the excise tax were eligible for the refund. IRS projected that 10 to 30 million individuals who did not have a tax filing obligation could claim TETR. Approximately 410,000 individuals from this group have asked for a TETR refund (2.8 percent of the 14.5 million IRS expected by this time).¹¹

As of March 24, fewer than 61,000 individual taxpayers chose to split their refunds into different accounts out of the 44.8 million taxpayers who had their refunds directly deposited. This volume compares to the 3.8 million IRS projected for the filing season.

IRS delayed processing a small number of returns claiming tax extender provisions until February 3 to complete changes to its tax processing systems.

Call Volume Continues to Decline, but Performance Is Mixed

The number of calls to IRS's toll-free telephone lines has been less than last year and is significantly less than in 2002 for both automated and live assistance (see table 1). Similar to last year, IRS assistors answered about 40 percent of the total calls, while the rest of the calls were answered by an automated menu of recordings.

¹⁰ We have previously reported that we cannot independently verify this estimate and its basis is unclear because IRS's cost accounting system is not yet able to support preparation of such cost estimates. See GAO, *Tax Administration: IRS Improved Performance in the 2004 Filing Season, but Better Data on the Quality of Some Services are Needed*, [GAO-05-67](#) (Washington, D.C.: Nov. 15, 2006).

¹¹ We are in the process of obtaining additional information to evaluate IRS projections on TETR and split refund volumes.

Table 1: IRS Telephone Volume in the Filing Seasons, 2002 through 2007

Volume in thousands	2002	2003	2004	2005	2006	2007
Telephone assistance ^a						
Total calls	34,489	27,905	29,085	23,340	21,616	20,732
Answered by assistors	9,208	9,434	10,143	9,421	8,653	8,434
Answered by automated menu of recordings	25,281	18,471	18,942	13,919	12,963	12,298

Source: IRS.

^a Telephone assistance data are based on actual counts from January 1 to March 16, 2002; March 15, 2003; March 13, 2004; March 12, 2005; March 11, 2006; and March 10, 2007.

Taxpayers' ability to access IRS's telephone assistors is somewhat less than last year, but IRS is meeting its goals. As shown in table 2, the percentage of taxpayers who attempted to reach an assistor and actually got through and received services—referred to as the level of service—was one percentage point less than the same time period last year. This level of performance is slightly greater than IRS's fiscal year goal of 82 percent which is the same as last year's goal. Average speed of answer, which is the length of time taxpayers wait to get their calls answered, is just over 4 minutes, almost 40 percent longer than last year, but is better than IRS's annual goal of 4.3 minutes.

Taxpayer disconnects, which is the rate at which taxpayers waiting to speak with an assistor abandoned their calls to IRS, increased to 12.3 percent to about 1.4 million calls compared to the same time period last year. While IRS disconnects are a smaller percentage of all calls it receives, those disconnects were down from approximately 491,000 at this time last year to 148,000 (a 70 percent decline).

Using a statistical sampling process, IRS estimates that the accuracy of telephone assistors' responses to tax law and account questions to be comparable to the same time period last year. IRS officials noted that there was unprecedented hiring for fiscal year 2007, and while every employee working tax law applications completes a requisite certification process, new employees will be less productive than seasoned employees. IRS has implemented several initiatives, such as targeted monitoring of staff and mini-training sessions, to assist the new hires.

Table 2: IRS Telephone Performance in the Filing Season, 2002 through 2007

	2002	2003	2004	2005	2006	2007
Telephone performance-access ^a						
Assistor level of service ^b	69%	82%	84%	83%	84%	83%
Average speed of answer (in minutes) ^c	3.8	3.1	3.3	3.9	3.0	4.2
Telephone performance-accuracy ^d						
Accounts customer accuracy rate estimates	88.3% +/- 0.9%	87.9% +/- 0.7%	89.1% +/- 0.8%	91.7% +/- 0.7%	92.7% +/- 0.7%	92.9% +/- 0.9%
Tax law customer accuracy rate estimates	83.5% +/- 0.7%	81.2% +/- 1.0%	75.8% +/- 1.3%	87.5% +/- 1.0%	90.2% +/- 1.0%	88.7% +/- 1.5%

Source: IRS.

