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Testimony

Before the Subcommittee on Federal Workforce, Postal Service, and the District of Columbia, Committee on Oversight and Government Reform, House of Representatives

For Release on Delivery
Expected at 10:00 a.m. EST
Thursday, November 5, 2009

U.S. POSTAL SERVICE

**Financial Challenges
Continue, with Relatively
Limited Results from
Recent Revenue-Generation
Efforts**

Statement of Phillip Herr, Director
Physical Infrastructure Issues



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Highlights of [GAO-10-191T](#), a testimony to the Subcommittee on Federal Workforce, Postal Service, and the District of Columbia, Committee on Oversight and Government Reform, House of Representatives

Why GAO Did This Study

The U.S. Postal Service's (USPS) financial condition and outlook deteriorated significantly during fiscal year 2009. USPS was not able to cut costs fast enough to offset declining mail volume and revenues resulting from the economic downturn and changing mail use. Facing an unprecedented cash shortfall, USPS stated that it would have insufficient cash on hand to make its mandated \$5.4 billion payment to prefund postal retiree health benefits that was due by the end of the fiscal year.

In July, 2009, GAO added USPS's financial condition to the list of high-risk areas needing attention by Congress and the executive branch to achieve broad-based transformation. GAO stated that USPS urgently needs to restructure to address its current and long-term financial viability. GAO also stated that USPS needs to use its flexibility to generate revenue through new or enhanced products.

This testimony will (1) update USPS's financial condition and outlook, (2) describe changes made by the Postal Accountability and Enhancement Act (PAEA) of 2006 that provided USPS with greater flexibility to generate revenues, (3) outline USPS's revenue-generation actions and results using this flexibility, and (4) discuss options for USPS to generate increased revenues in the future. This testimony is based on GAO's past and ongoing work.

View [GAO-10-191T](#) or key components. For more information, contact Phillip Herr, (202) 512-2834 or herrp@gao.gov.

U.S. POSTAL SERVICE

Financial Challenges Continue, with Relatively Limited Results from Revenue-Generation Efforts

What GAO Found

USPS's financial condition for fiscal year 2009 and its financial outlook continue to be challenging:

- In fiscal year 2009, mail volume declined about 28 billion pieces, or about 14 percent, from the prior fiscal year, when volume was about 203 billion pieces; revenue declined from about \$75 billion to about \$68 billion.
- A looming cash shortfall necessitated last-minute congressional action to reduce USPS's mandated payments to prefund retiree health benefits by \$4 billion. In the absence of congressional action, USPS was on track to lose about \$7 billion.
- USPS debt increased at the end of fiscal year 2009 by the annual statutory limit of \$3 billion, bringing outstanding debt to \$10.2 billion. At this rate, USPS will reach its total \$15 billion statutory debt limit in fiscal year 2011.
- USPS projects annual deficits over \$7 billion in fiscal years 2010 and 2011, and continuing large cash shortfalls.

PAEA and implementing regulations gave USPS more flexibility to set prices, test new postal products, and retain earnings. USPS has broad latitude to set rates that take effect unless the Postal Regulatory Commission finds the rates would violate legal requirements, such as a price cap that generally limits rate increases for most mail to the rate of inflation.

Except for annual rate increases, USPS revenue-generation actions since PAEA was enacted have generally achieved limited results compared to USPS's deficits. To its credit, USPS has taken actions to use its pricing flexibility to address the pressing need for additional revenue. These actions generated some revenues, although their positive impacts were overwhelmed by the recession—with its cutbacks in consumer spending and corporate advertising—and ongoing diversion of mail to electronic alternatives.

Looking forward, USPS has opportunities to continue pursuing the flexibilities provided by PAEA to help generate additional revenue from postal products and services. However, results will continue to be constrained by the economic climate and by changing use of the mail. Mail volume has typically returned after past recessions, but much of the recent volume decline may not return. Increasing postal rates may provide a short-term revenue boost but would risk depressing mail volume and revenues in the long-term, in part by accelerating diversion of mail to electronic alternatives. USPS has asked Congress to change the restrictions established by PAEA so that it could offer new nonpostal products and services such as banking and insurance. Allowing USPS to compete more broadly with the private sector could lose money, and fair competition issues would need to be considered. Thus, in addition to its revenue-generation initiatives, USPS will need to continue making significant reductions in its workforce and network costs. When we recently added USPS's financial condition to our high-risk list, we said that restructuring will require USPS to align its costs with revenues, generate sufficient earnings to finance capital investment, and manage its debt.