^a Telephone performance access data are based on actual counts from January 1 to March 16, 2002; March 15, 2003; March 13, 2004; March 12, 2005; March 11, 2006; and March 10, 2007.

^b Assistor level of service is the percentage of taxpayers who wanted to talk with an assistor and actually got through and received services.

^c The number of minutes a taxpayer waits in queue to speak with an assistor.

^d Based on a representative sample estimate at the 90 percent confidence interval for January and February 2006 and 2007. The percentage of calls in which telephone assistors provided accurate answers for the call type and took the appropriate action.

IRS officials reported that tax system changes have had minimal impact on telephone operations so far this filing season. TETR-related calls are a small fraction of what IRS projected. Between January 1 and March 10, 2007, IRS expected 7.5 million TETR-related calls, but received about 370,000. This represented 1.8 percent of total calls received by IRS.

IRS hired 650 full-time equivalents in fiscal year 2007, with the expectation that those hires would be used to cover anticipated attrition in 2008. Their first assignment was answering TETR telephone calls. They were also trained to handle other accounts calls and paper inventory should the demand for TETR assistance not materialize.¹²

¹² In addition to answering telephones, IRS's telephone assistors also work on paper correspondence, such as amended returns. According to IRS officials, staff is working more paper correspondence than anticipated. From October 1, 2006 through March 24 2007, receipts of paper inventory were up about 6 percent and IRS had closed 10 percent more paper inventory than at the same time period last year.

IRS anticipated little impact on telephone service from the split refund option and tax provision extenders. For split refunds, IRS anticipated it would receive about 7,000 calls compared to the 70 million total calls it receives each year. IRS did not have projections for tax provision extenders.

Use of Some Web Site Applications Continues to Increase, and Performance Remains High

Use of IRS's Web site has increased so far this filing season compared to prior years except for downloads of forms and publications and tax law questions. From January 1 through February 28, IRS's Web site was visited more often and the number of searches increased. The number of downloaded forms and publications has decreased 14 percent over the same period compared to last year. According to IRS officials, it is too early in the filing season to determine why downloads have decreased. In terms of new features, IRS added a state deduction calculator this filing season, which IRS wants to use as a new standard for developing other on line calculators. Web site assistance is important because it is available to taxpayers 24 hours a day and it is less costly to provide than telephone and walk-in assistance.

Table 3 IRS Web Site Use, 2006 and 2007 (data are in thousands)

Uses	2006	2007	Percentage change
Visits ^a	66,571	72,979	9.6
Downloads ^a	56,405	48,449	-14.1
Searches ^a	35,917	41,435	15.4
Where's My Refund ^b	19,776	24,724	25.0
Number of TETR-related visits ^c	N/A	3,283	N/A

Source: GAO analysis of IRS data.

Note: N/A means not applicable.

^a Web site visits and searches and downloads from January and February 2006 and 2007. A visit begins when a visitor views their first page on IRS.gov, and ends when the visitor leaves the site. A visit is not a count of the number of unique individuals who have accessed the site.

^b For January 1 through March 20, 2006, and 2007.

^c Visits to a Web page specific to TETR, which was not operational in 2006. For October 1, 2006, through March 10, 2007.

In addition to the Free File program, IRS's Web site offers several important features, such as Where's My Refund, which allows taxpayers to check on the status of their refunds. This year, the feature allows taxpayers to check on the status of split refunds, and tells the taxpayer if one or more of the deposits were returned from the bank because of an

incorrect routing or account number. However, for certain requests, the feature is not useful. For example, IRS stopped some refunds related to TETR requests, but Where's My Refund informed taxpayers that their refunds had been issued. Further, if taxpayers make a mistake calculating the amount of their refund the feature would indicate that IRS corrected the refund amount, but will not show the new amount. IRS is considering providing more information about taxpayer accounts on its Web site is part of IRS's strategy to improve taxpayer services at reduce costs.