Chairman Lynch, Ranking Member Chaffetz, and Members of the Subcommittee:

I am pleased to be here today to participate in this oversight hearing on the U.S. Postal Service's (USPS) revenue-generation initiatives and opportunities. My statement will (1) provide an update on USPS's financial condition and outlook, (2) describe the changes made by the Postal Accountability and Enhancement Act (PAEA) of 2006¹ that provided USPS with greater flexibility to generate revenues, (3) outline the actions that USPS took and results from using this flexibility since 2006, and (4) discuss options for USPS to generate increased revenues in the future.

My statement is based upon our past and ongoing work, including our work on postal reform issues and opportunities created by PAEA,² our continuing oversight of the financial condition, challenges, and opportunities facing USPS,³ and our past reports on USPS's efforts to generate revenue. We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

¹Pub. L. No. 109-435, 120 Stat. 3198, enacted Dec. 20, 2006.

²GAO, *U.S. Postal Service: Postal Reform Law Provides Opportunities to Address Postal Challenges*, [GAO-07-685T](#) (Washington, D.C.: Apr. 19, 2007); *U.S. Postal Service: Key Elements of Comprehensive Postal Reform*, [GAO-04-397T](#) (Washington, D.C.: Jan. 28, 2004); *U.S. Postal Service: Bold Action Needed to Continue Progress on Postal Transformation*, [GAO-04-108T](#) (Washington: D.C.: Nov. 5, 2003).

³GAO, *U.S. Postal Service: Restructuring Urgently Needed to Achieve Financial Viability*, [GAO-09-958T](#) (Washington, D.C.: Aug. 6, 2009); *U.S. Postal Service: Broad Restructuring Needed to Address Deteriorating Finances*, [GAO-09-790T](#) (Washington, D.C.: July 30, 2009).

USPS's Financial Condition and Outlook Remain Challenging

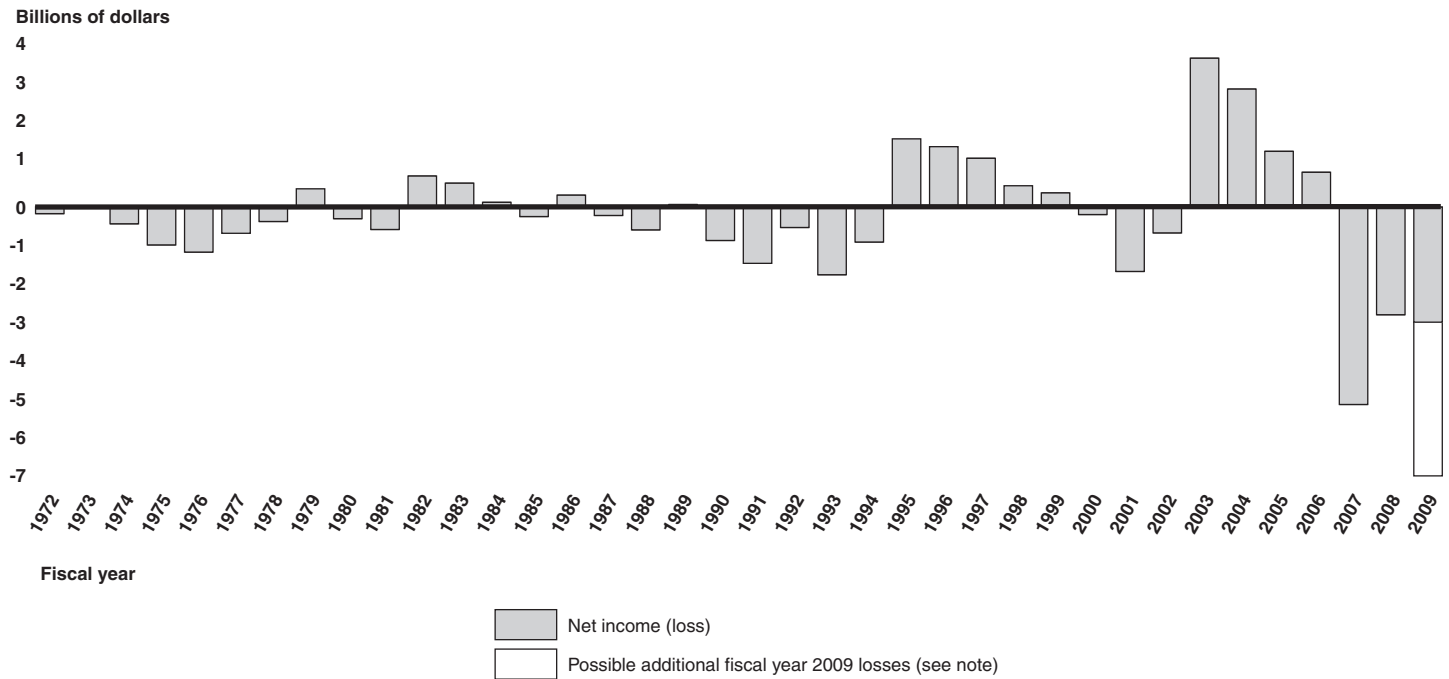
USPS's financial condition and outlook continue to be challenging despite recent congressional action that relieved USPS of \$4 billion in mandated payments to prefund postal retiree health benefits by September 30, 2009.⁴ Preliminary results from the end of fiscal year 2009 and USPS's outlook include:

- In fiscal year 2009, mail volume declined about 28 billion pieces, or about 14 percent, from the prior fiscal year, when volume was about 203 billion pieces; revenue declined from about \$75 billion to about \$68 billion.
- A looming cash shortfall necessitated last-minute congressional action to reduce USPS's mandated payments to prefund retiree health benefits from \$5.4 billion to \$1.4 billion. In the absence of this congressional action, USPS was on track to lose about \$7 billion. USPS and its auditors are currently considering whether the \$4 billion in relief will be booked in fiscal year 2009 or fiscal year 2010. Regardless of the outcome, USPS will have a large net loss for the third consecutive fiscal year and one of its largest losses in decades (see fig. 1).
- USPS debt at the end of fiscal year 2009 increased by the annual statutory limit of \$3 billion, bringing outstanding debt to \$10.2 billion. If debt continues to increase by \$3 billion annually, USPS will reach its total statutory debt limit of \$15 billion in fiscal year 2011.
- Looking forward, USPS has projected annual deficits exceeding \$7 billion in fiscal years 2010 and 2011, and continuing large cash shortfalls.⁵

⁴The change in prefunding payments does not change USPS's responsibility to eventually pay for its unfunded retiree health care obligation, which was about \$53 billion according to USPS's fiscal year 2008 annual report.

⁵These projections were provided to GAO in August 2009 and are the most recent USPS has made available.

Figure 1: USPS Net Income (Loss), Fiscal Years 1972 to 2009



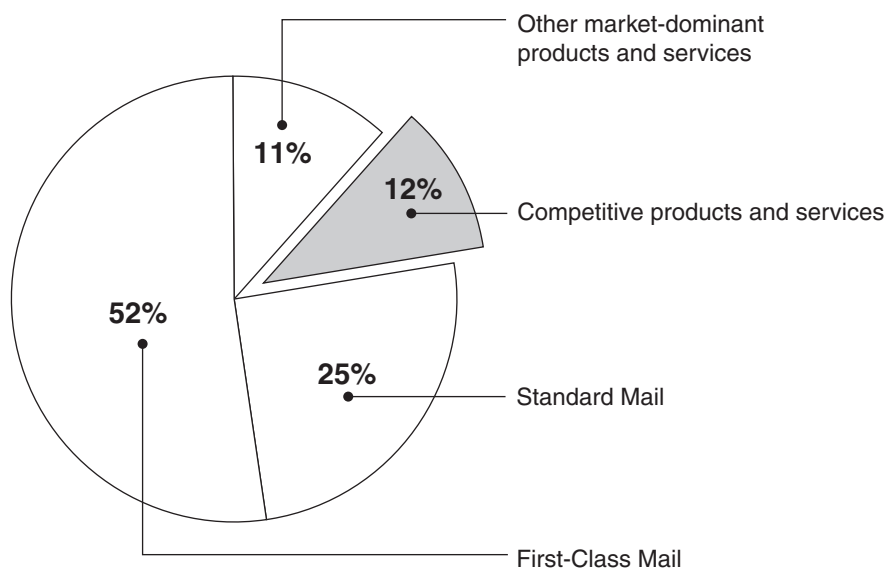
Source: USPS.

Note: A looming cash shortfall necessitated last-minute congressional action to reduce USPS's mandated payments to prefund retiree health benefits from \$5.4 billion to \$1.4 billion. In the absence of this congressional action, USPS was on track to lose about \$7 billion. USPS and its auditors are currently considering whether the \$4 billion in relief will be booked in fiscal year 2009 or fiscal year 2010.

As we previously reported, USPS's cost-cutting efforts and rate increases have not fully offset the impact of huge declines in mail volume (a decline of about 28 billion pieces in fiscal year 2009) and other factors—notably semi-annual cost-of-living allowances (COLA) for employees covered by union contracts. Compensation and benefits constitute close to 80 percent of USPS costs—a percentage that has remained similar over the years despite major advances in technology and automating postal operations. These costs declined by 1.3 percent in the first 11 months of fiscal year 2009 (the most recent data available) as compared to the same time period in fiscal year 2008, in contrast to other costs such as transportation, supplies and services, and depreciation, which together declined 8.2 percent.

Over this same period, total revenue declined by 8.6 percent, including declines of 9.1 percent for market-dominant products⁶ and about 4.0 percent for competitive products.⁷ (See app. I for a summary of market-dominant and competitive products.) About 88 percent of USPS revenue was generated from market-dominant products and services, with competitive products and services generating about 12 percent of revenues (see fig. 2).

Figure 2: USPS Revenue by Type of Mail and Service, Fiscal Year 2009



Source: USPS.

Note: Data are based on preliminary results for the first 11 months of the fiscal year.

⁶Market-dominant products primarily include First-Class Mail (e.g., correspondence, bills, payments, statements, and advertising), Standard Mail (mainly bulk advertising and direct mail solicitations), periodicals (mainly magazines and local newspapers), and some types of package services (primarily single-piece Parcel Post, Media Mail, library mail, and bound printed matter).

⁷Competitive products primarily include Express Mail, Priority Mail, bulk Parcel Post (which USPS calls Parcel Select), and bulk international mail.

Legal Changes Provided USPS with Greater Flexibility to Generate Revenues

PAEA and implementing Postal Regulatory Commission (PRC) regulations provided USPS with greater flexibility to set prices, test new postal products, and retain earnings so that it can finance needed capital investments and repay its debt. PAEA abolished the former ratemaking structure that involved a lengthy, costly, and litigious process. Under the new structure, USPS has broad latitude to announce rate changes that are implemented in a streamlined process unless PRC determines these rates would violate legal requirements. Key requirements and flexibilities provided in the law include:

- A price cap based on the Consumer Price Index generally applies to market-dominant classes of mail, such as First-Class Mail and Standard Mail. This means that in general, USPS has the flexibility to increase some individual rates either above or below the rate of inflation as long as the average rate increase for each class of mail does not exceed the cap.
- USPS can request that PRC approve a rate increase that exceeds the price cap on the basis of extraordinary or unexpected circumstances (postal stakeholders refer to this as an “exigent” rate increase). PRC must determine whether such an increase would be reasonable, equitable, and necessary “to maintain and continue developing postal services of the kind and quality adapted to the needs of the United States.”⁸
- Worksharing discounts for market-dominant products are generally limited to the costs avoided by USPS as a result of specified mailer activities.⁹
- Each competitive product must generate sufficient revenues to cover its costs. In addition, competitive products must collectively cover what PRC determines to be an appropriate share of USPS’s overhead costs. PRC has determined this share to be 5.5 percent of USPS’s overhead costs. Within these constraints, USPS was given broad pricing flexibility for its competitive products, which are not subject to a price cap. USPS can also establish volume discounts for competitive products as well as enter into contract rates with individual mailers.
- PAEA generally restricted USPS to offering postal products and services by prohibiting it from initiating new nonpostal products and services.