There is further evidence that IRS's Web site is performing well as these examples show.

- According to the American Customer Satisfaction Index,¹³ IRS's Web site is scoring above other government agencies, nonprofits, and private sector firms for customer satisfaction (74 for IRS versus 72 for all government agencies surveyed and 71 for all Web sites surveyed).
- An independent weekly study by Keynote, a company that evaluates Web sites, reported that IRS's Web site has repeatedly ranked in the top 6 out of 40 government agency Web sites evaluated in terms of average download time. Last year, IRS consistently ranked second for the same time period. Average download time remained about the same for IRS compared to last year, indicating that IRS is not performing worse but that other government agencies are performing better.
- On the basis of our own searches, we found IRS's Web site to be readily accessible, easy to navigate, and easy to search.

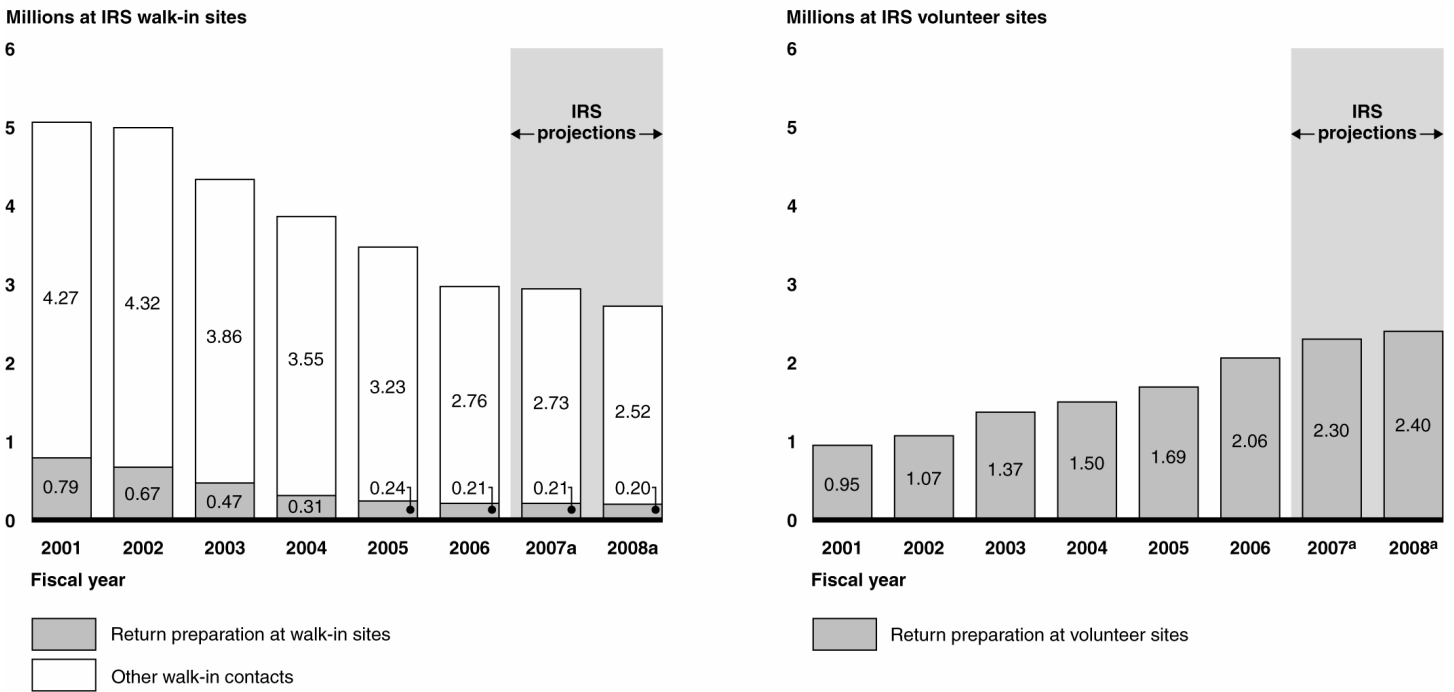
¹³ The American Customer Satisfaction Index tracks trends in customer satisfaction and is considered to be an industry leader.

**Limited Data on the
Quality of Face-to-Face
Assistance Show
Improvement, but
Concerns Remain**

As of March 17, 2007, approximately 2 million taxpayers used IRS's 401 walk-in sites, which is comparable to the same period last year. Figure 2 shows the trend in walk-in site use for the entire filing season including a slight projected decline in 2007. At walk-in sites, staff provide taxpayers with information about their tax accounts, answer a limited scope of tax law questions about, for example, to income and filing status, and provide limited tax return preparation assistance.¹⁴ As of March 10, 6,700 taxpayers have requested TETR on Form 1040EZ-T at walk-in sites, which is 5.3 percent of the 126,000 individuals IRS expected.

¹⁴ IRS provides limited return preparation assistance to those who meet an IRS-specified income requirement that approximates the amount for claiming the Earned Income Tax Credit or less than \$39,000.

Figure 2: Assistance Provided at IRS Walk-in Sites and Volunteer Sites, 2001—2008 (contacts in millions)



Source: GAO analysis of IRS data.

Notes: “Other walk-in contacts” includes assistance for account notices, tax law inquiries, forms, and compliance work, but not return preparation. For the walk-in sites, the time periods covered are December 31, 2000, through April 28, 2001; December 30, 2001, through April 27, 2002; December 29, 2002, through April 26, 2003; December 28, 2003, through April 24, 2004; and December 26, 2004, through April 23, 2005. For volunteer sites, the time period covered for 2001 is January 1, through April 21, 2001; December 30, 2001, through April 27, 2002; December 29, 2002, through April 26, 2003; December 28, 2003, through April 24, 2004; December 26, 2004, through April 23, 2005; and January 1, through April 23, 2006.

^aFiscal years 2007 and 2008 are IRS projections. For walk-in sites, projections cover the time periods of December 31, 2006, through April 28, 2006, and January 1, through April 30, 2008. For volunteer sites, projections cover the time periods from January 1 through April 30, 2007 and 2008. For volunteer sites, projections cover the time periods from October 1 through September 30 for 2007 and 2008. According to IRS, most taxpayers having their returns prepared at volunteer sites do so during the filing season, which is from January 1 through April 30.

IRS officials attribute this year’s projected decline in walk-in use to taxpayers’ increased use of tax preparation software and IRS.gov. This decline has allowed IRS to devote 4 percent fewer full-time equivalents compared to last year for walk-in assistance (down from 187 to 179 full-time equivalents).

Volunteer sites, often run by community-based organizations and staffed by volunteers who are trained and certified by IRS, do not offer the range

of services provided at walk-in sites. Instead, volunteer sites focus on preparing tax returns primarily for low-income and elderly taxpayers and operate chiefly during the filing season. The number of taxpayers getting return preparation assistance at over 11,000 volunteer sites has increased to approximately 1.3 million, up 8 percent from last year and continuing a trend since 2001. Although no projections have been made for TETR claims, over 33,000 taxpayers have claimed this credit at these locations. We have reported that the shift of taxpayers from walk-in to volunteer sites is important because it has allowed IRS to transfer time-consuming services, such as return preparation, from IRS to other less costly alternatives that can be more convenient for taxpayers.