⁸39 U.S.C. § 3622(d)(1)(E).

⁹Worksharing discounts are defined by law as rate discounts provided to mailers for the presorting, prebarcoding, handling, or transportation of mail. 39 U.S.C. § 3622(e).

USPS was required to discontinue existing nonpostal products—such as passport photo services and photocopying services—except for those that PRC determined should be continued.¹⁰ Subsequently, PRC determined that most existing USPS nonpostal products should be continued.

USPS Actions to Generate Revenue since PAEA Have Generally Achieved Limited Results

In the short time since PAEA was enacted, with the exception of annual rate increases, revenue-generation actions have generally achieved limited results compared to USPS's deficits. We commend USPS for taking action to use its pricing flexibility to address the pressing need for additional revenue. Although these actions generated some revenues, their positive impacts were overwhelmed by the recession—with its cutbacks in consumer spending and corporate advertising—and ongoing diversion of mail to electronic alternatives. Further, the potential of some actions was limited because they applied to types of mail that generate only a small fraction of USPS revenues. Other actions, such as targeted sales for some types of mail, were implemented this year with little advance notice, which may have limited mailer response. Key USPS revenue-generation actions since PAEA was enacted are summarized below.

- *Rate Increases for Market-Dominant Mail:* Under the ratemaking system established by PAEA, USPS annually increased rates in 2008 and 2009 for market-dominant classes of mail at virtually the maximum allowable amount under the price cap. To put this into context, historically, rate increases have been a key action that USPS has taken to remain financially viable.
- *Volume-Based Incentives for Specific Types of Market-Dominant Mail:* USPS has recently implemented three targeted rate incentives to stimulate additional mail volume and take advantage of its excess operational capacity.¹¹
 - First, a 2009 “summer sale” for Standard Mail offered lower rates for volumes that exceeded specific thresholds, with the goal of increasing mail volume during a typically slow period.
 - Second, an ongoing “fall sale” for First-Class Mail aimed at commercial mailers is providing lower rates for volume over specific thresholds.

¹⁰39 U.S.C. §404(c).

¹¹Results are not yet available for these recent initiatives.

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- Third, an ongoing Saturation Mail¹² incentive program also is providing lower rates for volume over specific thresholds.
 - *Negotiated Service Agreements (NSA)*¹³ for Market-Dominant Products: According to USPS data, its seven NSAs for market-dominant products collectively did not generate any net revenue in fiscal years 2007 and 2008 combined. These NSAs generally offered mailers lower rates for volumes that exceeded specific thresholds. Mailers also agreed to actions to reduce some USPS costs, such as the substitution of electronic notices in lieu of USPS returning undeliverable advertising mail.
 - *Rate Changes and Contract Rates for Competitive Products*: Under the ratemaking system established by PAEA, USPS annually increased rates in 2008 and 2009 for competitive products such as Priority Mail and Express Mail. USPS also made product and pricing changes to enhance their competitiveness, such as a new small flat-rate box for Priority Mail and the introduction of zone-based rates for Express Mail. USPS has introduced volume discounts for Express Mail, Priority Mail, and bulk Parcel Post. USPS has also introduced lower rates for electronic postage used for some competitive products such as Express Mail and Priority Mail. In addition, USPS has entered into close to 90 contracts with mailers of competitive products that included Priority Mail, Express Mail, bulk Parcel Post, Parcel Return Service, and various types of bulk international mail. These contracts are generally volume based and have provisions intended to lower USPS's mail handling costs. USPS does not publicly report results for its individual contracts because it considers this information to be proprietary.