While IRS is collecting better data on the quality of service at walk-in sites, concerns about quality of the data and service remain. According to IRS, it is measuring the accuracy of tax law and accounts assistance. IRS has reported a goal for tax law accuracy, and plans to use data collected for 2007 to set an annual goal for accounts accuracy.¹⁵ While IRS provides return assistance for 125,000 taxpayers, it lacks information on the accuracy of that assistance. For volunteer sites, as of March 2, for a small non-statistical sample, IRS reported a 69 percent accuracy rate for return preparation, compared to its goal of 55 percent. Independent from IRS, but using similar methods, TIGTA showed a 60 percent accuracy rate.

IRS Is Addressing TETR Compliance Issues During the Filing Season

TETR is the only one of the three tax changes that created new compliance concerns for IRS (filers could request greater TETR amounts than they are entitled to). The split refund option does not create compliance concerns for IRS since it relates to the accounts into which taxpayers want their refunds deposited rather than to complying with tax provisions.¹⁶ Since the provisions extending the tax laws already existed, IRS anticipates that any compliance concerns for 2006 returns will be the same as for previous years’.

¹⁵ As of March 10, IRS reported tax law and accounts assistance accuracy rates of 74 and 85 percent respectively. However, because IRS could not provide confidence intervals for these estimates, we do not know how precise these estimates are and, whether the tax law accuracy rate of 74 percent would achieve the goal if a confidence interval were considered.

¹⁶ While there are no compliance concerns, there is a potential for errors due to taxpayers entering incorrect account numbers on Form 8888 (Direct Deposit of Refund to More Than One Account) or IRS incorrectly transcribing the account numbers or the dollar amounts to be deposited into each account.

IRS developed a plan before the filing season began, to audit suspected TETR overclaims before issuing refunds. IRS's plan for TETR was consistent with good management practices identified in previous GAO reports. IRS's plan included appointing an executive, developing an implementation plan for TETR that included standard amounts that individuals could request, developing a compliance plan to select TETR requests for audit, and monitoring and evaluating compliance by using real-time data to adjust TETR compliance efforts. For example, each week, IRS reviews the requests for TETR and selects some for audit and revises the criteria for audit selection as necessary.

As of March 24, about 211,000 individuals had requested the actual amount of telephone excise tax paid for a total of \$98.8 million. IRS selected about 5 percent of these requests for audit, involving about \$29 million.¹⁷ IRS has closed four of the individual audits with the taxpayer agreeing to accept the standard amount, and has not completed the remaining individual audits or any of the business audits.¹⁸ About 189,000 businesses had requested TETR for a total of about \$74.7 million. IRS selected about 560 for audit, involving about \$5.6 million. IRS reassigned about 77 full-time equivalent staff from discretionary audits and earned income tax credit audits to conduct TETR audits. Additionally, Criminal Investigation has spent 13 full-time equivalent staff on TETR activities in 2007.

Paid Preparers Play a Major Role in Tax Administration but They Make Errors

Many taxpayers choose to pay others to prepare their tax returns rather than prepare their own returns. Sixty-two percent of all the individual tax returns filed for the 2006 filing season used a paid preparer.

In most states, anyone can be a paid preparer regardless of education, training, or licensure. However, there are different types of preparers. Paid preparers who hold professional certificates include CPAs and attorneys. Other preparers vary in their backgrounds. Some have extensive training and experience and others do not.

¹⁷ According to IRS officials, as of March 17, 2007, only individuals claiming the actual amount of telephone excise tax paid have been selected for audit. None claiming the standard amount were selected for audit.

¹⁸ Individuals can claim a standard amount ranging from \$30 to \$60, depending on the number of exemptions they claim or they can use Form 8913 (Credit for Federal Telephone Excise Tax Paid) to claim the actual amount paid.

In 2003 we reported to this Committee that while many taxpayers who used paid preparers believed they benefited from doing so, some were poorly served.¹⁹ Last year we reported to this Committee on errors made by commercial chain preparers, including the results of undercover visits to 19 locations.²⁰

In our visits to 19 outlets of several commercial chain preparers, we found that paid preparers made mistakes in every one of our visits, with tax consequences that were sometimes significant. The errors resulted in unwarranted extra refunds of up to almost \$2,000 in five instances, while in two cases they cost the taxpayer over \$1,500. Some of the most serious problems involved preparers

- not reporting business income in 10 of 19 cases;
- not asking about where a child lived or ignoring our answer to the question and, therefore, claiming an ineligible child for the earned income tax credit in 5 out of the 10 applicable cases;
- failing to take the most advantageous postsecondary education tax benefit in 3 out of the 9 applicable cases; and
- failing to itemize deductions at all or failing to claim all available deductions in 7 out of the 9 applicable cases.

At the time, IRS officials responded that, had our undercover investigators been real taxpayers filing tax returns, many of the preparers would have been subject to penalties for such things as negligence and willful or reckless disregard of tax rules and some may have risen to the level of criminal prosecution for willful preparation of a false or fraudulent return. The taxpayers in these cases would also have been potentially exposed to IRS enforcement action.

The limited data did not permit observations about the quality of the work of paid tax preparers in general. Undoubtedly, many paid preparers do their best to provide their clients with tax returns that are both fully

¹⁹ GAO, *Tax Administration: Most Taxpayers Believe They Benefit from Paid Tax Preparers, but Oversight for IRS is a Challenge*, [GAO-04-70](#), (Washington, D.C.: Oct. 31, 2003).

²⁰ [GAO-06-563T](#).

compliant with the tax law and cause them to neither overpay nor underpay their federal income taxes.

IRS and the paid preparer community have taken some actions as a result of our work. After we provided the results of our 19 visits to IRS, IRS determined that 4 of these cases warranted a Program Action Case. In a Program Action Case, IRS selects 30 tax returns from a preparer and audits them to look for a pattern of compliance problems. IRS officials told us that these audits would begin in April 2007. Other cases were referred to the office responsible for monitoring earned income tax credit compliance, and we have been told that 10 preparers that we visited will receive visits to check for compliance with the due diligence requirements of that program. IRS also referred the cases to the office that monitors electronic filing compliance.

We also presented our findings at all six of its nationwide tax forums last year, large educational conferences for the paid preparer community. In addition, we have been told that some tax preparation chains and preparer organizations have incorporated the results of our work into their educational materials. Finally, we recommended that IRS conduct research to determine the extent to which paid preparers live up to their responsibilities to file accurate and complete tax returns based on information they obtain from their customers. IRS officials have described plans to develop data to use to research paid preparer compliance issues, including whether tax preparers who are noncompliant themselves are more likely to prepare client returns that are noncompliant. To date, this research has not been completed. While this may be useful research, we do not believe such research would determine the extent to which paid preparers live up to their responsibilities.

Recent suits filed by the Justice Department highlight the obligations of paid preparers. The Justice Department filed suits to stop fraudulent return preparation at more than 125 outlets in four states of one preparation chain for allegedly taking part in preparation scams that led to fraudulent returns.

Because they help the majority of taxpayers prepare their returns, paid preparers are a critical quality control checkpoint for the tax system. Due diligence by paid preparers has potential to prevent non-compliance and reduce IRS's cost and intrusiveness.

Progress Made in BSM Implementation, but Challenges and Risks Remain

BSM is critical to supporting IRS's taxpayer service and enforcement goals and reducing the tax gap. For example, BSM includes projects to allow taxpayers to file and retrieve information electronically and to provide technology solutions to help reduce the backlog of collections cases. Despite progress made in implementing BSM projects and improving modernization management controls and capabilities, significant challenges and serious risks remain, and further program improvements are needed, which IRS is working to address.