¹²Saturation Mail is Standard Mail that is sent to all or most addresses on selected carrier routes and meets presorting and mail preparation requirements.

¹³NSAs generally specify mutual agreements between USPS and mailers involving the preparation, presentation, acceptance, processing, transportation and delivery of mailings under particular rate, classification and service conditions, and restrictions that go beyond those required of other mailers.

USPS Revenue- Generation Options Involving Postal Products and Services Appear More Promising than Venturing into New Risky Areas

Looking forward, USPS has opportunities to continue pursuing the flexibilities provided by PAEA to help generate additional revenue from postal products and services. For example, USPS is continuing to pursue its “Click-N-Ship” initiative that allows customers to print out mailing labels with postage, as well as flexible pricing for Express Mail, Priority Mail, and bulk Parcel Post. USPS is also promoting voting by mail to stimulate additional First-Class Mail volume. However, results from USPS revenue-generation efforts will continue to be constrained by the economic climate and by changing use of the mail. USPS has asked Congress to change the restrictions established by PAEA so that it could offer new nonpostal products and services such as banking and insurance. However, USPS has not presented a business plan which details what markets it might enter, its prospects for profitability, and what specific legislative changes would be needed. Allowing USPS to compete more broadly with the private sector would raise risks and concerns. As with USPS’s nonpostal ventures before PAEA was enacted, new nonpostal ventures could lose money; and even if they were to make money, issues related to unfair competition would need to be considered.

On the other hand, increasing postal rates may provide a short-term revenue boost but would risk depressing mail volume and revenues in the long term, in part by accelerating diversion of payments, communications, and advertising to electronic alternatives. Recognizing this, the Postmaster General recently announced that there will not be an “exigent” price increase in 2010 for market-dominant products such as First-Class Mail and Standard Mail.¹⁴ He explained: “While increasing prices might have generated revenue for the Postal Service in the short term, the long-term effect could drive additional mail out of the system.” Similarly, increasing rates for competitive products such as Express Mail and Priority Mail may provide a short-term revenue boost but risk long-term losses in mail volume, revenues, and USPS competitiveness. Further, the short-term impact of increasing competitive rates would likely be limited because competitive products and services generate about 12 percent of USPS revenue. USPS has not announced whether it will increase rates for competitive products in 2010.

¹⁴The price cap is expected to be zero for 2010 because of recent declines in the Consumer Price Index, so an “exigent” rate increase would be needed to raise average rates for market-dominant products.

Whether USPS should be allowed to engage in nonpostal activities should be carefully considered, including its poor past performance in this area, as should the risks and fair competition issues. We have previously reported that:

- USPS lost nearly \$85 million in fiscal years 1995, 1996, and 1997 on 19 new products, including electronic commerce services, electronic money transfers, and a remittance processing business, among others.¹⁵
- In 2001, we reported that none of USPS's electronic commerce initiatives were profitable and that USPS's management of these initiatives—such as an electronic bill payment service that was eventually discontinued—was fragmented, with inconsistent implementation and incomplete financial information.¹⁶

We testified during the debate on postal reform on some longstanding questions about whether USPS should enter into nonpostal initiatives and the appropriate role of a federal entity competing with private firms, particularly since USPS has a statutory monopoly on letter mail and other disparities in legal status vis-à-vis its potential competitors, such as exemptions from taxes.¹⁷ Questions include:

- Should USPS be allowed to compete in areas where there are already private-sector providers, and if so, on what terms?
- What laws should be applied equally to USPS and its competitors, such as anti-trust and consumer protection laws?
- What transparency and accountability mechanisms would be needed for any new nonpostal products and services to prevent unfair competition and inappropriate cross-subsidization from postal products and services?

¹⁵GAO, *U.S. Postal Service: Development and Inventory of New Products*, [GAO/GGD-99-15](#) (Washington, D.C.: Nov. 24, 1998)

¹⁶GAO, *U.S. Postal Service: Update on E-Commerce Activities and Privacy Protections*, [GAO-02-79](#) (Washington, D.C.: Dec. 21, 2001). Also see GAO, *U.S. Postal Service: Postal Activities and Laws Related to Electronic Commerce*, [GAO/GGD-00-188](#) (Washington, D.C.: Sept. 7, 2000).