Over the past year, IRS has made further progress in implementing BSM projects and in meeting cost and schedule commitments, but two key projects experienced significant cost overruns during 2006—CADE and Modernized e-File. During 2006 and the beginning of 2007, IRS deployed additional releases of the following modernized systems that have delivered benefits to taxpayers and the agency: CADE, Modernized e-File, and Filing and Payment Compliance (a tax collection case analysis support system). Each of the five associated project segments that were delivered during 2006 were completed on time or within the targeted 10 percent schedule variance threshold, and two of them were also completed within the targeted 10 percent variance threshold for cost. However, one segment of the Modernized e-File project as well as a segment of the CADE project experienced cost increases of 36 percent and 15 percent, respectively. According to IRS, the cost overrun for Modernized e-File was due in part to upgrading infrastructure to support the electronic filing mandate for large corporations and tax-exempt organizations, which was not in the original projections or scope.

IRS has also made significant progress in implementing our prior recommendations and improving its modernization management controls and capabilities, including efforts to institutionalize configuration management procedures and develop an updated modernization vision and strategy and associated 5-year plan to guide information technology investment decisions during fiscal years 2007 through 2011. However, critical controls and capabilities related to requirements development and management and post implementation reviews of deployed BSM projects have not yet been fully implemented. In addition, more work remains to be done by the agency to fully address our prior recommendation of developing a long-term vision and strategy for completing the BSM program, including establishing time frames for consolidating and retiring legacy systems. IRS recognizes this and intends to conduct further analyses and update its vision and strategy to address the full scope of tax administration functions and provide additional details and refinements on the agency's plans for legacy system dispositions.

Future BSM project releases continue to face significant risks and issues, which IRS is taking steps to address. IRS has reported that significant challenges and risks confront its future planned system deliveries. For example, delays in deploying the latest release of CADE to support the current filing season have resulted in continued contention for key resources and will likely impact the design and development of the next two important releases, which are planned to be deployed later this year. The potential for schedule delays, coupled with the reported resource constraints and the expanding complexity of the CADE project, increase the risk of scope problems and the deferral of planned functionality to later releases. Maintaining alignment between the planned releases of CADE and the new Accounts Management Services project is also a key area of concern because of the functional interdependencies.²¹ The agency recognizes the potential impact of these project risks and issues on its ability to deliver planned functionality within cost and schedule estimates and, to its credit, has developed mitigation strategies to address them. We will, however, continue to monitor the various risks IRS identifies and the agency's strategies to address them and will report any concerns.

IRS has also made further progress in addressing high-priority BSM program improvement initiatives during the past year, including efforts related to institutionalizing the Modernization Vision and Strategy approach and integrating it with IRS's capital planning and investment control process, hiring and training 25 entry-level programmers to support development of CADE, developing an electronic filing strategy through 2010, establishing requirements development/management processes and guidance (in response to our prior recommendation), and defining governance structures and processes across all projects. IRS's high-priority improvement initiatives continue to be an effective means of assessing, prioritizing, and incrementally addressing BSM issues and challenges. However, more work remains for the agency to fully address these issues and challenges.

²¹Accounts Management Services (AMS) is a strategic project intended to deliver improved customer support and functionality by leveraging existing IRS applications and new technologies to bridge the gap between modernization initiatives, such as CADE, and legacy systems. AMS is to enhance CADE by providing applications for IRS employees and taxpayers to access, validate, and update accounts on demand. The development and implementation of the AMS project is also essential to enabling CADE to accept more complicated tax returns and to deal with taxpayer issues. AMS project releases are to provide functional components synchronized with the CADE development schedule as well as other components delivered independent of the CADE schedule.

In addition, we recently reported that IRS could improve its reporting of progress in meeting BSM project scope (i.e., functionality) expectations by including a quantitative measure in future expenditure plans.²² This would help to provide Congress with more complete information on the agency's performance in implementing BSM project releases. IRS recognizes the value of having such a measure and, in response to our recommendation, is in the process of developing it.