¹⁷GAO, *U.S. Postal Service: Bold Action Needed to Continue Progress on Postal Transformation*, [GAO-04-108T](#) (Washington, D.C.: Nov. 5, 2003).

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- Should USPS be subject to the same regulatory entities and regulations as its competitors if it could compete in banking, insurance, and retail services? Would the PRC have an oversight role for any new nonpostal activities?
 - If USPS used existing retail presence of 37,000 facilities to offer new nonpostal products and services—such as leasing or subleasing excess capacity in its facilities—would this be an unfair competitive advantage?
 - How would USPS finance its nonpostal activities, considering its difficult financial condition? Would USPS be allowed to borrow at Treasury rates more favorable than those available to other businesses?

In conclusion, when we recently added USPS's financial condition to our high-risk list, we stated that USPS urgently needs to restructure to achieve short-term and long-term financial viability.¹⁸ USPS has not been able to cut costs fast enough or generate sufficient revenue to offset the accelerated decline in mail volume and revenue. USPS restructuring will require aligning its costs with revenues, generating sufficient earnings to finance capital investment, and managing its debt. Although USPS has taken some action to use its pricing and product flexibility under PAEA, results to date have been limited and will be constrained by the economic climate and changing use of the mail. Mail volume has typically returned after past recessions, but much of the recent volume decline may not return. Nevertheless, USPS has opportunities to generate new revenues from postal products and services that appear more promising than venturing into new risky nonpostal areas, while also making significant reductions in its workforce and network costs.

Mr. Chairman, this concludes my statement. I would be pleased to answer any questions that you or other Members of the Subcommittee may have.

¹⁸GAO, *High-Risk Series: Restructuring the U.S. Postal Service to Achieve Sustainable Financial Viability*, [GAO-09-937SP](#) (Washington, D.C.: July 28, 2009).

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Acknowledgments**

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Appendix I: Highlights of Market-Dominant and Competitive Products

Market-dominant products	Summary description
First-Class Mail	Domestic and international single-piece mail (e.g., bill payments and letters) and domestic bulk mail (e.g., bills and advertising)
Standard Mail	Mainly bulk advertising and direct mail solicitations
Periodicals	Mainly magazines and local newspapers
Package Services	Mainly the following: <ul style="list-style-type: none"> • Single-piece Parcel Post (e.g., packages and thick envelopes with gifts and merchandise) • Media Mail (e.g., books, CDs, and DVDs) • Library mail (e.g., items on loan from or mailed between academic institutions, public libraries, and museums) • Bound printed matter (e.g., permanently-bound sheets of advertising, or directories such as catalogs and phone books)
Market-dominant special services	A variety of services, such as <ul style="list-style-type: none"> • Post office box service • Money orders • Insurance • Delivery receipt services (e.g., Delivery Confirmation, Signature Confirmation) • Certified Mail and Registered Mail • Address list services (e.g., services to update and correct business mailing lists) • Caller service (business mail pickup at a USPS facility)
Competitive products	Summary description
Express Mail	Guaranteed overnight delivery to most locations for time-sensitive letters, documents or merchandise
Priority Mail	2-3 day service to most domestic locations that is often used to expedite delivery
Parcel Select	Bulk Parcel Post parcel mailings entered at USPS facilities that are generally close to the destination of the mail
International Express Mail	Expedited delivery of items to foreign countries, with guaranteed date-certain service to some locations
International Priority Mail	Delivery of items to foreign countries that generally has faster service standards than International First-Class Mail
Bulk international mail	Bulk mailings sent to other countries (e.g., bills, statements, advertising, and magazines)
Parcel Return Service	Business retrieval of returned parcels from USPS facilities
Competitive special services	A variety of services, such as <ul style="list-style-type: none"> • Premium Forwarding Service (reshipping mail from a primary residential address and some P.O boxes to a temporary address using Priority Mail) • International delivery receipt services, such as Registered Mail, return receipt, and restricted delivery

Source: USPS.

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