Continued Research Is Essential to Estimating the Impact of IRS's Service and Enforcement on Compliance and the Tax Gap

Continued compliance research is essential to IRS's ability to effectively focus its service and compliance efforts, and we have long been a supporter of such research. Well designed compliance research gives IRS and Congress an important measure of taxpayer compliance and it allows IRS to better target enforcement resources towards noncompliant taxpayers. Taxpayers benefit as well, because properly targeted audits mean fewer audits of compliant taxpayers and more confidence by all taxpayers that others are paying their fair share.

IRS develops its tax gap estimates by measuring the rate of taxpayer compliance—the degree to which taxpayers complied with their tax obligations fully and on time. That rate is then used, along with other data and assumptions, to estimate the dollar amount of taxes not timely and accurately paid. For instance, IRS most recently estimated a gross tax gap of \$345 billion for tax year 2001 and that underreporting of income represented over 80 percent of the gap.²³ IRS developed these estimates using compliance data collected through its 2001 NRP study, which took several years to plan and execute.

In that study, IRS reviewed the compliance of a random sample of about 46,000 individual taxpayers and used those results to estimate compliance for the population of all individual taxpayers and identify sources of noncompliance. IRS also used the 2001 NRP results to update its computer models for selecting likely noncompliant tax returns and used that model to select cases beginning with returns filed in 2006. IRS's fiscal year 2008 budget request states that this improved targeting of audits has increased

²² [GAO-07-247](#).

²³ IRS has concerns with the certainty of the overall tax gap estimate in part because some areas of the estimate rely on old data and IRS has no estimates for other areas of the tax gap. For example, IRS used data from the 1970s and 1980s to estimate underreporting of corporate income taxes and employer-withheld employment taxes.

dollar-per-case yield and reduced “no change” audits of compliant taxpayers. IRS now has a second NRP study underway, this one looking at 5,000 S corporation tax returns filed in 2003 and 2004.²⁴

IRS’s fiscal year 2008 budget request includes a proposal for a rolling NRP sample of individual taxpayers and a dedicated cadre of examiners to conduct these research audits. Using a rolling sample, IRS plans to replicate the 2001 NRP study by conducting audits of a smaller sample size. At the end of 5 years, IRS would have a comparable set of results to the 2001 study and continue to update the study annually by sampling the same number of taxpayers, dropping off the oldest year in the sample, and adding the new years’ results every year. We support this approach. In previous GAO products, we have observed that doing compliance studies once every few years does not give IRS or others information about what is happening in the intervening years, and that a rolling sample should reduce costs by eliminating the need to plan entirely new studies every few years or more and train examiners to carry them out.²⁵ Compliance research in this way will also give Congress, IRS, and other stakeholders more frequent and more current information about IRS’s progress towards its long term compliance goals.

Mr. Chairman, this concludes my prepared statement. We would be happy to respond to questions you or other members of the Committee may have at this time.

Contacts and Acknowledgments

For further information regarding this testimony, please contact James R. White, Director, Strategic Issues, at 202-512-9910 or whitej@gao.gov or David A. Powner, Director, Information Technology Management Issues at 202-512-9296 or pownerd@gao.gov. Contacts for our Offices of Congressional Relations and Public Affairs may be found on the last page

²⁴ IRS has no estimates for other areas of the tax gap, and it is inherently difficult to measure some types of noncompliance. The tax gap estimate for areas such as corporate income tax and employer-withheld employment tax underreporting rely on decades-old data.

²⁵ GAO, *Internal Revenue Service: Assessment of the Interim Results of the 2006 Filing Season and Fiscal Year 2007 Budget Request*, [GAO-06-499T](#) (Washington, D.C.: Apr. 27, 2006); *Tax Compliance: Better Compliance Data and Long-term Goals Would Support a More Strategic IRS Approach to Reducing the Tax Gap*, [GAO-05-753](#) (Washington, D.C.: July 18, 2005); and *Tax Compliance: Reducing the Tax Gap Can Contribute to Fiscal Sustainability but Will Require a Variety of Strategies*, [GAO-05-527T](#) (Washington, D.C. Apr. 14, 2005).

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